United States Tax Court

T.C. Memo. 2022-57

WILLIAM E. MUSSELWHITE, JR. AND MELISSA MUSSELWHITE,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 14380-16. Filed June 8, 2022.

Felicia L. Branch, for petitioners.

Scott Lyons and *Tammie A. Geier*, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

ASHFORD, *Judge*: By statutory notice of deficiency dated March 30, 2016, respondent determined a deficiency in petitioners' federal income tax of $356,607 and an accuracy-related penalty pursuant to section 6662(a) of $71,321 for the 2012 taxable year.[1] After certain concessions by the parties,[2] the sole issue remaining for decision is whether Mr. Musselwhite's sale of four land lots resulted in a $1,022,726

[1]Unless otherwise indicated, all statutory references are to the Internal Revenue Code, Title 26 U.S.C., in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2]As set forth in a Joint Stipulation of Settled Issues filed by the parties before the trial of this case, the parties agree that for 2012 petitioners (1) are entitled to a $2,847 additional deduction for "Self-employed SEP, Simple, and Qualified Plans," (2) received but failed to report a state income tax refund of $84, (3) have Schedule E, Supplemental Income and Loss, passive income from a partnership of $4,594, and (4) are not liable for the accuracy-related penalty.

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[*2] ordinary loss as petitioners reported on Schedule C, Profit or Loss From Business.[3] We resolve this issue in favor of respondent.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and the attached exhibits are incorporated herein by this reference. Petitioners resided in North Carolina when their petition was timely filed with the Court.

I. *Mr. Musselwhite's Background*

Mr. Musselwhite received his undergraduate degree, majoring in business, from Wake Forest University and his law degree from Campbell University. Since 1981 (the year he graduated from Campbell University's law school) he has been a personal injury attorney at the law firm started by his father and uncle in 1955 in Lumberton, North Carolina.

In addition to being actively engaged in the practice of law, Mr. Musselwhite has been involved in several real estate ventures, as further discussed below.

II. *Mr. Musselwhite's Real Estate Ventures*

Mr. Musselwhite's first real estate venture was in 1986 with his father, uncle, and brother.[4] The four of them, along with two engineers, purchased 100 acres of undeveloped land adjacent to an existing residential subdivision in Lumberton. The land was divided into approximately 90 lots that were developed with homes in phases, creating a new subdivision called Wycliffe East. The project lasted 13 years, and all 90 lots were eventually sold.

During the development of Wycliffe East, Mr. Musselwhite and his brother were approached to participate in another real estate venture, also in Lumberton. They formed Carolina Group Partnership (CGP), and CGP purchased 100 acres of undeveloped land which was developed in phases into a residential subdivision called Northwoods.

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[3]Mrs. Musselwhite is a party to this case because she filed a joint federal income tax return for 2012 with her husband, Mr. Musselwhite.

[4]Mr. Musselwhite's brother attended Campbell University's law school at the same time he did, and his brother also practiced law at the family's law firm.

[*3] In 1989 Mr. Musselwhite purchased a lot in Wrightsville Beach, North Carolina, with the intent to build a home for his family. Ultimately, Mr. Musselwhite became good friends with the builder who built that home, and because of that relationship Mr. Musselwhite became interested in getting involved in real estate ventures in the Wrightsville Beach-Wilmington, North Carolina, area.

Mr. Musselwhite's first real estate venture in the Wrightsville Beach-Wilmington area was with David Stephenson. Mr. Stephenson had been a successful businessman with an existing real estate development company in Lumberton and initially had been friends with Mr. Musselwhite's father. Mr. Stephenson and Mr. Musselwhite got to know each other well in 2003, when Mr. Stephenson bought a house across the street from Mr. Musselwhite in Wrightsville Beach. In 2005 Mr. Stephenson approached Mr. Musselwhite seeking a business partner (as Mr. Stephenson's two previous business partners had passed away), and on or about June 22, 2005, they formed DS & EM Investments, LLC (DS & EM Investments), as a two-member limited liability company.

DS & EM Investments' Limited Liability Company Annual Report filed with the State of North Carolina (LLC report) for 2005 indicated that the nature of its business was real estate investment. DS & EM Investments' 2006–12 LLC reports continued to report the nature of its business as real estate investment.

