***Reily v. Commissioner, 53 T. C. 8 (1969)***

The holding period for a new option to lease cannot be tacked onto the holding period of a prior expired option for the purpose of determining long-term capital gain treatment.

**Summary**

James S. Reily sold an option to lease real property on February 23, 1962, which he had acquired on September 5, 1961. Reily argued that this option was a continuation of a prior option from June 5, 1961, and thus should be considered held for more than six months for long-term capital gain treatment. The U. S. Tax Court disagreed, holding that the September option was a new and distinct contract, and its holding period could not be combined with the expired June option. The court emphasized that each option is a separate asset with its own identity and expiration, and thus the gain from the sale of the September option was short-term capital gain.

**Facts**

James S. Reily and Hermye B. Reily were residents of Shreveport, Louisiana. In June 1961, Reily obtained an option to lease a tract of land in Baton Rouge from Robert A. Hart II, which was set to expire on September 5, 1961. On that date, a new option was executed with Robert L. Roland as the optionee, with Reily present as a witness. This new option, which was to expire on March 15, 1962, was sold to Lakeshore Development Corp. on February 23, 1962. Reily claimed that this option was a continuation of the June option and should be considered held for more than six months for tax purposes.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in the Reilys' income tax for the years 1962, 1963, and 1964, treating the gain from the sale of the option as short-term capital gain. The Reilys petitioned the U. S. Tax Court to challenge this determination, arguing for long-term capital gain treatment.

**Issue(s)**

1. Whether the option to lease sold on February 23, 1962, was held by Reily for more than six months, entitling the Reilys to treat the proceeds as long-term capital gain.
2. Whether the Reilys are liable for the addition to tax under section 6653(a) for the years in issue.

**Holding**

1. No, because the September 5, 1961, option was a new and distinct contract from the prior June 5, 1961, option, and its holding period could not be combined with the

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expired June option for long-term capital gain treatment.
2. Yes, because the Reilys failed to provide evidence to overcome the presumption of correctness in the Commissioner's determination of negligence or intentional disregard of rules and regulations, making them liable for the addition to tax under section 6653(a).

**Court's Reasoning**

The Tax Court reasoned that each option is a separate contract with its own identity and expiration date. The court highlighted that the September 5, 1961, option was a new contract, granted for a different period, with new consideration and a different method of exercise than the June 5, 1961, option. The court cited the Internal Revenue Code of 1954, which defines short-term capital gain as gain from the sale of an asset held for not more than six months, and found that the Reilys did not meet their burden to prove the option was held for more than six months. The court also noted the absence of any legal authority allowing the tacking of holding periods of separate contracts. Additionally, the court upheld the addition to tax under section 6653(a) due to the Reilys' failure to provide evidence to the contrary.

**Practical Implications**

This decision clarifies that taxpayers cannot combine the holding periods of separate options to achieve long-term capital gain treatment. Practitioners must advise clients that each option is a distinct asset, and its holding period begins anew upon its acquisition. This ruling affects how options are treated for tax purposes, requiring careful tracking of each option's acquisition and disposal dates. The decision also underscores the importance of maintaining accurate records and understanding the nuances of tax law to avoid penalties for negligence or disregard of regulations. Subsequent cases have reinforced this principle, emphasizing the need for clear documentation and understanding of the legal nature of options in tax planning.

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