Buono v. Commissioner, 74 T. C. 187 (1980)

Subdivision of land for sale as a single tract can still qualify as a capital asset, not inventory, if the primary intent is investment.

Summary

In Buono v. Commissioner, shareholders of Marlboro Improvement Corp. formed a subchapter S corporation to purchase undeveloped land in New Jersey with the intent to sell it once subdivision approval was obtained. The corporation faced zoning disputes, eventually selling the property in 1973 after obtaining approval. The Tax Court held that the property was a capital asset, not held primarily for sale to customers in the ordinary course of business, and thus the gain was capital in nature. The decision emphasizes the importance of the intent to hold the property as an investment, despite the efforts to enhance its value through subdivision.

Facts

In 1967, Henry Traphagen learned of a 130-acre farmland for sale in Marlboro, New Jersey. He and John Fiorino purchased the land in 1968 through Marlboro Improvement Corp. , a newly formed subchapter S corporation, with the intent to sell it intact after obtaining subdivision approval. The corporation faced zoning disputes, leading to a lawsuit settled in 1972, allowing for a revised subdivision plan. The property was sold to Fairfield Manor, Inc. in 1973 for $513,500. Marlboro Improvement had no other real estate transactions except for a state condemnation and the later sale of a shopping center portion.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the shareholders' 1973 tax returns, asserting that the gain from the land sale should be treated as ordinary income. The shareholders filed a consolidated petition to the Tax Court, which heard the case and issued its decision in 1980.

Issue(s)

1. Whether the sale of the real property by Marlboro Improvement Corp. constituted the sale of a capital asset under section 1221, I. R. C. 1954?
2. Whether the activities of certain shareholders should be imputed to Marlboro Improvement Corp. under section 1. 1375-1(d), Income Tax Regs. , affecting the character of the gain from the property's sale?

Holding

1. Yes, because the property was not held primarily for sale to customers in the ordinary course of a trade or business, but rather as an investment, despite the subdivision efforts.

2. No, because the property would have been a capital asset in the hands of the shareholders, and the regulation was not applicable to the facts of this case.

Court's Reasoning

The court focused on the intent behind the purchase and sale of the property, determining that Marlboro Improvement Corp. held the land as an investment, not for sale to customers in the ordinary course of business. The court applied the factors from United States v. Winthrop and similar cases, emphasizing the lack of frequent and substantial sales activity, and the absence of improvements beyond subdivision. The court also rejected the Commissioner's argument that subdivision alone should convert the property into inventory, noting that the corporation's intent was to sell the land as a single tract. The court distinguished this case from Jersey Land & Development Corp. v. United States, where continuous commercial activity was present. Regarding the second issue, the court found that the regulation did not apply, as the property would have been a capital asset in the hands of the shareholders with real estate activities.

Practical Implications

This decision clarifies that obtaining subdivision approval does not automatically convert investment property into inventory, provided the primary intent remains investment. For practitioners, this case suggests that clients engaged in similar transactions should document their intent to hold property as an investment, even if they pursue subdivision to enhance its value. The ruling impacts how real estate transactions are structured and reported for tax purposes, particularly for subchapter S corporations. It also informs future cases involving the characterization of gains from real estate sales, emphasizing the importance of intent over the nature of activities undertaken to enhance property value.

