Hoven v. Commissioner, 56 T. C. 50 (1971)

The holding period for property, for tax purposes, begins when ownership is acquired, which is determined by when the buyer assumes the burdens and benefits of ownership.

Summary

In Hoven v. Commissioner, the court determined that the taxpayer's holding period for real property began upon the execution of a final contract of sale on September 23, 1963, not an earlier preliminary agreement. The court found that the taxpayer acquired ownership when he gained an unconditional right to the deeds and assumed the burdens and benefits of ownership. Additionally, the court allocated the cost basis between two parcels of land, finding $96,800 allocable to one tract and $33,200 to the other, based on expert testimony and market values. This case clarifies how to determine the start of a holding period for tax purposes and how to allocate cost basis between multiple properties.

Facts

On May 23, 1963, Vernon Hoven, acting as attorney for Inland Empire Trailer Parks, Inc. , entered into a preliminary "Receipt and Agreement to Sell and Purchase" with Albert N. Hefte for two parcels of land in Missoula, Montana. The agreement was contingent on several conditions, including title approval and the absence of legal restrictions preventing the land's use for trailer park purposes. On September 23, 1963, Hefte and Inland Trailer (with Hoven as the actual buyer) entered into a final "Contract of Sale" for the same properties. Hoven assumed ownership obligations, including prorated taxes and insurance from October 1, 1963, and took possession of the property shortly thereafter. Hoven sold one parcel on the same day he executed the September 23 contract and later sold portions of the second parcel. The dispute centered on whether the holding period began on May 23 or September 23, 1963, affecting the tax treatment of the gains as short-term or long-term capital gains.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Hoven's income tax for 1963 and 1964, treating the gains from the property sales as short-term capital gains based on a September 23, 1963, acquisition date. Hoven petitioned the U. S. Tax Court, arguing that the holding period began on May 23, 1963, which would classify the gains as long-term. The Tax Court held that the holding period started on September 23, 1963, and also determined the allocation of the cost basis between the two parcels.

Issue(s)

1. Whether the taxpayer's holding period for the real property began on May 23,

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1963, when the preliminary agreement was signed, or on September 23, 1963, when the final contract of sale was executed.
2. What portion of the total purchase price of $130,000 should be allocated to each of the two parcels of land for the purpose of computing their respective cost bases.

Holding

1. No, because the taxpayer acquired ownership and the holding period began on September 23, 1963, when he entered into the final contract of sale, gaining an unconditional right to the deeds and assuming the burdens and benefits of ownership.
2. Of the $130,000 cost basis, $96,800 is allocable to the 148-acre lower tract, and $33,200 is allocable to the 120-acre upper tract, based on the relative fair market values and expert testimony presented.

Court’s Reasoning

The court applied the principle that the holding period for tax purposes begins when ownership is acquired. It examined the contracts under Montana law, finding that the May 23 agreement was merely an executory agreement to buy, not a sale, and did not pass ownership. The September 23 contract, however, consummated the sale, with an absolute obligation for the seller to deliver deeds and the buyer to pay the purchase price, alongside the assumption of ownership burdens and benefits like taxes and possession. The court cited *McFeely v. Commissioner* and other cases to emphasize that ownership involves both legal title and the practical burdens and benefits of property. For the cost basis allocation, the court considered expert testimony on the relative values of the two parcels, adjusting for inconsistencies in how experts treated additional features like a house and well on one tract.

Practical Implications

This decision impacts how attorneys and taxpayers determine the holding period of real property for tax purposes, emphasizing that it begins when the buyer gains an unconditional right to the property and assumes ownership responsibilities, not merely when a preliminary agreement is signed. Practitioners must carefully review contract terms and state law to assess when ownership transfers occur. The case also provides guidance on allocating cost basis between multiple parcels based on their relative market values, which is critical for computing gains or losses on sales. Subsequent cases may reference Hoven to clarify similar issues, particularly in jurisdictions with analogous property law. Businesses involved in real estate transactions should consider this ruling when planning acquisitions and sales to optimize tax strategies.

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