28 T.C. 1173 (1957)

Real property sold by a taxpayer is considered held for sale in the ordinary course of business, and thus taxable as ordinary income rather than capital gains, if the taxpayer's actions demonstrate a business of buying and selling real estate, even if the sales are conducted through a related corporation.

Summary

The Tax Court addressed whether the gain from the sale of undeveloped land by August Engasser to a corporation he primarily owned, should be taxed as ordinary income or capital gains. Engasser, along with his son, had been in the business of building and selling houses. Engasser purchased a parcel of land (the Amherst property), intending to build houses on it, but then sold it to a corporation he, his wife and son owned, which would then develop the property. The Court held that the gain was ordinary income because Engasser's history of real estate transactions, even when done through a corporation, demonstrated that he was in the business of selling real estate. The court focused on Engasser's overall business activities rather than a narrow focus on this single transaction, and found that the Amherst property was held for sale to customers in the ordinary course of his business.

Facts

August Engasser and his son formed a partnership in 1946 to construct and sell houses. In 1948, they formalized the partnership. In 1950, they organized Layton-Cornell Corporation to continue the business. Engasser held 49% of the corporation's stock, his wife 2%, and his son 49%. Engasser was president and his son managed operations. The partnership and later the corporation purchased vacant lots, built houses, and sold the properties. Engasser purchased about 5.5 acres of unimproved land, known as the Amherst property, in 1949, with the intent of building houses. In 1952, before any improvements, Engasser sold the Amherst property to the corporation for $52,500; his basis was $8,400. Engasser reported the resulting $44,100 gain as long-term capital gain.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Engasser's income tax, asserting that the gain from the sale of the Amherst property should be taxed as ordinary income, not capital gain. The Tax Court reviewed the Commissioner's determination and found that Engasser had indeed realized ordinary income.

Issue(s)

Whether the Amherst property was held by Engasser primarily for sale to customers in the ordinary course of trade or business.

Holding

Yes, because the court found that Engasser was in the business of buying and selling real estate, the Amherst property was held primarily for sale to customers in the ordinary course of his business, making the gain from its sale ordinary income.

Court's Reasoning

The court focused on whether Engasser held the Amherst property primarily for sale in the ordinary course of his business. The court looked at Engasser's history of real estate transactions, including those conducted through the partnership and the corporation. The court stated that Engasser and his son were in the business of building and selling homes, which was continued by the corporation. It found that the purchase of the Amherst property was consistent with this business model. The court also noted that the fact Engasser did not have a real estate license was not significant because the sales were made by the corporation and partnerships, which Engasser controlled. The court cited its prior holding in *Walter H. Kaltreider*, in which a similar factual pattern was found, and held that the Engassers were engaged in the real estate business. The court concluded that Engasser's activities demonstrated that the Amherst property was held for sale to customers in the ordinary course of his business and that this was ordinary income.

Practical Implications

This case highlights the importance of analyzing the totality of circumstances to determine whether a taxpayer is in the business of buying and selling real estate. The court looks beyond the specific transaction and examines the taxpayer's overall business activities, history, and intent. The case also demonstrates that using a corporation to conduct real estate sales does not automatically shield the individual from being considered to be in the real estate business. Real estate professionals and tax attorneys must be mindful of how frequent, substantial real estate transactions could cause property sales to be recharacterized from capital gains to ordinary income. This case serves as a reminder that form should not be elevated over substance when determining the tax treatment of real estate transactions and that factors like the volume of sales, the nature of the property, and the intent of the taxpayer will be scrutinized.

