1944 Tax Ct. Memo LEXIS 112

A taxpayer's activities can constitute a 'trade or business' even if those activities are curtailed due to economic circumstances, and property acquired with the intent to resell at a profit can be considered held primarily for sale to customers in the ordinary course of that trade or business, despite a period of inactivity.

Summary

Farwell sought to deduct losses from real estate sales as ordinary losses, arguing he was in the trade or business of selling real estate. The Tax Court agreed that despite a period of inactivity due to the Great Depression, Farwell's intent to resell properties for profit, combined with his prior history of real estate dealings, established that he was in the trade or business of selling real estate, and the properties were held primarily for sale to customers. Thus, the losses were ordinary losses, not capital losses, and were fully deductible. The Court further held that only one-half of the loss from the sale of property held as tenants by the entireties could be deducted.

Facts

- Farwell acquired several properties, including 2930 West Grand Boulevard, Pallister & Churchill Streets property, and an 80-acre tract of land, with the intent to resell them at a profit.
- He actively engaged in real estate operations for years prior to 1931, realizing substantial profits.
- After 1931, his real estate sales activity virtually ceased due to the economic depression.
- In 1940 and 1941, Farwell sustained losses on the disposal of the West Grand Boulevard and Pallister & Churchill Streets properties.
- He also disposed of the 80-acre tract of land in 1941, sustaining a loss. This property was held with his wife as tenants by the entireties.

Procedural History

The Commissioner determined that the losses were capital losses, subject to limitations. Farwell petitioned the Tax Court for a redetermination, arguing the losses were ordinary losses because he was in the trade or business of selling real estate and the properties were held primarily for sale to customers.

Issue(s)

1. Whether, during 1940 and 1941, Farwell was engaged in the trade or business of selling real estate, and whether the properties in question were held primarily for sale to customers in the ordinary course of that business.
2. Whether Farwell could deduct the full loss sustained on the disposal of the 80 acres of land in 1941, or only one-half, since the property was held as tenants

by the entireties.

Holding

1. Yes, Farwell was engaged in the trade or business of selling real estate, and the properties were held primarily for sale to customers because he acquired the properties with the intention of selling them at a profit, and his prior activities demonstrated a pattern of real estate sales, even though his activity was curtailed due to economic circumstances.
2. No, Farwell could only deduct one-half of the loss because under Michigan law, property held as tenants by the entireties is considered owned one-half by each tenant.

Court's Reasoning

The court reasoned that Farwell's intent to resell the properties at a profit, coupled with his historical real estate activities, established that he was in the trade or business of selling real estate. The court acknowledged the decline in activity after 1931 but attributed it to the economic depression, not an abandonment of the business. The court emphasized that the properties were acquired for resale, not for rental income or investment. The court quoted Julius Goodman, 40 B. T. A. 22 stating that none of these transactions was "an isolated holding dissimilar from any other transaction and unrelated to the history of petitioner's activities." Regarding the tenancy by the entireties, the court followed Michigan law, citing *Commissioner v. Hart, 76 Fed. (2d) 864*, which dictates that each tenant owns one-half of the property, thus each can only deduct one-half of the loss.

Practical Implications

This case clarifies that a temporary reduction in business activity due to external economic factors does not necessarily negate a taxpayer's status as being engaged in a trade or business. It reinforces the importance of considering the taxpayer's intent at the time of acquisition and the history of their business activities. The case also serves as a reminder that state property laws, such as those governing tenancies by the entireties, can significantly impact federal tax treatment, particularly in the context of gains and losses. Later cases will need to determine if the inactivity is due to external forces or a true change in business strategy. The case provides a framework for analyzing whether real estate holdings should be treated as ordinary assets or capital assets, influencing the tax consequences of their sale.

