GASKINS v. UNITED STATES
67-2 USTC ¶9662; 20 AFTR. 2d 5144 (M.D. Ga. 1966).
***Aff'd* 381 F.2d 729; 67-2 USTC ¶9663;**
20 AFTR 2d 5577 (5th Cir. 1967).

Key Topics

DISPOSAL WITH A RETAINED ECONOMIC INTEREST
• Effect of cutting arrangement being terminal at will

Facts

The taxpayer had an oral agreement with a second party under which the second party cut and purchased standing timber owned by the taxpayer. Both the taxpayer and the purchaser testified that the taxpayer could have terminated the purchaser's cutting of the timber at any time. The taxpayer treated his profits from the sales as capital gain under section 631(b) of the Code. The government contended that the taxpayer's profits constituted ordinary income.

District Court

Held: For the Government. Capital gain treatment under section 631(b) is permitted only where the taxpayer has made a disposal of standing timber under a contract by virtue of which he retains an economic interest in the timber. For a taxpayer to obtain capital gain treatment under section 631(b) the contract must provide (1) that the purchaser has both the right and the obligation to cut an amount of timber agreed upon between the parties; (2) that the purchaser is to own all of the timber cut when and as cut; and (3) that the purchaser is required to pay for the timber according to the amount cut. Here, both parties to the oral agreement testified that the taxpayer could have called off the arrangement at will. Thus, the purchaser did not have the right and obligation to cut an agreed upon amount of timber. The arrangement was an option to sell rather than a disposal, and consequently capital gain treatment under section 631(b) is not allowable.

Court of Appeals

Held: Affirmed Per Curiam.

Case Text

BOOTLE, District Judge.

THE COURT: Members of the Jury, counsel and the Court have studied this case pretty carefully and have studied the income tax laws as they relate to this particular type transaction, our study having begun some little time back. Counsel's study began before mine did. Mine began with a pretrial conference when we met down here some two or three weeks ago and looked over the calendar and the cases to see what questions were involved in the various cases, and as a result of that study counsel agreed in advance that the controlling issue in this case would be reached and disposed of by submitting to the jury three questions. And before I read those questions I will read the statute that you have heard counsel refer to.

Sec. 631(b) of the Code says: "In the case of the disposal of timber held for more than six 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."

You notice it is not talking about the sale and disposal of pulpwood as such, but the sale and disposal of timber, and a regulation applicable here defines the words "economic interest" as contained in the statute this way: *"An* economic interest is possessed in every ease in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form or legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must look for a return of his capital."

Now one of the cases which has construed these provisions, the *Ray* case, says: "It is apparent that if the term disposal as used in the statute is not construed to require a disposition of the cutting rights an owner of timber who cuts his own timber could avoid the election required by" a certain section "and obtain what are usually the greater benefits of the section involved by the use of the mere formality of contracting with a timber buyer to sell his timber to such buyer as cut at the then prevailing price."

Well, coming back to what I started with, counsel have agreed--not to the disposition I am going to give this case, but they have agreed that the controlling three questions would be these:

Was there an oral agreement between Mr. Gaskins and Mr. Barrentine which provided three things: (1) that Mr. Barrentine had both the right and the obligation to cut an amount of timber agreed upon between the parties; (2) that Mr. Barrentine was to own all of the timber cut when and as cut; and (3) that Mr. Barrentine was required to pay for timber according to the amount cut.

Counsel agreed further that an appropriate charge to the jury were I to submit to you those three questions, would be this: "You will remember that the first question was whether Mr. (Gaskins and Mr. Barrentine entered an agreement under which Mr. Barrentine had both the right and the obligation to cut an agreed amount of timber."

Now therein this case falls, in my judgment, after all of the evidence was in, both by deposition, the taking of Mr. Gaskins' and Mr. Barrentine's sometime back, and their testimony here yesterday afternoon and this morning. Mr. Barrentine testified that under his understanding of the agreement Mr. Gaskins could have stopped him, under this agreement, any time he wanted to. Mr. Gaskins testified virtually and practically and substantially to the same effect, so there was no disposal of the standing pulpwood, no disposal of the rights to cut the pulpwood. At most, as I see it, there was an option. They would go along as long as both of them were agreeable to doing it. Either one could have stopped it any time he wanted to. We are dealing here with the principle of a sale, final, binding disposition of a capital asset, either the timber itself, the pulpwood standing, or the cutting rights in them. Whether or not a party has a right or obligation under an agreement depends upon, among other things, whether or not both parties to the agreement consider themselves bound to the terms of the agreement at the time they made it. In determining whether the parties had or had not agreed upon a specific amount of timber it is sufficient if the parties agree that all of the timber in a certain agreed upon category would be cut. If either party was free to call off the arrangement at will then there was no obligation or right to cut an agreed upon amount of timber and you should so find.

Well, when both parties testify that that was it, there is nothing for me to submit to you, so I am going to grant the motion of the Government for a directed verdict, and you may prepare your verdict, Mr. Williams, or Mr. Clerk you may prepare it for him on the pleadings. And, of course, I overrule the motion made by Mr. Barham.

VERDICT

At the direction of the Court, we the jury find in favor of the defendant, the United States, this 21st day of September, 1966.

Court of Appeals

Per Curiam: The trial court, in this suit for refund of income taxes, directed a verdict for the United States when it concluded that all the evidence demanded a negative answer to the question: "Was there an oral agreement between Mr. Gaskins and Mr. Barrentine which provided..." (1) That Mr. Barrentine had both the right and the obligation to cut an amount of timber agreed upon between the parties?" The parties agreed in effect, by a pretrial stipulation, that the jury must find that the oral agreement included this provision in order for the appellants-taxpayers to recover.

We agree with the trial court that the evidence demanded a negative answer to this interrogatory. Thus the trial court did not err in directing a verdict for the United States.

The judgment is AFFIRMED.