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

The intention to collapse a corporation, for purposes of Section 117(m) of the 1939 Internal Revenue Code (collapsible corporation provisions), must exist during the construction of the property to render the corporation collapsible.

Summary

The case of *Glickman v. Commissioner* addresses whether a corporation was a "collapsible corporation" under Section 117(m) of the 1939 Internal Revenue Code. The central issue was the timing of the shareholders' intent to sell their stock relative to the corporation's construction of a shopping center. The Tax Court held that the shareholders' intent to sell the stock arose before the completion of the shopping center's construction, making the corporation collapsible, and therefore the shareholders' gain on the stock sale was taxed as ordinary income, not capital gains. The court emphasized that the intention to collapse must exist during construction and that construction is not complete until the project is ready to earn net income.

Facts

Petitioners, the Glickmans, owned stock in a corporation formed to construct a shopping center. The corporation completed the physical structure of the shopping center by mid-December. However, a retaining wall and parking area still needed to be finished. The shareholders sold their stock, realizing a gain. The Commissioner determined that the corporation was "collapsible" within the meaning of Section 117(m) of the Internal Revenue Code of 1939, meaning the gain from the stock sale should be taxed as ordinary income and not capital gain. The Commissioner's assessment was based on the contention that the shareholders formed the intention to sell their stock before the shopping center construction was completed.

Procedural History

The Commissioner of Internal Revenue determined that the gain from the sale of stock should be taxed as ordinary income under the collapsible corporation provisions of the 1939 Internal Revenue Code. The taxpayers, Glickman, contested the determination, leading to a case in the United States Tax Court. The Tax Court reviewed the facts to determine the timing of the intent to sell the stock and the completion of construction.

Issue(s)

1. Whether the Commissioner's regulations, which require the intention to collapse the corporation must occur during "construction", constitute a valid interpretation of section 117(m) of the 1939 Code?
2. Whether, given the timing of construction and the shareholders' intent to sell, the corporation was a "collapsible corporation" under section 117(m)?

Holding

1. Yes, the regulations are a valid interpretation of the statute.
2. Yes, the corporation was a collapsible corporation because the decision to sell the stock was fixed no later than late November or early December, and the date of full completion was not earlier than January.

Court's Reasoning

The court first addressed the validity of the Commissioner's regulations defining when the intention to collapse the corporation must exist. The court determined that the regulations were a reasonable interpretation of the statute and should be given effect. The court emphasized that the intention to collapse must exist during construction and the word "construction" is not considered complete until the project is ready to begin earning a "substantial part" of the net income.

The court then examined the factual question of when construction was completed and when the shareholders decided to sell the stock. The court found the decision to sell stock occurred before the shopping center was ready to earn a substantial part of its net income. The court found the date of full completion was not earlier than January and the intention to sell the stock was fixed before completion. The court considered the definition of construction and determined that it was not complete until the retaining wall and parking area were also completed. The court noted, "the project should not be considered constructed until it is in shape to begin to realize net income." Because the sale occurred before a substantial part of the net income was realized, the corporation was deemed collapsible. The court rejected the petitioners' argument that the Commissioner's determination was arbitrary, finding the characterization of the situation was supported by the necessary supporting conclusions.

Practical Implications

This case highlights the importance of timing in determining whether a corporation is collapsible. It establishes that the intent to collapse must exist during the construction phase and that construction is not complete until the property is ready to generate income. The court's emphasis on the practical impact of the construction suggests that factors that affect income generation, such as a parking lot, are important. For attorneys, this means carefully scrutinizing the sequence of events – when construction began and ended, when the intent to sell was formed, and when income started to flow. This case informs how to analyze fact patterns in tax planning, particularly when forming a corporation or structuring a sale of assets or stock. It also serves as a reminder of the importance of considering all activities, including those not directly related to the main structure, in determining the completion of construction.

