16 T.C. 854 (1951)

The determination of whether livestock sales qualify for capital gains treatment depends on whether the animals were part of a breeding herd, considering factors beyond mere registration, such as actual use for breeding and the age of the animals.

Summary

Walter and Eleanor Fox, cattle breeders, disputed the IRS's assessment of deficiencies on income taxes from 1944-1946. The Foxes argued that gains from the sale of registered Aberdeen-Angus cattle should be taxed at capital gains rates, while the IRS contended it should be taxed as ordinary income. The Tax Court distinguished between cattle held primarily for breeding and those held primarily for sale. The court held that cattle under 26 months (females) or 34 months (males) old were held primarily for sale and thus gains were ordinary income, while older cattle were part of the breeding herd and eligible for capital gains treatment. This case provides a practical framework for distinguishing breeding livestock from those held for sale.

Facts

The Foxes operated Highlands Farm, raising Aberdeen-Angus cattle, primarily for sale to other breeders, not for meat. They aimed to improve the breed and sell them as a herd. They started in 1939 and registered most calves with the American Aberdeen-Angus Association by six months old. Registered animals were kept separate until breeding age (13 months for bulls, 15 months for heifers). However, many were sold before or shortly after being bred once. The breeding herd size was limited by available resources. On average, very few male calves met the Foxes' breeding quality standards and bulls could not be reliably assessed until 32 months old. All registered bulls were bred at least once to guarantee fertility. The Foxes reported gains from unregistered cattle as ordinary income but treated registered cattle sales as capital gains.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Foxes' income taxes for 1944, 1945, and 1946, which the Foxes paid. The Foxes then filed amended petitions claiming overpayments. The cases were consolidated for hearing before the Tax Court.

Issue(s)

1. Whether the registered cattle sold by the Foxes during the years in question were part of their breeding herd, thus qualifying for capital gains treatment under Section 117(j) of the Internal Revenue Code.

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Holding

1. No, for cattle sold before reaching certain ages. Yes, for cattle sold after reaching certain ages. The court held that heifers raised, registered, and sold before dropping a calf were not part of the breeding herd, but those that dropped a calf while owned by the Foxes were. Registered bulls had to be 34 months or older to be classified as part of the breeding herd.

Court’s Reasoning

The court reasoned that Section 117(j) of the Internal Revenue Code allows capital gains treatment for the sale of

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