General Counsel Memorandum 38779

July 27, 1981

Memorandum to:

GERALD G. PORTNEY

Assistant Commissioner (Technical)

Attention: Director, Individual Tax Division

By memorandum dated September 11, 1980, addressed to our Tax Litigation Division, you requested that the Service's acquiescence in Hazard v. Commissioner, 7 T.C. 372 (1946), acq., 1946-2 C.B. 3, be reconsidered.

In Hazard, the taxpayer owned residential property in Kansas City, Missouri. The property was purchased in 1930 and was occupied by the taxpayer as his residence from 1930 until July 1939, at which time the taxpayer moved to Pittsburgh, Pennsylvania. In 1940 the taxpayer listed the Kansas City property with real estate agents for sale or rent. The property was rented in early 1940 and continued to be rented until it was sold on November 1, 1943. The taxpayer recognized a net loss of $6,844.22 from the sale of the property and claimed that the loss was an ordinary loss because the Kansas City property was used by him in his trade or business, although he was a full time practicing lawyer in Pittsburgh. The Commissioner did not dispute the loss, but argued that the loss was a long-term capital loss because the Kansas City property was not used in the taxpayer's trade or business. In other words, the Commissioner argued that the taxpayer's property was held simply for investment.

The Tax Court, relying on the Board of Tax Appeal's decision in Fackler v. Commissioner, 45 B.T.A. 708 (1941), aff'd133 F.2d 509 (6th Cir. 1943), held that the taxpayer recognized an ordinary loss because a single piece of real property that is rented constitutes property used in a trade or business whether or not the taxpayer is engaged in any other trade or business. The Service has acquiesced in the Hazard decision, see O.M. 6528, Leland Hazard, A.O.D. (Nov. 26, 1946), and has consistently followed that decision since 1946. In addition, a number of cases have either followed Hazard or have reached a similar result. See Gilford v. Commissioner, 201 F.2d 735 (2d Cir. 1953), aff'g No. 29641 (T.C.M. 1952); Elliott v. Commissioner , 32 T.C. 283 (1959); Post v. Commissioner, 26 T.C. 1055 (1956), acq., 1958-2 C.B. 7; Schwarchz v. Commissioner, 24 T.C. 733 (1955), acq. , 1956-1 C.B. 5; Lagreide v. Commissioner, 23 T.C. 508 (1954); Crawford v. Commissioner, 16 T.C. 678 (1951); Good v. Commissioner, 16 T.C. 906 (1951), acq. , 1951-2 C.B. 2; Stratton v. Commissioner, T.C.M. 1962-218 (1962) and Gibney Estate v. Commissioner, No. 6184 (T.C.M. 1945).

Despite the Service's acquiescence in Hazard, and the subsequent case law, you believe that the Hazard decision is not a correct interpretation of sections 1221(2) and 1231, and that rental property of the type at issue in Hazard should be considered property held for investment as

opposed to property used in a trade or business. Thus, you believe that such property should be considered a capital asset rather than a section 1231 asset.

Your concern with Hazard stems from a recent technical advice request. On

*** the taxpayer received in liquidation of

*** certain real property known as the

*** lots. The fair market value of the property on the date of liquidation was

*** The property was subject to a

*** year lease which still had

*** years to run. At the time the taxpayer received the lots in liquidation of the

*** company, the

*** Hotel was located on the premises. The taxpayer received rents for approximately 36 years, until

*** . Soon thereafter the hotel was closed and the lessee defaulted on the lease. Following default, the taxpayer tried to enforce the terms of the lease but was unsuccessful. The taxpayer, therefore, sold the property on

*** , at which time the taxpayer's adjusted basis in the property was

*** . The taxpayer sold the property for

*** thereby recognizing a loss of

*** On the taxpayer's

*** tax return, the taxpayer deducted the

*** as an ordinary loss claiming that such property was held in its trade or business. On audit of the taxpayer's

*** tax return the revenue agent determined that the loss was a capital loss. The agent believed that the taxpayer's activities in connection with the real property were passive. Technical advice on this issue was requested and on July 20, 1980, in a National Office technical advice memorandum, the Individual Tax Division advised the District Director that the real property in question was property used by the taxpayer in a trade or business and that the loss sustained was an ordinary loss. The technical advice memorandum cited Hazard and Good v. Commissioner, supra.

