

CONSOLIDATED NAVAL STORES CO. v. FAHS
54-2 USTC ¶ 9456; 48 AFTR 1233 (S.D. Fla. 1954).
Rev'd 227 F.2d 923; 56-1 USTC ¶ 9132;
48 AFTR 717 (5th Cir. 1955).

[The opinion which follows is that of the U.S. District Court. The complete text of the Court of Appeals' opinion and the Editor's Summary of the case are at p. 773.]

Case Text

FINDINGS OF FACT AND CONCLUSIONS OF LAW

BARKER, District Judge: These cases were consolidated for the purpose of trial and came on for trial in due course on November 9, 1953. The Court, having considered the evidence, the stipulation of facts entered into between the parties and filed with the Court, and the brief and arguments of counsel, finds the facts and states its conclusions of law, as follows:

FINDINGS OF FACT

1. The plaintiff is a corporation, organized and existing under the laws of the State of Florida, having obtained its Charter in 1902. Hereinafter it is sometimes referred to as "taxpayer".
2. The defendant was, at all times material hereto, the Collector of Internal Revenue for the District of Florida.
3. The taxpayer files its federal income tax returns and keeps its books and records on the accrual basis. Its taxable year is the calendar year.
4. The taxpayer timely filed its income tax return for the year 1946, with the defendant, and paid him the tax shown thereon, \$51,060.03, as follows:

March 20, 1947	\$12,765.01
June 18, 1947	12,765.01
September 17, 1947	12,765.01
December 17, 1947	12,765.00

Thereafter, the taxpayer filed its amended income tax return for the year 1946 with the defendant, reporting a total tax of \$57,212.81, and paid him the remainder of said tax, \$6,152.78, on June 9, 1948.

The Commissioner of Internal Revenue later determined that there was due from the taxpayer a deficiency in income tax for the year 1946 in the amount of \$831.57. The taxpayer paid this amount, with interest thereon, or a total of \$989.98, to the defendant on June 6, 1950.

5. The taxpayer timely filed its income tax return for the year 1947, with the defendant, and paid him the tax shown thereon, \$111,533.74, as follows:

March 22, 1948	\$27,883.44
June 18, 1948	27,883.44
September 20, 1948	27,883.44
December 21, 1948	27,883.42

6. The taxpayer timely filed its income tax return for the year 1948 with defendant, and paid him the tax shown

thereon, \$22,835.70, as follows:

March 15, 1949	\$5,875.00
June 14, 1949	5,708.93
September 15, 1949	5,708.93
December 14, 1949	5,542.84

The Commissioner of Internal Revenue later determined that there was due from the taxpayer a deficiency in income tax for the year 1948 in the amount of \$7,146.43. The taxpayer paid this amount with interest thereon in the amount of \$784.44, or a total of \$7,930.87, to the defendant on February 2, 1951.

7. In each of its 1946 and 1947 income tax returns, Consolidated Naval Stores Company treated various sales of land as sales in the ordinary course of its business and computed its tax liability accordingly. In its 1948 income tax return, Consolidated Naval Stores Company treated such sales of capital assets and computed its tax accordingly; but the Commissioner of Internal Revenue treated these sales as made in the ordinary course of the taxpayer's business, and accordingly assessed the deficiencies set out above for that year.

8. On its 1946 tax return Consolidated Naval Stores Company treated its sales of 274 breeding cattle as sales of property other than capital assets, and computed its tax accordingly.

9. The taxpayer filed its claims for refund of income taxes alleged to have been erroneously or illegally assessed and collected for each of the taxable years 1946, 1947 and 1948 with the defendant on February 23, 1950, December 6, 1950, and August 31, 1951, respectively, within the time provided therefor by law. In these claims for refund the taxpayer contended that its sales of land during the years 1946, 1947, and 1948, and its sales of breeding cattle during the year 1946, should be treated as sales of capital assets, and its tax for each year recomputed accordingly. The Commissioner of Internal Revenue rejected these contentions and disallowed the claims.

10. Thereafter, and within the time provided therefor by law, Consolidated Naval Stores Company brought these actions against the defendant to recover the taxes it paid to him, insofar as they resulted from the Commissioner's treatment of its sales of land and breeding cattle as sales of property other than capital assets.