DS & EM Investments initially purchased for investment five condominiums in Wrightsville Beach; they immediately sold two, one to a realtor friend. DS & EM Investments also acquired for investment purposes undeveloped lots in Lumberton and in the Seawatch subdivision in Brunswick County, North Carolina, and a house in Wilmington (Wilmington House).[5]

In summer 2006 Adam Lisk, a North Carolina real estate developer, contacted DS & EM Investments, proposing an arrangement whereby he would purchase the Wilmington House and DS & EM Investments would purchase four undeveloped wooded lots in the

[5]Separate and apart from DS & EM Investments, Mr. Musselwhite owned portions of several mobile home parks that Mr. Stephenson had conveyed to him. Additionally, sometime in 2006 he and Mr. Stephenson, together with Nick Garrett, formed Garrett & Stephenson, LLC, which in turn acquired 14 acres of undeveloped land in the Landfall subdivision in the Wrightsville Beach-Wilmington area. Mr. Musselwhite got out of that venture in 2010 before any development began.

[*4] Cypress Lakes subdivision in Brunswick County that Mr. Lisk owned. From Mr. Musselwhite's perspective the arrangement was an opportunity to invest in a subdivision that Mr. Lisk was developing (the subdivision consisted of nine undeveloped wooded lots owned by Mr. Lisk). After several weeks of discussions that included creating an implementable plan as to all nine lots, on August 30, 2006, Mr. Lisk and DS & EM Investments entered into a written agreement memorializing the plan.

Pursuant to this agreement, Mr. Lisk agreed to give DS & EM Investments a one-year personal guaranty that the four lots it was purchasing would sell within one year and that it would net $1 million from such a sale or he would buy back the remaining unsold lots. Additionally, Mr. Lisk and DS & EM Investments agreed that Mr. Lisk would receive the first $49,000 of potential profit on the four lots over the net $1 million, with Mr. Lisk and DS & EM Investments splitting 50/50 any additional profit over the $49,000. Mr. Lisk also agreed that he and his real estate agent, Amanda Carpenter of Intracoastal Realty (Intracoastal), would, in good faith, equally market all nine lots, and he agreed to give DS & EM Investments a deed of trust covering his five lots. DS & EM investments agreed to release the first three of the five lots from the deed of trust upon Mr. Lisk's sale of those three lots with some mutually agreed-upon payment to it. Mr. Lisk and DS & EM Investments further agreed that Mr. Lisk could not sell his remaining two lots until DS & EM Investments had only two of its four lots remaining, at which time Mr. Lisk could sell one of his remaining lots, and Mr. Lisk could only sell his final remaining lot once DS & EM Investments had only one lot remaining of its four lots. Finally, although this arrangement was not reflected in the agreement, Mr. Lisk agreed to complete certain improvements to all nine lots so that the lots could be effectively marketed by Ms. Carpenter.

On August 31, 2006, in accordance with the agreement, DS & EM Investments purchased the four lots from Mr. Lisk for $1 million and Mr. Lisk purchased the Wilmington House from DS & EM Investments for $2,069,000. DS & EM Investments partially financed its purchase with a $750,000 loan from BB&T Bank (BB&T), which was secured by a deed of trust covering the four lots in favor of BB&T; to purchase the Wilmington House, Mr. Lisk used $1,069,000 of his own money and the $1 million he received from DS & EM Investments for the four lots.

In 2007 the real estate market across the country began to take an ugly turn. It was even worse in Brunswick County than across the

[*5] country because the developer of the Seawatch subdivision, Mark Saunders, had not completed all the improvements he had promised; consequently, he was being sued by multiple landowners alleging that he had misrepresented the Seawatch subdivision development, and he had started to flood the market in Brunswick County with hundreds of distressed properties. Mr. Lisk felt the crunch of the downward-spiraling and distressed real estate market and slowed on completing the improvements for all nine lots. He had multiple other business partners filing for bankruptcy or having serious financial problems. He started having financial problems himself, as well as family problems.

The four lots did not sell within one year; and on or about November 15, 2007, DS & EM Investments filed a complaint against Mr. Lisk in the General Court of Justice, Superior Court Division, in Robeson County, North Carolina, alleging that he was in breach of the August 30, 2006, agreement and that his actions were fraudulent in that he had failed to (1) complete all planned improvements, (2) properly market the four lots, (3) buy back the four lots (and instead spent large sums of money on the Wilmington House), and (4) provide a deed of trust covering his five lots. DS & EM Investments sought specific performance of the agreement or alternatively an order that Mr. Lisk reconvey the Wilmington House and transfer his five lots to it, and punitive damages and costs.

