

tion requires the achievement of substantial cost reductions in housing by the building industry, coupled with a general improvement in standards of living of non-whites and others in the lower economic groups.

Conclusion

The inadequacies of this nation's present housing supply brought forth the housing programs of the federal government. At least as to the non-white, these programs may well be self-defeating. In public housing, the use of the neighborhood pattern of occupancy formula merely ratifies the existing inequities in the present housing market in which there is a greater proportion of non-white substandard housing than white. This practice, together with an unfavorable private housing market for non-whites, seriously complicates the problem of relocation in urban redevelopment.

FEDERAL INCOME TAXATION OF SUBDIVIDED REALTY—THE IMPACT OF SECTION 1237 ON CAPITAL ASSET CHARACTERIZATION

The imposition of a federal income tax on gains from the sale of capital assets has created serious problems of categorization.¹ Because capital gains are taxed at a lower rate than ordinary income, courts have frequently been confronted with the difficulty of identifying a particular asset as capital or non-capital. During the last few decades an apparent

has been suggested that the federal government authorize a program under which direct loans can be made to housing cooperatives. See Recommendations of the National Housing Conference on Housing for Families of Middle Income in *Hearings Before the House Committee on Banking and Currency on Housing Amendments of 1955*, 84th Cong., 1st Sess. 330, 331 (1955).

1. Shortly after the adoption of the Sixteenth Amendment, the argument was advanced that gains from the sale of property were accretions in value and therefore not income. MORONEY AND MOSER, *CAPITAL GAINS AND LOSSES, FUNDAMENTALS OF FEDERAL TAXATION 1* (Practicing Law Institute, Griswold and Warren eds. 1946). The Supreme Court, however, soon held that these profits were income and were taxable. *Merchants Loan and Trust Co. v. Smietanka*, 255 U.S. 509 (1921).

There has been more controversy over the capital gains issue than over any other single feature of the revenue system. TAX INSTITUTE, *CAPITAL GAINS TAXATION 1* (1946). American writers have differed widely in their views on the economic validity of the capital asset concept. See generally SELTZER, *THE NATURE AND TAX TREATMENT OF CAPITAL GAINS AND LOSSES* (1951); SIMONS, *FEDERAL TAX REFORM* (1950); TAX ADVISORY STAFF OF THE SECRETARY, UNITED STATES TREASURY DEPARTMENT, *FEDERAL INCOME TAX TREATMENT OF CAPITAL GAINS AND LOSSES* (1951); TAX INSTITUTE, *CAPITAL GAINS TAXATION* (1946); P. Miller, *The "Capital Asset" Concept: A Critique of Capital Gains Taxation*, 59 YALE L.J. 837 and 1057 (1950).

inconsistency has developed. Real estate, historically the principal example of a capital asset,² has often been considered a non-capital asset when sold in subdivided portions.³ Specifically, such property was said to be held by the taxpayer primarily for sale to customers in the ordinary course of business, thereby being excluded from the capital asset category by the statutory definition.⁴ Congress has now adopted a provision which permits gains from some sales of subdivided realty to be taxed at the preferred capital gains rates through an amplification of the capital asset definition.

Section 1237 of the Internal Revenue Code of 1954 contains the provisions intended to benefit subdividers of realty. This section pro-

2. The legal concepts, capital and income, evolved from that period of history when real estate constituted the essence of durable property. The courts considered one's capital or estate, usually a farm or several farms, as constituting a physical entity, and the income therefrom its separable fruit or harvest. The concept of income developed from the practice of entailing estates whereby the heir was entitled to the income for his life while the entity passed on again to his heir. This same concept was carried forward as trusts of securities and saleable realty came into use where gains from sales of trust properties were allotted between income beneficiaries and remaindermen. SELTZER, *op. cit. supra* note 1, at 26-27; TAX INSTITUTE, CAPITAL GAINS TAXATION 2-3 (1946).

The inception of British income taxation found the *res* concept again firmly imbedded, and even today capital gains are not taxed in England. See SIMONS, FEDERAL TAX REFORM 71 (1950); MORONEY AND MOSER, *op. cit. supra* note 1, at 1; May, *The British Treatment of Capital Gains*; 73 J. ACCOUNTANCY 505 (1942); P. Miller, *supra* note 1, at 857.

The American economy, however, did not develop in the confining geographical environment limiting the British. Therefore, land in the United States was a plentiful commodity, easily acquired and frequently sold as the expanding economy produced rapid changes in real estate value. Capital gains became an important source for the accumulation of wealth and, for speculators, was the sole source of consumption income. SELTZER, *op. cit. supra* at 29-30. Since capital gains and ordinary income become scarcely distinguishable for many individuals, the result in *Merchants Loan and Trust Co. v. Smietanka*, *supra* note 1, is readily understood.

3. When Representative Reed, Chairman of the House Ways and Means Committee, first introduced his committee's draft of the 1954 Internal Revenue Code, he indicated provision had been made to remove the uncertainty and inequity existing under prior law where real property was sold in lots. 100 CONG. REC. 3423 (1954). The uncertainty under prior law surrounding the sale of realty produced much litigation. See Clark, *Distinguishing Between Dealer and Investor Sales by the Same Taxpayer*, N.Y.U. EIGHTH ANNUAL INSTITUTE ON FEDERAL TAXATION 855, 857 (1950).

The problem recently became acute due to the housing shortage which followed World War II. The increased demand for land permitted those who purchased land in the 1920's to sell at a profit by subdividing. See Troll, *The Sale of Unimproved or Subdivided Land*, 25 TAXES 441 (1947). However, the threat of taxation on the gains from such subdivision and sale at ordinary income rates caused many landowners to forego this profit opportunity. *Hearings Before the Committee on Ways and Means of the House*, 83d Cong., 1st Sess., 1013, 1029, 1031, 1166 (1953).

4. The statutory definition provides that "[T]he term 'capital assets' means property held by the taxpayer . . . but does not include . . . property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Int. Rev. Code of 1939, § 117(a) (1), as amended, 64 STAT. 932 (1950) (now INT. REV. CODE OF 1954, § 1221). See Brodsky, *Converting Ordinary Assets into Capital Assets*, N.Y.U. THIRTEENTH ANNUAL INSTITUTE ON FEDERAL TAXATION 1173 (1955).

vides in substance that a lot or parcel, which is part of a tract of real property in the hands of a taxpayer⁵ is not to be deemed held primarily for sale to customers in the ordinary course of business at the time of sale solely because the taxpayer has subdivided the tract for purposes of sale or because of any activity incident to such subdivision or sale.⁶ The property must be held by the taxpayer for a period of five years, unless it was acquired by inheritance or devise.⁷

Section 1237 is inapplicable, however, if the tract or any part of it has been previously held primarily⁸ for sale to customers in the ordinary course of business.⁹ This exception is apparently more restrictive than

5. The section as originally enacted applied only to individuals and their agents probably because the classification of assets held by corporations could be determined through reference to the corporate charter and appropriate laws. A Miller, *Tax Status of Subdivisions Under the Internal Revenue Code*, 33 CHI-KENT L. REV. 201, 203, 229 (1955).

That provision in the House Bill allowing capital gains treatment of subdivisions by real estate dealers met objection in the Senate because corporations were excluded. *Hearings before the Committee on Finance, United States Senate*, 83d Cong., 2d Sess. 338 (1954). See note 55 *infra*.

An amendment of April 7, 1956, now permits corporations to qualify for these § 1237 benefits ". . . if no shareholder directly or indirectly holds real property for sale to customers in the ordinary course of trade or business . . ." and only in case the property has been acquired in connection with certain foreclosure proceedings. INT. REV. CODE OF 1954, § 1237, as amended, Pub. L. No. 495, 84th Cong., 2d Sess. § 214 (April 27, 1956). The foreclosure must be of a lien on the property which secured indebtedness to the corporation, or which secured indebtedness to a creditor who transferred the foreclosure bid to the taxpayer in exchange for all of its stock and other consideration. Property adjacent to the property acquired by such methods is also covered by § 1237 if 80% of the real property owned by the corporate taxpayer has been acquired by foreclosure. *Ibid.*; See S. REP. No. 1705, 84th Cong., 2d Sess. 1 (1956), as reprinted in 1956 U.S. CODE CONG. & AD. NEWS 1778, 1803-05.

6. INT. REV. CODE OF 1954, § 1237, 68A STAT. 330 (later amended by 70 STAT. (1956)), hereinafter cited as INT. REV. CODE OF 1954, § 1237 unless otherwise indicated.

