23 T.C. 441 (1954)

A literary property purchased by an individual intending to use it in their profession as a director, but not held primarily for sale to customers in the ordinary course of their trade or business, constitutes a capital asset.

Summary

Anatole Litvak, a motion picture director, purchased the motion picture rights to a literary property, intending to use it as the basis for a film he would direct. He sold the rights and claimed the proceeds as capital gains. The Commissioner of Internal Revenue argued the income should be taxed as ordinary income, contending that the property was held in connection with his trade or business. The Tax Court held that the property was a capital asset because Litvak did not hold it primarily for sale to customers in the ordinary course of his business. The court emphasized that the sale was incidental to his profession as a director, not a business activity in itself, thus, the gain was a capital gain, not ordinary income.

Facts

Anatole Litvak was a motion picture director. In 1946, he purchased the motion picture rights to the literary property "Sorry, Wrong Number." He intended to direct a film based on the property. He negotiated with independent producers for its production. These negotiations failed. Litvak then sold the rights to Hal Wallis Productions, Inc. He also entered into an employment agreement to direct a film, which ultimately became "Sorry, Wrong Number." Litvak reported the gain from the sale as a capital gain, but the Commissioner assessed the income as ordinary income.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Litvak's 1947 income tax, asserting that the gain from the sale of the literary property should be taxed as ordinary income. Litvak petitioned the United States Tax Court to dispute this determination, claiming the gain qualified as a long-term capital gain. The Tax Court ruled in favor of Litvak, and this is the reported decision.

Issue(s)

Whether the gain realized by Litvak from the sale of the motion picture rights to the literary property, "Sorry, Wrong Number," constituted a long-term capital gain or ordinary income?

Holding

Yes, because the court determined that Litvak did not hold the literary property primarily for sale to customers in the ordinary course of his trade or business, the

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gain was considered a capital gain.

Court’s Reasoning

The court relied on Section 117 (a)(1)(A) of the Internal Revenue Code of 1939, which defines a capital asset as property held by the taxpayer but excludes “property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.” The court found that Litvak, as a motion picture director, acquired the property with the primary intention of using it in his directorial work and not for resale to customers as a dealer in literary properties. The court stated, “…although the literary property in question had been held by petitioner in connection with his trade or business of being a director, it was not held by him primarily for sale to customers in the ordinary course of trade or business.” The court distinguished the case from situations involving securities traders or speculators, emphasizing that Litvak’s activities were not the type of business excluded by the statute. Furthermore, the court noted, “The issue here is not different from the comparable issue in Fred MacMurray, 21 T.C. 15, and we reach the same result in this case.”

Practical Implications

This case establishes a key distinction for how the IRS treats income from creative works. It clarifies that, for a director or other creative professional, property acquired for use in their creative work and not for resale may be considered a capital asset, provided the taxpayer is not a dealer in such property. Attorneys should advise clients in creative professions to document their intent when purchasing literary properties or similar assets. If the primary intent is to use the asset in their work, rather than to profit from its sale, it may be treated as a capital asset for tax purposes. This case offers a precedent for those who acquire literary or artistic works for their own use and then sell them. The court’s finding of capital gains treatment, rather than ordinary income, is a significant benefit for the taxpayer and can potentially result in lower tax liability. Later cases involving the sale of intellectual property by individuals involved in the creative arts should consider this case, especially if the facts demonstrate that the property was purchased for use, not for sale, in the ordinary course of business.

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