Ultimately, DS & EM Investments and Mr. Lisk came to an agreement resolving all issues in the Robeson County court action. Mr. Lisk agreed to complete the rest of the improvements and transfer his five lots to DS & EM Investments so that DS & EM Investments would have the whole subdivision, and in exchange DS & EM Investments agreed to voluntarily dismiss its lawsuit against Mr. Lisk.

On December 22, 2008, Mr. Lisk transferred his five lots to DS & EM Investments, and on or about January 8, 2009, DS & EM Investments voluntarily dismissed its lawsuit against Mr. Lisk. After December 22, 2008, Mr. Lisk had no involvement with the Cypress Lakes subdivision, any of the nine lots, or DS & EM Investments.

With respect to the lots, Mr. Lisk as of December 22, 2008, had: (1) removed trees to build a road; (2) removed underbrush from the lots; (3) completed grading for the creation of a road; (4) completed grading for the creation of storm water drainage; (5) paved a road (with a curb and gutter added); (6) obtained septic tank permits; (7) designed a gate and fence; (8) obtained a Coastal Area Management Act permit for a

[*6] kayak dock; (9) requested additional entrance approval from the North Carolina Department of Transportation; and (10) confirmed that the lots could support well systems and were close to electric service and water lines. After December 22, 2008, no improvements were made to the lots by DS & EM Investments except to occasionally clean up the lots.

After December 22, 2008, Intracoastal's for sale signs remained on the lots for an unspecified period (but no later than the end of September 2011, when BB&T prepared an appraisal of the lots, as discussed below), although by May 2008 Ms. Carpenter had left Intracoastal to work with another real estate company in Wilmington. The record is unclear as to what, if any, additional marketing of the lots was done.

BB&T had appraisals prepared with respect to the four lots on or about May 1, 2009, September 29, 2011, and June 27, 2012. The appraised values reflect the continued effect of the housing market crash; the appraised value of the four lots was $55,000 in May 2009, $23,500 in September 2011, and $17,500 in June 2012.[6] The 2011 and 2012 appraisals also recited the following with respect to the four lots: "THE SUBJECT HAS NO KNOWN PRIOR SALES HISTORY WITHIN THE PAST 3 YEARS AND IS NOT KNOWN TO BE CURRENTLY FOR SALE."

In the light of the continued depressed housing market, BB&T's mounting pressure with respect to the four lots as the holder of a deed of trust covering these lots, and both Mr. Musselwhite's and Mr. Stephenson's personal debt exposure with respect to the mobile home parks, Mr. Musselwhite and Mr. Stephenson agreed that it was prudent to distribute or convey to each other some of their properties (including properties of DS & EM Investments), dividing up the debt. Accordingly, Mr. Musselwhite conveyed his interest in the mobile home parks to Mr. Stephenson (and Mr. Stephenson promised to remove Mr. Musselwhite from the personal guaranty). Additionally, sometime in either 2011 or 2012 DS & EM Investments distributed a condominium to Mr. Musselwhite, and on July 27, 2012, it distributed the four lots to Mr. Musselwhite.

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[6]BB&T also had an appraisal prepared with respect to the four lots on or about June 2, 2006; the appraised value of the four lots was $952,000 in June of 2006.

[*7] On August 3, 2012, Mr. Musselwhite sold the condominium for $515,250, resulting in a $137,780 loss. Regarding the four lots, Mr. Musselwhite hired Donna Cote, a licensed real estate broker in North Carolina with her own company in Wilmington, to market the lots and bring them to sale. The record in this case includes a January 8, 2016, letter from Ms. Cote to petitioners' former counsel of record.[7] In this letter Ms. Cote recites that in early summer 2012 she met with Mr. Musselwhite to discuss assisting him with aggressively marketing the lots and bringing them to sale. She further recites that just after DS & EM Investments distributed the four lots to Mr. Musselwhite, she met with him again, spending much of a day at the lots assessing them and assessing the general geographical area to discern what other properties were for sale and their values. According to Ms. Cote, she immediately began to aggressively market the four lots and explore various options for their disposition; to wit, with an extensive network of developers, builders, investors, realtors, and potential purchasers from having actively participated in the development and sale of lots in so many subdivisions in Brunswick and neighboring New Hanover Counties, she consistently presented information on the lots to multiple people and spent substantial time and effort marketing the lots for sale. Ultimately, on or about November 14, 2012, Mr. Musselwhite was able to sell the four lots for a total of $17,500, resulting in a $1,022,726 loss.

