25 T.C. 109 (1955)

Whether livestock, specifically young horses, are considered 'property used in the trade or business' for capital gains purposes depends on the taxpayer's primary purpose for holding each animal, not a general intention for the herd, requiring a fact-specific analysis of each animal's circumstances.

Summary

Robert B. Jewell, a breeder of standard-bred trotting horses, sold eleven yearlings and sought to treat the profits as capital gains under Section 117(j) of the 1939 Internal Revenue Code, arguing they were 'property used in the trade or business' because they were initially intended for breeding. The Tax Court analyzed each horse individually, finding that while Jewell intended to build a breeding herd, his primary purpose for holding most of the sold horses was ultimately for sale due to discovered defects or lack of breeding potential. The court held that only three horses, Jalapa, Jettsam, and Juggernaut, qualified for capital gains treatment, as they were held for breeding purposes until defects arose, necessitating their sale. The gains from the other eight horses were deemed ordinary income.

Facts

Robert Jewell operated a farm where he bred and raised standard-bred trotting horses. His business strategy shifted from selling foals as weanlings to raising them until they were yearlings. Jewell aimed to improve his breeding stock through selective breeding, retaining only horses with desired traits for breeding or racing. He sold most yearlings that did not meet his breeding standards. During 1947-1949, Jewell sold eleven yearlings. None of these horses had been used for breeding or racing. Some horses were co-owned with partners who also desired to sell.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Jewell's income tax for 1947, 1948, and 1949, arguing that gains from the horse sales were ordinary income, not capital gains. Jewell contested this determination in the United States Tax Court.

Issue(s)

1. Whether the gains from the sale of eleven trotting horses, sold as yearlings, should be treated as ordinary income or long-term capital gains under Section 117(j)(1) of the Internal Revenue Code of 1939.
2. Specifically, whether each of the eleven horses was 'property used in the trade or business,' meaning held primarily for breeding purposes and subject to depreciation, rather than held primarily for sale to customers in the ordinary course of business.

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Holding

1. Yes, in part. The gains from the sale of three horses (Jalapa, Jettsam, and Juggernaut) were long-term capital gains because these horses were held primarily for breeding purposes until defects arose. No, for the remaining eight horses, the gains were ordinary income because they were not proven to be held primarily for breeding purposes.

Court's Reasoning

The Tax Court emphasized that determining the primary purpose for which property is held is a factual question, focusing on the taxpayer's intent for each specific horse. The court acknowledged Jewell's intent to build a quality breeding herd but stressed that this general intention did not automatically classify all colts as 'property used in the trade or business.' The court stated, "*While there is no over-all rule which will apply to all animals or even to any particular type of animal, we think in the instant case each horse was unique and the purpose for which each was held must be determined separately.*"

For Jalapa, Jettsam, and Juggernaut, the court found they were held for breeding for over six months until defects emerged, leading to their culling and sale. This aligned with the principle that "*a draft, breeding, or dairy purpose may be present in a case where the animal is disposed of within a reasonable time after its intended use for such purpose is prevented by accident, disease, or other circumstance.*"

Conversely, for the other horses, the court found insufficient evidence that they were held primarily for breeding. Some were co-owned, and the co-owners' intent was not established. For stallions like Johnny Vinegar, James VI, and Jereboam, their lineage and the limited need for stallions in Jewell's herd indicated they were less likely intended for breeding. Horses like Joyous Day and Jocose were deemed to have been held primarily for sale due to early recognition of defects or lack of proof of timely sale after defect discovery.

The court distinguished this case from others where taxpayers were primarily engaged in using animals (e.g., for dairy or racing), noting Jewell's primary business was selling horses. The court also noted that unlike cases where animals were sold immediately upon defect discovery, Jewell held yearlings for a longer period, potentially to increase their sale value, further suggesting a primary purpose of sale for many of the horses.

Practical Implications

Jewell v. Commissioner provides crucial guidance on classifying livestock as 'property used in the trade or business' for capital gains treatment. It clarifies that a blanket intention to build a breeding herd is insufficient. Taxpayers must demonstrate that each animal, individually, was primarily held for breeding, draft, or

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dairy purposes, not primarily for sale in the ordinary course of business. This case necessitates a detailed, fact-based analysis, considering factors like the animal's qualities, defects, intended use, duration of holding, and the taxpayer's actions. It emphasizes that the 'primary purpose' is assessed at the time of sale, not merely at birth or initial intention. Legal practitioners must advise clients in livestock businesses to maintain thorough records demonstrating the specific intent and use for each animal to support capital gains treatment upon sale, especially when culling animals from a breeding program. Subsequent cases have cited *Jewell* to reinforce the need for this individualized, intent-focused approach in similar contexts.

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