A "tract" means a single piece of property. If two or more pieces of property are contiguous in the hands of the taxpayer, however, they will be considered a tract. Furthermore, if the two properties were contiguous in the hands of the taxpayer at any time within the previous five years, they will be deemed a single tract. Therefore, a tract laid out in a single row of lots which is divided into two portions by early sales of middle lots apparently does not become two tracts. Two pieces of property will be considered contiguous where they would be contiguous except for the interposition of a road, street, railroad, stream, or similar property. "This rule means that if the boundary lines of the pieces of real property were continued in the same direction in which they were running at the time they met the road, street, railroad, stream, or similar property, the two pieces of real property then would meet at more than a single point." S. REP. No. 1622, 83d Cong., 2d Sess. 443 (1954).

7. INT. REV. CODE OF 1954, § 1237 (a) (3). The holding period is computed by excluding the first and including the last day. *Hooper v. Commissioner*, 26 B.T.A. 758 (1932).

8. "Primarily" means "primus" or "first" and not "ultimus." *United States v. Bennett*, 186 F.2d 407 (5th Cir. 1951). "Primarily" means "essential" or "substantial" and not "principal" or "chief." *Rollingwood Corporation v. Commissioner*, 190 F.2d 263 (9th Cir. 1951).

9. INT. REV. CODE OF 1954, § 1237 (a) (1). See Brodsky, *supra* note 4, at 1178.

"Business" has been construed differently under various issues in the revenue laws.

prior law in one respect. Its literal interpretation might not permit a change in the purpose for which the property has been held.¹⁰ Some cases decided before the 1954 Code permitted capital gains rates to be applied when property was sold which had originally been acquired solely for purposes of resale and was later retained as an investment.¹¹

Section 1237 benefits are also barred where, in the year of sale, other real property is held for sale to customers in the ordinary course of business.¹² Activities of the taxpayer related to the subdivided tract may be considered together with activities related to the other property in determining whether a capital asset was sold¹³ even though the other property was a second subdivision project.¹⁴ It is conceivable that extensive activities will be permitted where the sale of only one tract is involved, while very limited activities related to the subdivision and sale of two or more smaller tracts will defeat capital gains treatment of sales.¹⁵ It might be suggested, therefore, that the word "other" as used in the section should refer to *other types* rather than to *other holdings* of real property.¹⁶

A broad meaning has been indicated under the capital asset definition, thus limiting the chances for capital gains treatment. A business may be part-time, seasonal, or be carried on through agents. *Snell v. Commissioner*, 97 F.2d 891 (5th Cir. 1938); *A. Miller, supra* note 5, at 206. However, where the taxpayer seeks a deduction for a loss suffered and therefore wishes to have his activities considered a business, the term is construed narrowly. *United States v. Wooten*, 132 F.2d 400 (5th Cir. 1942), *Mente v. Eisner*, 266 Fed. 161 (2d Cir. 1920).

10. The exclusion of property previously held for sale to customers in the ordinary course of business does not operate where ". . . such tract at such previous time would have been covered by this section. . . ." INT. REV. CODE OF 1954, § 1237 (a)(1). A situation, however, may arise where a taxpayer will not be protected by that provision. Suppose an individual conducting an extensive business of dealing in real property for profit disposes of all property except a farm. Although he might rent the farm as an investment for several years, he would apparently receive no benefit from § 1237 on subsequent subdivision and sale of the farm in lots. This result occurs because the farm was previously held primarily for sale in the ordinary course of business as a real estate dealer and not because of activities permitted under § 1237.

11. *Collin v. United States*, 57 F. Supp. 217 (N.D. Ohio 1944); see *Phipps v. Commissioner*, 54 F.2d 469 (2d Cir. 1931). *But see Ehrman v. Commissioner*, 120 F.2d 607 (9th Cir.), *cert. denied* 314 U.S. 668 (1941); *but cf. Manella, Capital Gains and Losses Under the Internal Revenue Code of 1954*, 1955 SO. CALIF. TAX INST. 735, 751 (Ervin ed.).

12. INT. REV. CODE OF 1954, § 1237 (a)(1).

13. S. REP. NO. 1622, 83d Cong., 2d Sess. 441 (1954).

14. *Ibid.* See Comment, 6 HASTINGS L.J. 374, 380 (1955).

15. *Manella, supra* note 11, at 753-54, n. 41.

16. Other "types" of real property would mean property held for sale other than tracts of land subdivided into lots for sale. This interpretation would permit an individual to subdivide a farm which is composed of several land areas not contiguous as defined in the Senate Committee Report without selling all lots from one area before subdividing and selling the second. S. REP. NO. 1622, 83d Cong., 2d Sess. 443 (1954); see note 6 *supra*.

To so interpret "other property," however, could permit those operating many subdivision projects to receive capital gains benefits. Therefore, some sort of a limiting

If substantial improvements are made to the tract which substantially enhance the value of the lot or parcel sold, section 1237 will not cover the transaction.¹⁷ But a taxpayer who has held the lot or parcel for ten years may construct roads or install sewer, water, and drainage facilities¹⁸ when necessary to permit the sale of the lot at the prevailing

standard would be needed. Such a standard might take the nature of a longer holding period requirement for the second and subsequent tracts.

17. INT. REV. CODE OF 1954, § 1237 (a) (2). This is true whether the improvements are made by the taxpayer himself, are deemed to have been made by him, or are made pursuant to a contract of sale between the taxpayer and a buyer. An improvement is deemed to have been made by the taxpayer if it is made by the following members of his family: brothers or sisters whether by whole or half blood, spouse, ancestors, and lineal descendants. The provision also applies where improvements are made by a corporation controlled by the taxpayer, by a partnership of which he is a partner, a lessee if the improvement constituted income to the taxpayer, and by federal, state or local government or their political subdivisions if an addition to basis was thereby allowed.

A substantial improvement on one lot, however, which does not substantially enhance the value of other lots, though it may increase their saleability, would not bar the sale of those other lots from capital gains treatment. Thus, if a taxpayer erects his personal residence on one lot, the others may be easier to sell, but the value of the other lots is not thereby increased. S. REP. No. 1622, 83d Cong., 2d Sess. 442 (1954).

Also, an addition which is not substantial in itself, but which substantially enhances the value of the lots will not prevent a capital gain. Construction of a dirt access road would be an improvement which is not substantial in and of itself. *Ibid.* The committee reports indicate that Congress intended the term "substantial," as used in subsection (a) (2) of § 1237 to permit the taxpayer to make certain modifications if ". . . either the improvements were minor or they resulted in but slight enhancement of the value of the lots sold from the tract." *Ibid.* Examples given of "permissible" improvements are clearing operations and the construction of ". . . minimum all-weather access roads to each lot sold." These roads may be gravel where required by the climate but may not be hard surface roads. *Ibid.*

It must be emphasized that this discussion of "permissible" improvements which are not to be considered substantial improvements is found in the Senate Committee Report. Therefore, the concept of "necessary" improvements added by the Conference Committee amendment is not incorporated within nor limited by the foregoing discussion of "permissible" improvements. See note 18 *infra*. In particular, while road construction under the "permissible" concept is limited to minimum all-weather roads, under the latter "necessary" concept hard surfaced roads are allowed where the provisions of § 1237 (b) (3) are met.

18. INT. REV. CODE OF 1954, § 1237 (b) (3) as amended, Pub. L. No. 495, 84th Cong., 2d Sess. § 214 (Apr. 27, 1956). This important provision was added in conference. Statement of the Managers on the Part of the House, *Int. Rev. Code of 1954, Conference Report*, H. R. REP. No. 2543, 83d Cong., 2d Sess. 70-71 (1954); 100 CONG. REC. 12420 (1954). For discussion of the 1956 inclusion of "drainage" facilities see S. REP. No. 1705, 84th Cong., 2d Sess. 1, 2 (1956). This "necessary improvement" provision in § 1237(b) (3) greatly expands the restricted explanation of "substantial improvement" found in the Senate Committee Report. See S. REP. No. 1622, 83d Cong., 2d Sess. 442 (1954); note 17 *supra*.

