Security Construction Co. v. Commissioner, 21 T.C. 27 (1953)

When a partnership builds and rents houses, the court examines the intent and business activities to determine whether the houses were held primarily for sale in the ordinary course of business (ordinary income) or as investment property (capital gains).

Summary

Security Construction Company, a partnership, built multiple-unit houses and rented them before selling. The Commissioner of Internal Revenue determined that the profits from these sales were ordinary income because the houses were held primarily for sale, not as investment property. The Tax Court agreed, finding that the partnership's original business was building and selling houses, and the rental activity was incidental to that primary purpose. The court considered factors like the partnership's intent, the continuity of sales, and the volume of sales relative to rental income to conclude the houses were held for sale.

Facts

Security Construction Company, a partnership, built multiple-unit houses. Initially, the partnership's business was building houses for sale, and the partners sought priorities for construction materials. They built houses for sale to comply with N. H. A. regulations. The partnership rented the houses for a period and subsequently sold them. The partners claimed that the houses were investment properties, entitling them to capital gains treatment upon sale. The Commissioner of Internal Revenue determined that the houses were held primarily for sale to customers in the ordinary course of business, and thus the profits were ordinary income.

Procedural History

The Commissioner determined the profits from the sale of the houses were ordinary income. The partnership challenged this determination in the United States Tax Court. The Tax Court sided with the Commissioner, upholding the determination that the houses were held primarily for sale and the profits were ordinary income, not capital gains.

Issue(s)

1. Whether the 69 multiple-unit houses sold in 1945 were held primarily for sale to customers in the ordinary course of the partnership's business, or were they held as investment property?

Holding

1. Yes, because the houses were held primarily for sale in the ordinary course of the partnership's business.

© 2025 SCOTUSreports.com. All rights reserved.

Court’s Reasoning

The court applied the principle that the character of the property (sale vs. investment) is a question of fact. The court examined several factors to determine the partnership’s intent, including:

- The partnership’s original business: building and selling houses.
- The purpose for which the houses were acquired: for sale.
- The partnership’s activities: building, renting, and selling houses.
- The substantiality of sales: The court noted the frequency, continuity, and substantiality of sales.

The court found the rental of the houses was incidental to the partnership’s primary business of building and selling. The court distinguished this case from others, such as Nelson A. Farry, where the taxpayer had a long history of owning rental properties. The court emphasized that the partnership built the houses with the intention of selling them and used the rental period to comply with regulations and potentially gain tax advantages before selling them to the customer.

The court stated, “In that situation it must be concluded that ‘one of the essential purposes (in acquiring or holding the houses) is the purpose of sale… and the profit on sale cannot be treated as capital gain.”

© 2025 SCOTUSreports.com. All rights reserved.