17 T.C. 1583 (1952)

Breeding turkeys, held for more than six months and used to produce eggs and poults, are considered property used in a trade or business and are eligible for capital gains treatment upon sale, even if sold after only one breeding season, provided that selling after one season is normal trade practice.

Summary

Glenn and Phyllis Magee, turkey farmers, sold their breeding turkeys after one breeding season following the death of their son, who managed the turkey business. The IRS argued the turkeys were held primarily for sale to customers, thus ordinary income, not capital gains, applied. The Tax Court held that the turkeys were held primarily for breeding purposes, not for sale in the ordinary course of business, and were therefore eligible for capital gains treatment. This was based on the fact that the turkeys were kept for breeding, and selling after one season was normal trade practice.

Facts

The Magees operated a ranch producing various crops. In 1943, they started a turkey business to encourage their son to stay on the ranch.
They kept over 5,000 turkeys from the 1944 hatch as breeding stock for 1945.
Their son enlisted in the Navy in February 1945 and died in April 1945. The Magees then decided to quit the turkey business after the 1945 season.
Between May and June 1945, they sold 4,804 hens and 706 toms for $31,861.18. All had been held for breeding for more than 6 months.
The normal industry practice was to sell the entire breeding herd annually due to declining productivity and increased disease susceptibility.
Turkeys from breeding stock typically fetch lower prices than non-breeding stock due to damage during breeding.

Procedural History

The IRS determined deficiencies in the Magees' 1945 income taxes.
The Magees petitioned the Tax Court, contesting the deficiency assessment.
The sole issue presented to the Tax Court was whether the turkeys were held primarily for sale to customers.

Issue(s)

Whether the turkeys sold in 1945 were property held by the taxpayers primarily for sale to customers in the ordinary course of their trade or business as defined by Section 117(j) of the Internal Revenue Code.

Holding

No, because the turkeys were held primarily for breeding purposes, not for sale in the ordinary course of business. They qualify for capital gains treatment under Section 117(j) of the Internal Revenue Code.

Court’s Reasoning

The court emphasized that the turkeys were withheld from sale in 1944 and retained for breeding purposes.
The court distinguished between breeding and non-breeding stock, noting the investment of time, money, and labor in maintaining breeding stock, as well as the strategic decision to withhold them from the peak fall season.
The court rejected the IRS’s argument that the purpose for which the birds were held should be determined only at the time of sale, citing *McGah v. Commissioner*, 193 F.2d 662.
The court found that the sale of the breeding stock was secondary to the primary purpose of producing eggs and poults.
The court noted that while the turkeys were sold at the same price as non-breeding stock, this was not determinative due to wartime meat shortages and government price ceilings.
The court considered Section 324 of the Revenue Act of 1951 but concluded that it did not disturb the court’s conclusion. The court noted that prior to 1951, poultry was neither expressly included nor excluded from Section 117(j).
The court referenced *Franklin Flato*, 14 T.C. 1241 and *William Wallace Greer, Jr.*, 17 T.C. 965, supporting the position that the sale of animals kept for breeding purposes results in capital gain under Section 117(j).
The court found that the taxpayers’ actions demonstrated an intent to quit the business, further supporting the idea that they weren’t holding the turkeys primarily for sale in the ordinary course of business.

Practical Implications

This case illustrates that the primary purpose for holding livestock, not just the purpose at the time of sale, is the crucial factor in determining eligibility for capital gains treatment. It’s a key case for agricultural businesses.
Even if livestock is sold after only one breeding season, it can still qualify for capital gains if this practice is customary in the industry.
The IRS’s position on the length of usefulness of the animal for breeding, draft, or dairy purposes was not supported by the Tax Court’s decision. Taxpayers can argue against a rigid, time-based interpretation.
The decision highlights the importance of demonstrating that the animals were, in fact, held for breeding, draft, or dairy purposes, with the sale being secondary to that primary purpose.
While Section 324 of the Revenue Act of 1951 now excludes poultry from capital gains treatment, this case remains relevant for understanding the principles used to determine the primary purpose of holding livestock before the amendment.