III. *DS & EM Investments' and Petitioners' Tax Reporting*

Mr. Musselwhite hired Charles Edwards, a certified public accountant (CPA) with his own CPA firm in Lumberton to prepare and file DS & EM Investments' 2005–12 Forms 1065, U.S. Return of Partnership Income, and petitioners' 2011–13 Forms 1040, U.S. Individual Income Tax Return.[8]

A. *DS & EM Investments*

DS & EM Investments' 2005–12 Forms 1065 reported that (1) DS & EM Investments' principal business activity was "INVESTMENT," (2) its principal product or service was "PROPERTY," and (3) it had no

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[7]On November 1, 2017, the Court granted this individual's Motion to Withdraw as counsel in this case. Five days before that, petitioners' current counsel of record entered an appearance in this case.

[8]Although the record includes only these tax returns, Mr. Edwards has been doing tax preparation work for Mr. Musselwhite's entire family and their various business entities since at least 1981.

[*8] gross receipts or sales. However, capital gains and/or losses with respect to sales of real property were reported on DS & EM Investments' 2006, 2007, 2009, 2010, and 2012 Forms 1065 (and also reflected on Schedules D, Capital Gains and Losses, which were attached to those forms); no sales of real property were reported on its Forms 1065 for 2005, 2008, and 2011 (and no Schedules D were attached to those forms).

The Schedules L, Balance Sheets per Books, of DS & EM Investments' 2005–10 Forms 1065 reported that DS & EM Investments had no "[i]nventories"; these Schedules L reflected, inter alia, that DS & EM Investments had "[o]ther investments," which included "INVESTMENT-REAL ESTATE."

It was on DS & EM Investments' Schedule L of the 2011 Form 1065 that the four lots (as well as the five lots that Mr. Lisk had transferred to DS & EM Investments in 2008) were first reported as being held as "[i]nventories" at the beginning and end of the taxable year. When DS & EM Investments' 2011 Form 1065 was filed on April 29, 2012, DS & EM Investments and Mr. Musselwhite were aware that the fair market values of the nine lots were less than DS & EM Investments' bases in the lots. The Schedule L of DS & EM Investments' 2012 Form 1065 also reported "[i]nventories" at the beginning of the taxable year but with a blank as to the end of the taxable year.

Despite the fact that (1) the four lots were reported as being held as "[i]nventories" on DS & EM Investments' 2011 and 2012 Schedules L and (2) Mr. Edwards testified at trial that it was his professional judgment that the lots were always held as inventory (upon reviewing the August 30, 2006, agreement, which Mr. Musselwhite first presented to him in the 2010–11 timeframe), Mr. Edwards did not file amended Forms 1065 for DS & EM Investments as to the prior taxable years reporting the lots' purported status as inventory. Additionally, the record is unclear as to whether Mr. Edwards had any discussions with Mr. Musselwhite regarding the lots' reclassification from investment to inventory before filing either the 2011 or the 2012 Form 1065 for DS & EM Investments.

B. *Petitioners*

Petitioners' 2011 Form 1040 reported total income of $928,332, the bulk of which consisted of (1) $111,679 of capital gain primarily attributable to the sale of various stocks and (2) $750,154 of income from partnerships and S corporations, zero of which was attributable to DS

[*9] & EM Investments but most of which was attributable to $708,042 of income Mr. Musselwhite received from his family's law firm. The return also claimed various deductions (including various itemized deductions as detailed on Schedule A, Itemized Deductions) and reported four exemptions, a credit from Form 8801, Credit for Prior Year Minimum Tax—Individuals, Estates, and Trusts, and payments for federal income tax withheld and "2011 estimated tax payments and amount applied from 2010 return." No Schedule C relating to Mr. Musselwhite's real estate activities was attached to this return.[9]

