

BURROUGHS AND COLLINS COMPANY v. UNITED STATES
68-1 USTC ¶ 9389;
21 AFTR 2d 1423 (D.S.C. 1968).

Editor's Summary

Key Topics

DISPOSAL WITH A RETAINED ECONOMIC INTEREST

- Contract of disposal required
- Oral contract is sufficient if binding

Facts

The taxpayer, a corporation, owned several tracts of timber. In the tax years in question, 1961 and 1962, it followed its usual procedure of having designated trees cut from its tracts by buyers of timber. The procedure would be as follows: The taxpayer's forester would designate certain trees on a specific tract to be cut. The buyer's agent would then cruise the timber to determine what unit price would be offered for the designated timber. The taxpayer's agent and the buyer's agent would then discuss the price, usually in the field where the timber was to be cut, and would enter into an oral agreement on the unit price. Afterwards, the buyer would come in and cut the designated timber. The agreed price per unit was paid after the logs were scaled and measured. The taxpayer treated its gain from its disposals of timber as capital gain under Section 631(b). The Government, however, took the position that the *oral* cutting arrangements made between the taxpayer's agent and the buyer's agent were not binding contracts as required by Section 631(b). The Government contended that the buyer was free to terminate his cutting at any time, and that the so-called contracts would not have been enforced had a dispute arisen between the parties.

District Court

Held: For the taxpayer. The Court disagrees with the Government's position. The buyers, through their authorized agents, would offer to purchase specifically designated trees at a specific unit price. When the taxpayer, through its authorized agent, accepted this offer, a valid oral contract was entered into and was binding on both parties. The question is not whether the contract *would* have been enforced. Rather, it is whether the contract *could* have been enforced. The Court finds that there was an enforceable contract on each of the occasions in question in this case. [Compare this case with *Ah Pah Redwood Co. v. Commissioner*, 251 F. 2d 163 (9th Cir. 1957), reported at Vol. 3 *Timber Tax Journal* 790 (1966). In *Ah Pah Redwood Co.*, the Court of Appeals held that the oral "arrangement" between the timber owner and the contract cutter did not constitute a "contractual disposal" for the reason that the cutter in that case was under no obligation to remove any specifically designated timber, and could terminate cutting operations at any time.]

Case Text

MARTIN, JR., District Judge: This is an action for the recovery of certain federal income taxes allegedly overpaid for the calendar years 1961 and 1962 brought pursuant to 28 U. S.C. §1346(a). The case was tried before a jury at Florence, South Carolina, on March 25, 1968. At the close of presentation of evidence the plaintiff and defendant each made motions for a directed verdict. The Court determined that there were no issues to present to the jury and the jury was dismissed.

The plaintiff is a South Carolina Corporation which during the years 1961 and 1962 reported long term capital gains on the sale of saw timber and pulpwood as follows:

	Timber	Pulpwood
1961	\$62,351.88	\$6,098.41
1962	44,713.87	4,751.73

Thereafter the defendant's agents determined that the gains realized from such sales by the plaintiff were taxable as ordinary income and computed and assessed additional income taxes and interest as follows:

	Deficiency In tax	Interest	Total
1961	\$17,089.78	\$2,760.96	\$19,850.74
1962	13,973.86	1,594.24	15,568.10
Total	\$31,063.64	\$4,355.20	\$35,418.84

Plaintiff paid the additional taxes and interest and filed a timely claim for refund of alleged overpayment,¹ The claim was denied and this suit was commenced.

The issue for determination is whether the timber sales in question qualified for capital gain treatment under §631(b) of the Internal Revenue Code of 1954.² The sole question in dispute is whether there was a mutually binding and enforceable contract to buy and sell timber which antedated the cutting of the timber. The parties concede, and the Court so finds, that the other requirements of § 631(b) have been met.

