## *Jacobson v. Commissioner*, 28 T.C. 1171 (1957)

A corporation formed to construct property with the intent to sell the stock before realizing substantial income from the constructed property can be classified as a "collapsible corporation," and the resulting gain from the stock sale will be taxed as ordinary income rather than capital gains.

### Summary

The case concerns the tax treatment of gains realized from the sale of stock in Hudson Towers, Inc., a corporation formed to build apartment buildings. The IRS determined that the corporation was a "collapsible corporation" under Section 117(m) of the 1939 Internal Revenue Code. This meant the shareholders' gains from selling their stock should be taxed as ordinary income, not capital gains. The court agreed, finding that the shareholders had the required "view" of selling their stock before the corporation realized substantial income from the project. The court also addressed a dispute over whether the 10% stock ownership limitation in Section 117(m)(3)(A) applied to Rose M. Jacobson. The court held that this limitation did not apply to her, as she owned more than 10% of the stock when her husband's stock was attributed to her.

### Facts

Morris Winograd purchased land with the intent to build apartment buildings. He, along with Joseph Facher, Morris Kanengiser, Lewis S. Jacobson, and William Schmitz, formed Hudson Towers, Inc. The corporation was created on April 29, 1949. Hudson Towers, Inc. then entered into agreements to construct five apartment buildings. The construction was completed by June 16, 1950. After construction was finished, an alleged crack appeared in one of the buildings. The shareholders decided to sell their stock in Hudson Towers, Inc. on November 14, 1950, with the sale consummated on February 28, 1951. The shareholders reported their gains as long-term capital gains. The Commissioner of Internal Revenue determined that the gains should be reported as ordinary income.

### Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax, asserting that the gains from the sale of stock in Hudson Towers, Inc., should have been taxed as ordinary income instead of capital gains, due to the collapsible corporation rules. The petitioners challenged this determination in the Tax Court.

### Issue(s)

1. Whether Hudson Towers, Inc., was a "collapsible corporation" under section 117(m) of the Internal Revenue Code of 1939, so that the gain realized by the petitioners upon the sale of stock was ordinary income rather than capital gains.

 

2. If Hudson Towers, Inc. was a collapsible corporation, whether the 10 percent stock ownership limitation of section 117(m)(3)(A) applied to petitioner Rose M. Jacobson.

## Holding

1. Yes, because the court found that the corporation was formed with the "view" to sell the stock before the corporation realized substantial income.

2. No, because the limitation did not apply, and the court found Rose Jacobson's ownership exceeded the 10% threshold.

## Court's Reasoning

The court applied Section 117(m) of the Internal Revenue Code of 1939, which deals with collapsible corporations. The court stated that a corporation will be considered collapsible when it is formed for construction, and the construction is followed by a shareholder's sale of stock before the corporation realizes a substantial portion of the income from the construction, resulting in a gain for the shareholder. The court found that the petitioners had the "view" of selling their stock before the corporation earned substantial income, and the timing of the sale was a key factor. The court dismissed the petitioners' claims that an unforeseen crack in one of the buildings motivated the sale. The court found the testimony to be unconvincing because it did not hold any independent verification and contradicted the prior statements made by the petitioners. The court found that the taxpayers intended to profit from the stock sale. Regarding the ownership limitation, the court determined that since Lewis Jacobson owned more than 10% of the company's stock via attribution, and Rose Jacobson owned 7% directly, the 10% ownership limitation did not apply to Rose, since her husband's shares are attributable to her.

## Practical Implications

This case highlights the importance of the "view" requirement in determining if a corporation is collapsible. Tax practitioners must carefully consider the intent of the shareholders at the time of the corporation's formation and throughout its existence. A change of plans after construction does not automatically shield a corporation from collapsible status if the original intent was to sell the stock. This case emphasizes that the IRS and the courts will look closely at the timing of stock sales relative to the corporation's income and the shareholders' motivations. It is important to document reasons for stock sales and any potential changes in intent. The case also underscores the importance of how stock ownership is attributed for purposes of the tax code. The case serves as a reminder of the complexity of tax law and the need for thorough analysis of the facts and applicable regulations.

 