Williams v. United States
53 AFTR 2d 84-884, 84-1 USTC ¶9384 (DC TX, 3/1/1983).

Memorandum Opinion and Order

MAHON, District Judge: Plaintiffs D. J. Williams and Bobbie Williams [*2] filed this suit seeking a refund of federal income taxes alleged to have been overpaid for the years 1970 and 1971 and further seeking the Court's determination of the amount of the 1974 net operating loss to be carried back from the year 1974 to 1971 year. Trial was to the Court without a jury. Having heard and considered all the evidence presented at trial and the arguments and briefs of the parties, the Court now enters its opinion and judgment. This opinion will address the following:

(1) D. J. Williams' Personal Background;

(2) Ordinary Income or Capital Gain;

(3) Findings of Fact; and

(4) Conclusions of Law.

I. D. J. Williams' Personal Background.

Plaintiffs D. J. and Bobbie Williams, during 1970, 1971 and 1974 (the three tax years involved) were husband and wife residing in Arlington, Texas. They filed joint income tax returns for these three years with the Internal Revenue Service Center in Austin, Texas. Plaintiff Bobbie Williams is involved in this case only by reason of having filed joint income tax returns with D. J. Williams for the years involved.

D. J. Williams was born during 1927 in Palestine, Anderson County, Texas. His formal education consisted [*3] of between ten and eleven years of school in Anderson County. He first went to work at age 15 and quit school to support his family at age 16. Prior to 1963, D. J. Williams was a truck driver delivering mobile homes from Texas to various points in the United States. He later became a dispatcher. One time while driving in California, he noticed a pickup truck, the bed of which had been covered by a device that was called a "pickup truck cover" or "camper." After purchasing one of these items in California and transporting it to Arlington, Texas, Mr. Williams disassembled and duplicated the device he had purchased. Immediately after selling the camper he made, he decided to make campers for a living. During the mid-1960's the business was first a sole proprietorship known as "Williams Mfg. Co." and then a corporation known as "Williams Mfg. Co., Inc." During 1969, Plaintiffs sold approximately one-half of the stock of Williams Mfg. Co., Inc. in a public offering. Incident to the public offering, the corporate name was changed to "Williams Craft, Inc.," which had been the trade name that was installed on and identified the line of pickup truck covers, pickup campers, slide-in campers, [*4] travel trailers and mobile homes manufactured by Williams Mfg. Co., Inc.

By 1969 Williams Craft, Inc.'s sales had increased to approximately $7,000,000 and the company employed approximately 700 people operating eight plants in Georgia, California, Mississippi, Ohio, and in two towns in Texas.Unitl the company went public, Williams Craft, Inc.'s capital consisted solely of funds that had been accumulated by the corporation since the inception of the camper manufacturing business, and approximately $220,000 that Mr. Williams had contributed to the corporation as invested capital. Incident to the public sale of the stock, Williams Craft, Inc.'s invested capital was increased by approximately $1,000,000.

During the years 1963 through 1971, D. J. Wiliams devoted essentially all of his waking hours to the affairs of Williams Craft, Inc. and its predecessors. Until late 1971, when Plaintiffs sold all the stock they owned in Williams Craft, Inc. to AVTEK Corp., Mr. Williams worked 52 weeks a year, six days a week, an average of about 12 hours a day. As a result of his hard work and the success of the recreational vehicle enterprise, Plaintiffs were able to save and accumulate after-tax [*5] monies for investment.

AVTEK Corp., the 1971 purchaser of Plaintiffs' Williams Craft, Inc. stock was a publicly-traded company chartered in Rhode Island. Pursuant to the terms of the stock sale to AVTEK Corp., Mr. Williams terminated his management position with William Craft, Inc.

During 1966 Plaintiffs began a ranching business in northeast Texas, in Titus County, with 225 acres. Later, they commenced a ranching operation in Cherokee County on slightly over 1,000 acres. When funds were available, they purchased an additional 900 acres, then 80 acres and finally 300 additional acres. By 1971, the ranching operation in Cherokee County involved over 1,000 head of cattle in a cow-calf operation.

The ranch operations involved four or five employees with D. J. Williams devoting approximately 15 hours per week to the ranches during the period 1966 through 1971.

After terminating his connection with Williams Craft, Inc. in late 1971, Mr. Williams began to sell lumber to the recreational vehicle industry utilizing a corporation known as "Arlington Spruce Lumber Company." During 1972, Mr. Williams became employed by Pacer Corporation, (owned by a former officer of Williams [*6] Craft, Inc.), which manufactured and sold mobile homes. Plaintiffs owned no interest in Pacer Corporation; instead, D. J. Williams merely tried to help make a success of his venture. Through 1972, 1973 and 1974, Mr. Williams was active in both Arlington Spruce Lumber Company and the Pacer Corporation. While he simultaneously conducted these businesses, he devoted approximately three to four days per week to the ranching operation, which by then was being conducted only in Cherokee County, the Titus County ranch have been sold. When Plaintiffs and their children were at the ranch, they stayed in the "bunk house" on the ranch property and they all worked the cattle, maintained the pastures and fences, and the like. [1] Because of the drop in the price of cattle from 1972 through 1974, the ranch sustained tremendous losses. As the years progressed, Plaintiffs dovoted more and more time to the ranching operation, trying to stem the tide of losses. In due course, however, Mr. Williams concluded that he must terminate the ranching business. Between the sale in 1971 of Plaintiffs' stock in Williams Craft, Inc. to AVTEK Corp. and the date of the sale of the Cherokee County ranch in late [*7] 1974, D. J. Williams devoted approximately ten to twelve hours a day, six days a week, to the combined operations of the lumber company, Pacer Corporation and the ranch. By late 1974, Plaintiffs had sold all of the ranching properties in Cherokee County and closed both the lumber company and Pacer Corporation. The ranching operation during 1974 incurred losses of approximately $750,000.

1 Neither the Titus County ranch nor the Cherokee County ranch had resort-type amenities; rather, both were simple working ranches.