The alleged contracts in question were oral agreements entered into by agents of the plaintiff and agents of the buyers. Plaintiff owns various tracts of land in Horry County, South Carolina, totaling approximately 20,000 acres, a substantial portion of which is timberland. As had been the custom over a period of years, during the taxable years 1961 and 1962 plaintiff would periodically clear certain trees from various tracts. Plaintiff dealt primarily with Redhill Chip Corporation and Canal Wood Corporation. Plaintiff's forester would designate certain trees on a specific tract to be cut. The method of designating trees which were to be cut was by painting a mark on same or by painting a mark on trees not to be cut and selling the remainder of the timber. The buyer's agent would then cruise the timber to determine what unit price would be offered for the timber so designated for cutting. Plaintiff's agent and buyer's agent would then discuss the price usually in

the field where the timber was to be cut, and would enter an oral agreement on the unit price after which buyer would come in and cut the designated timber. The agreed price per unit was paid after the timber was cut and the logs were scaled and measured at buyer's mill, or after pulpwood was measured at buyer's customer's mill. This arrangement had been found satisfactory by all parties over a period of years and the oral contracts had been fully performed.

It is the government's position that the evidence submitted in this case is insufficient to support an inference that there was a binding obligation on plaintiff's buyers to cut timber. The Court disagrees. The buyers through their authorized agents would offer to purchase specifically designated trees at a specific unit price. When the plaintiff, through its authorized agent accepted this offer, a valid oral contract was entered into and was binding on both parties. The government attempted to prove that the agreements were such that the plaintiff or the buyer could stop the cutting at any time. The uniform testimony is, however, that there was no agreement to this effect. The testimony upon which the government relies at best might raise the question of whether the contract would have been enforced had a disagreement occurred. That, however, is not the issue. The issue is whether there existed a contract which could have been enforced. There was an enforceable contract on each of the occasions in question in this case. As stated in *Barclay v. U.S.*, 333 F. 2d 847 (1964):

"... it must be remembered that the statute speaks of a disposal 'by any form or type of contract. This language covers just about every means by which people come to an understanding with one another. It could cover the lift of a finger or the winking of an eye or the nod of the head at an auction sale-any means by which people come to an agreement with one another."

The transactions in question were more than mere purchases as contended by the government. As stated supra, the purchases were under enforceable contracts for the sale of specific trees, on specific tracts of land, at a specific unit price. The factual situation in *Reynolds v. Stockman*, 109 S. C. 112, 95 S. E. 341 (1918), upon which the government relies, is clearly distinguishable from the factual situation in the instant case. Under the contract in that case the buyer was *allowed* to enter the tract and cut and saw all timber thereon, measuring six inches in diameter. The Court properly interpreted the provision "all the timber thereon, measuring six inches in diameter" as descriptive of the timber which the buyer was *allowed* to cut. There was no provision obligating him to cut the same. To the contrary in the instant case, the contract called for the cutting of specific trees which had been designated prior to the contract negotiations. The terms of the contract in the instant case are somewhat similar to the contract in *Springfield Plywood Corp. v. Commissioner*, 15 T. C. 697, 698 which defendant cites in its brief:

"[vendor] does hereby agree to sell unto the vendees and the vendees do hereby agree to purchase of and from the Vendor at the price and upon the terms and conditions hereinafter stated all the merchantable timber standing and down old growth and second growth fir timber and all merchantable standing and down hemlock and cedar timber..."

The Court held the agreement created a mutually binding obligation to sell and cut timber. Indeed, the contract in the instant case is more specific than that contract in that the specific trees to be

cut were designated prior to the contract negotiations. To accept the government's view would be in effect, to say that there can be no valid oral contract entered into by way of an offer to purchase or sell a specific item by one party and the acceptance of that offer by the other party. Such is not the law.

Having determined that plaintiff met all requirements of § 631(b) plaintiff is entitled to Judgment against defendant in the amount of \$29,794.05 for overpaid income taxes plus \$4,228.39 for interest paid or a total of \$34,014.44 together with interest as provided by law from October 18, 1965, and costs.

IT IS SO ORDERED. Let copies of this Order be served on the parties to this action.

1 \$16,973.32 for 1961 and \$12,856.73 for 1962 and a total interest of \$4,228.39. These amounts are not in dispute.

2 Internal Revenue Code of 1954: Sec. 631. *Gain or Loss in the Case of Timber or Coal.*

****(b) Disposal of Timber With a Retained Economic Interest.*-In the case of the disposal of timber held for more than 6 months before such disposal, by the owner thereof, under any form or type of contract by virtue of which such owner retains an economic interest in such timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. The date of disposal of such timber shall be deemed to be the date such timber is cut, but if payment is made to the owner under the contract before such timber is cut the owner may elect to treat the date of such payment as the date of disposal of such timber. For purposes of this subsection, the term "owner" means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber.