32 T.C. 1162 (1959)

A builder’s profits from a construction project are taxed as ordinary income, not capital gains, when the project is part of the builder’s regular business of constructing and selling properties to customers.

Summary

George Heebner, a builder, constructed a warehouse for Nash-Kelvinator, which was then sold to Prudential Insurance. The IRS determined that the profit Heebner made from the transaction was ordinary income, not capital gain. Heebner challenged this, arguing it was a one-off sale of a capital asset. The Tax Court sided with the Commissioner, finding that the project was part of Heebner’s regular business, even if it was a “package deal” involving site selection, financing, and construction. The court focused on Heebner’s history as a builder and the interdependence of the Nash-Kelvinator, Frankford Trust, and Prudential commitments, all geared towards a sale. The court held that the profit should be taxed as ordinary income.

Facts

George Heebner, the taxpayer, was a builder and contractor. In 1951, he began planning a warehouse project for Nash-Kelvinator. He secured a site, arranged construction through his corporation, secured financing, and ultimately sold the completed warehouse to Prudential Insurance. Heebner had been in the building business for many years and regularly engaged in building and construction projects. He also occasionally engaged in “package building,” which included procuring a site, arranging financing, and delivering the completed project to the purchaser. Heebner reported the income from the warehouse sale as a capital gain.

Procedural History

The IRS determined a deficiency in Heebner’s income tax for 1953, reclassifying the profit from the warehouse sale as ordinary income. Heebner challenged this determination in the United States Tax Court. The Tax Court ruled in favor of the Commissioner.

Issue(s)

Whether the profit realized by George Heebner from the disposition of the Sharon Hill warehouse project was taxable as ordinary income or capital gain.

Holding

Yes, because the Tax Court found that Heebner was in the business of building and selling property, and the warehouse project was part of his regular business operations.

Court’s Reasoning

The court focused on whether the warehouse project was part of Heebner’s regular business. The court noted that Heebner was an experienced builder who had been in the construction business for years, and engaged in similar projects. Heebner’s actions in securing the land, arranging financing, and the eventual sale of the completed building to Prudential were all part of a coordinated plan. The court emphasized that “the ultimate design was to build this particular warehouse for sale and that is what actually happened.” The court also considered the interdependence of the commitments from Nash-Kelvinator, Frankford Trust, and Prudential. All of the participants were aware of the project’s ultimate sale to Prudential from the beginning. The court also found that the project was a “package deal,” even if it was not a regular occurrence, and that Heebner’s “protracted time he spent on the complicated transactions necessary to the deal” was an indication of an ordinary business transaction.

Practical Implications

This case is important for builders and real estate developers. It establishes that profits from construction projects are classified as ordinary income when the projects are part of a builder’s regular business. When a builder engages in activities such as site selection, securing financing, and arranging for the ultimate sale of a property, the transaction is more likely to be viewed as part of their ordinary course of business. A taxpayer who engages in multiple construction projects with similar attributes should be aware that the IRS may classify their profits from those projects as ordinary income. This case is a reminder to closely examine all the facts and circumstances in these situations to determine whether a gain from a real estate transaction should be taxed as ordinary income or as a capital gain.