***Bynum v. Commissioner*, T.C. Memo. 1967-49**

Gains from the sale of subdivided real estate are taxed as ordinary income, not capital gains, when the property is deemed to be held primarily for sale to customers in the ordinary course of business, based on the taxpayer's activities and purpose at the time of sale.

Summary

Petitioners, owners of a nursery and landscaping business, subdivided a portion of their farm into residential lots to alleviate financial pressures and pay off a bank loan. They argued that the profits from these sales should be taxed as capital gains, asserting they were merely liquidating an investment. The Tax Court disagreed, holding that the Bynums' activities, including subdividing, improving, advertising, and actively selling the lots, constituted a real estate business. Consequently, the gains were deemed ordinary income, as the property was held primarily for sale to customers in the ordinary course of that business.

Facts

Petitioners S.O. and Fannie Bynum owned and operated a nursery and landscaping business on a 113-acre farm they purchased in 1942. Facing financial difficulties and pressure from their bank to reduce a $70,000 loan secured by the farm, they decided to subdivide a portion of their land into residential lots in late 1959. They invested significantly in improvements, including streets, water, and sewerage, costing approximately $650 per lot for the initial 38 lots. They advertised the subdivision, named Morayshire Estates, in local newspapers and listed the lots with realtors. Mr. Bynum personally handled sales, and no real estate commissions were paid. In 1960 and 1961, they sold 12 and 8 lots respectively.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Bynums' income taxes for 1960 and 1961, asserting that gains from the real estate sales were taxable as ordinary income, not capital gains. The Bynums petitioned the Tax Court for review.

Issue(s)

1. Whether the gains from the sales of subdivided lots in 1960 and 1961 are taxable as ordinary income or long-term capital gain?

Holding

1. No. The Tax Court held that the gains from the sales of subdivided lots were taxable as ordinary income because the property was held by the Bynums primarily for sale to customers in the ordinary course of their business.

© 2025 SCOTUSreports.com. All rights reserved.

Court’s Reasoning

The court focused on the language of sections 1221(1) and 1231(b)(1)(B) of the Internal Revenue Code, which excludes from capital asset treatment property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Citing *Malat v. Riddell*, 383 U.S. 569 (1966), the court emphasized that “primarily” means “of first importance” or “principally.” The court stated, “The statutory word is ‘held’ and the law is now well settled that no more is required. The taxpayers’ purpose at the time of acquisition has evidentiary weight, but the end question is the purpose of the ‘holding’ at the time of the sale or sales.”

The court found that the Bynums’ activities went beyond mere liquidation of investment property. They actively subdivided and improved the land, advertised the lots, and engaged in sales activities. The court noted the substantial improvements made to the land, the advertising efforts, and the fact that Mr. Bynum personally conducted the sales. Although Mr. Bynum claimed to spend most of his time on the nursery business, the court concluded that he had also entered into the business of selling subdivided lots. The court reasoned that the significant gain realized was attributable to the petitioners’ development and sales activities, not merely the appreciation of raw land value, referencing *Commissioner v. Gillette Motor Co.*, 364 U.S. 130 (1960), which stated capital gains treatment is meant for “situations typically involving the realization of appreciation in value accrued over a substantial period of time.” The court concluded that the gains were generated by the Bynums’ business activities and were therefore taxable as ordinary income.

Practical Implications

Bynum v. Commissioner serves as a practical illustration of how activities related to real estate can transform investment property into property held for sale in the ordinary course of business, triggering ordinary income tax treatment upon sale. For legal professionals and taxpayers, this case highlights the importance of considering the extent and nature of development, marketing, and sales activities when determining whether gains from real estate sales qualify for capital gains treatment. It emphasizes that the taxpayer’s purpose for holding the property at the time of sale, evidenced by their actions, is paramount, even if the initial acquisition was for investment or personal use. This case is frequently cited in cases involving real estate professionals and developers to distinguish between capital gains and ordinary income in land sales, particularly when improvements and active selling efforts are involved. It reinforces the principle that capital gains exceptions are narrowly construed and that active business endeavors in real estate are generally taxed at ordinary income rates.

© 2025 SCOTUSreports.com. All rights reserved.