Petitioners' 2012 Form 1040 reported total income of $225,568, the bulk of which was attributable to $1,202,943 of income from partnerships and S corporations, zero of which was attributable to DS & EM Investments but most of which was attributable to $1,182,664 of income Mr. Musselwhite received from his family's law firm, which was offset by a deduction for a $1,022,726 business loss as detailed on an attached Schedule C. This Schedule C was for Mr. Musselwhite's "ACTIVTIES RELATED TO REAL ESTATE"; to wit, the sale of the four lots on or about November 14, 2012. The lots' price ($17,500) was reported as gross receipts or sales, and Mr. Musselwhite's adjusted bases in the lots ($1,040,226) were reported as cost of goods sold. Mr. Musselwhite's $137,780 loss from the sale of the condominium on August 3, 2012 (i.e., "SALE OF INVESTMENT CONDO") was reported, together with a net long-term capital gain of $108,500, on an attached Schedule D; but because of section 1211(b), petitioners' total income included only the maximum amount allowed for a net capital loss (−$3,000). Petitioners' 2012 Form 1040 also claimed various deductions (including various itemized deductions as reflected on Schedule A) and reported three exemptions and payments for federal income tax withheld and "2012 estimated tax payments and amount applied from 2011 return."[10]

Petitioners' 2013 Form 1040 reported total income of $936,699, the bulk of which consisted of $846,465 of income from partnerships and S corporations, nearly all of which was attributable to $845,786 of income Mr. Musselwhite received from his family's law firm. Petitioners' total income also included business income of $4,431, consisting of gross receipts or sales of that same amount from "LEGAL

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[9]Ultimately, this return reported a refund, which was directed to be applied to petitioners' 2012 estimated tax.

[10]Ultimately, this return reported a refund, which was directed to be applied to petitioners' 2013 estimated tax.

[*10] SERVICES" of Mr. Musselwhite as reflected on an attached Schedule C. No other Schedule C was attached to this return. This return claimed various deductions (including various itemized deductions as detailed on Schedule A) and reported two exemptions, a credit from Form 8801, and payments for federal income tax withheld and "2013 estimated tax payments and amount applied from 2012 return." [11]

IV. *Notice of Deficiency*

Following an examination of petitioners' 2012 Form 1040, respondent determined in pertinent part that petitioners are not entitled to the reported $1,022,726 Schedule C loss because the four lots were capital assets and thus their sale generated a capital (and not ordinary) loss. The March 30, 2016, notice of deficiency issued to petitioners reflects this determination.

OPINION

I. *Applicable Law Regarding the Character of Petitioners' Reported Loss*

On or about November 14, 2012, less than four months after DS & EM Investments distributed the four lots to Mr. Musselwhite, he sold them for $17,500, realizing a loss of $1,022,726. The sole dispute here is whether that loss should be characterized as an ordinary loss, as petitioners contend, or as a capital loss, as respondent contends. Both parties agree that the resolution of this dispute centers around whether the lots were

> stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

See § 1221(a)(1). If they were, then their sale resulted in an ordinary loss and not a capital loss.

The purpose of section 1221(a)(1) is to "differentiate between the 'profits and losses arising from the everyday operation of a business' on

[11]Ultimately, this return reported a refund, which was directed to be applied to petitioners' 2014 estimated tax.

[*11] the one hand . . . and 'the realization of appreciation in value accrued over a substantial period of time' on the other hand." *Malat v. Riddell*, 383 U.S. 569, 572 (1966) (first quoting *Corn Prods. Refining Co. v. Commissioner*, 350 U.S. 46, 52 (1955); and then quoting *Commissioner v. Gillette Motor Transp., Inc.*, 364 U.S. 130, 134 (1960)).

The Supreme Court has defined "primarily" as used in section 1221(a)(1) to mean "of first importance" or "principally." *Malat*, 383 U.S. at 572. Additionally, whether property is property described in section 1221(a)(1) is purely a factual question, and the burden of proof is on petitioners to demonstrate that Mr. Musselwhite held the four lots as described in section 1221(a)(1) (and not as a capital asset).[12] *See Pasqualini v. Commissioner*, 103 T.C. 1, 6 (1994) (and cases cited thereat); *Maddux Constr. Co. v. Commissioner*, 54 T.C. 1278, 1284 (1970); *see also* Rule 142(a).