The true significance of the "necessary improvement" subsection is appreciated when the requirements of zoning ordinances, building codes, and city planning commission regulations are considered. It is customary to require paved streets, public sewer systems, storm water sewers, and public water supply. HORACK AND NOLAN, *LAND USE CONTROLS* 205-06 (1955); McMICHAEL, *HOW TO FINANCE REAL ESTATE* 5, 23 (1949); McMICHAEL, *REAL ESTATE SUBDIVISIONS* 23 (1949); McMICHAEL, *HOW TO OPERATE A REAL ESTATE BUSINESS* 4-5 (1947). The minimum standards established by the Federal Housing Administration must also be considered so that purchasers will be permitted to use FHA approved financing. HORACK AND NOLAN, *LAND USE CONTROLS* 207 (1955); Mc-

local price for similar building sites.¹⁹ The taxpayer must agree to make no adjustment to basis for the expenses incurred.²⁰

The substantial improvement need not be made upon that particular lot which is sold, since it is enough that the value of the lot sold is thereby enhanced.²¹ There will be no loss of section 1237 benefits if the lessee of a lot makes such an improvement so long as the improvement does not constitute income to the taxpayer.²²

The substantial improvement limitation is not necessarily controlling in every situation where a taxpayer attempts to sell lots from a tract. In one case decided before the 1954 Code was adopted, a taxpayer was granted capital gains treatment where extensive improvements, which would be barred by section 1237, were made pursuant to a contract of sale.²³ In that case, however, the facts clearly indicated that the property was held for investment and that the improvements were a necessary step in liquidation of the asset.²⁴

MICHAEL, REAL ESTATE SUBDIVISIONS 140 (1949).

Under the 1939 Code, when a taxpayer was forced to subdivide in order to sell and could not subdivide without complying with municipal requirements for improvements, capital gains treatment was denied because the taxpayer had invested in improvements. *Shearer v. Smyth*, 116 F. Supp. 230 (N.D. Cal. 1953).

19. The statutory language is that it must be ". . . shown . . . that the lot or parcel . . . would not have been marketable at the prevailing local price for similar building sites without such improvement. . . ." INT. REV. CODE OF 1954, § 1237 (b) (3) (B). The phrase, "without such improvement," apparently refers to the lot or parcel under tax consideration and not to "similar building sites." Therefore, where improvements are made by other subdividers not because of a municipal regulation but because of community market standards, the taxpayer may avail himself of § 1237 benefits. The municipal requirement hurdle is, of course, surmounted implicitly by this provision. See note 18 *supra*. A recent amendment excepts property acquired by foreclosure from subsection (b) (3) (B). INT. REV. CODE OF 1954, § 1237 (b) (3), as amended, Pub. L. No. 495, 84th Cong., 2d Sess. § 214 (Apr. 27, 1956).

20. Nor is this requirement applicable when the property has been acquired by foreclosure. *Ibid*.

21. If a shopping center is erected on one part of the tract § 1237 probably would not cover the sale of other lots, since the shopping center would in most cases enhance the value of all lots in most tracts. S. REP. NO. 1622, 83d Cong., 2d Sess. 442 (1954).

22. INT. REV. CODE OF 1954, § 1237 (a) (2) (B). A further exception might arise where acts of a trespasser substantially improve the value of the lots. Such acts would not prohibit § 1237 benefits since the improvement must be made by the taxpayer. S. REP. NO. 1622, 83d Cong., 2d Sess. 442-43 (1954).

23. *Thrifty v. Commissioner*, 15 T.C. 366 (1951); see *Phipps v. Commissioner*, 54 F.2d 469 (2d Cir. 1931).

24. The taxpayer owned 62 acres of unimproved land. He had been approached by various groups who wanted to buy lots which prompted him to set his price for lots. No sales were consummated. Later he was contacted by a group of home builders who thought the land was a good building location. Since the builders were short on capital, the taxpayer agreed to improve the land by putting in water, sewers, and streets. In turn the builders were to take certain lots for their construction of homes. The taxpayer turned down all offers from other individuals and sold only to the builders. The Tax Court allowed capital gains treatment.

Under § 1237 these improvements would prohibit capital gains treatment because the substantial improvements made pursuant to a contract of sale between the taxpayer

Upon the sale of the sixth lot from any tract, gains during the year of that sixth sale and during subsequent years are treated as gain from the sale of non-capital assets to the extent of five percent of the selling price.²⁵ Section 1237 refers to the sale or exchange of the first five *lots or parcels*, not to the first five *sales*.²⁶ If five lots were sold to the first purchaser, it then appears that the five percent rule could immediately apply on the second sale.²⁷ On the other hand, it could well be contended that five lots sold to one purchaser constituted only one parcel.²⁸ This latter interpretation should be urged to effectuate the purpose of section 1237.

The expenses of the sale are allowed as deductions in computing taxable income to the extent of the portion of the gain treated as ordinary income.²⁹ Therefore, if the expenses of the sale amount to five percent of selling price, the net effect is to cancel the five percent ordinary income rule.³⁰ Selling expenses over and above five percent of selling price are allowed as reductions of the amount realized on the sale or exchange.³¹

The impact of the five percent rule can be also meliorated under subsection (c) where a tract is defined to include the balance of a tract from which lots were previously sold if no sales have been made for a period of five years from the last of such previous sales.³² Thus the computation of the five sales under the five percent ordinary income rule

and the buyer could not be excepted as necessary improvements since the land had not been held for ten years. However, the result of *Thrift v. Commissioner*, *supra* note 23, could well occur today since the facts of the case indicate that § 1237 is not needed to find this property was not held primarily for sale to customers in the ordinary course of business. See p. 530-31 *infra*.

25. INT. REV. CODE of 1954, § 1237 (b)(1). To take full advantage of capital gains treatment on the first five sales, the sixth sale must not occur within the same taxable year as any of the first five. The House Committee Report contains examples showing application of this five percent rule. H.R. REP. No. 1337, 83d Cong., 2d Sess. A282-83 (1954).

26. Manella, *supra* note 11, at 765.

27. *Ibid.*

28. The language of the Senate Committee Report, though somewhat ambiguous on this point, seems to place more emphasis on the fact that five sales occurred than on the significance of selling to one or more purchasers five areas as marked out on a plat. This interpretation is also in harmony with the general purpose of Section 1237 in minimizing the effect of the degree of a taxpayer's activity upon the tax treatment accorded sales from a subdivided tract.

29. INT. REV. CODE of 1954, § 1237(b)(2). For illustrative computations, see H.R. REP. No. 1337, 83d Cong., 2d Sess. A282-83 (1954).

30. Selling expenses are likely to exceed five percent. Commissions paid to salesmen of lots in subdivisions average from seven and one-half to ten percent, and only occasionally are as low as five percent. McMICHAEL, HOW TO OPERATE A REAL ESTATE BUSINESS 206 (1947).

31. INT. REV. CODE of 1954, § 1237 (b)(2).

32. *Id.* § 1237 (c).

could be started again after the expiration of the five year period.³³ Also, where husband and wife own separate or even adjoining tracts, each apparently could sell five lots before the five percent rule would apply.³⁴

Whether section 1237 would apply to losses as well as to gains realized is not clear. The language of the section would permit its provisions to be applied in either case.³⁵ If section 1237 is interpreted as a relief provision, its limitations, *arguendo*, should not prevent classification of the tract as a non-capital asset where losses are incurred on sale.³⁶

Determining the general applicability of section 1237 involves ascertaining what conditions, in spite of its provisions relating to subdivision and sale, will cause the property to be characterized as held ". . . primarily for sale to customers in the ordinary course of his trade or business."³⁷ This controlling phrase, as under the 1939 Code, is found

33. S. REP. No. 1622, 83d Cong., 2d Sess. 443 (1954).

34. It has been suggested that, as a precautionary measure, one spouse should complete the first five sales before the other spouse sells any lots. Manella, *supra* note 11, at 768 n. 72.

35. The language of § 1237 (a), which sets forth the general conditions for application of the section, is similar to the language of the capital asset definition in § 1221. Whether a transaction results in either gain or loss is not material since the tax consequences flow from characterization of the asset as "capital" or "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." INT. REV. CODE of 1954, §§ 1221, 1237 (a).

One writer, who suggests that § 1237 applies only to gains, apparently bases his conclusion on the presence of the special five percent ordinary income rule which applies only in case of gain. MONTGOMERY, FEDERAL TAXES 9-11 (36th ed. 1955). The five percent rule, however, would not prevent the application of § 1237 to losses, thereby classifying the loss as capital and limiting the amount of allowable deduction. Manella, *supra* note 11, at 770-71. The writer does correctly, and therefore inconsistently, indicate that the taxpayer must show he is a dealer to deduct his losses in full. MONTGOMERY, FEDERAL TAXES 9-11 (36th ed. 1955).

36. This argument, however, is tenuous. During the same taxable year, some sales from a given tract might result in loss while others would produce gain. Manella, *supra* note 11, at 771.

