Zack v. Commissioner, 25 T.C. 629 (1956)

When determining whether income from the sale of property is taxed as ordinary income or capital gains, the crucial factor is whether the property was held primarily for sale to customers in the ordinary course of a trade or business.

Summary

The case concerns the tax treatment of profits from the sale of bomb hoists. The Commissioner of Internal Revenue argued that the profits were ordinary income because the hoists were held primarily for sale to customers in the ordinary course of business. The Tax Court agreed, finding that the taxpayer and his associates actively marketed the hoists, making the sales part of a regular business activity, and therefore, not capital assets. The court rejected the taxpayer's argument that the sales should be treated as capital gains, emphasizing the active and ongoing nature of the sales efforts.

Facts

Zack, along with his sons and son-in-law, acquired bomb hoists and sold them. They shared the profits from the sales. Breakstone, one of the associates, actively promoted the hoists through brochures, direct contact with potential customers, and displaying the hoists. Zack's salesmen also sought customers, and Tyroler was involved in sales negotiations. The Commissioner determined that the income was ordinary income from a trade or business, not capital gains.

Procedural History

The case was heard in the Tax Court. The Commissioner's determination of ordinary income versus capital gains was contested by the taxpayers. The Tax Court reviewed the facts and upheld the Commissioner's assessment.

Issue(s)

1. Whether the arrangement between Zack, his sons, and son-in-law was a sham.

2. Whether income from the sale of bomb hoists should be treated as ordinary income or long-term capital gains.

Holding

1. No, because the agreement reflected their actual sharing of profits, and they all actively participated in the selling of the bomb hoists.

2. Yes, because the hoists were held primarily for sale to customers in the ordinary course of their business.

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Court’s Reasoning

The court first addressed the arrangement among Zack, his sons and his son-in-law and found that the family members had a valid agreement to share in the profits, and the Commissioner erred by including the sons’ and son-in-law’s shares of the profit from the sales of the bomb hoists in the income of the petitioners.

The court then focused on whether the hoists were held as capital assets or for sale in the ordinary course of business. The court cited that, “the only purpose in buying the bomb hoists was to resell them at a higher price.” The court found that Zack and his associates engaged in significant promotional activities, including advertising, direct sales efforts, and the use of sales staff, demonstrating that they were actively involved in the business of selling hoists. The court stated, “The activities amounted to the carrying on of a business of selling the bomb hoists and the sales were to customers in the ordinary course of that business. The sales were not of capital assets.”

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