Fraser v. Commissioner, 64 T. C. 554 (1975)

The sale of an inchoate right or option to acquire a partnership interest can be treated as a long-term capital gain if the option is sold rather than exercised and immediately sold.

Summary

In Fraser v. Commissioner, Robert D. Fraser, a real estate developer, sought to have a payment of $175,000 treated as a long-term capital gain from the sale of his inchoate right to a partnership interest in B & D Properties. Fraser had an oral agreement with Gerson Bakar, the lead partner, to acquire a partnership interest contingent on financial contribution. Due to his financial difficulties, Fraser never became a partner but instead sold his right to participate for $175,000. The Tax Court held that this transaction constituted the sale of an option held for more than six months, qualifying as a long-term capital gain under Section 1234 of the Internal Revenue Code.

Facts

Robert D. Fraser, a lawyer and real estate developer, learned in early 1963 that Simmons Co. wished to exchange its Northpoint property. Due to his financial insolvency, Fraser could not participate directly but initiated negotiations with Simmons Co. , later involving Gerson Bakar. An oral agreement was made between Fraser and Bakar, giving Fraser the right to acquire a one-third interest in the Northpoint property development. Fraser actively participated in the project's planning and financing but did not contribute capital. In May 1967, needing funds, Fraser sold his right to participate to Bakar and other partners for $175,000, which he reported as a long-term capital gain on his 1967 tax return.

Procedural History

Fraser filed a petition with the U. S. Tax Court to redetermine a deficiency in income tax assessed by the IRS for 1967. The IRS argued that the $175,000 should be taxed as ordinary income or as a short-term capital gain. The Tax Court heard the case and issued its decision in 1975.

Issue(s)

1. Whether the $175,000 received by Fraser constituted payment for services and should be taxed as ordinary income.
2. Whether the transaction constituted the sale of an option, resulting in a long-term capital gain under Section 1234 of the Internal Revenue Code.

Holding

1. No, because the payment was for the sale of an inchoate right or option, not for

© 2025 SCOTUSreports.com. All rights reserved.

services rendered.
2. Yes, because the transaction was a sale of an option held for more than six months, qualifying as a long-term capital gain under Section 1234.

Court's Reasoning

The Tax Court found that Fraser had an inchoate right or option to become a partner in B & D Properties, established through an oral agreement with Bakar. This right was a capital asset under Section 1234. The court rejected the IRS's argument that the payment was for services, emphasizing that Fraser received no compensation for his efforts in the project's development. The court also distinguished this case from Saunders v. United States, noting that Fraser's option did not have a defeasance clause allowing the other partners to pay him in lieu of participation. The court determined that Fraser's intent was to sell his option rather than exercise it and then sell the partnership interest, thereby qualifying the transaction as the sale of an option held for more than six months, resulting in a long-term capital gain. The court supported its decision with direct testimony from Bakar, confirming the existence and nature of the agreement with Fraser.

Practical Implications

This decision clarifies that an inchoate right or option to acquire a partnership interest can be treated as a capital asset under Section 1234, and its sale can result in a long-term capital gain if held for more than six months. Legal practitioners should carefully document any agreements regarding future interests in partnerships or similar ventures, as the form of the transaction may not dictate its tax treatment. The ruling underscores the importance of the intent behind a transaction, particularly whether an option is sold outright or exercised and then sold. This case may influence how similar transactions are structured and reported for tax purposes, emphasizing negotiation over prearranged agreements. Subsequent cases have cited Fraser to distinguish between the sale of an option and the sale of an acquired interest, impacting how taxpayers and their advisors approach tax planning in real estate and partnership contexts.

© 2025 SCOTUSreports.com. All rights reserved.