37. INT. REV. CODE OF 1954, § 1221. This phrase was first enacted in 1924 as ". . . property held by the taxpayer primarily for sale in the course of his trade or business. . . ." Revenue Act of 1924, § 208 (a) (8), 43 STAT. 262 (1924). At that time this phrase was designed to exclude ordinary business profits arising out of dealings in real property from capital gains treatment. Clark, *supra* note 3, at 856. In 1934 the words "to customers" and "ordinary" were added to the phrase. Revenue Act of 1934, § 117(b), 48 STAT. 714 (1934). The purpose in adding these words was to expand the scope of the capital asset definition in order to prevent professional traders from deducting losses on sales of securities in full as offsets against ordinary income. MORONEY AND MOSER, *supra* note 1, at 5; Fink, *Dealing in Real Estate*, 2 TAX L. REV. 111, 114-15 (1946); Hendricks, *Federal Income Tax: Capital Gains and Losses*, 49 HARV. L. REV. 262, 267 n. 18 (1935); P. Miller, *supra* note 1, at 844. It would seem that since the addition of the words "to customers" and "ordinary" in 1934 was to narrow the exclusionary clause to limit losses, the clause should also be construed narrowly when gains occur. The interpretation has not been that consistent. Shaw, *When Does a Seller of Real Estate Become a Dealer?*, 1950 SO. CALIF. TAX INST. 325, 326 (Brown ed.). This phrase was also found in the 1939 Code. INT. REV. CODE OF 1939, § 117(a) (1), 53 STAT. 50 (1939).

"Sale" in the exclusionary phrase is broad enough to include "exchange." *Gruver v.*

in the statutory definition of a capital asset where it serves to exclude property so classified from capital gains treatment. Section 1237, by stating that property shall not be so classified merely because of subdivision and sale or activities related thereto, restricts the statutory definition and its pre-1954 interpretation which excluded the sales of subdivided realty from capital gains treatment.

Two common shorthand terms, "dealer" and "investor", have been developed by writers through frequent discussion of this capital asset definition.³⁸ The use of these terms can be attributed to the difficulty courts have had in identifying capital assets. Particularly troublesome has been the phrase, ". . . held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."³⁹ Though these terms are convenient expressions, they can be misleading when used to refer to transactions occurring since the 1954 Code.

Statements which indicate that only "investors" can take advantage of section 1237 are particularly inaccurate, because the concept of property held for "investment" purposes is one which developed under decisions interpreting the statutory definition as it existed before adoption of the 1954 Code. The "investment" purpose concept, if it is to be used at all, now must always be qualified by the modifying effect of section 1237 as applied to the cases involving subdivision.⁴⁰ Subsection (a) (1) of section 1237 requires that the "investment" concept which arose under prior law be so modified.⁴¹ True, the Senate Committee Report indicates section 1237 is to benefit ". . . an individual who subdivides real property held for *investment purposes* . . ." because such

Commissioner, 142 F.2d 363 (4th Cir. 1944). For an application of the word "ordinary" as a loss exclusion device, see *Thompson Lumber Co. v. Commissioner*, 43 B.T.A. 726 (1941).

38. These terms are found nowhere in the statutes and seldom in decisions. A Miller, *supra* note 5, at 203; Comment, 6 HASTINGS L.J. 374 (1955). See Shaw, *supra* note 37, at 325.

39. In the business versus investment area, it is almost impossible to determine how a case might be decided. P. Miller, *supra* note 1, at 851. This difficulty is undoubtedly aggravated by the pronounced absence of any identifiable rationale of the capital asset concept. "Other than a few elliptical and superficial sentences scattered throughout congressional hearings and reports covering nearly thirty years, there is no comprehensive statement of whatever policies may constitute the *raison d' etre* of segregating capital gains and losses." *Id.* at 1085.

40. Section 1237, by providing that certain activities incident to subdivision and sale should no longer permit a finding that the property was held primarily for sale to customers in the ordinary course of trade or business, expanded the investment classification considerably by overruling those cases which so readily prohibited investor classification because of those very activities. INT. REV. CODE OF 1954, § 1237 (a).

41. In excluding property from the benefits of § 1237 where that property had been previously held primarily for sale to customers in the ordinary course of trade or business, Congress added the parenthetical qualification, ". . . (unless such tract at such previous time would have been covered by this section). . . ." *Id.* § 1237 (a) (1).

an individual “. . . may find that the only way to dispose of it (such real property) at a reasonable price is to subdivide it into lots.”⁴² This language, however, should not control the interpretation clearly required by the statute. The Senate Finance Committee certainly did not intend that its report should have that effect. Contrariwise, it appears that the term “investment purposes” is used loosely in the report and contemplates the modifying effect of section 1237.⁴³

The various evidentiary tests employed under prior law to determine whether the property was held by the taxpayer primarily for sale to customers in the ordinary course of business have now in part lost their significance for classification of subdivided property. These tests aided courts in deciding which facts should be considered important to a determination of whether a transaction involved disposition of a capital or non-capital asset.⁴⁴ As section 1237 stipulates that certain facts are no longer significant for purposes of this determination, the old evi-

42. S. REP. No. 1622, 83d Cong., 2d Sess. 115 (1954). (Emphasis added.) Statements to the same effect were made in the House Committee Report, H.R. REP. No. 1337, 83d Cong., 2d Sess. 4 (1954), and by Representative Reed when introducing H.R. 8300 in the House, 100 CONG. REC. 3423 (1954).

43. In its detailed discussion of § 1237 (a), the Senate Finance Committee first considered the general applicability of the section. In reference to the exclusion of property previously held primarily for sale to customers in the ordinary course of trade or business, the committee indicated that sales activities of the taxpayer related to the property in question could be considered where other property was held for sale. Particularly mentioned was the subdivision of other property. The committee did not, however, indicate that reference to sales activity related to the property in question could be made where no other property was held for sale. S. REP. No. 1622, 83d Cong., 2d Sess. 441 (1954). Thus, the committee must have contemplated in its discussion the definitely modifying effect of the parenthetical qualification in subsection (a) (1) on the investment concept when that term was used in the report. See notes 40 and 41 *supra*.

That these comments of the committee were made in the general discussion of the first part of § 1237(a) before discussion of the three specific conditions does not refute this position. See Manella, *supra* note 11, at 753. It is quite apparent that the committee, in this general discussion, anticipated the first of the three conditions, that contained in subsection (a)(1). The subsequent discussion in subsection (a)(1) contains nothing more than a rephrased version of the statutory language.

44. Whether property was held primarily for sale to customers in the ordinary course of trade or business presents a factual question. Allison, *When and How to be A Dealer Rather Than an Investor*, N.Y.U. SIXTH ANNUAL INSTITUTE ON FEDERAL TAXATION 444, 465 (1948); A. Miller, *supra* note 5, at 202. The cases can be said to set up rules of evidence. *Id.* at 203. The relevant facts have been frequently classified by writers, most of which include: purpose of acquisition, frequency, continuity, and substantiality of sales, activities of the taxpayer or his agent, and purpose in disposition. See *ibid.*; Allison, *supra* at 456; Clark, *supra* note 3, at 859; Troll, *supra* note 3, at 443; Fink, *supra* note 37, at 115; Shaw, *supra* note 37, at 328; Comment, 6 HASTINGS L.J. 374 (1955). No one factor controls, and the interplay of the several factors through the whole sequence of past events must be studied. Clark, *supra* note 3, at 858; Malley, *Is Original Purpose Controlling*, N.Y.U. EIGHTH ANNUAL INSTITUTE ON FEDERAL TAXATION 845, 854 (1950). The burden of proof lies on the taxpayer. Greene v. Commissioner, 141 F.2d 645 (5th Cir.), *cert. denied* 323 U.S. 717 (1944); *cf.*, Fidelity Trust Co. v. United States, 39 F. Supp. 451 (W.D. Pa. 1939).

dentiary tests should be reappraised.⁴⁵

Though no one test is determinative in itself, as to capital assets generally, the best evidence of participation in a business lies in the acts of the taxpayer.⁴⁶ Here the courts consider the method of sale, and the frequency, continuity, and substantiality of the transactions.⁴⁷ The decisions have most often turned on the frequency and continuity of the sales.⁴⁸

Though the extent and nature of activity related to one type of asset may establish a business purpose, the same degree of activity when associated with other assets may produce a different conclusion.⁴⁹ This is illustrated by comparing sales of securities with sales of subdivided land. Investment classification has been permitted where taxpayers have been engaged in extensive security transactions.⁵⁰ The business

45. By considering the evidentiary tests under prior law in light of § 1237, it is believed that doubt will be reflected upon certain earlier suggestions that the section will have only a very limited application and effect. See A. Miller, *supra* note 5, at 228; Piper, *Certain Changes in Capital Gain or Loss Treatment Under the 1954 Code*, N.Y.U. THIRTEENTH ANNUAL INSTITUTE ON FEDERAL TAXATION 1233, 1236 (Sellin ed. 1955); Orem, *Capital Gains of Dealers in Real Property*, 33 TAXES 147, 151 (1955); Manella, *supra* note 11, at 750; Comment, 6 HASTINGS L.J. 374, 379 (1955).