11. The organizers of Consolidated Naval Stores were a group of naval stores operators and factors, and the purpose of Consolidated Naval Stores at the time of its organization in 1902 was to provide factorage and financial backing for its organizers, shareholders, and others in the State of Florida in the naval stores business. The naval stores business is that of processing and extracting turpentine and gum rosin from timber, primarily pines.

12. The corporate charter of Consolidated Naval Stores Company authorized it at all times during its existence, among other things, to buy, own, mortgage, sell and lease lands and to act as broker, factor or agent for the purchase, sale, management or disposition of lands.

13. At and shortly after its organization, Consolidated Naval Stores Company acquired large tracts of land in northwest and central Florida. 1,112,576.90 acres were so acquired by it by the end of 1903. These lands were originally acquired with an intent to operate them for the production of rosin and turpentine.

14. In 1903 Consolidated Naval Stores Company caused to be organized the Consolidated Land Company, which was at all times during its existence a Florida corporation wholly owned by Consolidated Naval Stores Company. This subsidiary was organized for the purpose of conducting the land operations in which Consolidated Naval Stores Company was interested, which consisted at that time of leasing suitable stands of timber

to naval stores operators. After the timber had been fully exploited for naval stores use, Consolidated Land Company could either cut the timber or make arrangements for its cutting by others. Nontimbered lands were held by Consolidated Land Company during that period as non-revenue producing properties or sold. Consolidated Land Company purchased during its existence, in addition to the acreage transferred to it on its organization by Consolidated Naval Stores Company 2,035,544 acres of land, and sold during the same period 2,122,931 acres to purchasers other than Florida Industrial Company.

15. Most of the timber cutting and leasing operations in which Consolidated Naval Stores Company was interested were carried on through a second-tier subsidiary, Florida Industrial Company. That corporation was organized in 1920, and Consolidated Land Company throughout its own existence held 50% of the stock of Florida Industrial Company. The latter corporation was engaged throughout its existence primarily in the development, cutting and leasing for cutting purposes of timbered lands in Florida. The company occasionally owned, held or disposed of non-timbered lands or lands which had been timbered over. Consolidated Land Company transferred to Florida Industrial Company on its organization in 1920 1,020,467.19 acres of land, and timber or turpentine rights to a slightly larger acreage.

16. Consolidated Land Company was liquidated in 1931, and transferred its assets, including its lands and its stock ownership in Florida Industrial Company, to Consolidated Naval Stores Company as a liquidating dividend. Consolidated Naval Stores Company acquired the remaining stock of Florida Industrial Company in 1935, and in 1936 Consolidated Naval Stores Company received all of Florida Industrial Company's assets, including its lands, in its complete liquidation.

17. On April 30, 1944, Lake Placid Land Company was merged into Consolidated Naval Stores Company. In this merger Consolidated Naval Stores Company acquired 11,760 acres of land, which were included in the assets of Lake Placid Land Company.

18. The total acreage of land received by Consolidated Naval Stores Company in the liquidations and merger referred to above was 1,548,960.54 acres. All of these lands had been held by the predecessors of Consolidated Naval Stores Company in the course of their respective businesses for turpentine, for the timber thereon, or for lease purposes, or were timbered-over or otherwise non-revenue-producing lands held for sale.

19. Except for certain lands which were acquired by Consolidated Naval Stores Company through repossession or foreclosure of mortgages, the acreage of which was quite small, all lands sold by Consolidated Naval Stores Company, the treatment of which is in dispute here, were parts of the 1,548,960.54 acres acquired as stated above.

20. From 1932 to 1952, Consolidated Naval Stores Company engaged continuously in the sale of lands. Its annual profit from such sales varied in amount from \$2,418.49 in 1932 to \$416,431.90 in 1950, and in percentage of total revenue from 1.4% in 1947 (one of the years in suit) to 46.7% in 1942.

21. Consolidated Naval Stores Company did not adopt a consistent attitude with regard to the treatment of its land sales for tax purposes. From 1932 to 1941, it reported these sales as sales of non-capital items. In 1942 and 1943 it reported them as sales of capital assets. From 1944 to 1947, it again reported them as sales of non-capital items, and from 1948 to 1952 it again reported them as sales of capital assets. Its treatment of its 1942 and 1943 land sales as sales of capital assets was not accepted by the Commissioner of Internal Revenue, who treated these sales as sales of non-capital items and assessed deficiencies accordingly. This aspect of the deficiencies for the years 1942 and 1943 was accepted by the taxpayer.

