20 T.C. 630 (1953)

The character of a loss from the sale of an asset (capital or ordinary) depends on whether the asset was used in the taxpayer's trade or business, and certain contracts can be amortized over their useful life.

Summary

Stewart Title Guaranty Company and Stewart Title Company challenged tax deficiencies related to the sale of abstract plants. The central issue was whether losses from these sales constituted ordinary losses or capital losses. The Tax Court held that the loss on the sale of a plant not used in the trade or business was a capital loss, while the loss on the sale of a plant used in the trade or business was an ordinary loss. The court also allowed Stewart Title Guaranty to amortize the value of a 5-year service contract received as partial consideration for one of the plants.

Facts

Stewart Title Guaranty acquired an abstract plant (Texas Title) in 1926, operating it until 1932 before placing it in storage. In 1946, it sold this plant to Jack Rattikin for a promissory note and a 5-year agreement to provide daily take-off cards. Stewart Title Company, a related entity, sold another abstract plant (Green Company) in 1946, which *was* used in its business. Neither company had taken depreciation or obsolescence deductions on the plants. The IRS assessed deficiencies, arguing the plant sales resulted in capital losses, not ordinary losses.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax for the years 1946 and 1947. Stewart Title Guaranty Company and Stewart Title Company petitioned the Tax Court for a redetermination of these deficiencies. The cases were consolidated.

Issue(s)

1. Whether the losses resulting from the sale of the abstract plants are ordinary losses or long-term capital losses.

2. Whether the petitioners were entitled or required to take certain deductions for obsolescence.

3. Whether petitioner Stewart Title Guaranty Company was entitled to certain business deductions related to the service contract received.

Holding

1. No for the Texas Title plant sale; Yes for the Green Company plant sale because

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the Texas Title plant was surplus property not used in Stewart Guaranty's trade or business, making it a capital asset, while the Green Company plant was used in Stewart Title's business, making it not a capital asset.

2. Yes, abstract plants are subject to obsolescence, but the petitioners failed to prove any actual obsolescence occurred during the tax years in question.

3. Yes, Stewart Guaranty is entitled to amortize over the life of Rattikin's service contract the reasonable value of his annual services.

Court's Reasoning

The court relied on section 117 of the Internal Revenue Code, which defines capital assets. The court reasoned that for property to be excluded from the definition of capital assets, it must both be of a character subject to depreciation under section 23 (l) and used in the taxpayer's trade or business. Although abstract plants are subject to obsolescence (included in depreciation under Crooks v. Kansas City Title & Trust Co., 46 F. 2d 928), the Texas Title plant was not used in Stewart Guaranty's business. The court emphasized that take-off cards were not filed but merely tied together, indicating the plant was stored as surplus. The Green Company plant *was* used in Stewart Title's business, leading to ordinary loss treatment. Regarding the service contract, the court reasoned that it was essentially an exchange of property for future services, and that "an expenditure made in acquiring a capital asset or a contract which is expected to be income-producing over a series of years is in the nature of a capital expenditure which must be amortized ratably over the life of the asset or the period of the contract."

Practical Implications

This case clarifies the distinction between capital assets and ordinary assets in the context of business property. It reinforces the principle that the *use* of an asset in a trade or business is crucial in determining the character of gain or loss upon its sale. Further, it confirms that contracts for services with a definite term are amortizable assets. This decision informs how businesses should classify and treat the sale of various assets, particularly those that may or may not be actively used in day-to-day operations. It also provides guidance on the tax treatment of non-cash consideration, such as service contracts, received in business transactions. Later cases applying this ruling would focus on whether an asset was truly "used" in the business and how to determine the fair market value and useful life of intangible assets such as service agreements.

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