46. See Clark, *supra* note 3, at 858; Malley, *supra* note 44; Troll, *supra* note 3, at 443.

47. Method of sale: Austin v. United States, 116 F. Supp. 283 (S.D. Tex. 1953); Houston Deepwater Land Company v. Scofield, 110 F. Supp. 394 (S.D. Tex. 1952); Trapp v. United States, 79 F. Supp. 320 (W.D. Okla. 1948), *aff'd* 177 F.2d 1 (10th Cir. 1949), *cert. denied* 339 U.S. 913 (1950); see Friend v. Commissioner, 198 F.2d 285 (10th Cir. 1952); Boomhower v. United States, 74 F. Supp. 997 (N.D. Iowa 1947); Thrift v. Commissioner, 15 T.C. 366 (1951). Substantiality, frequency and continuity: Williamson v. Commissioner, 201 F.2d 564 (4th Cir. 1953); Palos Verdes Corporation v. United States, 201 F.2d 256 (9th Cir. 1952); Mauldin v. Commissioner, 195 F.2d 714 (10th Cir. 1952); Rollingwood Corporation v. Commissioner, 190 F.2d 263 (9th Cir. 1951); White v. Commissioner, 172 F.2d 629 (5th Cir. 1949); Brown v. Commissioner, 143 F.2d 468 (5th Cir. 1944); Oliver v. Commissioner, 138 F.2d 910 (4th Cir. 1943); Ehrman v. Commissioner, 120 F.2d 607 (9th Cir.), *cert. denied* 314 U.S. 668 (1941); Commissioner v. Boeing, 106 F.2d 305 (9th Cir.), *cert. denied* 308 U.S. 619 (1939); Blake v. Kavanaugh, 107 F. Supp. 179 (E.D. Mich. 1952); Larson v. Korth, 92 F. Supp. 704 (D. Utah 1950); Guthrie v. Jones, 72 F. Supp. 784 (W.D. Okla. 1947); Wood v. Commissioner, 16 T.C. 213 (1951); Samuel D. Leidesdorf, 26 B.T.A. 881 (1932); Ralph H. Horton, 13 T.C.M. 899 (1954); Arnold v. Commissioner, 12 T.C.M. 280 (1953); Brodsky, *supra* note 4, at 1179.

48. Allison, *supra* note 44, at 456; Clark, *supra* note 3, at 860; Shaw, *supra* note 37, at 331; Fink, *supra* note 37, at 115.

49. P. Miller, *supra* note 1, at 850-51, 866-67.

50. One individual who had a yearly average of 584 security transactions and sold on her own account through brokers, and even maintained an office for this purpose, was considered to be an investor. Commissioner v. Burnett, 118 F.2d 659 (5th Cir. 1941). Another individual, registered with the Securities and Exchange Commission and the State of New York as a securities dealer was held to be an investor and not a dealer as to his securities. Achille O. Van Suetendael, 3 T.C.M. 987 (1944), *aff'd per curiam*, 152 F.2d 654 (2d Cir. 1945).

purpose has been denoted for only a few sales of lots.⁵¹

This perplexing result can probably be attributed to the presence of the word "customer" in the statutory definition of a capital asset.⁵² It has been suggested that the purchaser of real estate is considered a customer because of the personal contact nature of the transaction and the uniqueness of each property, whereas the buyer of securities customarily deals with a broker and will never know who sold the shares which he purchased.⁵³ This *ad hoc* explanation fails, however, when it is noted that the sale of a patent, a transaction of exemplary personal nature, is given capital gains treatment.⁵⁴ Why the courts so readily attached the ordinary income label to gains from repeated sales of realty is therefore not clear. If the capital asset concept is designed to alleviate the tax burden on gains accruing over an extended period, it is anomalous that the courts have been more strict in applying the dealer classification to sellers of real property than of securities which are normally held for shorter periods of time.⁵⁵

51. Capital gains treatment was denied in cases where only a few sales of real property occurred: three tracts sold to the same purchaser at the same time in one year, *Spanish Trail Land Co.*, 10 T.C. 430 (1948); six transactions in two years, *Martin v. United States*, 119 F. Supp. 468 (N.D. Ga. 1954); three sales in one year, *Lobello v. Dunlap*, 210 F.2d 465 (5th Cir. 1954); eight lots sold in two taxable years, *Boomhower v. United States*, 74 F. Supp. 997 (N.D. Iowa 1947). See generally, MORONEY AND MOSER, *supra* note 1, at 5-6; SELTZER, *op. cit. supra* note 1, at 213-15; Shaw, *supra* note 37, at 325; P. Miller, *supra* note 1, at 867; Note, 32 TEX. L. REV. 344, 346 (1954); *Hearings Before the Committee on Finance, United States Senate*, 83d Cong., 2d Cong., 2d Sess. 325, 338 (1954); *Hearings Before the Committee on Ways and Means of the House*, 83d Cong., 1st Sess. 1028, 1031 (1953).

52. See P. Miller, *supra* note 1, at 851; *cf. Ehrman v. Commissioner*, 120 F.2d 607 (9th Cir.), *cert. denied*, 314 U.S. 668 (1941), where the court indicated that if one is in a trade or business, those to whom he sells must be customers. See note 37, *supra*.

53. Allison, *supra* note 45, at 455; Fink, *supra* note 37, at 115.

54. INT. REV. CODE OF 1954, § 1235. See P. Miller, *supra* note 1, at 851.

55. One of the few plausible arguments for favorable treatment of capital gains stems from the bunched income factor. BLUM AND KALVEN, *THE UNEASY CASE FOR PROGRESSIVE TAXATION* 17 (1953); Shaw, *supra* note 37, at 327; P. Miller, *supra* note 1, at 840-41; Comment, 6 HASTINGS L.J. 374 (1955).

A further inconsistency arises under the capital asset definition which permits dealers in securities to hold securities for personal investment while dealers in real property may not so hold realty. *Hearings Before the Committee on Finance, United States Senate*, 83d Cong., 2d Sess. 325, 338 (1954); *Hearings Before the Committee on Ways and Means of the House*, 83d Cong., 1st Sess. 1165 (1953). Considerable effort was exerted by realtors to correct this situation in hearings held before the adoption of the 1954 Code. *Id.* at 1013-14, 1030-32, and 1061-63. The problem is not a simple one, and the attempt of the House to clarify the situation was discarded by the Senate because insufficient study had been made. S. REP. NO. 1622, 83d Cong., 2d Sess. 114 (1954); 100 CONG. REC. 9033-34 (1954).

Some recent cases, arising from the construction of F.H.A. rental housing during World War II, have held that where a real estate dealer builds houses for rental purposes and adequately segregates the two asset categories on his books, he may be considered an investor as to subsequent sales of houses held for rental purposes. *Crabtree v. Commissioner*, 20 T.C. 841 (1953); *Nelson A. Farry*, 13 T.C. 8 (1949); see PAUL AND MERTENS, *LAW OF FEDERAL INCOME TAXATION* § 1915 (1934); SELTZER, *op. cit.*

Additional factors were considered indicative of a business purpose where real property had been sold. If the taxpayer maintained an office, advertised and listed properties for sale, or represented to the public that he was in the real estate business, it was almost impossible to establish an investment purpose in the ownership of property.⁵⁶ The courts also considered the ratio of real estate assets to total assets together with the proportion of total income derived from real estate transactions.⁵⁷ Though there was no presumption that subdivision of property established a business purpose, such activity seriously jeopardized the taxpayer's chances for investor classification.⁵⁸ Where the taxpayer subdivided and also made improvements on real estate, the preferred capital gains treatment was almost always foreclosed.⁵⁹

Section 1237 has greatly restricted the extent to which the courts may consider the nature and frequency of transactions in holding the sale of subdivided realty to have been in the course of business. The frequency, continuity, and substantiality of transactions, insofar as they involve lots or parcels of a tract, apparently can not now defeat capital

supra note 1, at 215; Brodsky, *supra* note 4, at 1174; Orem, *Capital Gains of Dealers in Real Property*, 33 TAXES 147 (1955); *cf.*, Recent Decisions, 41 VA. L. REV. 669 (1955). But see Cohn v. Commissioner, 21 T.C. 90 (1953); Eckstrom v. Commissioner, 12 T.C.M. 214 (1953).

