Glickman v. Commissioner, 35 T.C. 820 (1961)

To classify a corporation as "collapsible" under Section 117(m) of the 1939 Internal Revenue Code, the intention to engage in a transaction like the sale of stock must exist during the construction phase of the project undertaken by the corporation, and construction is not complete until the project is ready to generate net income.

Summary

The case of Glickman v. Commissioner deals with the application of the collapsible corporation provisions of the Internal Revenue Code. The issue was whether the taxpayer's gain from the sale of stock in a corporation that constructed a shopping center should be taxed at ordinary income rates because the corporation was "collapsible." The Tax Court held that the intent to sell the stock existed during the construction phase and before the realization of substantial net income. Thus, the corporation was "collapsible" and the gain was taxed at ordinary income rates, affirming the Commissioner's determination. The case emphasizes the importance of the timing of the taxpayer's intent, relative to the construction phase of the project, for determining whether a corporation is collapsible.

Facts

The taxpayers, Glickman, owned stock in a corporation that constructed a shopping center. The corporation was formed for the construction of the shopping center. Before the corporation realized substantial income from the shopping center, the stockholders decided to sell their stock. Construction of the shopping center was substantially completed by mid-December, but a retaining wall and parking area were not completed until January. The taxpayers sold their stock in March 1950. The Commissioner of Internal Revenue determined that the gain from the sale of the stock should be taxed as ordinary income under Section 117(m) of the 1939 Internal Revenue Code, which deals with collapsible corporations.

Procedural History

The case was heard in the United States Tax Court. The Tax Court agreed with the Commissioner and ruled that the corporation was collapsible, and the gains from the sale of the stock should be treated as ordinary income. The case was reviewed by the entire court.

Issue(s)

1. Whether the Commissioner's regulations regarding the timing of the intent to collapse the corporation during construction, were a valid interpretation of Section 117(m) of the 1939 Internal Revenue Code.
2. Whether, under the facts, the intention to sell the stock originated before the completion of construction.

Holding

1. Yes, the regulations were a valid interpretation.
2. Yes, the intention to sell the stock originated before the completion of construction.

Court’s Reasoning

The court first addressed the validity of the Commissioner’s regulations, which required that the intent to collapse the corporation must exist during the construction period. The court found that these regulations were a reasonable interpretation of the statute. The court reasoned that the regulations allowed for the flexibility needed to fulfill the legislative purpose of taxing as ordinary income the gains from certain transactions that the statute was aimed at. The court held that the word “construction” in the regulation included all periods until the project was ready to generate net income. The court then determined that the intention to sell the stock occurred before the shopping center was fully operational and earning income.

The court stated, “The statute is concerned with the realization of ‘net income from the property.’ It aims at a situation where, before a substantial part of that net income has been realized, the individual stockholders take action designed to result only in capital gain.”

The court found that the intention to sell the stock was formed no later than December. The court held that construction was not complete until all integral parts of the project were finished, which, in this case, was not until January, when the retaining wall and parking area were completed and ready to be used.

Practical Implications

This case illustrates the importance of timing in determining whether a corporation is collapsible. The court’s emphasis on the completion of construction and the point at which net income is realizable is critical. This case informs how courts will analyze similar cases. Legal practitioners must carefully document the dates relevant to both the construction project’s progress and the formation of the intent to collapse the corporation. The case is still relevant to the current version of the collapsible corporation rules, found in Section 341 of the Internal Revenue Code. Understanding the definition of construction, which extends to all actions before the project can generate income, is essential. Finally, the case highlighted the need to analyze the subjective intent of the taxpayer within the context of objective facts, which is a central theme in all tax cases involving intent. Later cases have cited Glickman to support the timing rules, demonstrating its continuing importance in tax law.