E. Everett Thorness, 3 T.C. 666 (1943)

Property held by a real estate professional for both sale and exchange is considered "primarily for sale" when determining capital gains treatment, even if a substantial portion of the business involves trades or exchanges rather than outright sales.

Summary

The Tax Court addressed whether profits from the sale of real estate by a real estate professional should be taxed as ordinary income or capital gains. The petitioner, Thorness, argued that because he held the property for both sale and exchange, it did not fall under the statutory exclusion of "property held…primarily for sale." The court ruled against Thorness, holding that even if a significant portion of his business involved trades or exchanges, the properties were still held primarily for sale to customers in the ordinary course of his business, thus subject to ordinary income tax rates.

Facts

- Thorness had been in the real estate business since 1908, accumulating and developing property through buying, selling, trading, and exchanging.
- He argued that the properties in question were held not only for sale but also for trade or exchange.
- Thorness frequently dealt with real estate brokers and speculators rather than directly with end-users.
- A substantial part of Thorness's business consisted of selling property for cash, although the exact ratio of sales to trades was unclear.

Procedural History

The Commissioner of Internal Revenue determined that the profit from Thorness's property sales in 1939 and 1940 constituted ordinary income. Thorness contested this determination, arguing it should be treated as capital gains. The Tax Court reviewed the Commissioner's decision.

Issue(s)

1. Whether the property held by Thorness was held "primarily for sale" within the meaning of Section 117(a)(1) of the Internal Revenue Code, despite being held for both sale and exchange.
2. Whether the real estate brokers and speculators Thorness dealt with constituted "customers" in the ordinary course of his business.

Holding

1. Yes, because even though Thorness engaged in trades and exchanges, he held the property as much for money sale as for trade or exchange; therefore, the

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property was held primarily for sale in his business.
2. Yes, because Thorness's business involved buying, selling, trading, and exchanging property, and therefore he held property for buyers and traders, who constitute his customers.

Court's Reasoning

The court reasoned that the term "sale" could encompass trades or exchanges, particularly when involving differences in value or price. Even if Thorness's trades and exchanges were a substantial part of his business, these transactions still represented dollar values and profit-making activities. The court emphasized that a substantial part of his business was selling property for cash, indicating that the properties were held as much for money sale as for trade or exchange. The court stated, "Although a substantial part of the petitioner's business may have been in trades and exchanges, yet those trades and exchanges represented dollars and cents values to him, and it was his business to make dollars and cents in the long run from his transactions." Furthermore, the court found that the real estate brokers and speculators Thorness dealt with were his "customers" in the ordinary course of his business, as his business involved holding property for buyers and traders.

Practical Implications

This case clarifies the definition of "primarily for sale" in the context of real estate capital gains, establishing that a real estate professional cannot avoid ordinary income tax rates simply by engaging in trades or exchanges alongside sales. The key factor is whether the property is held for sale to customers as a core part of the business. This decision impacts how real estate professionals structure their transactions and how the IRS assesses taxes on real estate profits. Later cases likely cite this decision to support the treatment of profits as ordinary income when a taxpayer is actively engaged in the real estate business and holds property for sale, even if other types of transactions occur. It emphasizes the importance of examining the taxpayer's overall business activities to determine the primary purpose for holding the property.

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