56. Maintenance of an office for real estate transaction purposes: Snell v. Commissioner, 97 F.2d 891 (5th Cir. 1938); Beals v. United States, 91 F. Supp. 1013 (W.D. Mo. 1950); Hay v. Commissioner, 25 B.T.A. 96 (1932). Advertising, listing properties for sale, and representing to the public that taxpayer was in the real estate business: Oliver v. Commissioner, 138 F.2d 910 (4th Cir. 1943); Shearer v. Smyth, 116 F. Supp. 230 (N.D. Cal. 1953); Larson v. Korth, 92 F. Supp. 704 (D. Utah 1950); Hutchinson v. Commissioner, 8 T.C.M. 597 (1949). In one case, however, capital gains treatment was allowed where the executor of an estate in liquidating a subdivision project maintained an office, placed signs on the property, and had a business telephone listing. Garrett v. United States, 128 Ct. Cl. 100, 120 F. Supp. 193 (1954). See generally MORONEY AND MOSER, *supra* note 1, at 6-7.

57. Mauldin v. Commissioner, 195 F.2d 714 (10th Cir. 1952); Oliver v. Commissioner, 138 F.2d 910 (4th Cir. 1943); Crabtree v. Commissioner, 20 T.C. 841 (1953); Eckstrom v. Commissioner, 12 T.C.M. 214 (1953); see Allison, *supra* note 44, at 457.

58. The act of subdivision indicates a business purpose. McFaddin v. Commissioner, 148 F.2d 570 (5th Cir. 1945); Gruver v. Commissioner, 142 F.2d 363 (4th Cir. 1944); Snell v. Commissioner, 97 F.2d 369 (9th Cir. 1936); Hay v. Commissioner, 25 B.T.A. 96 (1932). For discussion see A. Miller, *supra* note 5, at 229; Allison, *supra* note 44, at 458; Lerner, *When is One a Real Estate Dealer*, 24 TAXES 645, 648 (1946); Shaw, *supra* note 37, at 337-38; Comment, 6 HASTINGS L.J. 374, 378 (1955).

59. Oliver v. Commissioner, 138 F.2d 910 (4th Cir. 1943); Welch v. Solomon, 99 F.2d 41 (9th Cir. 1938); Richards v. Commissioner, 81 F.2d 369 (9th Cir. 1936); Shearer v. Smyth, 116 F. Supp. 230 (N.D. Cal. 1953); Calvella v. Commissioner, 43 B.T.A. 6 (1940); Hutchinson v. Commissioner, 8 T.C.M. 597 (1949); see 47 C.J.S., Internal Revenue, § 161 (1946). Substantial improvements did not defeat the case for capital gains in one situation where the land was already subdivided when acquired and the lots were sold to contractors who built houses on them. Fahs v. Crawford, 161 F.2d 315 (5th Cir. 1947). *Cf.*, page 521 *supra*.

gains treatment.⁶⁰ Neither will maintenance of an office, listing of the lots for sale, subdividing, or limited improvement earmark a transaction as the sale of a non-capital asset.⁶¹

The courts, under prior law, also considered the nature of the taxpayer's occupation,⁶² and the amount of time devoted by the taxpayer or his agent to the development or sale of the realty was material in determining whether a business was being conducted.⁶³ The degree of personal participation did not need to be great.⁶⁴ Active participation

60. Such factors constitute activity incident to subdivision or sale and are permitted under § 1237. INT. REV. CODE OF 1954, § 1237(a).

61. Use of an office, advertising the lots through newspaper listings, and placing of signs on the property are now permitted. Also, the extent of activity involved in the platting, surveying, and marking of lots on the tract is not limited. See note 60 *supra*. For discussion of improvements now permitted, see pages 520-21 *supra*.

62. Though apparently no case has been decided exclusively in reliance on the occupation of the taxpayer, this is frequently mentioned. Shaw, *supra* note 37, at 328.

A taxpayer may be engaged in more than one occupation or business. Williamson v. Commissioner, 201 F.2d 564 (4th Cir. 1953); Snell v. Commissioner, 97 F.2d 891 (5th Cir. 1938); Hay v. Commissioner, 25 B.T.A. 96 (1932); Collin v. United States, 57 F. Supp. 217 (N.D. Ohio 1944) (dictum); see Clark, *supra* note 3, at 862-63; *Hearings Before the Committee on Ways and Means of the House*, 83d Cong., 1st Sess. 1115 (1953).

63. Efforts used to sell the lots have been particularly convincing to courts in denying capital gains classification. Home Co. v. Commissioner, 212 F.2d 637 (10th Cir. 1954); Galena Oaks Corp. v. Scofield, 116 F. Supp. 333 (S.D. Tex. 1953); Shearer v. Smyth, 116 F. Supp. 230 (N.D. Cal. 1953); Larson v. Korth, 92 F. Supp. 704 (D. Utah 1950); Beals v. United States, 91 F. Supp. 1013 (W.D. Mo. 1950); Weber v. Kavanaugh, 52 F. Supp. 619 (E.D. Mich. 1943); Walter G. Morley, 8 T.C. 904 (1947); Black v. Commissioner, 45 B.T.A. 204 (1941); Samuel D. Leidesdorf, 26 B.T.A. 881 (1932); see A. Miller, *supra* note 5, at 207; Messamer, *What Constitutes a Trade or Business Under Federal Income Tax Laws*, 3 KAN. L. REV. 99, 113-14 (1954); Comment, 6 HASTINGS L.J. 374, 378 (1955).

Passive conduct of the taxpayer, usually in situations where the sale resulted only when the buyer approached the taxpayer, has occasionally been grounds for permitting capital asset characterization. Lobello v. Dunlap, 210 F.2d 465 (5th Cir. 1954); Victory Housing No. 2 v. Commissioner, 205 F.2d 371 (10th Cir. 1953); Pope v. Commissioner, 77 F.2d 599 (6th Cir. 1959); Phipps v. Commissioner, 54 F.2d 469 (2d Cir. 1931); Martin v. United States, 119 F. Supp. 468 (N.D. Ga. 1954); Houston Deepwater Land Company v. Scofield, 110 F. Supp. 394 (S.D. Tex. 1952); Boomhower v. United States, 74 F. Supp. 997 (N.D. Iowa 1947); Guthrie v. Jones, 72 F. Supp. 784 (W.D. Okla. 1947); Wood v. Commissioner, 16 T.C. 213 (1951); Minnie Steinau Loewenburg, 7 T.C.M. 702 (1948); Vaughan v. Commissioner, 7 T.C.M. 288 (1948).

That the activities indicating a business purpose classification were conducted by an agent of the taxpayer rather than by the taxpayer in person does not warrant capital gains treatment. Brown v. Commissioner, 143 F.2d 468 (5th Cir. 1944); Welch v. Solomon, 99 F.2d 41 (9th Cir. 1938); Snell v. Commissioner, 97 F.2d 891 (5th Cir. 1938); Arnold v. Commissioner, 12 T.C.M. 280 (1953); see MERTENS, LAW OF FEDERAL INCOME TAXATION § 22.08 (1942); Shaw, *supra* note 37, at 335.

64. Oliver v. Commissioner, 138 F.2d 910 (4th Cir. 1943); see Mauldin v. Commissioner, 195 F.2d 714 (10th Cir. 1952); Welch v. Solomon, 99 F.2d 41 (9th Cir. 1938); Richards v. Commissioner, 81 F.2d 369 (8th Cir. 1936); Ralph H. Horton, 13 T.C.M. 899 (1954); *accord*, Rollingwood Corporation v. Commissioner, 190 F.2d 263 (9th Cir. 1951). This has been discussed by Brodsky, *supra* note 4, at 11 and 78-79.

The proper measure of participation has been suggested to be the extent of legal

was excused only in those cases where the taxpayer could establish that his primary reason for sale was the liquidation of his property holding,⁶⁵ and clearly not the securing of profit.⁶⁶

Under section 1237 it is not necessary to consider the extent of personal participation, since activities incident to subdivision or sale are no longer indicative of a business purpose.⁶⁷ The liquidation purpose ex-

responsibility of the taxpayer rather than the time spent in personal activity. A. Miller, *supra* note 5, at 209.

65. McGah v. Commissioner, 210 F.2d 769 (9th Cir. 1954); Victory Housing No. 2 v. Commissioner, 205 F.2d 371 (10th Cir. 1953); Fahs v. Crawford, 161 F.2d 315 (5th Cir. 1947); Three States Lumber Co. v. Commissioner, 158 F.2d 61 (7th Cir. 1946); Garrett v. Commissioner, 128 Ct. Cl. 100, 120 F. Supp. 193 (1954); Houston Deepwater Land Company v. Scofield, 110 F. Supp. 394 (S.D. Tex. 1952); Wood v. Commissioner, 16 T.C. 213 (1951); Frieda E. J. Farley, 7 T.C. 198 (1946); see Shaw, *supra* note 37, at 338-39.

66. Frequent and very substantial sales will be overlooked where the taxpayer establishes a genuine intention to liquidate a property holding. Chandler v. United States, 226 F.2d 403 (7th Cir. 1955); see Crabtree v. Commissioner, 20 T.C. 841 (1953); Thompson Lumber Co. v. Commissioner, 43 B.T.A. 726 (1941); Shaw, *supra* note 37, at 331-32.