About the time the ranch was sold and continuing into 1975, Mr. Williams, for personal reasons relating to the health of a member of his family, spent a substantial portion of his time in Kerrville, Texas.

During early 1975 D. J. Williams organized a new manufacturing business, "Classic Manufacturing, Inc.," to convert delivery vans into recreational vans. Since 1975 this corporate business has been conducted in Mansfield, Texas. Four additional corporations have been opened in Houston and Arlington, Texas and High Point and Greensboro, North Carolina. By 1977 the van operation employed approximately 300 people and had achieved an annual sales volume [*8] of about $17,000,000. From 1975 until the time of trial, Mr. Williams has devoted all of his time and attention to directing the affairs of Classic Manufacturing, Inc. and the related corporate operations and has traveled extensively from plant to plant, supervising operations and visiting various suppliers.

II. Ordinary Income or Capital Gain

This Court must address the narrow issue of whether the proceeds from certain sales of raw land are to be treated as ordinary income or capital gain. There are thirteen sales directly in question in this cause. Plaintiffs assert that two of the tracts sold were "Section 1231 assets," and the remaining eleven tracts were capital assets. The Fifth Circuit, in Suburban Realty Co. v. United States, 615 F. 2d 171 (5th Cir.) cert. denied, 449 U.S. 920 (1980), states that in the "real estate capital gains/ordinary income issue" the ultimate inquiry is "whether the property at issue was "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business"" 26 U.S.C. § 1221(1). The Fifth Circuit goes on to caution that the "factors" or "tests" developed in United States v. Winthrop, 417 F2d 905 (5th [*9] Cir. 1969) and Biedenharn Realty Co. Inc. v. United States, 526 F. 2d 409 (5th Cir.) (en banc),, cert denied 429 U.S. 819 (1976), to resolve this question must not be allowed to acquire an "independent meaning of their own." Suburban at 177. [2] Instead, the Fifth Circuit in Suburban used the statutory language in § 1221(1) to develop a set of "principal inquiries," Suburban at 178 to fit the particular case before it, and then applied the Biedenharn -- Winthrop factors in its determination of these "principal inquiries." This Court will do likewise.

2 The Biedenharn -- Winthrop factors are:

(1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the number, extent, continuity and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; (5) the use of a business office for the sale of the property; (6) the character and degree of supervision or control exercised by the taxpayer and (7) the time and effort the taxpayer habitually devoted to the sales.

Winthrop at 910.

The three "principal inquiries" used [*10] in Suburban were:

(1) Was taxpayer engaged in a trade or business, and, if so, what business?

(2) Was taxpayer holding the property primarily for sale in that business?

(3) Were the sales contemplated by taxpayer "ordinary" in the course of that business?

The Court has concluded that these are appropriate inquiries in the present case, and would add the following inquiries:

(4) Were the contemplated purchasers "customers" of the taxpayer?

(5) Should the business activity of others be imputed to taxpayer so as to be considered "taxpayer's business"?

See Suburban at 178, note 19.

The Court now makes the following findings of fact and conclusions of law concerning the above five inquiries.

III. Findings of Fact.

1. The facts set out in the Stipulation filed by the parties on March 8, 1982 are adopted as findings of the Court and will be taken into account for purposes of computing a final judgment in this action.

Was Taxpayer Engaged in a Trade or Business and, if so, what Business?

2. In 1970 and 1971 Mr. Williams was engaged in two separate businesses. He was manager of Williams Craft, Inc. which required up to 70 hours per week of his time, and [*11] he was also manager of his ranching business which required up to 15 hours per week of his time. In addition to income from these businesses, Mr. Williams made investments in the mid-1960's in income-producing properties such as office buildings, warehouses, and the like. During the years 1970, 1971 and 1974, he reported rental income from these properties and depreciation with respect to these properties on his income tax returns.

3. In 1974, Mr. Williams was engaged in three businesses. Arlington Spruce Lumber Company, the Pacer Corporation, and his ranching properties. He sold his ranching properties and closed both the lumber company and the Pacer Corporation in late 1974.

4. During the years 1968 through 1974, Mr. Williams made 45 real estate sales transactions. He made an additional 73 lot sales in the years 1966 through 1972, which the Court will treat separately, discussed more fully below.

5. Of the 45 real estate transactions made between 1968 and 1974, fifteen of these related to property which Mr. Williams held primarily for rental income productions, or held for other business reasons, such as his ranching business, William Mfg. Co., Inc. and Williams [*12] Craft, Inc. These fifteen sales are not at issue in this case, and should not be considered as indicative of the existence of a real estate business or properties held primarily for sale to customers.

6. Two other sales made in 1971 are at issue here, with plaintiffs contending they were § 1231 assets. In one sale that year, Mr. Williams sold a 125.62 acre ranch in Titus County, which was originally sold in 1968, was repossessed in March 1969 and was resold in June 1971.

7. Also in 1971, Mr. Williams sold a 18.3-acre tract which he contends was § 1231 property.It was located on a highway and had been platted and subdivided into a mobile home park on the back of the previous owner. There were two buildings near the road which the previous owner had rented and which Mr. Williams continued to rent after purchasing the property. He intended to use the back portion of the property with lots for mobile homes in his Williams Craft, Inc. business by selling mobile homes and lots as a package. In April 1971, he sold the whole tract to Williams Craft, Inc. for a $10,000 profit. Shortly after the sale of all of his stock in Williams Craft, Inc. to AVTEK, Corp., Mr. Williams was [*13] advised that his sale of this tract to AVTEK, Corp. would have to be highlighted in a public offering which AVTEK, Corp. intended to make. Thus, the decision was made in late 1971 to buy back the property from Williams Craft, Inc. for $120,000, the exact amount that Williams Craft, Inc. had paid Mr. Williams for the property.

