Dunn v. Commissioner, 69 T. C. 723 (1978)

The court determines whether an activity is engaged in for profit based on the taxpayer's good faith expectation of profitability, and stock redemption can qualify for capital gain treatment if it results in a complete termination of interest in the corporation.

Summary

In Dunn v. Commissioner, the court addressed two main issues: whether Herbert Dunn's harness horse racing and breeding activities constituted a trade or business, and whether the redemption of Georgia Dunn's stock in Bresee Chevrolet, Inc. , qualified as a complete termination of her interest for capital gain treatment. The court found that Herbert's activities were not engaged in for profit due to lack of a bona fide expectation of profitability, influenced by his age and the consistent losses incurred. For Georgia, the court ruled that the stock redemption qualified for capital gain treatment because it resulted in a complete severance of her interest in the corporation, despite restrictions imposed by General Motors.

Facts

Herbert Dunn, aged 76 in 1969, had been interested in horses since at least 1940. He owned horses for pleasure and later entered them in harness races, reporting losses on his tax returns from 1968 to 1975. Despite advice to consider racing as a business, his horses did not enter races in 1969, and only a few races in subsequent years resulted in minimal winnings. Georgia Dunn inherited and later purchased stock in Bresee Chevrolet, Inc. , which she eventually redeemed in 1970 under pressure from General Motors, receiving payments over time with interest.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Dunns' federal income tax for 1970 and 1971. The Dunns petitioned the Tax Court, which heard the case and ruled on the two primary issues: Herbert's trade or business status and Georgia's stock redemption.

Issue(s)

1. Whether Herbert Dunn was engaged in the trade or business of harness horse racing and breeding.
2. Whether the redemption of Georgia Dunn's stock in Bresee Chevrolet, Inc. , constituted a complete termination of her interest in the corporation under sections 302(b)(3) and 302(c)(2).

Holding

1. No, because Herbert's activities did not demonstrate a good faith expectation of

© 2025 SCOTUSreports.com. All rights reserved.

profitability, given his age and the consistent losses over the years.
2. Yes, because the redemption resulted in a complete severance of Georgia's interest in the corporation, and the restrictions imposed by General Motors did not negate her status as a creditor.

Court's Reasoning

The court applied the test from section 183 of the Internal Revenue Code to determine if Herbert's activities were engaged in for profit. They considered factors such as the taxpayer's primary motive, the business-like manner of conducting the activity, and the history of income and losses. The court found that Herbert's age, lack of racing in 1969, and consistent losses indicated a hobby rather than a business. For Georgia's stock redemption, the court focused on whether she retained an interest other than as a creditor after the redemption. Despite restrictions from General Motors, the court determined that the redemption was a bona fide severance of her interest, citing cases where similar restrictions did not negate creditor status.

Practical Implications

This decision emphasizes the importance of demonstrating a good faith expectation of profitability when claiming business deductions for activities that might be considered hobbies. Taxpayers must show a business-like approach and potential for profit. For stock redemptions, the ruling clarifies that restrictions imposed by third parties do not necessarily prevent a complete termination of interest, allowing for capital gain treatment. This case has implications for how tax professionals advise clients on the classification of activities and structuring stock redemptions to achieve favorable tax treatment.

© 2025 SCOTUSreports.com. All rights reserved.