***17 T.C. 308 (1951)***

To qualify for an ordinary loss deduction instead of a capital loss, a taxpayer must demonstrate that the foreclosed real property was actively used in their trade or business.

**Summary**

The case of *Emery v. Commissioner* concerns whether a loss sustained by a trust, in which the petitioner had an interest, due to a property foreclosure, should be classified as an ordinary loss or a capital loss for income tax purposes. The Tax Court held that the waterfront property in question was not "real property used in the trade or business of the taxpayer" under Section 117(a)(1) of the Internal Revenue Code. Therefore, the loss was classified as a capital loss, not an ordinary loss, because the taxpayer failed to prove active use in a trade or business. This determination significantly impacted the deductibility of the loss for the petitioner.

**Facts**

Susan P. Emery was a beneficiary of the Pittock Heirs Liquidating Trust, which held various real properties, including the "Mock Bottom Property," a waterfront parcel. The trust's purpose was to liquidate these properties. The Mock Bottom Property was rented for log storage from 1928 to 1942, generating varying amounts of rental income. In 1942, a portion of the property was leased to the U.S. Maritime Commission, with rental income initially applied to back taxes. The beneficiaries did not instruct the trustee to pay taxes on the Mock Bottom Property. Foreclosure proceedings commenced in 1943 due to delinquent taxes, and most of the Mock Bottom Property was conveyed via foreclosure deed in 1944, except for the portion leased to the Maritime Commission.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in Emery's income tax liability for 1944 and denied her claim for a refund. Emery contested this determination, arguing that the loss from the property foreclosure should be treated as an ordinary loss. The Tax Court was tasked with determining the proper classification of the loss.

**Issue(s)**

Whether the loss sustained by the petitioner through her interest in the Liquidating Trust, due to the foreclosure of the Mock Bottom Property, constitutes an ordinary loss or a capital loss for income tax purposes?

**Holding**

No, because the petitioner failed to prove that the foreclosed property was "real

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property used in the trade or business of the taxpayer" as required by Section 117(a)(1) of the Internal Revenue Code.

## Court's Reasoning

The Tax Court emphasized that the petitioner bore the burden of proving that the property was used in her trade or business. The court found that the petitioner failed to meet this burden, stating, "The property in question was not used in the trade or business of the taxpayer." Because the property did not meet the statutory exclusion from the definition of a capital asset, the loss was properly classified as a capital loss. The court did not elaborate extensively on the specific facts that led to this conclusion, but it clearly indicated that the minimal rental activity and the lack of active management or development of the property were insufficient to establish use in a trade or business. The Court stated, "Suffice it to state that the facts do not establish the contention on which the petitioner's case rests."

## Practical Implications

*Emery v. Commissioner* highlights the importance of demonstrating active and substantial involvement in a trade or business to qualify for ordinary loss treatment on the disposition of real property. Taxpayers must show more than mere ownership or incidental rental activity. The case reinforces that the determination of whether property is used in a trade or business is a fact-specific inquiry. Later cases have cited *Emery* for the proposition that a taxpayer must actively and regularly engage in activities related to the property to demonstrate its use in a trade or business. This decision serves as a reminder that passive investment or minimal business activity is insufficient to transform a capital asset into property used in a trade or business. It informs tax planning and litigation strategy, emphasizing the need for detailed documentation of business activities related to the property.

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