Winnick v. Commissioner, 21 T.C. 529 (1954)

The intent for which property is held at the time of sale, rather than the original purpose of acquisition, determines whether the property is held primarily for sale to customers in the ordinary course of business, thus affecting its capital asset status.

Summary

Winnick v. Commissioner addressed whether the gains from the sale of rental houses, originally built for defense workers, should be taxed as ordinary income or capital gains. The Tax Court held that the properties were held primarily for sale to customers in the ordinary course of business during the tax years in question (1945-46), despite the original intent to hold them as rental properties. This determination hinged on the frequency and continuity of sales, the activities of the sellers, and the extent of the transactions during those years.

Facts

Albert Winnick and his partnership constructed 52 houses in 1943 and 1944, initially intended as rental properties for defense workers, due to wartime restrictions. To obtain materials, they agreed with the National Housing Agency to rent the houses. However, they also built and sold 29 houses for immediate sale during the same period. Starting in 1945, the partnership began selling the rental houses, continuing throughout 1946 and into 1947. After restrictions were lifted in 1946, they built and sold 12 new houses upon completion.

Procedural History

The Commissioner of Internal Revenue determined that the gains from the sales of the rental houses were taxable as ordinary income, not capital gains. The Winnicks petitioned the Tax Court, arguing the properties were used in their trade or business and qualified for capital gains treatment under Section 117(j) of the Internal Revenue Code.

Issue(s)

Whether the rental properties were held by the taxpayers primarily for sale to customers in the ordinary course of their trade or business during the tax years 1945 and 1946, thus disqualifying the gains from capital gains treatment.

Holding

No, because the evidence demonstrated that the primary purpose for holding the houses during 1945 and 1946 was for sale to customers in the ordinary course of business, overriding the initial intent to hold them for rental income.

Court’s Reasoning

The court applied several tests to determine the primary purpose for which the properties were held. These included the continuity and frequency of sales, the activity of the seller or their agents, and the extent of the transactions. The court emphasized that the original intent to rent the properties was not controlling. The court stated, "[T]he purpose for which property is originally acquired does not stamp it with a permanently fixed and unalterable status. The taxpayer may change his objective with respect to his property, and thereby change the status of the property, tax-wise, from capital assets to non-capital assets or vice versa." The court noted the petitioners were clearly in the business of constructing and selling houses and that sales were made in the ordinary course of that business, particularly after wartime restrictions eased. The court distinguished other cases cited by the petitioners, noting those cases typically involved isolated transactions or a small portion of investment properties, unlike the comprehensive sales activity in this case.

Practical Implications

This case underscores that a taxpayer's intent at the time of sale is the crucial factor in determining whether property is held primarily for sale in the ordinary course of business. It clarifies that an initial investment purpose does not guarantee capital gains treatment if the taxpayer's activities shift toward selling the property. Real estate developers and investors must carefully document their activities and intentions, particularly when converting rental properties to sales, to avoid ordinary income tax treatment. Later cases applying Winnick often focus on the level of sales activity and marketing efforts as indicators of intent during the relevant tax years. This ruling highlights the potential tax consequences of actively marketing and selling properties, even if those properties were initially acquired for investment purposes.

