20 T.C. 663 (1953)

For tax purposes, the holding period of a newly constructed building begins upon its completion, not from the date of land acquisition or the commencement of construction contracts.

Summary

The petitioner, Paul, sold an apartment building shortly after its construction. The IRS argued that the profit from the sale should be taxed as ordinary income rather than as a capital gain, as the building was not held for more than six months. The Tax Court agreed with the IRS, holding that the holding period for the building commenced upon its completion. Since the building was sold within six months of completion, the gain was taxable as ordinary income. The court emphasized that for tax purposes, buildings and land are treated separately, and the holding period of the building itself begins when it is complete and ready for use.

Facts

The petitioner constructed an apartment building, intending to rent the apartments. He did rent them out. The building was sold shortly after construction. The petitioner reported rental income and claimed operating expenses related to the building. The petitioner argued that the holding period of the building began when he entered into construction contracts.

Procedural History

The Commissioner of Internal Revenue determined that the gain from the sale of the apartment building should be taxed as ordinary income, not as a capital gain. The petitioner appealed this determination to the Tax Court.

Issue(s)

1. Whether the apartment building constituted property “used in his trade or business” under Section 117(a)(1)(B) of the Internal Revenue Code.
2. Whether the holding period of a newly constructed building, for capital gains purposes, begins when construction contracts are signed or upon completion of the building.

Holding

1. Yes, because the petitioner constructed the building with the intention of renting the apartments, and he did rent them out, demonstrating that the building was being used in his trade or business.
2. No, because the holding period begins only when the building is complete, as the taxpayer cannot “hold” something that does not yet exist.

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Court’s Reasoning

The court reasoned that the petitioner was engaged in the trade or business of renting apartments. The fact that he had another primary business was irrelevant. Regarding the holding period, the court cited *McFeely v. Commissioner*, stating that “to hold property is to own it. In order to own or hold one must acquire. The date of acquisition is, then, that from which to compute the duration of ownership or the length of holding.” The court found that the petitioner did not “acquire” the building until it was completed. The court explicitly rejected the argument that the holding period began when the construction contracts were signed, as the building did not exist at that time. The court also referenced *Helen M. Dunigan, Administratrix, 23 B. T. A. 418*, noting the established principle that land and buildings are treated separately for federal tax purposes.

Practical Implications

This case provides a clear rule for determining the holding period of newly constructed buildings for tax purposes. It clarifies that the holding period starts upon completion of the building, not from earlier events like land acquisition or signing construction contracts. This is particularly relevant for developers and real estate investors who frequently sell properties shortly after construction. This ruling emphasizes the importance of tracking the completion date of construction projects to accurately determine capital gains tax liabilities. Later cases and IRS guidance have consistently followed this principle, solidifying the distinction between the holding period of land and the holding period of improvements made to that land.

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