Under 9th Circuit leadership, however, most decisions have tended to summarily dismiss good faith assertions of a liquidation purpose and have looked primarily to the frequency and continuity of sales. Palos Verdes Corporation v. United States, 201 F.2d 256 (9th Cir. 1952); Rollingwood Corporation v. Commissioner, 190 F.2d 263 (9th Cir. 1951); Brown v. Commissioner, 143 F.2d 468 (5th Cir. 1944); Ehrman v. Commissioner, 120 F.2d 608 (9th Cir.), *cert. denied*, 314 U.S. 668 (1941); Commissioner v. Boeing, 106 F.2d 305 (9th Cir.), *cert. denied*, 308 U.S. 619 (1939); Snell v. Commissioner, 97 F.2d 891 (5th Cir. 1938); Richards v. Commissioner, 81 F.2d 369 (9th Cir. 1936); Galena Oaks Corp. v. Scofield, 116 F. Supp. 333 (S.D. Tex. 1953); Spanish Trail Land Co., 10 T.C. 430 (1948); Ralph H. Horton, 13 T.C.M. 899 (1954).

The liquidation problem under prior law has been well-expressed by the 10th Circuit:

"One may of course liquidate a capital asset. To do so it is necessary to sell. The sale may be conducted in the most advantageous manner to the seller and he will not lose the benefits of the capital gains provision of the statute, unless he enters the real estate business and carries on the sale in the manner in which such a business is ordinarily conducted. In that event, the liquidation constitutes a business and a sale in the ordinary course of such a business and the preferred tax status is lost." Home Co. v. Commissioner, 212 F.2d 637, 641 (10th Cir. 1954).

For further discussion see A. Miller, *supra* note 5, at 214-15; Shaw, *supra* note 37, at 338; Reznick, *Tax Problems in Liquidation*, 26 TAXES 1109 (1948).

The rule that the intent at the time of sale is controlling has apparently been instrumental in causing the Internal Revenue Service to urge that the mere fact of sale was sufficient to establish that the property was held primarily for sale. Shaw, *supra* note 37, at 336; *Hearings Before the Committee on Finance, United States Senate*, 83d Cong., 2d Sess. 338 (1954); *Hearings Before the Committee on Ways and Means of the House*, 83d Cong., 1st Sess. 1116 (1953). There is evidence that the Internal Revenue Service has campaigned recently against all who have had over four sales of real estate in a year. *Id.* at 1014. The government has found its position embarrassing where the taxpayer sought full deduction of a loss as a business expense while the government asserted a capital asset classification to limit the loss. Beals v. United States, 91 F. Supp. 1013 (W.D. Mo. 1950).

67. INT. REV. CODE OF 1954, § 1237(a); see *Hearings Before the Committee on Finance, United States Senate*, 83d Cong., 2d Sess. 338 (1954).

ception to the personal activity test, however, may retain significance where a taxpayer sells property in liquidation which is not covered by section 1237 because it was previously held for sale to customers in the ordinary course of business.⁶⁸

Another test employed by courts was the purpose for acquisition of the property.⁶⁹ Where land was acquired which had already been subdivided, a business purpose may have been indicated.⁷⁰ Section 1237 will probably have little effect upon this test. The five-year holding period requirement may not control.⁷¹ Where a taxpayer buys a tract which is already subdivided, holds the property for five years and then sells, a court could still find that the property was acquired for the purpose of sale to customers in the ordinary course of business.⁷² On the other hand, where the property has been acquired for investment purposes, and, though subdivided, is sold clearly in liquidation of the investment, capital gains treatment might be permitted even though the property was not held for five years if the activities related to sale were not sufficient to constitute a business apart from section 1237.⁷³

Under prior law, a prima facie case was made out for classification

68. Property previously held for sale in the ordinary course of business does not fall within the § 1237 benefits. INT. REV. CODE OF 1954, § 1237(a) (1); see pages 518-19 *supra*. Property sold in liquidation which had been previously held primarily for sale has been given capital gains treatment. See *Austin v. United States*, 116 F. Supp. 283 (S.D. Tex. 1953); *Vaughan v. Commissioner*, 7 T.C.M. 288 (1949); *accord*, *Fahs v. Crawford*, 161 F.2d 315 (5th Cir. 1947).

69. Acquired for sale: *Black v. Commissioner*, 45 B.T.A. 204 (1941); *Calvella v. Commissioner*, 43 B.T.A. 6 (1940); *Burman v. Commissioner*, 23 B.T.A. 639 (1931). Acquired for use in a trade or business other than sale of realty: *Lobello v. Dunlap*, 210 F.2d 465 (5th Cir. 1954); *Three States Lumber Co. v. Commissioner*, 158 F.2d 61 (7th Cir. 1946). Acquired in foreclosure of a mortgage: *Minnie Steinau Loewenburg*, 7 T.C.M. 702 (1948). Acquired by a trustee from the trust on the request of beneficiaries to aid the financial position of a trust: *Boomhower v. United States*, 74 F. Supp. 997 (N.D. Iowa 1947). *Cf.*, purpose of construction of housing units: *McGah v. Commissioner*, 210 F.2d 769 (9th Cir. 1954); *Victory Housing No. 2 v. Commissioner*, 205 F.2d 371 (10th Cir. 1953); *Cohn v. Commissioner*, 21 T.C. 90 (1953); *John P. Dougherty*, 12 T.C.M. 425 (1953).

For discussion of the purpose of acquisition see *Allison*, *supra* note 44, at 456; *Troll*, *supra* note 3, at 444.

70. See *Ehrman v. Commissioner*, 120 F.2d 607 (9th Cir. 1941); but see, *Fahs v. Crawford*, 161 F.2d 315 (5th Cir. 1947); *Guthrie v. Jones*, 72 F. Supp. 784 (W.D. Okla. 1947); *A. Miller*, *supra* note 5, at 229.

Where the taxpayer shows, however, that such property had been acquired by inheritance, by foreclosure, or in order to protect a lien, the courts were more likely to give the property an investment classification even though later sold in lots. *Id.* at 219; *Shaw*, *supra* note 37, at 331; see *Clark*, *supra* note 3, at 865-66.

71. If the property is acquired in anticipation of profit from an early sale, § 1237 probably would not apply. The purpose of acquisition is hardly included in those activities incident to subdivision and sale which the section declares are now immaterial to a determination of capital or non-capital classification.

72. See *Manella*, *supra* note 11, at 755 n. 42.

73. See *A. Miller*, *supra* note 5, at 214 and 229; *Fink*, *supra* note 37, at 117; *Shaw*, *supra* note 37, at 331-32.

as a dealer when the intent of the taxpayer indicated that the property was held for profit rather than investment.⁷⁴ That a taxpayer hoped at some future time to realize an increment in the value of the property did not necessarily establish this intent.⁷⁵ However, where it appeared that he had a present intent to gain from a relatively early sale rather than an intent to *hold* the property, the courts were willing to find a profit purpose.⁷⁶ Where a pre-existing profit purpose was not otherwise established, the length of the holding period could prevent ordinary income treatment of the gain.⁷⁷ The holding period was significant only in absence of the profit purpose,⁷⁸ and where property was initially held for a profit purpose, the courts were extremely reluctant to accept a contended change to investment purpose.⁷⁹ On the other hand, though a taxpayer established that he originally held the property for investment purposes, the courts readily ignored this purpose where other circum-

74. A. Miller, *supra* note 5, at 208. This intention of the taxpayer to hold for a profit purpose, though a prima facie case, can be rebutted by conditions subsequent such as the lack of sufficient activity on the part of the taxpayer to constitute the conduct of a business. *Ibid.*

The term "profit purpose" as it has been generally used by courts and writers is probably essentially the equivalent of "business purpose." What appears to be an attempt by one writer to distinguish between the two terms raises questions about the validity of his distinction since his use of both terms seems inconsistent. *Ibid.* As used in the present discussion, "profit purpose" is considered synonymous with "business purpose," and the former is employed at this point only because it tends to more precisely direct attention to the taxpayer's intent.

Evidence of a profit purpose, of course, may be found in the factors previously discussed: method of sale; frequency, continuity, and substantiality of transactions; maintenance of an office; advertising; proportion of income from real estate transactions; subdividing; ratio of real estate to total assets; taxpayers' occupations; activities of taxpayers or agents; purpose of acquisition; and purpose of disposition.

