Crow v. Commissioner, 79 T. C. 541 (1982)

Capital losses on stock sales are classified as business or nonbusiness for net operating loss calculations based on their direct relationship to the taxpayer's trade or business.

Summary

In Crow v. Commissioner, the Tax Court addressed whether capital losses from the sale of Bankers National and Lomas & Nettleton stocks were business or nonbusiness capital losses for net operating loss (NOL) calculations. Trammell Crow, a real estate developer, purchased Bankers National stock hoping to secure loans, but no such relationship developed. Conversely, he bought a significant block of Lomas & Nettleton stock to keep it out of unfriendly hands, given their crucial financial relationship. The court ruled the Bankers National loss as nonbusiness due to its indirect connection to Crow's business, but deemed the Lomas & Nettleton loss as business-related due to its direct impact on maintaining a favorable business relationship.

Facts

Trammell Crow, a prominent real estate developer, purchased 24,900 shares of Bankers National Life Insurance Co. in 1967 following a suggestion from an investment banker, hoping to establish a lending relationship. Despite attempts, no such relationship materialized, and Crow sold the stock at a loss in 1970. Separately, Crow acquired a significant block of 150,000 shares of Lomas & Nettleton Financial Corp. in 1969 to prevent the stock from falling into unfriendly hands, given Lomas & Nettleton's crucial role in financing Crow's real estate ventures. He sold 41,000 shares of this block at a loss in 1970.

Procedural History

The Commissioner disallowed a portion of Crow's NOL carryback from 1970 to 1968 and 1969, classifying the losses from the stock sales as nonbusiness capital losses. Crow petitioned the U. S. Tax Court, which heard the case and issued a decision on September 27, 1982.

Issue(s)

1. Whether the loss on the sale of Bankers National stock was a business or nonbusiness capital loss for purposes of computing the NOL under section 172(d)(4) of the Internal Revenue Code.
2. Whether the loss on the sale of Lomas & Nettleton stock was a business or nonbusiness capital loss for purposes of computing the NOL under section 172(d)(4) of the Internal Revenue Code.

Holding

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1. No, because the Bankers National stock was not directly related to Crow's real estate business, the loss was classified as a nonbusiness capital loss.
2. Yes, because the Lomas & Nettleton stock was purchased to maintain a favorable business relationship, the loss was classified as a business capital loss.

Court's Reasoning

The court applied the statutory requirement that losses must be "attributable to" the taxpayer's trade or business to qualify as business capital losses. For Bankers National, the court found no direct connection to Crow's real estate business, as the purchase was primarily an investment with an indirect hope of securing loans. The court emphasized that the stock was not integral to Crow's business operations, and the failure to establish a lending relationship further supported this classification.
For Lomas & Nettleton, the court found a direct business nexus. The purchase was motivated by a desire to keep the stock out of unfriendly hands, given the critical role Lomas & Nettleton played in financing Crow's projects. The court noted the significant premium paid for the stock as evidence of this business purpose. The court also considered the legislative history of section 172(d)(4), which was intended to allow losses on business assets to be included in NOL calculations.
The court rejected the Commissioner's alternative argument to treat gains on other stock sales as ordinary income, finding insufficient evidence that these securities were held for business purposes.

Practical Implications

This decision clarifies the criteria for classifying capital losses as business or nonbusiness for NOL calculations. Practitioners should focus on demonstrating a direct relationship between the asset and the taxpayer's business operations. For real estate developers and similar businesses, this case suggests that stock purchases aimed at securing financing or maintaining business relationships can be classified as business assets if they are integral to the business's operations.
The ruling may influence how businesses structure their financing and investment strategies, particularly when seeking to offset business gains with losses. It also underscores the importance of documenting the business purpose behind asset acquisitions. Subsequent cases, such as Erfurth v. Commissioner, have cited Crow in affirming the validity of the regulations governing NOL calculations.

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