8. Disregarding the seventeen sales discussed above, there are 28 other properties that were sold between 1968 and 1974, all of which plaintiffs contend were held primarily for investment. Eleven of these 28 sales are at issue in this case, with the government contending that those eleven properties were held primarily for sale to customers in the ordinary course of D. J. Williams' real estate business. Of these 28 sales in seven years, the Court notes an average of four sales every year. Even taking into account the other fifteen sales of rental income property and ranching property and the two contested sales of § 1231 property which the government contends must be considered, the Court notes an average of 6 3/7 sales per year. Data with respect to each of the 28 transactions are as follows (those indicated with an "*" being at issue in this case): [*14]

Year	Property Description	Tax Basis In Property	Holding Period	Contracted Gain (Loss) on Sale
1968	Lot in Knight Addn.,		7 months	
	Tarrant County	$ 4,558	19 days	(308)
	9.73 acres -- Ezzel		1 month	
	property	15,074	1 day	$ 12,316
	6 acres -- H. E. Scott		3 months	
	tract	16,546	11 days	1,459
1969	None			
1970	* 10.96 acres -- Armstrong		7 months	
	Survey,	30,145	12 days	13,605

Year	Property Description	Tax Basis In Property	Holding Period	Contracted Gain (Loss) on Sale
	Tarrant County			
	* 16.64 acres -- Pierce		18 months	
	tract	31,879	1 day	957
	* 31.19 acres -- Holt		12 months	
	property	166,106	30 days	49,558
1971	* 286.132 acres on		16 months	
Highway 157	910,673	4 days	284,416	
	* 33.94 acres -- Ramsey		19 months	
	Survey	146,647	27 days	39,912
	* 10.96 acres -- Armstrong		8months	
	Survey, Tarrant County	42,910	1 day	6,409

Year	Property Description	Tax Basis In Property	Holding Period	Contracted Gain (Loss) on Sale
1972	4.625 acres --		5 months	
	Bradshaw Survey	5,210	9 days	4,610
	4.5 acre tract --			
	Ferguson Survey	834	26 months	797
	30.98 acre tract --		9 months	
	Daniels Survey	120,949	25 days	80,350
	9.715 acre tract --		9 months	
	Harris County	100,085	22 days	34,915
	14.51 acre tract --		38 months	
	Maise Survey	48,430	7 days	10,570
	4.6 acres -- Ferguson			

Year	Property Description	Tax Basis In Property	Holding Period	Contracted Gain (Loss) on Sale
	Survey	1,004	Unknown	1,065
1973	55 acre tract --		7 months	
	Armstrong Survey	192,521	6 days	17,026
	132.67 acre tract --		1 month	
	Ellis County	103,744	13 days	16,255
	10.96 acres -- Armstrong		Repossessed	
	Survey, Tarrant County	41,615	and sold the	18,665
			same day	
	101.887 acres -- McKnight		6 months	
	property and		21 days and	

Year	Property Description	Tax Basis In Property	Holding Period	Contracted Gain (Loss) on Sale
	the 57.39			
	acres -- Henderson County	678,321	15 months	172,214
			26 days	
	9 acres -- Henderson		38 months	
	Survey	1,668	4 days	2,831
	4.5 acres -- Henderson		37 months	
	Survey	834	4 days	1,415
	13.93 acre tract --		6 months	
	Lane Addition	202.099	11 days and	207,873
			19 months	
			2 days	
	119 acres in		25 months	
	Harris Survey	245,467	7 days	471,718
1974	* Part of Lot		16 months	

Year	Property Description	Tax Basis In Property	Holding Period	Contracted Gain (Loss) on Sale
	D --			
	Farrell Addition	1,828	13 days	1,841
	371.57 acre tract --		8 months	
	William Hickman Survey	569,963	10 days	358,982
	* 164.744 acre tract --		20 months	
	T. O. Harris Survey	617,050	18 days	74,341
	* 52.85 and 35.87		36 months	
	acres -- Bradshaw		12 days and	
	Survey	185,493	30 months	(40,654)
			15 days	
	* 4.8 acre Grevious		13 months	
	Ray tract	19,163	18 days	837

[*15] 9. As already discussed, almost all of Mr. William's waking hours during the years in question were spent in several different businesses, none of which was related to the sale of real

estate. D. J. Williams never had a real estate salesman's or broker's license. Furthermore, the evidence is undisputed that he never spent longer than one or two hours on his efforts to acquire a piece of property, and spent even less time on the sales of his property. He never actively sought out properties to acquire, and he never engaged anyone to assist him in acquiring the properties. He never negotiated the terms and prices of these acquisitions. Instead he either accepted or rejected the purchase after being approached by a realtor or owner of the property to inquire if he would be interested in purchasing the property. Likewise, in his sales of these properties, he never negotiated the terms or price in a buyer's offer. He would simply accept or reject the buyer's offer after being approached by the buyer's realtor with an earnest money contract. On only one or two occasions did he ever meet the purchasers in these transactions and he never attended any of the closings. These actions [*16] suggest that Mr. Williams was not in the trade or business of selling real estate.

10. Statistics with regard to the sources of D. J. Williams' income from the years 1968 through 1974 are as follows:

Source of Income	1968	1969	1970	1971
Salary	$111,700	$ 86,950	$105,130	$ 84,800
Dividend income	-0-	-0-	-0-	-0-
Interest Income	15,631	27,049	32,848	34,032
Profit (Loss) from sale of stock other than Williams Craft, Inc.	4,987	5,907	1,370	-0-
Profit from sale of Williams Craft, Inc. stock	-0-	-0-	-0-	1,900,000
Cattle Sales	3,200	85,238	17,254	247,172
Profit from sale of land at issue in this case *	-0-	-0-	51,681	102,928
Profit from sale of land not at issue in this case	3,405	25,829	9,166	4,831
Profit from sale of Ranch	-0-	-0-	-0-	-0-
Profit from collection of sale price of lots from Apala/Williams Partnerships	18,858	11,526	16,076	16,022
Rent & Royalties	40,495	20,423	9,067	20,530
Business Receipts	329,762	79,425	7,538	-0-
	$528,038	$342,347	250,130	$2,410,315

* This includes only the amounts that are reportable in the years 1970, 1971 and 1974, pursuant to Plaintiffs' election of installment reporting on certain tracts. See Section 453, Internal Revenue Code.