The U.S. Court of Appeals for the Fourth Circuit, the court to which an appeal of this case would lie absent stipulation of the parties otherwise, *see* § 7482(b)(1)(A), (2),[13] has held that several factors are relevant in resolving a section 1221(a)(1) dispute. Among the factors to be considered are (1) the purpose for which the property was acquired; (2) the purpose for which the property was held; (3) improvements, and their extent, made to the property by the taxpayer; (4) the frequency, number, and continuity of sales; (5) the extent and substantiality of the transaction; (6) the nature and extent of the taxpayer's business; (7) the extent of advertising or lack thereof; and (8) the listing of the property for sale directly or through a broker. *Graves v. Commissioner*, 867 F.2d 199, 202 (4th Cir. 1989) (citing *Mathews v. Commissioner*, 315 F.2d 101 (6th Cir. 1963), *aff'g* T.C. Memo. 1961-213, 1961 Tax Ct. Memo LEXIS 136). However, no one factor or group of factors is determinative, *id.*, and not all factors may be relevant in a particular case or factors may have varying degrees of relevance depending on the facts of a particular case, *S&H, Inc. v. Commissioner*, 78 T.C. 234, 243–44 (1982). Additionally, objective factors carry more weight than the taxpayer's subjective statements of intent. *See Guardian Indus. Corp. v.*

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[12]Petitioners do not otherwise contend that the burden of proof should shift to respondent under section 7491(a) as to any relevant issue of fact, nor have they established that they met the requirements for shifting the burden of proof. Accordingly, the burden of proof remains on petitioners. *See* § 7491(a)(2).

[13]We follow the relevant precedent of the Court of Appeals to which an appeal would generally lie. *See Golsen v. Commissioner*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

[*12] *Commissioner*, 97 T.C. 308, 316 (1991), *aff'd without published opinion*, 21 F.3d 427 (6th Cir. 1994).

Accordingly, we will consider and weigh these factors to resolve the sole dispute here concerning the character of petitioners' reported loss arising from Mr. Musselwhite's sale of the four lots.

II. *Analysis*

A. *The Purpose for Which the Property Was Initially Acquired and Subsequently Held (Factors 1 and 2)*

Mr. Musselwhite acquired the four lots via a distribution by DS & EM Investments as part of an agreement with Mr. Stephenson to deal with the mounting pressure DS & EM Investments was facing from BB&T as the holder of a deed of trust covering these lots and his and Mr. Stephenson's personal debt exposure with respect to certain mobile home parks. Mr. Musselwhite had no intention whatsoever of developing the lots when he acquired them and thereafter while holding them, and he never undertook any development of the lots during the few months he held them before they were sold; investment was his principal (or really sole) purpose. Indeed, as part of the agreement with Mr. Stephenson, DS & EM Investments also distributed a condominium to Mr. Musselwhite. Like the four lots, he sold the condominium in 2012, but he reported the condominium sale as a Schedule D loss.

Furthermore, in point of fact, when the four lots were distributed to Mr. Musselwhite, there was no change in purpose. We are very much convinced that DS & EM Investments purchased and held the lots for investment, the same purpose it had with respect to all of its property. Mr. Musselwhite testified that all the things he and Mr. Stephenson were doing through DS & EM Investments were "really investment" and that specifically with respect to DS & EM Investments' acquisition of the four lots, it was an opportunity to invest in a subdivision that Mr. Lisk (who was an established developer) was already developing (as the owner of the other five lots in the subdivision). His testimony is consistent with the representations made on (1) DS & EM Investments' 2005–12 Forms 1065 that its principal business activity was "INVESTMENT" and (2) DS & EM Investments' 2005–12 LLC reports that its business was real estate investment. The 2005–12 Forms 1065 also reported no gross receipts or sales, but sales of real property were reported on DS & EM Investments' 2006, 2007, 2009, 2010, and 2012 Forms 1065 (as well as detailed on attached Schedules D), while no sales

[*13] whatsoever of real property were reported on DS & EM Investments' 2005, 2008, and 2011 Forms 1065 (and no Schedules D were attached to those forms). Additionally, the August 30, 2006, agreement between DS & EM Investments and Mr. Lisk, together with the testimony of Messrs. Musselwhite and Lisk, shows that DS & EM Investments had no responsibility at all for developing and marketing the four lots (and did none), but, rather, Mr. Lisk did.

