

BROADHEAD ESTATE V. COMMISSIONER ¹
31 T.C.M. 951; P.H.T.C. Memo ¶ 72, 195 (1972)

Editor's Summary

Key Topics

OUTRIGHT SALE - CAPITAL GAIN V. ORDINARY INCOME

- Primarily for sale
- Intent at time of sale

Facts

From 1951 to 1960 the decedent acquired substantial timberlands in several states. Up through at least 1958, he had attempted to arrange timber cut, ting operations on his lands. Such activities, however, ceased prior to 1961. Although decedent never advertised to sell lands, on many occasions he talked to a real estate salesman about selling his land as well as buying other land.

In 1961 the decedent sold three tracts of real estate consisting separately of 36,000 acres, 6,740 acres and 4,000 acres of timberland. In 1963, he sold four different parcels of land, consisting of 40 acres, 23,000 acres, 6,740 acres and some timberland. The decedent reported the gain on the sales as long-term capital gain. The Commissioner determined that the income from these sales of property was taxable as ordinary income on the ground that these properties were held primarily for sale to customers in the ordinary course of his trade or business.

Tax Court

Held: For the Government. The Tax Court held that the taxpayers had failed to carry the burden of proving that the properties involved were not being held by them primarily for sale to customers in the ordinary course of a trade or business. It was the Court's opinion that the decedent had decided that land operations were more profitable than sawmill operations and that the intent for which the property was held had changed from what it originally may have been. The Court reasoned that the number of sales made by the decedent justified their conclusion that, as of January 1, 1961, the property was being held "principally" for sale to customers in the ordinary course of a trade or business. Accordingly, the gain from these sales was taxable as ordinary income.

Case Text
[Timber Issue Only]

DAWSON, Judge

Sales of Real Property

During the years 1961 and 1963, Broadhead made the following sales of real property:

1. Sale of properties to Ark Investments, Inc., on May 18, 1961.
2. Sale of timberland in Yazoo County in 1963.
3. Sale of 40 acres of Sturgis property in Arkansas in 1963.
4. Sale of property located in Avoyelles, Louisiana on October 3, 1963, to William R. Easterling.
5. Sale of Togo Island to McGill Realty Co. on October 18, 1963.

Broadhead reported the income from the 1963 sales on his Federal income tax return as long-term capital gains. Respondent determined in his statutory notice of deficiency in docket No. 5127-65 and docket No. 1836-66 that the income from these sales of property (including the 1961 sales which Broadhead did not report in his 1961 Federal income tax return) was taxable as ordinary income.

Broadhead sold Togo Island in 1963 to McGill Realty Co. for \$326,000 and reported the gain from the sale in his 1963 Federal income tax return under the installment method of reporting income. Respondent in his statutory notice of deficiency in docket No. 1836-66 computed the gain for 1963 realized by Broadhead on the Togo Island sale by attributing an adjusted basis of \$269,600 to the property. This amount was based upon a fair market value for the property that was subsequently rejected by this Court in the prior Broadhead case.

Broadhead sold the 40 acres of Sturgis property in Arkansas in 1963 for \$1,000 and reported a gain of \$700 from the sale. Respondent determined in his statutory notice of deficiency in docket No. 1836-66 that the basis of the property was \$260 rather \$300 and that the gain realized in 1963 from the sale Was \$740.

Broadhead sold the property in Avoyelles, Louisiana, which consisted of 23,000 acres, for the amount of \$1,200,000 and reported the gain from the sale in his 1963 Federal income tax return under the installment method of reporting income. Respondent in his statutory notice of deficiency in docket No. 1836-66 computed the gain for 1963 realized by Broadhead on this sale by attributing an adjusted basis of \$629,900 to the property. This amount was based upon a fair market value for the property that was rejected by this Court in the prior Boardhead case. In computing the gain for the year 1964, the respondent determined in his statutory notice of deficiency in docket No. 1340-68 that the adjusted basis of the property was \$401,820 which purportedly reflected the findings of this court in the prior Broadhead case.

* * *

4. *Sales of real property-ordinary income or capital gains.* We are confronted with the issue as to whether petitioners are entitled to capital gain or ordinary income treatment with respect to the gains and profits realized from the following sales of real property in 1961 and 1963:

- (1) Sale of lands to Ark Investments, Inc., on May 18, 1961
- (2) Sale of Yazoo County timberland in 1963
- (3) Sale of 40 acres of Sturgis property in 1963
- (4) Sale of property in Avoyelles, Louisiana in 1963 to William R. Easterling on October 3, 1963
- (5) Sale of Togo Island on October 18, 1963 to McGill Realty Co.

The resolution of this issue depends upon whether the properties sold were capital assets in petitioners' hands or were held by them primarily for sale to customers in the ordinary course of a trade or business within the meaning of section 1221(1) of the Code.