[*17]

Source of Income	1972	1973	1974	Totals
Salary	-0-	-0-	-0-	$388,580
Dividend income	-0-	-0-	-0-	-0-
Interest income	191,960	41,524	189,211	532,255
Profit (Loss) from sale of stock other than Williams Craft, Inc.	-0-	(111,905)	2,439	(92,202)

Source of Income	1972	1973	1974	Totals
Profit from sale of				
Williams Craft, Inc. stock	-0-	-0-	-0-	1,900,000
Cattle Sales	98,557	727,281	155,426	1,334,128
Profit from sale of land				
at issue in this case *	-0-	-0-	40,654	195,263
Profit from sale of land				
not at issue in this case	273,533	284,248	3,203	604,215
Profit from sale of Ranch	-0-	-0-	417,332	417,332
Profit from collection of				
sale price of lots from				
Apala/Williams Partnerships	16,680	28,257	11,805	119,224
Rents & Royalties	37,682	31,676	25,805	185,678
Business Receipts	-0-	46,000	-0-	462,725
	$618,412	$1,047,081	$845,875	6,042,198

* This includes only the amounts that are reportable in the years 1970, 1971 and 1974, pursuant to Plaintiffs' election of installment reporting on certain tracts. See Section 453, Internal Revenue Code.

Was the Taxpayer Holding the Property Primarily for Sale in That Business?

[*18] 11. Mr. Williams testified that he had made some investments in the stock market and that he subsequently decided he did not possess the necessary skills and knowledge to do so successfully. Therefore, he examined alternative investments and determined that purchasing unimproved real estate would provide the best hedge against inflation as well as provide the best and safest investment for him. His rule of thumb was to invest in property which was located on the outskirts of town (Arlington, Texas) in the direction of apparent expansion, which was unimproved, and which was available to him on credit. Furthermore, he planned to do nothing with the properties (no improvements, etc) except hold them as an investment. Accordingly, in his books of account, Mr. Williams separately accounted for each of the properties in question under the title "investments."

12. Of the eleven properties in question, all were unimproved when Mr. Williams purchased them. Furthermore, he made no effort to subdivide, develop, or in any way improve these properties. Thus, the Court notes that the properties before it are unimproved pieces of raw land.

Were the Sales Contemplated by Taxpayer "Ordinary" [*19] in the Course of That Business?

13. After acquiring the eleven properties in question, Mr. Williams never told a realtor that the properties were for sale. Also, he never placed signs on the properties to advertise their sales. When offers to buy his properties were made to him (unsolicited by him), he never spent any time negotiating on terms or prices, because he always either accepted or rejected the offers. Such activity would, at the very least, appear to be inconsistent with the motives of a person desiring to sell properties in the ordinary course of business.

14.Mr. Williams exercised no supervision or control over the realtors who approached him selling property. Several realtors testified that they were aware of the possibility of D. J. Williams purchasing or selling unimproved properties if an offer with the right price and terms was made to D. J. Williams. However, none of these realtors have been approached by Mr.

Williams to have them buy or sell property for him. Any offers brought to him originated in the efforts of the realtors and their customers, not in the efforts of Mr. Williams.

Were the Contemplated Purchasers "Customers" of the Taxpayer?

[*20] 15. After Plaintiffs sold their stock in Williams Craft, Inc. to AVTEK Corp., their record-keeping requirements, including paying bills in the ranching business, depositing receipts from the sale of cattle, keeping track of rental income, paying bills incident to rental properties, and collecting proceeds from the sale of land, necessitated the hiring of a bookkeeper. For several months Mr. Williams tried to operate out of his house and when that proved unsatisfactory he rented a small office that would accommodate the secretary/bookkeeper and provide a desk for him when he was there. That office was located at 3500 Pioneer Parkway, Arlington, Texas. When the office was opened it was necessary to get a telephone and the secretary/bookkeeper in 1972, made an entry for the telephone in the yellow pages under the caption "Land Companies" that reflected "Williams, D.J. Enterprises 3500 Pioneer Pkwy. W.". In 1973 listings appeared in the yellow pages of the telephone directory under the caption "Land Companies" that reflected "Williams, D.J. Enterprises, We Buy and Sell Land, 3500 Pioneer Pkwy. W." and under the caption "Investments" that reflected "Williams Industries, Land Investments [*21] & Ranching, 3500 Pioneer Pkwy. W.". In 1974, the office was moved to 3118 S. Cooper Street and in making yellow page entries the secretary/bookkeeper entered the listing under the caption "Investments" and reflected the name "Williams Industries, Land Investments & Ranching."

The defendant suggests that these yellow pages reveal Mr. Williams' intention to buy and sell real estate to customers in the ordinary course of business. However, the Court disagrees. Mr. Williams' purpose of "investment" is not inconsistent with the heading under which his office was listed.Furthermore, it was his secretary/bookkeeper, who was still receiving monthly payments from lot sales discussed below, that decided where and how to enter the telephone listings in the yellow pages. Also, Mr. Williams testified he was unaware of such listings and had not been approached concerning the decision of those listings, nor had he offered his advice on the listings. Of much greater importance to the Court is the fact that Mr. Williams did not use this office to meet the purchasers of his properties in question. In fact he never met the purchasers of his properties except on one or two occasions.

16. Plaintiff [*22] spent no time and effort finding "customers" for his properties. As already discussed above, he spent almost all of his time in his ranching, renting, camper manufacturing, and lumber businesses during the period in question, with no time left for actively seeking out "customers" to purchase his properties.

Should the Business Activity of Others be Imputed to the Taxpayer so as to be Considered "Taxpayer's Business"?

17. During the years 1966 through 1972 Mr. Williams made an additional 73 lot sales transactions in conjunction with an individual named Irene Apala. Mrs. Apala, who moved from Oklahoma to Texas with her husband during the 1950's, became a real estate sales agent in the Arlington area during the early 1960's and became a real estate broker in 1965. She met D. J. Williams about the time he was establishing his first camper manufacturing operation and assisted him in acquiring Williams Mfg. Co's first manufacturing site in Arlington.

