32 T.C. 1199 (1959)

Under Internal Revenue Code of 1939 §117(m)(3)(B), the collapsible corporation provisions apply unless more than 70% of the gain realized is attributable to the property manufactured or constructed, and any increase in land value due to the building project is included in the gain attributable to the property constructed.

Summary

The case involved a tax dispute over whether gains from the sale of stock in real estate corporations should be taxed as ordinary income or capital gains. The Commissioner determined that the corporations were "collapsible" under the Internal Revenue Code of 1939, leading to ordinary income tax treatment. The taxpayers argued that a significant portion of the gain was attributable to increases in land value independent of the apartment houses constructed, thus qualifying for capital gains treatment under an exception in the code. The Tax Court sided with the Commissioner, ruling that the taxpayers failed to prove that more than 30% of the gain was attributable to land value and that any increase in land value due to the building projects must be included in the gain "attributable to" the property constructed.

Facts

Erwin and Ruth Gerber, husband and wife, organized three corporations in 1948 to construct apartment houses in East Orange, New Jersey. The corporations acquired land and built apartment buildings. The Gerbers sold their stock in these corporations in 1950, realizing gains. The Commissioner determined that the corporations were "collapsible" corporations, and that the gain realized from the sale of the stock was to be taxed as ordinary income under section 117(m) of the Internal Revenue Code of 1939.

Procedural History

The Gerbers filed a joint income tax return for 1950, reporting the gain as long-term capital gain. The Commissioner determined a deficiency, treating the gain as ordinary income. The Gerbers challenged the determination in the United States Tax Court. The trial was delayed multiple times pending decisions in other cases involving similar issues. The Tax Court ruled in favor of the Commissioner, which led to this case brief.

Issue(s)

1. Whether the corporations were "collapsible" within the meaning of section 117(m)(2)(A) of the Internal Revenue Code of 1939.

2. Whether more than 70% of the gain realized was attributable to the property so manufactured, constructed, produced, or purchased under section 117(m)(3)(B) of

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the Internal Revenue Code of 1939.

3. Whether the increase in land value due to the building projects should be included in the gain attributable to the property constructed under section 117(m)(3)(B).

Holding

1. Yes, because the taxpayers did not deny that each of the three corporations were collapsible.

2. No, because the Tax Court found that the Gerbers failed to bring themselves within the exception in section 117(m)(3)(B).

3. Yes, because any increase in the land's value brought about by an apartment house development on such land must be included in the gain attributable to the property constructed.

Court's Reasoning

The court primarily focused on the application of section 117(m) of the 1939 Internal Revenue Code, dealing with "collapsible corporations." The taxpayers conceded that the corporations met the definition of collapsible corporations. However, they argued that an exception under section 117(m)(3)(B) applied because more than 30% of their gain was attributable to the increase in value of the underlying land, separate from the apartment houses constructed on it. The court found that the taxpayers failed to meet their burden of proving this, primarily due to the weakness of their expert's valuation of the land and the fact that any value increase in land due to construction must be included in the total gain. The court noted that under §117(m)(3)(B) the collapsible corporation provisions "shall not apply to the gain * * * unless more than 70 per cent of such gain is attributable to the property so manufactured, constructed, produced, or purchased."

Practical Implications

This case underscores the importance of precise valuation in tax disputes related to real estate development. It emphasizes that taxpayers seeking to invoke the exception under section 117(m)(3)(B) bear the burden of proving that a sufficient portion of the gain is attributable to the property constructed and not to the appreciation in value of the land itself. Furthermore, this case provides a practical understanding of the meaning of "attributable to" in cases where there are improvements to land and how the increase in land value directly related to the project cannot be excluded. This case is important for attorneys and real estate developers as it informs tax planning and litigation concerning collapsible corporations. Taxpayers should ensure that expert testimony and supporting evidence clearly delineate the sources of gain to meet the requirements to properly file and defend their taxes.

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