Rissler & McMurry Co. v. Commissioner, 26 T.C. 311 (1956)

Payments related to a property sale are considered part of the capital transaction and not ordinary business expenses, while the nature of the property (inventory or not) dictates whether gains from its sale are ordinary income or capital gains.

Summary

Rissler & McMurry Co., an automobile dealer, faced two tax issues: whether a payment made to a contractor related to a building exchange was deductible as an ordinary business expense or a capital expenditure, and whether gains from selling “company cars” were ordinary income or capital gains. The court determined the payment related to the building was a capital expenditure, increasing the cost basis, not a deductible expense. Additionally, the court ruled that the gains from the sale of company cars were ordinary income because the cars were considered inventory. The decision clarifies the distinction between ordinary business expenses and capital expenditures and how the nature of property affects the tax treatment of sales proceeds.

Facts

Rissler & McMurry Co. (the “Petitioner”), an automobile dealer, transferred an uncompleted building to the Johnson estate in exchange for its own stock and some cash. The Petitioner also made a payment to a contractor to settle a claim related to the building. The Petitioner also sold cars which were initially acquired as new cars and entered on its books in the new car inventory account before being transferred to a “company car” account for use by officials and salesmen. The IRS (the “Respondent”) disallowed a deduction for the contractor payment, and also treated gains from the sale of company cars as ordinary income.

Procedural History

The case was heard in the United States Tax Court. The Tax Court ruled in favor of the Commissioner of Internal Revenue.

Issue(s)

1. Whether the payment to the contractor related to the building exchange constituted an ordinary and necessary business expense, or a capital expenditure related to the sale of property.

2. Whether gains from the sale of “company cars” were taxable as ordinary income or capital gains.

Holding

1. No, because the payment was directly related to the building and was a part of

the consideration for the sale of the building; the payment was an additional cost of the building, increasing its cost basis.

2. Yes, because the cars were stock-in-trade and not capital assets, the gain from the sale of the automobiles was taxable as ordinary income.

Court's Reasoning

The court applied Regulations 111, section 29.22(a)-15, which states that if a corporation receives its own stock as consideration upon the sale of property, the gain or loss is computed as if any other property had been received. The court determined that the payment to the contractor was directly related to the building and increased its cost basis. The court found the transfer of the building for stock and cash constituted a sale for tax purposes, leading to a loss on the sale. The court reasoned that the cars initially purchased as inventory were not converted to capital assets, and were, at all times, held primarily for sale. The Court cited, in the reasoning, that the