18. In 1966, a 34-acre tract on the outskirts of Arlington was listed for sale with Mrs. Apala by a family named Dowtie.When it was listed, Mrs Apala began to call individuals in the area whom she thought might be interested in [*23] joining her in a subdivision of the tract two-acre lots. One of the individuals she approached was Mr. Williams. Mr. Williams agreed to the deal

on the conditions that he would put up the money to buy and improve the property and Mrs. Apala would do all the work necessary to install a gravel road and sell the lots. D. J. Williams devoted none of his time to this operation known as "Hollow Creek." Mrs. Apala and her staff supplied all the effort required. Mr. Williams also agreed to provide financing for the purchasers on a contract for deed arrangement with 10% to 20% down and installment payments over a ten to twenty-year period. The sales proceeds were to go first to reimburse Mr. Williams for his cost and out-of-pocket expenses, including real estate commissions, and the profits were to be split 50-50. Within a year the property was subdivided into sixteen two-acre tracts for single family homes and completely sold out at a price of approximately $4,000 per two-acre tract. When all sixteen tracts were sold, the contracts for deed were divided, with Mr. Williams receiving 9 and Mrs. Apala receiving 7. D. J. Williams' ledger for 1970 indicates that, at that time, he was still [*24] receiving monthly payments on four of the nine contracts, ranging from $25.00 per month to $87.01 per month. By 1974, only one installment agreement was still being paid to Mr. Williams from the Hollow Creek development. There is no challenge to the taxation of these properties and they are not at issue before this Court.

19. Following the successful Hollow Creek development, Mrs. Apala became known in the Arlington area as a developer of such lots and was constantly being contacted by potential buyers. She again approached Mr. Williams in 1966 to request that he permit her to sell small tracts out of a 30-acre tract Mr. Williams owned on Poly Webb Road in Arlington. He had originally purchased this tract in 1964 as a potential home for his family but had decided not to use it for that purpose because mobile home parks had begun to be developed in the area. Mr. Williams agreed to allow Mrs. Apala to sell three-to-six-acre tracts on a contract for deed basis with Mr. Williams to provide financing for the purchasers. There was no splitting of profits arrangement here; apparently Mrs. Apala's compensation was in the form of a real estate commission. The thirty-acre tract was [*25] sold in eight tracts ranging from three to six acres. Four tracts were sold in 1966 and the other four in 1967. This subdivision if referred to in Mr. Williams' records and in this proceeding as "Poly Webb," and no improvements of the property were made before or during the sales of the small tracts.His general ledger for 1970 reflects that in 1970, Mr. Williams was still receiving monthly installment payments from eight purchasers of these tracts. The payments ranged from $50 to $115 per month on remaining principal balances of from $3,663 to $12,629 at interest rates of 7 and 7 1/2%. Payments on four of the tracts were still being received by Mr. Williams in 1974. There is no challenge to the taxation of these properties and they are not at issue before this Court.

20.Mrs. Apala continued to be approached by people who desired to purchase home sites and to that end in 1967 she and a co-worker undertook a 54-acre development. This development, Chaparral Valley in Arlington, consisted of 34 lots from three-fourths acre to one and one-half acres in size. Mrs. Apala and her co-worker installed only a gravel road and a water line. D. J. Williams had no interest in these lots. [*26] When these lots were sold, Mrs. Apala had an overflow of potential purchasers and she again contacted Mr. Williams in mid-1967 to attempt to reach another agreement, whereby Mr. Williams would again provide the necessary money for purchasing and improving lots and Mrs. Apala would do all of the work. Mr. Williams consented and Mrs. Apala acquired and developed "Hidden Oaks," which was sold as 34 two-to-three acre lots.The only improvement was a gravel road and a bridge. When all the lots were sold Mr. Williams received 25 of the contracts for deed and Mrs. Apala got 9. Mr. Williams' general ledger for 1970 indicates that, at that time he was receiving monthly installment payments from eighteen Hidden Oaks purchasers. The payments ranged in amount from $36 to $83 on remaining principal balances from $2,679 to $6,500 at various interest rates of 7 1/2%, 8%, 8 1/2%, 9% and 9 1/2%. Payments on seven of the lots were still being received by Mr.

Williams in 1974. There is no challenge to the taxation of these properties and they are not at issue before this Court.

21. The final subdivision activity in which Mr. Williams was involved was in a development for mobile home sites known [*27] as "Chaparral Valley." At Mrs. Apala's suggestion, Mr. Williams acquired a 17-acre tract in Arlington in 1968. This tract adjoined a 54-acre development also called Chaparral Valley which Mrs. Apala had previously developed with another individual, not Mr. Williams. With regard to this 17-acre tract, an agreement was made between Mr. Williams and Mrs. Apala that she would take care of making the necessary improvements and would sell the lots. No profit-splitting arrangement was made on this development; Mrs. Apala received only a real estate sales commission. Mr. Williams put up the money to purchase the land and paid all necessary costs. Mrs. Apala arranged for surveying, installing a gravel road, and installing a water line. Mr. Williams financed the lots for the purchasers, and he received all profits from this venture. The 17-acre tract was divided into seventeen lots which were sold in 1968 and 1969. (There were two sales in this development in 1970 and two in 1971, but these were resales of lots repossessed from the original seventeen.) His general ledger for 1970 indicates that, in that year, Mr. Williams was receiving monthly installment payments on these seventeen [*28] lots. The payments were ranged in amounts from $44.29 to $114.05 on principal balances ranging from $2,365 to $8,535 at interest rates of 8% and 9 1/2%. Payments on fourteen of the lots were still being received by Mr. Williams in 1974. There is no challenge to the taxation of these properties and they are not at issue before this Court.

