32 T.C. 135 (1959)

A corporation is not considered "collapsible" if, at the time of the sale of its stock by shareholders, the corporation had realized a "substantial part" of the net income to be derived from its property, even if a substantial part of the income remained unrealized.

Summary

In this case, the Tax Court addressed the definition of a "collapsible corporation" under Section 117(m) of the Internal Revenue Code of 1939. The key issue was whether a corporation that sold land was a collapsible corporation, thereby converting the shareholders' capital gains into ordinary income. The court determined that a corporation is not collapsible if it realized a "substantial part" of the net income before the shareholders sold their stock. The court held that one-third of the net income was a substantial part, thereby allowing the taxpayers to treat their gain from the stock sale as capital gain. The court rejected the Commissioner's argument that only when substantially all income has been realized does the collapsible corporation provision not apply.

Facts

John Waltman and Jewell Van Slyke organized Island Shores, Inc. (the corporation) to develop and sell lots on a tract of land. Waltman owned two-thirds of the stock and Van Slyke one-third. The corporation purchased land and began subdividing it into lots. Waltman later bought out Van Slyke. Subsequently, Waltman and others sold their stock in the corporation to a syndicate. The syndicate then dissolved the corporation, and the purchasers sold the remaining lots. The IRS determined that the gains realized by the taxpayers on the sale of the stock constituted ordinary income from a "collapsible corporation" as defined by Section 117(m) of the Internal Revenue Code of 1939. The corporation had realized approximately one-third of the net income from the sale of its property before the taxpayers sold their stock. The primary issue was whether this one-third constituted a "substantial part" of the income.

Procedural History

The cases, consolidated for trial and opinion, involved deficiencies determined by the Commissioner of Internal Revenue. The petitioners (taxpayers) contested the IRS's classification of their gains as ordinary income. The U.S. Tax Court heard the case.

Issue(s)

1. Whether Island Shores, Inc. was a "collapsible corporation" under Section 117(m)(2)(A) of the Internal Revenue Code of 1939.

2. Whether the corporation had realized a “substantial part” of the net income from its property before the sale of the stock by the shareholders.

Holding

1. No, because the corporation had realized a substantial part of the net income prior to the sale of the stock.

2. Yes, because one-third of the net income was deemed a “substantial part.”

