*32 T.C. 893 (1959)*

A corporation is deemed 'collapsible' if formed or availed of with a 'view' to sell or exchange stock before the corporation realizes substantial income from constructed property, and this 'view' need not be the primary motive from inception but can arise during construction, unless solely attributable to unforeseeable post-construction events.

**Summary**

Petitioners, shareholders of Hudson Towers, Inc., a corporation formed to construct apartment buildings, sold their stock shortly after construction completion, reporting capital gains. The Commissioner determined the corporation was 'collapsible' under Section 117(m) of the 1939 I.R.C., thus gains should be ordinary income. The Tax Court upheld the Commissioner, finding the sale was not solely due to a post-construction crack as claimed by petitioners, but rather the 'view' to sell existed during or before construction. The court emphasized that the 'view' to collapse need not be the primary initial motive and can arise during the project's lifecycle. The court also held that Rose M. Jacobson met the stock ownership threshold for collapsible corporation rules.

**Facts**

Five individuals formed Hudson Towers, Inc. to construct apartment buildings, financing the project with loans and a mortgage insured by the Federal Housing Administration (FHA). Construction was completed by June 16, 1950, and apartments were rented out. In September or October 1950, a crack was noticed in one building. Shareholders, claiming fear of structural issues due to the crack, decided to sell their stock in Hudson Towers, Inc. They sold the stock in February 1951 and reported long-term capital gains. Hudson Towers, Inc. paid no dividends and reported net losses for 1949 and 1950.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax for 1951, arguing the gain from the stock sale was ordinary income because Hudson Towers, Inc. was a collapsible corporation. The petitioners contested this determination in the Tax Court.

**Issue(s)**

1. Whether Hudson Towers, Inc. was a 'collapsible corporation' within the meaning of Section 117(m) of the Internal Revenue Code of 1939, such that the gain from the sale of stock should be treated as ordinary income.
2. If Hudson Towers, Inc. was a collapsible corporation, whether the 10% stock ownership limitation of Section 117(m)(3)(A) applied to petitioner Rose M. Jacobson.

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## Holding

1. Yes, Hudson Towers, Inc. was a collapsible corporation because the petitioners failed to prove that the 'view' to sell the stock arose solely due to post-construction circumstances.
2. No, the 10% stock ownership limitation did not apply to Rose M. Jacobson because shares owned by her husband's partners were attributable to her, exceeding the 10% threshold.

## Court's Reasoning

The court found the Commissioner's determination presumptively correct, placing the burden on petitioners to prove error. The court stated, "Ordinarily a corporation will be considered collapsible when its activity is principally construction and the construction is followed by the shareholders' sale of their stock before the corporation realizes a substantial part of the income to be derived from the construction and the shareholders realize gain attributable to the constructed property." The petitioners argued their 'view' to sell arose *after* construction due to the crack, making the collapsible corporation rules inapplicable under Treasury Regulations. However, the court deemed the petitioners' testimony about the crack as the sole motive for sale "unconvincing and we can give it no weight." The court highlighted inconsistencies and improbabilities in their narrative, noting the shareholders' failure to seek expert advice on the crack and the timing of the sale shortly after completion and before substantial income realization. The court inferred that "at least some of the shareholders anticipated right along the possibility of making a profit from the sale of their stock before the corporation had realized any substantial net income." Regarding Rose Jacobson, the court interpreted Section 117(m)(3)(A)(ii) to mean that constructive ownership through her husband's partnership, combined with her direct ownership, surpassed the 10% threshold, thus the limitation did not apply to her. The court explicitly rejected the argument that Section 117(m) could not convert capital gain into ordinary income, stating the statute's plain language mandates such treatment for collapsible corporations.

## Practical Implications

*Jacobson v. Commissioner* is significant for clarifying the 'view' requirement in the collapsible corporation doctrine under the 1939 I.R.C. It demonstrates that the 'view' to sell stock and recognize gain before substantial corporate income realization need not be the primary or initial purpose when forming a corporation. The case emphasizes that the 'view' can arise during the construction phase itself. Taxpayers cannot easily avoid collapsible corporation treatment by claiming a post-construction event triggered the sale unless such event is demonstrably unforeseeable and the sole cause. This case underscores the importance of contemporaneous documentation and objective evidence to support claims of post-construction motivations for stock sales. It highlights the IRS's scrutiny of stock

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sales following construction projects and the courts' willingness to look beyond taxpayer's self-serving testimony to determine the existence of a 'view' to collapse. For legal professionals, *Jacobson* serves as a reminder of the broad scope of the collapsible corporation rules and the challenges in proving the absence of a proscribed 'view' during the relevant period.

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