The Commissioner of Internal Revenue has also refused to accept the taxpayer's treatment of its land sales from 1948 to 1952 as sales of capital assets, and assessed deficiencies accordingly. The resulting deficiency assessment

for the year 1948 and the taxpayer's attempt to reclassify its land sales for 1946 and 1947 as sales of capital assets, underlie the present suit.

22. During several years in which the taxpayer had losses from the sale of/and, it reported these losses as ordinary business losses and not as losses from the sale of capital assets.

23. The total acreage of lands sold by Consolidated Naval Stores Company from 1932 to 1952, in even hundreds of acres, is as follows:

	Acreage Sold
1932	6,500
1933	900
1934	2,700
1935	1,800
1936	111,000
1937	196,500
1938	82,400
1939	124,600
1940	117,700
1941	125,200
1942	241,000
1943	175,300
1944	13,300
1945	8,100
1946	3,200
1947	1,200
1948	11,800
1949	5,600
1950	90,800
1951	1,600
1952	116

24. The taxpayer's conduct in regard to its sales of land has been identical in all years from 1940 to the end of 1952.

25. In 1946 Consolidated Naval Stores Company sold 3,160.27 acres of land in 19 separate transactions.

26. In 1947 Consolidated Naval Stores Company sold 1,170.61 acres of land in 16 separate transactions.

27. In 1948 Consolidated Naval Stores Company sold 11,800.44 acres of land in 15 separate transactions.

28. The relation of Consolidated Naval Stores Company's profits from land sales during the years 1946-48 to all other revenue was as follows:

	Profit from Land Sales	All Other Revenue	Total Revenue
1946	\$26,044.32	\$ 808,741.22	\$ 834,785.54
1947	14,898.57	1,011,042.49	1,025,941.06
1948	55,142.55	776,540.51	831,683.06
Total	\$96,085.44	\$2,596,324.22	\$2,692,409.66

29. In 1946, 1947 and 1948, the following percentages of the taxpayer's invested capital were represented by lands:

	1946	1947	1948
Total invested capital	\$7,844,202.12	\$7,967,314.26	\$8,080,445.41
Capital invested in lands	\$ 910,886.68	\$ 902,025.19	\$1,025,944.31
Percentage represented by lands	11.61	11.32	12.70

30. From 1931, Consolidated Naval Stores Company has maintained a Land Department in its organization.

31. Consolidated Naval Stores Company actively carried on land sales activities through its Land Department.

32. Consolidated Naval Stores Company gave a prominent place to its Land Department in its annual reports to its stockholders, and its offices and directors attended to the functions of the Land Department with care in the regular course of their duties.

33. The officers of Consolidated Naval Stores Company were empowered to sell land in the regular course of business, at their discretion as to the suitability of offers received with regard to price and otherwise.

34. Business considerations other than the adequacy of the prices offered were frequently the determinative factors as to whether or not Consolidated Naval Stores Company would enter into land sales transactions during the period from 1940 to 1952. The testimony does not disclose the precise nature of these other business considerations for entering into sales of land, or refusing to enter into them; but the testimony conclusively shows that these considerations were of an ordinary business character.

35. Consolidated Naval Stores Company frequently received offers to buy lands. These offers were far in excess of those accepted by the company, and it frequently rejected such offers despite the adequacy of the offered price.

36. The taxpayer did not advertise its lands for sale or otherwise promote their sales by calling public attention to the availability of its lands or by improving them to make them more attractive to buyers. But it is apparent from the continuous flow of offers to Consolidated Naval Stores Company that such advertising would have been unnecessary, since interested persons must have been well aware of its possession of lands which might be sold. Also, the lands held by Consolidated Naval Stores Company were rural acreage which could not have been made more salable by improvement or subdivision.

37. Consolidated Naval Stores Company usually held lands for many years after the timber was removed from them, prior to sale.