Other factors not discussed in text which have been considered evidence of the taxpayer's intent are: the taxpayer's self-description of his business as written on his tax return, *Mauldin v. Commissioner*, 195 F.2d 714 (10th Cir. 1952); *White v. Commissioner*, 172 F.2d 629 (5th Cir. 1949); *Spanish Trail Land Co.*, 10 T.C. 430 (1948); a statement in the taxpayer's application for F.H.A. financing that houses were to be constructed for rental or sale, *Delsing v. United States*, 186 F.2d 59 (5th Cir. 1951).

For an interesting parallel discussion of intent as the basis for distinguishing between an investor and speculator in securities, see P. Miller, *supra* note 1, at 839-40.

75. *Phipps v. Commissioner*, 54 F.2d 469 (2d Cir. 1931); see Shaw, *supra* note 37, at 330.

76. *Eckstrom v. Commissioner*, 12 T.C.M. 214 (1953); see *Larson v. Korth*, 92 F. Supp. 704 (D. Utah 1950); *Schultz v. Commissioner*, 44 B.T.A. 146 (1941).

77. *Harriss v. Commissioner*, 143 F.2d 279 (2d Cir. 1944); see A. Miller, *supra* note 5, at 212; Allison, *supra* note 44, at 457.

78. See A. Miller, *supra* note 5, at 211.

79. Brodsky, *supra* note 4, at 1174. Where the inactivity of the taxpayer, which the government urged as evidence of a change in the purpose of holding, was due to general depressed economic conditions, it was held that the taxpayer's purpose in fact remained one of a business nature and therefore his loss was allowed in full. *Walter G. Morley*, 8 T.C. 904 (1947). *Contra*, *Collin v. United States*, 57 F. Supp. 217 (N.D. Ohio 1944).

stances even slightly indicated a profit purpose.⁸⁰

Whether the profit test retains significance under section 1237 is at least questionable. Though the holding period cannot of itself upset other evidence of a profit purpose, where the taxpayer has met the five-year requirement in section 1237, the Commissioner may experience some difficulty in producing convincing evidence not barred by that section which would show that the taxpayer held the property for profit rather than investment.⁸¹

Classification and treatment of the asset on the records of the taxpayer may be important when no other evidence establishes that the property was held for sale to customers in the ordinary course of business.⁸² The limitations imposed by section 1237 will undoubtedly cause the courts to resort more frequently to book classification of the land by the taxpayer as determinative of his intent.⁸³

The old evidentiary tests thus reviewed, it becomes apparent that it is not only "investors" as defined by pre-1954 case law interpreting the general capital asset definition who can take advantage of section 1237 benefits. This section, as part of that general definition, has extensively distended the investor concept. Full awareness of this effect is necessary to attain the preferred capital gains rates for the greatest number of real estate subdividers.

A probable effect of section 1237 will be to insulate the courts from part of the burdensome tax litigation arising in subdivision situations. Many inconsistent decisions are overruled by the new standard injected into the capital asset definition. All questions of definition, however, have not and cannot be answered. So long as our federal income tax

80. *Palos Verdes Corporation v. United States*, 201 F.2d 256 (9th Cir. 1952); *Friend v. Commissioner*, 198 F.2d 285 (10th Cir. 1952); *Shearer v. Smyth*, 116 F. Supp. 230 (N.D. Cal. 1933); *cf.*, *Richards v. Commissioner*, 81 F.2d 369 (9th Cir. 1936); *accord*, *Dillon v. Commissioner*, 12 T.C.M. 338 (1953).

For relevant discussion see *Shaw*, *supra* note 37, at 336; *Fink*, *supra* note 37, at 117; *Orem, Capital Gains of Dealers in Real Property*, 33 TAXES 147 (1955).

81. Assuming that the taxpayer has not held any other property primarily for sale, it appears that the profit test could be applied only by extending the phrase, previously held primarily for sale, to include evidence of statements made by the taxpayer when he acquired the property which indicated it was to be held for sale. Such an extension seems highly unlikely. See note 43 *supra*.

Dealers in real estate seem to appreciate the significance of a holding period as evidence of an investment purpose. See *Hearings Before the Committee on Ways and Means of the House*, 83d Cong., 1st Sess. 1013-14, 1030, 1061-63, 1115-16 (1953).

82. *Delsing v. United States*, 186 F.2d 59 (5th Cir. 1951); *Crabtree v. Commissioner*, 20 T.C. 841 (1953); *Nelson A. Farry*, 13 T.C. 8 (1949); *Carl Marks and Company v. Commissioner*, 12 T.C. 1196 (1949); . . .

83. The accounting entries of taxpayers will probably become helpful in determining whether other property is or has been held primarily for sale. See INT. REV. CODE OF 1954, § 1237(a); note 43 *supra*.

structure continues to employ such definitions as a basis for affording preferential rates to gains from the sale or exchange of capital assets, American taxpayers will insist upon the "capital" characterization of assets sold to secure minimum tax liability.⁸⁴

RECENT EXTENSIONS OF FELONY MURDER RULE

The requisite mens rea for murder is generally the intent to kill a human being.¹ An exception exists in felony-murder; there the intent to commit a felony suffices, and the felon who kills even accidentally while perpetrating a felony is guilty of murder.² An outgrowth of the common law,³ this doctrine has become embedded in the murder statutes of most states⁴ in spite of continued and increasing criticism.⁵ Though

84. P. Miller, *supra* note 1, at 885.

1. In addition, "[I]f an unlawful act, dangerous to, and indicating disregard of, human life, caused the death of another, the perpetrator is guilty of murder, although he did not intend to kill." 40 C.J.S. § 20.

2. Blackstone's statement of the rule was: "When an involuntary killing happens in consequence of an unlawful act, it will be either murder or manslaughter, according to the nature of the act which occasioned it. If it be in prosecution of a felonious intent, or in its consequences naturally tended to bloodshed, it will be murder; but if no more was intended than a mere civil trespass, it will only amount to manslaughter." 4 BL., COMM., § 192, § 193. Cf. CLARK & MARSHALL, CRIMES § 248 (1940). This was a substantial mitigation of the rule, as stated by Coke, that "[i]f the act be unlawful, it is murder." 3 CO. INST. 56 (1797), which was subjected to criticism because of its severity. "This is not distinguished by any statute but is the common law only of Sir Edward Coke." 6 HOBBS, ENGLISH WORKS 86 (1840).

3. Lord Dacres' Case, Moo. 216, 72 Eng. Rep. 458 (K. B. 1535), Lord Dacres, and others, unlawfully went into a forest to hunt. While he was some distance away, one of his companions killed a gamekeeper. All of the companions were adjudged guilty of murder. Also, in Mansell and Herbert's Case, 2 Dyer 128 b., 73 Eng. Rep. 279 (K. B. 1536), it was held that where persons assembled to seize goods by force and a woman was killed by a stone thrown by one of the assailants, this was murder in them all. These are apparently the earliest cases which involved application of the doctrine in a recognizable form.

4. See ALA. CODE tit. 14 § 314 (1940); ARIZ. CODE ANN. § 43-2902 (1939); ARK. STAT. § 41-2205 (1947); CAL. PEN. CODE § 187 (Deering 1950); COLO. STAT. ANN. c. 48, § 32 (1935); CONN. GEN. STAT. § 8350 (1949); DEL. REV. CODE c. 11, § 571 (1953); D. C. CODE ANN. § 22-2401 (1951); FLA. COMP. GEN. LAWS, c. 782 § 782.04 (1953); GA. CODE § 26-1009 (1933); IDAHO CODE ANN. § 18-4003 (1947); ILL. ANN. STAT. c. 38, § 363 (1953); IND. ANN. STAT. § 10-3401 (Burns 1947); IOWA CODE § 690.2 (1954); KAN. GEN. STAT. § 21-401 (1949); LA. CODE CRIM. LAW & PROC. ANN. art. 740-30 (1943); MD. CODE art. 27, § 497 (1951); MASS. ANN. LAWS c. 265, § 1 (1952); MICH. COMP. LAWS § 750.316 (1948); MINN. STAT. § 619.08 (1953); MISS. CODE ANN. § 2220 (1942); MO. ANN. STAT. § 559.010 (Vernon 1949); MONT. REV. CODES ANN. § 94-2503 (1947); NEB. REV. STAT. § 28-401 (1943); NEV. COMP. LAWS § 10068 (1935); N.H. REV. LAWS, c. 1, § 1 (1942); N.J. REV. STAT. § 2A: 113-1 (1937); N.M. STAT. ANN. § 40-24.4 (1953); N.Y. PEN. LAW § 1044 (1944); N.C. GEN. STAT. § 14-17 (1953); N.D. REV. CODE § 12-2708 (1943); OHIO GEN. CODE ANN. § 12400 (1939); OKLA. STAT. tit. 21, § 701 (1951); ORE. COMP. LAWS ANN. c. 169, § 163.010 (1953); PA. STAT. ANN.