28 T.C. 721 (1957)

A portrait painter's sale of a study portrait, not created for sale but as part of a larger artistic endeavor, is treated as a capital asset if the painter is not in the business of selling portraits.

Summary

Douglas Chandor, a renowned portrait painter, sold a study portrait of Winston Churchill. The Commissioner of Internal Revenue argued that the proceeds were taxable as ordinary income because the portrait was property held for sale in the ordinary course of business. The Tax Court disagreed, holding that the portrait was a capital asset, as Chandor's primary business was commissioned portraits, not selling pre-existing works. The court distinguished between Chandor's commissioned work and this single, isolated sale of a study portrait, concluding that it did not constitute holding property primarily for sale to customers, and thus the gain was taxable at capital gains rates.

Facts

Douglas Chandor, a portrait painter, conceived of painting a group portrait of the "Big Three" (Roosevelt, Churchill, and Stalin) after the Yalta Conference. He painted study portraits of Roosevelt and Churchill but could not obtain Stalin's agreement to sit for a portrait, causing the project to be abandoned. Chandor sold the Churchill study portrait in 1948 for $25,000. Chandor had previously made his living through commissioned portraits and had never sold a portrait before. The Commissioner determined that the gain from the sale of the Churchill portrait was ordinary income. Chandor argued for capital gains treatment.

Procedural History

The Chandors filed a joint income tax return for 1948, reporting the sale of the Churchill portrait as a capital asset. The Commissioner reclassified the income as ordinary income, leading to a tax deficiency. The Chandors contested the adjustment. The U.S. Tax Court reviewed the case and sided with the Chandors.

Issue(s)

1. Whether the sale of the Churchill portrait was the sale of a capital asset under Section 117 of the Internal Revenue Code of 1939.

2. Whether the Churchill portrait was property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Holding

1. Yes, the sale of the Churchill portrait was the sale of a capital asset.

2. No, the Churchill portrait was not property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business because the sale was isolated and not part of his regular business of commissioning portraits.

Court's Reasoning

The court analyzed Section 117 of the 1939 Code, which defines "capital asset" broadly but excludes property held primarily for sale to customers in the ordinary course of business. The court determined that the Churchill portrait was property. However, the crucial question was whether Chandor held it primarily for sale in his business. The court found that Chandor's business was painting commissioned portraits, not selling pre-existing portraits or studies. The court emphasized that this was Chandor's only portrait sale. The court cited a definition from *Herwig v. U.S.*, and *Fahs v. Crawford*, which stated that carrying on a business implies an occupational undertaking where one habitually devotes time, attention, or effort with substantial regularity. The court found that the single sale did not demonstrate that Chandor was in the business of selling portraits. The court also noted that a 1950 amendment to Section 117 would have precluded capital gains treatment, but it was not applicable to the year in question. The court stated, "We think it would be difficult to hold that Chandor was in the business of selling portraits. But even if it be held that Chandor's uniform practice of painting portraits under contract for a fixed fee to be paid when the portrait was completed had the effect of putting him in the business of selling portraits, we still think the Winston Churchill study portrait was not held for sale by him in that business."

Practical Implications

This case provides a framework for differentiating between property held as a capital asset versus property held for sale in the ordinary course of business, particularly for artists and other creators. Attorneys should consider:

1. The nature of the taxpayer's regular business – whether it involves the direct sale of created works or only commissioned projects.

2. The taxpayer's intent and how the property was used.

3. The frequency and regularity of sales – a single, isolated sale is less likely to be considered part of the ordinary course of business.

4. This case is useful in tax planning for artists who may wish to classify sales of their art as capital gains rather than ordinary income.

5. Subsequent cases continue to define the line of distinction.