Without specifically addressing the facts of the technical advice memorandum, we note that we understand your concern with the result that was reached. Moreover, from a technical standpoint it can be argued that a single piece of real property that is rented is property held for investment and, therefore, when sold, gives rise to a capital gain or loss. Some support for this position is found in the decision of the Second Circuit in Grier, v. United States , 218 F.2d 603 (2d Cir. 1955), aff'g, 120 F. Supp. 395 (D.Conn. 1954), which held that a single-family house rented by a taxpayer was not property used in a trade or business.

In Grier, the taxpayer acquired the property through inheritance in 1932. At that time the property had for many years been rented by the taxpayer's mother. The tenant continued to pay

rent to the taxpayer until the house was sold in 1946. From 1932 to 1946, the taxpayer provided, either by himself or through an agent, whatever services were necessary to maintain the rented property. The sale of the property resulted in a loss, which the taxpayer treated as a long-term capital loss. The Commissioner argued that the loss was an ordinary loss because the rental property was used in the taxpayer's trade or business. The court, discussing Hazard , noted that Hazard had relied on Fackler v. Commissioner, 133 F.2d 509 (6th Cir. 1943), and that Fackler had used the Flint v. Stone Tracey Company, 220 U.S. 107 (1935), definition of a trade or business, "that which occupies the time, attention and labor of men for the purpose of livelihood or profit " Applying that definition, the court stated that the activities of the taxpayer, although of long duration, were minimal in nature. The court, therefore, held that the activities of taxpayer in renting the property were not sufficient to be considered a trade or business for purposes of section 1231. The court stated that broader activities such as those stressed in Pinchot v. Commissioner, 113 F.2d 718 (2d Cir. 1954), (management of 11 buildings even though managed by agents) were necessary before an activity could be considered as constituting a trade or business.

Although Grier appears to support a stricter test for determining when the rental of property will constitute a trade or business, its analysis is much the same as that of the other cases that have followed Hazard . In the recent case of Curphey v. Commissioner, 73 T.C. 767 (1980), the Tax Court noted that the rental of a single piece of real property has repeatedly been recognized as the conduct of a trade or business. The court stated, however, that the ownership and rental of real property does not, as a matter of law, constitute a trade or business. After citing Grier, the court concluded: "In the final analysis, the issue is ultimately one of fact in which the scope of the ownership and management activities may be an important consideration "

We read the majority of cases that have been decided since Hazard as turning upon a factual finding that a particular taxpayer was engaged in a trade or business. In the typical case, the taxpayer has offered evidence of the various activities involved in managing the rental property and the court has accepted this evidence as indicating that the taxpayer was engaged in a trade or business. Even in a case such as that described in your recent technical advice memorandum, the taxpayer undoubtedly could offer evidence of various efforts to collect unpaid rents and other activities with respect to the property. Based upon the decided cases, there is substantial doubt that the Service would prevail if such a case were litigated.

For these reasons, we question whether a change in Service position in this area is advisable. The problem that you raise is not with the legal standard applied by the courts, but with the relatively small amount of activity that the courts have found to be indicative of a trade or business. In view of the number of cases that have been decided on this issue, only some of which have been cited above, it is unlikely that the Service could now persuade the courts to take a more restrictive approach with respect to the amount of activity required to find that a taxpayer's rental activity constituted a trade or business.

Finally, we would note that the Service's acquiescence in Hazard has little bearing on this issue. The acquiescence merely represents the Service's acceptance of the court's decision on what was admittedly a factual question. Moreover, although Hazard has been cited frequently in subsequent cases, the courts have not viewed the acquiescence as indicating Service position to be that every rental of real property is a trade or business. At most, it has been cited for the fact that rental of even a single piece of property may be a trade or business, a proposition with which we do not disagree. Thus, we believe that withdrawal of the Hazard acquiescence would have little effect on future cases.

JEROME D. SEBASTIAN

Acting Chief Counsel

By:

JAMES F. MALLOY

Chief, Branch No. 5

Interpretative Division

Attachments:

Hazard file

Tax Litigation Memo