22. The Court is aware that the activity of Mr. Williams in 1966 through 1969 in connection with these four subdivisions would, at first glance, suggest that he is a person who engages in the sale of real estate to customers in the ordinary course of business. However this Court, having heard the undisputed testimony of both Mrs. Apala and Mr. Williams is convinced that it was Mrs. Apala who always approached Mr. Williams with her desire to develop these subdivisions. Mr. Williams never originated the idea, nor did he encourage or request further subdivision activity when each one of these was completed. Furthermore, all Mr. Williams ever did was provide the necessary money with Mrs Apala doing all the work. Mr. Williams was in fact, if not in name, acting as a passive partner in these subdivisions. It should be noted that Mrs. Apala moved [*29] from Arlington in mid-1969 when she became ill, and that D. J. Williams was never again involved, either individually or as a partner, in land development activities. It is this Court's opinion that Mrs. Apala was both the originator and driving force in these activities, and when she left Arlington, these activities stopped for Mr. Williams.

23. All gain on the sales of the lots in Hollow Creek, Poly Webb, Hidden Oaks, and Chaparral Valley have been conceded by Mr. Williams to constitute ordinary income to him and not to qualify for capital gains treatment. Mr. Williams and other witnesses referred to his arrangement with Mrs. Apala on Hollow Creek and Hidden Oaks as "partnerships." However, plaintiffs acknowledge that no partnership tax returns were filed and that Mr. Williams' own records and tax returns do not reflect the income from these developments as "partnership" income. On the advice of his attorney, Mr. Albert Ross, D. J. Williams took the properties in his name so that his investment would be secure. The property was not titled in a partnership name because that would have unduly complicated title to lots that were selling for only $2,000-$4,000 each. The government [*30] would have this Court find that there was no partnership between Mrs. Apala and Mr. Williams and that Mr. Williams was developing and selling these lots individually.The Court disagrees. However even assuming that Mr. Williams did not observe the technicalities necessary to create a partnership with Mrs. Apala, the Court nevertheless finds that his arrangement with Mrs. Apala, for developing and selling real estate was at an end in 1969,

that he never again entered such an arrangement with any person, and that there is no evidence before this Court that any other acquistion of land by Mr. Williams (other than the land in these four arrangements with Mrs. Apala) was ever made for the purpose of individually developing and selling such land, or for becoming a passive partner supplying money for the development of the land by an active partner.

24. Any finding of fact which should be a conclusion of law is hereby made a conclusion of law.

IV. Conclusions of Law.

1. The Court has jurisdiction of the person and of the subject matter of this action. 28 U.S.C. § 1346(a)(1). All necessary parties are before the Court, and venue is proper.

2. The ultimate question to be [*31] decided in this case, whether plaintiffs are to be taxed at ordinary income or capital gains rates on the sales of certain real properties in 1970, 1971, and 1974, is what is usually referred to as a "real estate dealer" issue. This ultimate question is a mixed question of law and fact. Suburban Realty Co. v. United States, 615 F. 2d 171 (5th Cir. 1980).

3. Section 1202 of the Internal Revenue Code of 1954 (26 U.S.C.) provides favored tax treatment for long-term capital gain, defined in Section 1222(3) as gain upon the sale of a "capital asset." Section 1221(1) of the Code, in turn, defines "capital asset" and excludes therefrom, inter alia, "property held by the taxpayer primarily for sale in the oridinary course of his trade or business." The sole issue for decision in this case is whether the Commissioner of Internal Revenue was correct in his conclusion that the thirteen disputed parcels of land sold by Williams during the years in issue were held primarily for sale in the ordinary course of his trade or business.

4. In answering this question, the Court notes that the Supreme Court and the Fifth Circuit have recognized that the preferential capital gain provisions are [*32] to be strictly construed. Commissioner v. P.G. Lake, Inc., 356 U.S. 260, 265 (1958); Corn Products Co. v. Commissioner, 350 U.S. 42, 52 (1955); Suburban Realty Co. v. United States, 615 F. 2d 171, 187 (5th Cir. 1980); United States v. Winthrop, 417 F. 2d 905, 911 (5th Cir. 1969); Tomlinson v. Dwells, 318 F. 2d 60, 62 (5th Cir. 1963). The classic statement of this proposition is found in Corn Products Co. v. Commissioner, supra, 350 U.S. at 52, where the Supreme Court stated:

Since this section [Sec. 17 of the 1939 Code (26 U.S.C. 1952 ed.), Sec. 1221 of the 1954 Code] is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term "capital assets" in para. 117. See Hart v. Commissioner, 313 U.S. 28, 31; Kieselbach v. Commissioner, 317 U.S. 399, 403.

5.The most recent and extensive treatment of this issue is the Fifth Circuit's decision in Suburban Realty Co. v. United States, 615 F. 2d 171 (5th Cir. 1980). In Suburban, the Fifth Circuit found that [*33] a set of "principal inquiries" (discussed above) should be considered by applying the Biedenharn-Winthrop factors (listed above). The Court will now address those "principal inquiries."

Was Taxpayer Engaged in a Trade or Business, and, if so, What Business?

6. Yes, Mr. Williams was engaged in several trades and businesses. In 1970 and 1971, he was manager of Williams Craft, Inc. and manager of his ranching business. In 1974, he was

engaged in three businesses: Arlington Spruce Lumber Company, the Pacer Corporation and his ranching business. In the years in question, he also received rental income from such income producing properties as office buildings and warehouses.

7. Section 1221 of the Internal Revenue Code of 1954 (26 U.S.C. Section 1221) treats all assets as capital assets, except stock in trade, inventory, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business. In enacting this provision, Congress intended that the profits arising from the everyday operation of a business be taxed as ordinary income rather than capital gain, and that the preferential treatment provided by statute to capital assets not be applied [*34] to income that is generated in the normal course of business activity. Capital gain treatment was intended to apply to investment type transactions to relieve taxpayers from the higher ordinary income tax rates on gains that result from increases in the value of capital investments (rather than from value added by the business activity of the taxpayer). Corn Products Refining Co. v. Commissioner, 350 U.S. 46, 52 (1955). The purpose of the tests set forth in Section 1221 is to distinguish income generated from normal day-to-day business activity from gain that results from increase in the value of investment (capital) assets.