It is the respondent's position that the various properties involved were held by the petitioners primarily for sale to customers in the ordinary course of their trade or business. *Raymond Bauschard* [Dec. 23,432], 31 T. C. 910, affirmed [70-2 USTC ¶9533] 279 F. 2d 116(C.A. 9,1970) which in turn cites *Corn Products Refining Co. v. Commissioner* [55-2 USTC ¶ 9746], 350 U.S. 46 (1956), for the proposition that the capital gains provisions are an exception to the normal tax rates and, thus, are to be narrowly construed. The Supreme Court in the *Corn Products* case pointed out that Congress intended that profits and losses arising from the everyday operation of a business are to be considered as ordinary income or loss rather than capital gain or loss, that the preferential capital gains treatment applies to transactions in property which are not the normal source of business income, and that such treatment was intended to relieve the taxpayer from excessive tax burdens on gains resulting from a conversion of capital investments and to remove the deterrent effect of those burdens on such conversions. Subsequently, in *Malat v. Riddell* [66-1 USTC ¶9317], 383 U.S. 569 (1966), the Supreme Court stated that the words of revenue acts should be interpreted where possible in their ordinary, everyday sense. There is set forth the following rule for interpreting section 1221:

The purpose of the statutory provision with which we deal is to differentiate between the "profits and losses arising from the everyday operation of a business" on the one hand (*Corn Products Refining Co. v. Commissioner of Internal Revenue* [55-2 USTC ¶ 9746], 350 U.S. 46, 52, 76 S.Ct. 20 24, 100 L.Ed. 29) and "the realization of appreciation in value accrued over a substantial period of time" on the other. (*Commissioner of Internal Revenue v. Gillette Motor Transport, Inc.* [60-2 USTC ¶9556], 364 U.S. 130, 134, 80 S.Ct. 1497, 1500, 4 L.Ed.2d 1617). * * *

In *Malat* it was held that the word "primarily" as used in section 1221(1) means "of first importance" or "principally."

Many factors have been detailed by the courts as aids in determining this issue, although no one test is necessarily decisive. Among the criteria used are the purpose of the taxpayer in acquiring a property; the length of time a property is held; the continuity and frequency of sales; the

substantiality of the income from the sales; and the activity of the seller with respect to the property, such as the presence or absence of improvements to increase its marketability or activities in promoting sales, including advertising or listing with real estate brokers. See, e.g., *W. T. Thrift, Sr.* [Dec. 17,863], 15 T. C. 366 (1950). As pointed out by respondent, in determining whether property is held primarily for sale, the fact that it was not originally acquired for resale is not controlling. Rather, the test is whether the property was primarily held for sale when the sale was made. *Robert W. Pointer* [Dec. 28,611], 48 T. C. 906,915 (1967), affirmed [70-1 USTC ¶9118] 419 F. 2d 213 (C.A. 9, 1970),

Respondent's determination is presumed to be correct and the petitioners have the burden of proving it wrong. *Welch v. Helvering* [3 USTC ¶ 1164], 290 U.S. 111 (1933). Petitioners have presented little evidence on this issue other than attempt to portray Sam Broadhead as one who had no desire to sell the land acquired by him. Broadhead obviously had no reluctance to sell when the price was right because he sold several tracts in 1963 and one tract in 1961. Three additional sales were made in 1962 of the Sturgis property. In connection with the sale to Ark Investments, Inc., in 1961, McGill testified that Broadhead did not commit himself to sell at the first price offered but he did eventually agree to the sale.

The testimony of McGill also makes it quite clear that no significance can be placed on Broadhead's reluctance to sell. McGill testified that Broadhead would not commit himself on possible business transactions whether such transactions involved the selling of real estate or a car. It is also clear that Broadhead did not need advertising to sell lands since his holdings were quite extensive and naturally attracted real estate people. In this respect, McGill, who was a real estate salesman, testified that on many occasions he talked to Broadhead about his selling land as well as buying land.

In the prior case, *Estate of Sam E. Broadhead* [Dec. 27,834(M)], T. C. Memo. 1966-26 affirmed [68-1 USTC ¶9249] 391 F. 2d 841 (C. A. 5, 1968), this Court was persuaded by the fact that Sam E. Broadhead was attempting to arrange timber cutting operations on his lands throughout at least the taxable year 1958. By contrast, the record in the instant case makes it obvious that such activities ceased prior to the taxable year 1961. As we noted in *Robert W. Pointer, supra*, intent is subject to change and one must look to the purpose for which the property is held at the time of sale. In our view Sam Broadhead decided land operations were more profitable than sawmill operations and the intent for which the property was held changed. The number of sales fully justifies the conclusion that the property as of January 1, 1961, was being held "principally" for sale to customers in the ordinary course of a trade or business.

Upon consideration of the entire record, it is our opinion that the petitioners have failed to prove that the properties involved were not held by them primarily for sale to customers in the ordinary course of a trade or business. Accordingly, we approve the respondent's determination.

1 See *Estate of Broadhead v. Commissioner*, 391 F.2d 841 (5th Circuit, 1968), reprinted in part at 5 *Timber Tax Journal* 129, for an earlier case dealing with the same taxpayer.