Even assuming, arguendo, that DS & EM Investments acquired the four lots in 2006 for development purposes, all the evidence shows that it abandoned its "development plan" by the end of 2008. On December 22, 2008, in connection with DS & EM Investments' agreeing to voluntarily dismiss the lawsuit it had filed against Mr. Lisk, Mr. Lisk transferred his five lots to DS & EM Investments. As of that date, Mr. Lisk had completed certain development actions; after that date, he had no involvement with the subdivision, any of the nine lots, or DS & EM Investments, and DS & EM Investments did nothing to improve any of the lots (except to occasionally clean them up) or market them for sale. Indeed, the 2011 and 2012 appraisals of the lots by BB&T recited that the lots were not listed for sale at the time the appraisals were made. To be sure, "a taxpayer may hold lands primarily for sale to customers in the ordinary course of his trade or business and, at the same time, hold other lands for investment," *Gardner v. Commissioner*, T.C. Memo. 2011-137, slip op. at 8 (quoting *Mathews v. Commissioner*, 315 F.2d at 106), but said taxpayer can cease holding property primarily for sale to customers in the ordinary course of its business and begin to hold it only for investment purposes, *Sugar Land Ranch Dev., LLC v. Commissioner*, T.C. Memo. 2018-21, at *10–11.

Factors 1 and 2 weigh against petitioners (and in favor of respondent).

B. *The Extent of Improvements to the Property (Factor 3)*

Development activities may convert property originally acquired for investment into property held for sale to customers in the ordinary course of business. *See Bush v. Commissioner*, T.C. Memo. 1977-75, *aff'd*, 610 F.2d 426 (6th Cir. 1979). The only improvements to the four lots were made by Mr. Lisk, and he made them no later than December 22, 2008, the date he transferred the lots to DS & EM Investments, which was approximately 3½ years before DS & EM Investments distributed the lots to Mr. Musselwhite. After that date, as indicated above, no improvements were made to the lots by DS & EM Investments

[*14] (except to occasionally clean them up) and after DS & EM Investments distributed the lots to Mr. Musselwhite, he never made any improvements to the lots during the approximate 3½ months that he held them in 2012.

Factor 3 weighs against petitioners (and in favor of respondent).

C. *The Frequency, Number, and Continuity of Sales (Factor 4)*

On the one hand, in the 1980s and 1990s, other entities that Mr. Musselwhite and members of his family jointly owned developed land lots and sold those lots. On the other hand, as indicated above, from its inception in 2005 through 2012, DS & EM Investments did not report on its Forms 1065 any gross receipts or sales; the only reported sales of any kind were those from the sale of investment properties that resulted in capital gain or loss (and those sales did not include any of the nine lots during the time that DS & EM Investments held them). Ultimately, given the facts of this case, Mr. Musselwhite's activity alone should be the focus. To this end, all evidence supports the isolated nature of Mr. Musselwhite's sale of the four lots, rather than an ongoing sole proprietorship engaged in activities related to real estate.

Factor 4 weighs against petitioners (and in favor of respondent).

D. *The Extent and Substantiality of the Transaction (Factor 5)*

Mr. Musselwhite's sale of the four lots was the only sale associated with the transaction, and the record is silent as to any continued involvement by Mr. Musselwhite with the lots, e.g., development plans, after he sold them. Indeed, as indicated above, when DS & EM Investments distributed the lots to him, he had no intention of developing them, and by April 29, 2012, the date on which DS & EM Investments' Form 1065 was filed, he (and DS & EM Investments) knew that the fair market values of the lots were less than DS & EM Investments' bases in the lots. Incredibly, the 2011 Form 1065 was the first such form for DS & EM Investments on which the lots were classified as being held as "[i]nventories." To be sure, Mr. Musselwhite was continuing to experience financial problems in 2012, but such reclassification provided no incentive for him to hold on to the four lots and develop them; the reclassification was his purported "ticket" to getting a significant ordinary loss through a quick sale of the lots.

Factor 5 weighs against petitioners (and in favor of respondent).

