34 T.C. 675 (1960)

When a taxpayer is in the business of buying and selling real property and holds a property primarily for sale to customers in the ordinary course of that business, the profit from the sale of that property is considered ordinary income, not capital gain, even if the original plan to improve the property was not realized.

Summary

James Kesicki, a building contractor, purchased land with the intention of building a doctor's office and selling the improved property. Due to the doctor's inability to secure financing, the construction did not proceed. Kesicki then sold the vacant land. The IRS determined that the profit from the sale was ordinary income because the property was held for sale to customers in the ordinary course of Kesicki's business. The Tax Court agreed, ruling that the property was not a capital asset because Kesicki was in the business of building and selling properties, and this property was held for that purpose, regardless of the failed original plan. The court emphasized that the intent and activities related to the property indicated that it was held for sale to customers.

Facts

James Kesicki was a building contractor who purchased properties, built structures on them, and sold the completed packages. He entered an agreement with a doctor to purchase land, build a doctor's office building, and sell the completed project. Kesicki acquired the land, obtained building permits, and paid for architectural plans. However, the doctor could not obtain financing, and the project was abandoned. Kesicki then sold the vacant land in 1955. Throughout this process, Kesicki had a sign on the property indicating his business and willingness to build to suit.

Procedural History

The Commissioner of Internal Revenue determined a tax deficiency, arguing that the profit from the land sale was ordinary income. The Kesickis challenged this determination in the United States Tax Court.

Issue(s)

1. Whether the profit from the sale of the unimproved land should be taxed as ordinary income or capital gain?

Holding

1. Yes, because the land was held primarily for sale to customers in the ordinary course of Kesicki's business.

Court's Reasoning

The court focused on whether the land qualified as a capital asset under Section 1221 of the Internal Revenue Code of 1954. This section excludes "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" from the definition of a capital asset. The court found that Kesicki was in the business of buying vacant properties, erecting buildings, and selling the improved properties. Although the original plan to build the doctor's office fell through, the court determined that at the time of the sale, Kesicki still held the property for sale to customers in the ordinary course of his business. The court emphasized that the intent to sell and the related activities, such as obtaining permits and preparing plans, supported this conclusion.

The court referenced the following:

- The fact that Kesicki's sign on the property offered to "build to suit."
- The fact that Kesicki was willing to sell the property to anyone who made a suitable offer.

The court stated, "At the time he sold the land he was holding the property for sale to customers in the ordinary course of his business. The fact that he did not sell "a completed package" is not material. The character of the property was not changed by the failure to carry out the original plan."

Practical Implications

This case highlights the importance of the taxpayer's business and the intended use of the property in determining the character of income from a sale. Attorneys should advise clients in the real estate business that profits from the sale of property held primarily for sale to customers in the ordinary course of that business will likely be taxed as ordinary income, regardless of the form the sale takes. This case illustrates that even if the original plan for the property is not executed, the tax treatment hinges on the taxpayer's overall business and the intent at the time of sale. Moreover, it implies that holding out the property for sale and taking preliminary steps to improve it can support the conclusion that the property was held for sale.

Later cases often refer to this case when determining whether real property qualifies as a capital asset. The case is routinely cited in the context of determining whether property is held for investment or sale.

Meta Description

The Kesicki case establishes that profits from selling real estate held primarily for sale in the ordinary course of business are ordinary income, not capital gains, irrespective of unrealized development plans.

Tags

Kesicki v. Commissioner, Tax Court, 1960, Ordinary Income, Capital Gain, Real Estate, Held for Sale

