Commissioner v. Bagley & Sewall Co., T.C. Memo. 1959-189

Gains from transactions involving assets that are an integral part of a taxpayer's business operations, such as a newsprint supply contract for a newspaper publisher, are considered ordinary income, not capital gains, even if the asset might otherwise fit the definition of a capital asset.

Summary

Bagley & Sewall Co., a newspaper publisher, entered into a long-term newsprint contract to ensure a stable supply of paper. It later allowed other publishers to purchase newsprint under its contract, receiving payments for this arrangement. The Tax Court held that these payments constituted ordinary income, not capital gains. The court reasoned that the newsprint contract was integral to Bagley & Sewall's business of publishing newspapers, serving as a form of inventory and hedge against price fluctuations. Therefore, gains from allowing others to use this contract were ordinary income generated from the regular course of business operations, aligning with the precedent set in *Corn Products Refining Co. v. Commissioner*.

Facts

Petitioner, Bagley & Sewall Co., was engaged in the newspaper publishing business and relied on a consistent supply of newsprint paper. To secure this supply, Petitioner entered into a 10-year newsprint contract with Coosa River providing a stable price. In 1951 and 1952, Petitioner entered into agreements with three other publishers (Brush-Moore, Beacon, and Lorain County Printing Company). Under these agreements, the other publishers could purchase newsprint directly from Coosa River under Petitioner's contract quota. In return, these publishers paid Coosa River the contract price for the newsprint and an additional sum to Petitioner.

Procedural History

The Commissioner of Internal Revenue determined that the payments received by Petitioner were ordinary income, not capital gains. Petitioner contested this determination in the Tax Court.

Issue(s)

1. Whether payments received by Petitioner from other publishers, for allowing them to purchase newsprint under Petitioner's contract with Coosa River, constitute ordinary income or capital gain?

Holding

1. No, the payments constitute ordinary income because the newsprint contract was an integral part of Petitioner's business operations, and the transactions were

essentially dealings in its newsprint inventory.

Court's Reasoning

The court reasoned that the newsprint contract was not a capital asset in the context of Petitioner's business. Obtaining and maintaining long-term newsprint contracts was a customary and essential part of the publishing business, ensuring a continuous supply of paper at stable prices. The court emphasized that "Obtaining and having such contracts is an integral part of the conduct of petitioner's ordinary trade and business." The transactions were viewed as "anticipatory arrangements under which petitioner had deliveries made to others" of its contracted newsprint. Relying on *Corn Products Refining Co. v. Commissioner*, the court held that transactions related to inventory, integral to the taxpayer's business, result in ordinary income, even if the asset appears to fit the literal definition of a capital asset. The court likened the arrangement to a hedge, as the stable pricing in the Coosa River contract allowed Petitioner to profit from market fluctuations. The court distinguished cases cited by Petitioner, noting that the doctrine of cases like *Commissioner v. Covington* had been overruled by *Corn Products*.

Practical Implications

This case reinforces the principle established in *Corn Products* that the definition of a capital asset should be interpreted in light of the asset's role in the taxpayer's business. It demonstrates that even if an asset appears to be a contract right, if it is fundamentally tied to the company's inventory management or operational necessities, gains from its disposition in the ordinary course of business will likely be treated as ordinary income. For businesses, this means that long-term supply contracts, especially those designed to stabilize inventory and prices, are likely to be considered integral to business operations. Therefore, any income derived from assigning or altering these contracts may be taxed as ordinary income, not capital gains. This case highlights the importance of analyzing the business context and purpose of an asset when determining its capital or ordinary nature for tax purposes. Later cases applying *Corn Products* and its progeny continue to emphasize the "integral part of the business" test.