8. In light of all the evidence before the Court, Mr. Williams was not a real estate dealer in the years in issue. He made an average of four sales every year between 1968 and 1974 and he spent somewhere between 28 hours and 56 hours as his total time and effort in the acquisition and sale of his 28 properties over those seven years. His actions simply are not the actions of a person in the business of selling real estate and his testimony reveals his purpose in buying these properties was one of investment. The government's main contention in this case [*35] is that the frequency of the sales by D. J. Williams ipso facto requires that the sales produce ordinary income. The Fifth Circuit, in Suburban Realty Co. v. United States, 615 F. 2d 171, 176 (5th Cir. 1980), held that the frequency and substantiality of sales activity standing alone has never been held automatically to trigger ordinary income treatment. The Court concludes that the only evidence of a real estate business or holding of real estate primarily for sale in the instant case is that D. J. Williams sold 28 tracts over seven years. Furthermore, the lack of any marketing activity, the substantial holding periods, the clear investment motive, and the manner in which the sales were made leads the Court to the conclusion that despite the number of sales, the taxpayer has established that he was not in the real estate business in the years in question.

Was the Taxpayer Holding the Property Primarily for Sale in that Business?

9. Section 1231 of the 1954 Internal Revenue Code (26 U.S.C. Section 1231) provides capital gain treatment for gain on the sale of assets used in a taxpayer's trade or business. Such assets include (under Section 1231(b)(1) trade or business property [*36] which is subject to depreciation and real estate used in the taxpayer's trade or business which is not held primarily for sale to customers in the ordinary course of the taxpayer's trade or business. Two of the properties, the tax consequences of which are involved in this case, were Section 1231 assets: The first is the 125.62-acre tract that plaintiffs used as part of their Titus County ranch from 1966 until it was sold in 1969, repossessed for failure to pay in 1970, and resold in January of 1971. This property had been improved by fences which were subject to depreciation and the land was used for purposes of running cattle. The second is the 18.3-acre tract in Tarrant County, part of which was purchased and held by plaintiffs primarily for rental income production, the balance of which was purchased by plaintiffs and held primarily for purposes of conveyance to Williams Craft, Inc. so that Williams Craft, Inc. could employ that property to sell mobile homes. The government does not challenge the taxation of the original sale of the 125.62-acre ranch in 1968 as a sale of land Mr. Williams had used in his ranching business, but it does contend that the resale in June 1971 should [*37] be taxed as ordinary income. However, under § 1038 of the

Internal Revenue Code, a reacquisition of property through a foreclosure is treated as though the sale never occurred. The taxpayer is deemed by statute to have a holding period for the reacquired property that is the sum of the two holding periods of the initial and the second sale. 26 C.F.R. Section 1.1038-1(g)(3). Thus, the Court concludes that neither the 125.62-acre ranch nor the 18.3-acre tract were purchased or held primarily for sale to customers in the ordinary course of any business.

10. Of the 11 remaining properties at issue in this case, the Court concludes that Mr. Williams purchased these properties for investment purposes. Even assuming arguendo that Mr. Williams was in the business of buying and selling real estate, the Court concludes that Mr. Williams held the particular unimproved real estate at issue primarily as investments. He did not hold the tracts "primarily for sale." The Supreme Court in Malat v. Riddell, 383 U.S. 569 (1966) instructed that the phrase primarily for sale in Section 1221(1) dictated an inquiry into the taxpayer's principal reason, or the taxpayer's reason of first importance, [*38] in holding the property. In the instant factual situation the Court concludes and has found that D. J. Williams bought the tracts at issue in an unimproved state and did nothing to the tracts to increase their value; rather, Mr. Williams waited for the tracts to increase in dollar value due to inflation, the population explosion in Arlington, the construction of the Dallas-Fort Worth Regional Airport, and the construction and opening of highways and freeways in the Arlington area. Furthermore, these properties were separately listed in his accounting under the title "Investments."

11. The Court is aware that in Biedenharn, the Fifth Circuit stated that a person in the real estate business "need not engage in promotional exertions in the face of a favorable market. As such, we do not always require a showing of active solicitation where "business . . . [is] good, indeed brisk," Thompson, supra at 124, and where other Winthrop factors make obvious taxpayer's ordinary trade or business status." Biendenharn at 418.However, there are not present in this case "other Winthrop factors" which make obvious Mr. Williams' status as a real estate dealer. Furthermore, Mr. Williams did not [*39] react to the "favorable market" around him by meeting those persons who wished to buy his property and by attempting to negotiate the price or terms to an even greater advantage for himself. Instead he would either accept or reject offers without even meeting the person making the offers. These are not the actions of a person holding property primarily for sale. Based upon Mr. Williams' other business activities, certainly Mr. Williams has demonstrated an ability to market his manufactured goods. The complete failure to engage in any marketing activity leads the Court to conclude that Mr. Williams did not hold the property primarily for sale. D. J. Williams' attitude was to hold the property as an investment until someone solicited him to sell. Since Mr. Williams' primary purpose in holding the property was investment, he is entitled to capital gain treatment on the liquidation of those investments.

Were the Sales Contemplated by Taxpayer "Ordinary" in the Course of that Business?

12. Assuming arguendo that Mr. Williams was in the real estate business and that he held the 11 properties at issue primarily for sale, the Court concludes that the sales in the 11 transactions [*40] were not "ordinary" or usual or normal in the course of any trade or business of Mr. Williams. In each of the transactions, the entire tract was sold, not just a portion of it. He had made no effort to advertise the properties (as he "ordinarily" did to sell products in his manufacturing businesses); he made no effort to approach realtors and brokers to find land for him to buy and sell; he never negotiated prices or terms in offers made to him (he simply accepted or rejected these offers); and he exercised no control over the brokers and realtors bringing offers to him. None of these actions reveal sales in the "ordinary" course of business.

Were the Contemplated Purchasers "Customers" of the Taxpayer?

13. The Court concludes that the purchasers in the transactions at issue were not "customers" of Mr. Williams. Section 1221 states that assets are not capital assets (and thus sale thereof will produce ordinary income) if the property is held primarily for sale "to customers" in the ordinary course of the taxpayer's business. Prior to 1934, the statute did not contain the language "to customers" and therefore provided for ordinary income treatment if property was "held primarily [*41] for sale in the ordinary course of taxpayer's business." It is clear, therefore, that the phrase "to customers" was intended to add an additional test to determine whether a sale would be treated as producing ordinary income or capital gains. Burnett v. Commissioner, 118 F. 2d 659 (5th Cir. 1941). The distinction between sales "to customers" and sales to non-customers can be understood by examining the context of the 1934 amendment to the predecessor to Section 1221 adding "to customers" to the statute.

Under the pre-1934 statute, stock and securities traders, who were incurring substantial losses in the depression, began to claim that their day-to-day sales of stocks and securities were in the ordinary course of their business as traders, and thereby produced ordinary losses rather than capital losses. In response to this claim, Congress plugged the words "to customers" into the statute to make sure that capital gain and loss treatment was accorded to traders, regardless of the number of their daily sales. The rationale is that traders never sell "to customers" but, rather sell through broker/dealers; and it is broker/dealers who have customers. A trader never deals with a [*42] customer; rather, a trader makes decisions to buy or sell and converys instructions to the broker/dealer who in turn deals with the customers. H. Rep. No. 1385, 73 Cong., 2d Session. (1934), 1939-3 Cum. Bull. 632.

The functions of a "broker/dealer" as opposed to a "trader" are illustrated in Kemon v. Commissioner, 16 T.C. 1026, 1032-33 (1951):

Those who sell "to customers" are comparable to a merchant in that they purchase their stock in trade . . . with the expectation of reselling at a profit, not because of a rise in value during the interval of time between purchase and resale, but merely because they have or hope to find a market of buyers who will purchase from them at a price in excess of their cost. This excess or mark-up represents remuneration for their labors as a middle man bringing together buyer and seller, and performing the usual services of retailer or wholesaler of goods. . . . Such sellers are known as "dealers." Contrasted to "dealers" are those sellers of securities who perform no such merchandising functions and whose status as to the source of supply is not significantly different from that of those to whom they sell. That is, the securities are as easily [*43] accessible to one as the other and the seller performs no services that need be compensated for by a mark-up of the price of the securities he sells. The sellers depend upon such circumstances as a rise in value or an advantageous purchase to enable them to sell at a price in excess of cost. Such sellers are known as "traders." (Emphasis added).

Moreover, a trader (even though he is in the trading business) never will become a dealer because of the volume of his sales because he does not deal with customers. Rather, a trader becomes a dealer because and when he enters into the dealer's domain by selling directly (without broker/dealer intervention) to customers. Higgins v. Commissioner, 312 U.S. 212 (1941); Burnett v. Commissioner, supra. All of D. J. Williams' purchases and sales were made through brokers who had been engaged by others. He operated as would any other "trader" for his own account: brokers representing owners who were trying to sell would call on the telephone and describe the locale of the property. Typically, without visiting the property, D. J. Williams would decide on the purchase based upon his knowledge of the locale, the proximity of the tract to town, [*44] the direction of growth, the price of the property and the availability of credit terms. Respecting sales, D. J. Williams was contacted typically by a broker who

represented a buyer, a contract was presented, and if Mr. Williams decided to sell on the terms offered, he would execute the earnest money contract and in due course the deed to convey the property. He did not meet the buyers to negotiate at the time of closing; nor did he compromise on either price or terms. None of the tracts were advertised or otherwise offered for sale, and Mr. Williams never used his office to meet with those persons who desired to purchase his properties.

14. Mr. Williams chose to trade in real estate as opposed to stocks and securities for the reason that he did not believe he had sufficient education and experience to invest successfully in the stock market. Even if D. J. Williams' activity with regard to the real estate at issue in our case could rise to the point of being called a "business," the sales he made, like the stock traders' sales, cannot be viewed as sales "to customers" of D. J. Williams and, for this reason also, plaintiffs are entitled to capital gain treatment.

Should the [*45] Business Activity of Others be Imputed to the Taxpayer so as to be Considered "Taxpayer's Business"?

15. From 1966 to 1969, Mr. Williams entered four different arrangements with Mrs. Apala to provide all of the money necessary for Mrs. Apala to acquire certain land, subdivide and develop it, and sell in lots. The only thing Mr. Williams provided was money, and each of the four arrangements originated in Mrs. Apala's approach to Mr. Williams to make such an agreement. The idea did not originate with Mr. Williams and he acted as a passive partner in these arrangements. Although these arrangements may not be recognized as partnerships, the Court finds that such real estate business activity on the part of Mrs. Apala, with Mr. Williams providing only the money, should not be imputed to Mr. Williams, nor should it result in the conclusion that he individually was in the business of land development and sales. See Barham v. United States, 301 F. Supp. 43, 46 (M.D. Ga. 1969) aff'd, 429 F. 2d 40 (1970). Furthermore, even if the arrangements between Mr. Williams and Mrs. Apala caused the real estate business activities to be imputed to Mr. Williams in the years 1966 through 1969, those [*46] arrangements came to an abrupt halt in 1969 when Mrs. Apala moved from Arlington, and there is no evidence of any such arrangement ever being made with any other person after 1969.Clearly, such activity could not be imputed to Mr. Williams in the years 1970, 1971, and 1974.

16. Regarding sales made by D. J. Williams in the transactions at issue, it is similarly improper to impute to D. J. Williams the activities of the brokers who represented the buyers in soliciting D. J. Williams to sell the property. These brokers were agents of the buyers, not D. J. Williams, and legally there can be no imputation of the brokers' activities to the plaintiffs. Voss v. United States, 329 F. 2d 164 (7th Cir. 1964).

17. Any conclusions of law that should be findings of fact are hereby made findings of fact.
18. Counsel are instructed to present an appropriate Judgment herein.