Simonsen Industries, Inc., et al., Petitioners, v. Commissioner of Internal Revenue, Respondent, 26 T.C. 515 (1956)

Property held primarily for sale to customers in the ordinary course of business, or property that would be properly included in inventory, is not a capital asset and any gain from the sale of such property is taxed as ordinary income rather than capital gains.

Summary

Simonsen Industries, Inc. and the Simonsens were members of a syndicate that purchased and sold music wire. The Commissioner of Internal Revenue determined deficiencies, claiming the gains from wire sales should be taxed as ordinary income, not capital gains. The Tax Court agreed, finding that the wire was either stock in trade or property held primarily for sale to customers in the ordinary course of business. The court emphasized that the syndicate consistently used inventories to determine its profit and that sales were frequent and continuous, solidifying that the wire was not a capital asset. This meant the gains were properly taxed as ordinary income.

Facts

Simonsen Industries, Inc., Simonsen Metal Products Company, and the Simonsens formed a syndicate to purchase music wire from the War Assets Corporation in 1946. The syndicate purchased 57 lots of wire, approximately 1,500,000 pounds. From 1946 to 1951, the syndicate sold the wire to various customers. The syndicate used the inventory method to determine its profit. Over these years, the syndicate made a total of 973 sales, which was used to determine the proper tax treatment of the gains from the sale of the wire. The syndicate reported losses from 1946 to 1949, but reported gains and long-term capital gains in 1950 and 1951, but it had used inventories to compute its gross profit in each year.

Procedural History

The Commissioner of Internal Revenue determined tax deficiencies against Simonsen Industries, Inc., and the Simonsens for the tax years 1949, 1950, and 1951. The Commissioner determined the gains from the wire sales should be taxed as ordinary income. The case was brought before the United States Tax Court, which agreed with the Commissioner and decided in favor of the respondent, the Commissioner of Internal Revenue.

Issue(s)

1. Whether the music wire was a capital asset under section 117(a)(1)(A) of the 1939 Code, or whether it was property held primarily for sale to customers in the ordinary course of business, and thus taxable as ordinary income?

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2. Whether the music wire was of a kind that should be included in inventory, making the income from its sale ordinary income?

Holding

1. No, because the wire was property held primarily for sale to customers in the ordinary course of business.

2. Yes, because the wire was stock in trade, and the stock on hand at the end of each taxable year was properly included in the syndicate’s inventory.

Court's Reasoning

The court relied on section 117(a)(1)(A) of the 1939 Code, which excludes from the definition of capital assets property held for sale to customers in the ordinary course of business, and property that would be properly included in inventory. The court first determined that the wire would be properly included in the inventory. The court found the syndicate used inventories to determine gross profits from sales consistently from 1946 to 1951, and therefore, the wire was stock in trade. The court then found that the wire was held primarily for sale to customers in the ordinary course of business. The syndicate was formed for the purpose of marketing the wire, made frequent sales, and maintained a set of ordinary business books. The court highlighted that the sale of the wire was not a passive investment.

The court stated, “The music or piano wire was stock in trade of the syndicate and the stock on hand at the close of each taxable year was properly included in the syndicate’s inventory. The wire was held primarily for sale to customers in the ordinary course of its business.”

Practical Implications

This case emphasizes that the classification of an asset for tax purposes hinges on the nature of the business activity related to the asset. If property is sold to customers in the ordinary course of a business, or is the type of property included in inventory, it is not a capital asset. This means that profits are taxed as ordinary income. For businesses that buy and sell goods, especially those that use inventory accounting, this case provides a clear guide for tax planning. Legal practitioners and tax professionals should consider the frequency and continuity of sales, the purpose for which the asset was held, and whether the business used inventories to determine profits to determine if income should be taxed as capital gains or ordinary income.

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