38. Consolidated Naval Stores Company during the years in suit used some of the lands owned by it for ranches and groves. Of the remainder, the major part was leased for grazing, hunting, turpentine, etc., as shown in the following table:

	Lands Owned	Used for Ranches & Groves	Balance of Lands	Leased for grazing, Hunting, Turpentine, etc.
At Dec. 31, 1946	449,813.42	77,685.17	372,128.25	341,287.25
At Dec. 31, 1947	448,642.81	77,731.17	370,911.64	311,719.56
At Dec. 31, 1948	407,012.18	1,021.80	405,990.38	309,838.19

39. Consolidated Naval Stores Company, in considering whether to sell particular lands or not to sell them, did not regard the leases outstanding on these lands as a determinative factor. Lands were sold or not sold by it, regardless of whether or not leases were outstanding on them.

40. The taxpayer's objective in its sale of lands was the profit from each sale or the adjustment of its land holdings, and not the liquidation of its land holdings.

41. Over the years since its organization in 1902, a change in the ownership, control and business interests of Consolidated Naval Stores Company took place. Chicago brokerage interests acquired a good part of its stock, and the company is now directly engaged in the citrus business and in ranching in Florida. Through subsidiaries it operates packing houses and banks in this State. It owns stock in Chicago financial houses and in lumber companies operating in the Pacific Northwest, in whose management it participates through common directors. The taxpayer also possesses substantial mineral rights to large tracts of land which it has sold over the years.

At the same time, adverse changes caused the turpentine and factoring operations of Consolidated Naval Stores Company to decline seriously. These operations were finally abandoned in 1949. Consolidated Naval Stores Company is now engaged in far-flung business activities but not in those for which it was originally incorporated.

42. Consolidated Naval Stores Company frequently, over the course of the years, indicated that it considered itself to be in the business of selling lands. It so reported on many of its income tax returns; on some returns it described its principal business activities as "naval stores factors-land-etc." It referred to its land sales as ordinary business activities in its corporate minutes and in its reports to its stockholders. It accepted the Commissioner of Internal Revenue's rejection of its contention, for 1942 and 1943, that its land sales were not made in the regular course of business. Its president testified at the trial that he could sell land in the regular course of business. It follows that Consolidated Naval Stores has continuously considered itself to be in the business of selling its lands.

43. The sales of land made by Consolidated Naval Stores Company during the years in suit were made in the ordinary course of its business.

44. In the year 1946, Consolidated Naval Stores Company sold 274 breeding cattle, at a gain of \$6,162.71. These breeding cattle were capital assets of the taxpayer. The gain from their sale,

however, was treated by the Commissioner of Internal Revenue as ordinary income.

45. The defendant Collector of Internal Revenue collected income tax from the taxpayer in the amount of \$42,341.83, with accrued interest in the amount of \$198.57, for the year 1946, as the result of his determination that the sales of breeding cattle by the taxpayer in that year were not entitled to capital gains treatment. This amount is the difference between the tax due on such sales as sales of capital assets and as made in the ordinary course of the taxpayer's business.

CONCLUSIONS OF LAW

1. Whether the taxpayer held its lands at the time of their sales primarily for sale purposes is a question to be determined by the total background of the transactions; and the lack of any one particular sign of business activity is not determinative of this ultimate fact.

2. While certain signs of business activity often looked to determine whether land sales were made in the regular course of business or not are absent in this case, the taxpayer's conduct clearly indicates that it was in the business of selling its lands during the year in suit. Consolidated Naval Stores Company held its lands primarily for sale to customers in the ordinary course of its business, and the defendant Collector of Internal Revenue properly collected the tax resulting from the determination that the sales of these lands were made in the ordinary course of the business of Consolidated Naval Stores Company.

3. The sales of 274 breeding cattle by Consolidated Naval Stores Company in 1946 should have been treated as sales of capital assets, and the defendant Collector of Internal Revenue erroneously collected the tax and interest computed to be due by virtue of the Commissioner's erroneous treatment of these sales as made in the ordinary course of business.

4. Consolidated Naval Stores Company is entitled to judgment in No. 2083 for \$2,630.40, with interest from February 23, 1950.

5. The defendant Collector of Internal Revenue is entitled to judgment in Nos. 2084 and 2164-T in the amount of his costs, and dismissing the actions with prejudice.