[*15] E. *The Nature and Extent of the Taxpayer's Business (Factor 6)*

Mr. Musselwhite's everyday business was not the development and sale of real estate. Since the 1980s Mr. Musselwhite has been actively engaged in the practice of law as a personal injury attorney at his family's law firm in Lumberton, and his reported income from that endeavor for at least 2011–13 was substantial. According to petitioners' 2011–13 Forms 1040, Mr. Musselwhite received income from his family's law firm of $708,042 in 2011, $1,182,664 in 2012, and $845,786 in 2013. As relevant here, he (and Mr. Stephenson) formed and operated DS & EM Investments as a vehicle to invest in real estate and DS & EM Investments' federal and state filings bear this out.

Factor 6 weighs against petitioners (and in favor of respondent).

F. *The Extent of Advertising or Lack Thereof and the Listing of the Property for Sale Directly or Through a Broker (Factors 7 and 8)*

Once DS & EM Investments distributed the four lots to Mr. Musselwhite, he immediately hired Ms. Cote, a North Carolina-licensed real estate broker with her own company in Wilmington, to market and sell the lots. Although Ms. Cote did not testify at trial, the parties stipulated a January 8, 2016, letter from her to petitioners' former counsel of record. In this letter Ms. Cote outlines her discussions with Mr. Musselwhite regarding his desire to aggressively market the four lots and bring them to sale. She also indicates in the letter that she consistently presented information on the lots to multiple people and spent substantial time and effort marketing the lots for sale. With there being no objections reserved by respondent as to the letter, we have no reason to doubt the veracity of its contents.[14]

[14]We also note that the fact that Ms. Cote and not Mr. Musselwhite personally marketed and sold the lots does not per se remove this case from section 1221(a)(1) treatment. Courts have routinely held that the activities of brokers are attributable to the taxpayer who hired them. *See, e.g.*, *Hansche v. Commissioner*, 457 F.2d 429, 434 (7th Cir. 1972) ("That the actual advertising sales activities are here not performed by the taxpayers does not mean that they were not holding the property 'primarily for sale to customers in the ordinary course of [the taxpayers'] trade or business.'"), *aff'g* T.C. Memo. 1970-342; *Gamble v. Commissioner*, 242 F.2d 586, 592 (5th Cir. 1957) ("[P]roperty may be held primarily for sale in [the] ordinary course of [the taxpayer's] trade or business notwithstanding [that] sales are made only through

[*16] Factors 7 and 8 weigh in favor of petitioners (and against respondent).

On the basis of our review of the record before us, the overwhelming weight of these factors is against petitioners (and in favor of respondent). Accordingly, under the factors discussed above, we hold that the four lots in the hands of Mr. Musselwhite were neither his stock in trade, inventory, or property he held primarily for sale to customers in the ordinary course of business under section 1221(a)(1) but, rather, were capital assets.

G. *Petitioners' Other Argument*

Separate and apart from arguing that the aforementioned factors weigh in their favor, petitioners also argue that the four lots in DS & EM Investments' hands were inventory as defined in section 751(d) and that pursuant to section 735(a), the lots retained their inventory character, resulting in an ordinary loss to Mr. Musselwhite when he sold them because he did so well within five years of DS & EM Investments' distributing them to him.

Section 735(a)(2) provides that "[g]ain or loss on the sale or exchange by a distributive partner of inventory items (as defined in section 751(d)) distributed by a partnership shall, if sold or exchanged within 5 years from the date of the distribution, be considered as ordinary income or as ordinary loss, as the case may be." Under section 751(d), inventory items are defined by reference to section 1221(a)(1).

On the basis of our analysis and holding above, section 735(a) is inapplicable here and thus petitioners' argument lacks merit.

H. *Conclusion*

We sustain respondent's determination that the $1,022,726 loss resulting from Mr. Musselwhite's sale of the four lots was a capital loss.

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an agent."), *aff'g* T.C. Memo. 1955-289; *David Taylor Enters., Inc. & Subs. v. Commissioner*, T.C. Memo. 2005-127, slip op. at 23 (finding that the taxpayer's sales activities included those carried on through a broker); *Mathews,* 1961 Tax Ct. Memo LEXIS 136, at *16 (finding that the "[taxpayer] continuously made numerous and frequent sales of property" even though the taxpayer marketed and sold the property through brokers rather than personally).

[*17] We have considered all of the arguments made by the parties and, to the extent they are not addressed herein, we find them to be moot, irrelevant, or without merit.

To reflect the foregoing,

Decision will be entered under Rule 155.