19 T.C. 120 (1952)

A car dealership's "company cars," used for various business purposes, qualify for depreciation deductions and capital gains treatment upon sale, even though the dealership is in the business of selling cars.

Summary

Latimer-Looney Chevrolet, a car dealership, sought to deduct depreciation expenses on its "company cars" and treat the gains from their sale as long-term capital gains. The IRS argued that these cars should be treated as inventory, ineligible for such treatment. The Tax Court ruled in favor of the dealership, holding that the cars were used in the dealership's trade or business and were not held primarily for sale to customers in the ordinary course of business, entitling the dealership to both depreciation deductions and capital gains treatment.

Facts

Latimer-Looney Chevrolet operated a car dealership selling new and used Chevrolet and Cadillac cars and trucks. The dealership used certain new cars, designated as "company cars," for various business purposes, including employee transportation, customer loans, service vehicle use, and participation in a driver training program. The dealership accounted for these cars under a system prescribed by General Motors, initially entering them into an account for new cars available for sale but then transferring them to a separate "company car" account. The dealership sold these cars after they had been driven between 8,000 and 12,000 miles.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the dealership's federal income tax for the fiscal year ended September 30, 1949, and the short period ending December 31, 1949. The dealership petitioned the Tax Court for a redetermination of these deficiencies. The Tax Court ruled in favor of the petitioner, Latimer-Looney Chevrolet.

Issue(s)

1. Whether the gain on the sale of "company cars" was long-term capital gain under Section 117(j) of the Internal Revenue Code.

2. Whether the "company cars" were property used in the trade or business of the petitioner and subject to allowance for depreciation under Section 23(l) of the Internal Revenue Code.

Holding

1. Yes, because the cars were held primarily for use in the petitioner's trade or

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business and were not held primarily for sale to customers in the ordinary course of its business.

2. Yes, because the cars were used in the petitioner's trade or business and were not property includible in inventory or held primarily for sale to customers.

Court's Reasoning

The Court reasoned that the key factor was the purpose for which the property was held, not the nature of the property itself. The court noted examples of other types of property normally sold in a business that could also qualify for capital gains treatment if used in the trade or business such as securities, livestock, housing and even slot machines. The Court found that the dealership used the "company cars" extensively for various business purposes. Although the cars were initially accounted for as new cars available for sale, they were quickly transferred to a "company car" account and used for business operations. The Court rejected the IRS's argument that the dealership intended to hold the cars temporarily as demonstrators, noting that the cars were sold based on usage and increasing operating costs, not merely because they were outdated models. The court stated, "On the basis of the evidence as a whole, we conclude that the cars here in issue were held primarily for use in the petitioner's trade or business and, hence, are entitled to capital gains treatment under the provisions of section 117(j) of the Code and depreciation under section 23(l)."

Practical Implications

This case establishes that a business can treat assets it normally sells as capital assets if they are used in the business operations rather than held primarily for sale to customers. The key is demonstrating that the primary purpose for holding the asset shifted from sales to business use. Tax advisors should carefully analyze the taxpayer's intent and actual use of the asset to determine whether it qualifies for capital gains treatment and depreciation. This ruling offers a planning opportunity for businesses that use their inventory for internal operations before eventual sale. Subsequent cases distinguish this ruling on the basis of the taxpayer's intent, the extent of business use, and the accounting treatment of the assets.

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