***Weil v. Commissioner*, 28 T.C. 809 (1957)**

The intention to sell stock in a corporation formed for construction, if formed before the completion of construction, can classify the corporation as "collapsible," leading to ordinary income tax treatment on stock sale gains.

Summary

Edward Weil and Sol Atlas formed Edsol Realty, Inc. to construct a shopping center. Prior to the complete physical construction of the shopping center, but after substantial completion, Weil and Atlas decided to sell their Edsol stock. The Tax Court determined that Edsol was a collapsible corporation under Section 117(m) of the 1939 Internal Revenue Code because the intention to sell the stock was formed before the construction was fully completed. Consequently, the gain from the sale of stock was taxed as ordinary income rather than capital gains. The court upheld the validity of Treasury Regulations that interpret the statute to mean that the intention to collapse the corporation at any point during construction is sufficient to trigger collapsible corporation status.

Facts

In 1949, Edward Weil and Sol Atlas formed Edsol Realty, Inc. for the purpose of constructing a shopping center. Atlas contributed land to Edsol, and construction commenced around August 1, 1949. By December 9, 1949, a temporary certificate of occupancy was issued, indicating substantial completion of the building, although some work remained, including the parking area and a retaining wall. On December 15, 1949, Atlas authorized a broker to find a purchaser for the Edsol stock. A stock sale contract was signed on December 22, 1949. Physical construction of the shopping center was fully completed in January 1950. The sale of stock was finalized on March 30, 1950, and Weil realized a gain from the sale.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Weil's income tax for 1950. The IRS classified Edsol Realty as a collapsible corporation under Section 117(m) of the Internal Revenue Code of 1939. Weil petitioned the Tax Court to contest this determination.

Issue(s)

1. Whether Treasury Regulations, which interpret Section 117(m) to require that the intention to collapse a corporation must exist at any time during construction, are a valid interpretation of the statute.

2. Whether, based on the facts, the intention to sell the Edsol stock was formed before the completion of construction of the shopping center.

Holding

1. Yes, because the Treasury Regulations provide a reasonable and necessary interpretation of Section 117(m) to achieve its legislative purpose.

2. Yes, because the court found as a factual matter that the intention to sell the stock was formed in late November or early December 1949, which was prior to the completion of construction in January 1950.

Court's Reasoning

The Tax Court upheld the Treasury Regulations, stating they were a necessary and reasonable interpretation of Section 117(m). The court reasoned that the statute's purpose is to prevent the conversion of ordinary income into capital gains by selling stock before a corporation realizes substantial income from constructed property. To effectuate this purpose, "construction" must be interpreted to include all periods until completion, not just the initial phase. The court stated, "Partial completion, near completion, or even substantial completion are thus not effective substitutes for full completion of the 'construction.'" Regarding the timing of intent, the court found that the intention to sell the Edsol stock arose in late November or early December 1949, before the shopping center's construction was fully completed in January 1950. Even though the building was substantially complete in December, the court considered full completion, including associated work necessary for operation, as the relevant benchmark. The court rejected the petitioner's argument that the intent to sell must exist at the corporation's formation, stating the regulation's broader interpretation is necessary to prevent tax avoidance. The court also dismissed arguments about the IRS determination being arbitrary and the contract date predating the effective date of the statute, emphasizing that the gain was realized after the effective date.

Practical Implications

Weil v. Commissioner clarifies that the "collapsible corporation" rules can be triggered if the intent to sell stock arises at any point during the construction phase, not solely at the corporation's inception. The definition of "completion of construction" is interpreted practically, meaning when the property is ready to generate substantial income, which may extend beyond substantial physical completion to include necessary ancillary work like parking facilities. This case underscores the importance for real estate developers and investors to carefully consider the timing of stock sales in relation to construction completion to avoid unintended ordinary income tax consequences. It also reinforces the judicial deference given to Treasury Regulations in tax law when they provide a reasonable interpretation that furthers the legislative intent of the statute.