Winnick v. Commissioner, 21 T.C. 1045 (1954)

The character of income from property sales (ordinary income or capital gains) depends on the taxpayer's primary purpose for holding the property at the time of sale, not necessarily at the time of acquisition.

Summary

The Winnick case concerns whether profits from the sale of houses were taxable as ordinary income or capital gains. The petitioners, who built and sold houses, argued for capital gains treatment, claiming they initially held the houses for rental income due to wartime regulations. The Tax Court found the houses were held primarily for sale, based on the volume of sales and the petitioners' overall business pattern. The court determined that even though wartime regulations may have initially influenced the petitioners' decisions, the crucial factor was the purpose for which the properties were held at the time of the sale. Therefore, profits were considered ordinary income.

Facts

Petitioners built 66 defense housing units in 1943 and 1944 under wartime regulations that initially restricted sales. More than half of these units were sold before the restrictions were lifted. Petitioners also built houses for sale during the war years and after. The petitioners' income from sales exceeded rental income during the relevant years. After a corporate dissolution, some houses were transferred to a shareholder.

Procedural History

The Tax Court initially determined that profits from the house sales were ordinary income. On appeal to the Sixth Circuit, the case was remanded for additional findings regarding the petitioners' intentions. The Tax Court received further evidence and reaffirmed its original decision.

Issue(s)

1. Whether the profits from the sale of houses were taxable as ordinary income or capital gains.

2. Whether the petitioners were entitled to compute the gain on an adjusted cost basis, considering prior dividend payments and unsecured liabilities, related to the transfer of houses during corporate dissolution.

Holding

1. No, because the houses were held primarily for sale in the ordinary course of business at the time of sale, therefore the profits are ordinary income.

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2. Yes, because the petitioners were entitled to compute the gain on an adjusted cost basis for the houses received during the corporate dissolution.

Court’s Reasoning

The court emphasized the intent to hold the houses at the time of sale. Although the war regulations played a role, the volume of sales and the pattern of sales activity, demonstrated the business purpose of selling the properties.

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