T.C. Memo. 1961-247

A real estate dealer can also be an investor, and rental properties held primarily for investment purposes, even if eventually sold, may qualify for capital gains treatment rather than ordinary income taxation.

Summary

The Alsup case addresses whether profits from the sale of rental properties should be taxed as ordinary income or as capital gains. Alsup, a real estate developer, argued that profits from the sale of rental properties should be treated as capital gains because he held the properties for investment purposes. The Commissioner argued that Alsup held the properties primarily for sale to customers in the ordinary course of his business. The Tax Court held that Alsup proved he held the rental properties primarily for investment, entitling him to capital gains treatment under Section 117(j) of the Internal Revenue Code.

Facts

Alsup was a real estate developer who also owned rental properties. Alsup developed two subdivisions, Cedar Crest and Clarendon Heights, where he built and sold houses, reporting the profits as ordinary income. In addition to his development activities, Alsup purchased and held several rental properties. He reported income from rentals, insurance commissions, and real estate sales as ordinary income. Alsup sold some of his rental properties during the taxable years after receiving satisfactory offers.

Procedural History

The Commissioner determined that the profits from the sales of the rental properties were taxable as ordinary income. Alsup petitioned the Tax Court, arguing that the profits should be taxed as long-term capital gains under Section 117(j) of the Internal Revenue Code.

Issue(s)

Whether the rental properties sold by the taxpayer were held primarily for sale to customers in the ordinary course of his trade or business, thus disqualifying the profits from capital gains treatment under Section 117(j) of the Internal Revenue Code.

Holding

No, because the taxpayer proved by overwhelming evidence that he purchased and held these rental properties primarily for investment purposes.

Court’s Reasoning

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The court relied on Section 117(j) of the Internal Revenue Code, which provides that gains from the sale of property used in a trade or business are treated as capital gains if the property is not held primarily for sale to customers in the ordinary course of business. The court acknowledged that Alsup was a real estate dealer through his subdivision development but emphasized that a dealer can also be an investor. The court found that Alsup's primary purpose in holding the rental properties was for investment, generating revenue and potential appreciation, rather than for immediate sale in his ordinary course of business. The court distinguished Alsup's activities as a developer from his activities as a rental property owner, citing *E. Everett Van Tuyl, 12 T. C. 900*, and *Carl Marks & Co., 12 T. C. 1196* to support the proposition that investment property, clearly held for revenue and speculation, is classified as a capital asset, not property held primarily for sale. The court stated, "It seems to us that petitioner has proved by overwhelming evidence that he purchased and held these rental properties primarily for investment purposes. The fact that in the taxable years he received satisfactory offers for some of them and sold them does not establish that he was holding them 'primarily for sale to customers in the ordinary course of his trade or business.'"

Practical Implications

The Alsup case illustrates the importance of determining the taxpayer's primary purpose for holding property when classifying gains as either ordinary income or capital gains. It clarifies that real estate professionals can hold property for investment purposes, even if they are also engaged in the business of selling real estate. The case highlights that receiving unsolicited, satisfactory offers and selling property does not automatically classify the property as held primarily for sale. This decision emphasizes that the taxpayer's intent and the actual use of the property are key factors in determining its tax treatment. Later cases distinguish Alsup by focusing on the frequency and substantiality of sales activities, advertising efforts, and other factors indicative of a sales-oriented business. To successfully claim capital gains treatment on rental property sales, taxpayers must maintain clear records and demonstrate that the primary intent was long-term investment rather than short-term sales.

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