

**MCMULLAN v. UNITED STATES**  
**686 F.2d 915**  
**82-2 USTC ¶¶9539, 13,483**  
**50 AFTR2d 82-5494, 82-6199**  
(Timber issues only)

*Editor's Summary*

*Key Topics*

*CAPITAL V. EXPENSE*

Generally

Interest

*COLLATERAL ESTOPPEL*

*OUTRIGHT SALE--CAPITAL GAINS v.*

*ORDINARY INCOME*

Generally

Factors to be considered

*Facts*

The taxpayer owned and leased extensive acreages of timberland in West Virginia. In 1979 the Court of Claims ruled that for the years 1969-71, this taxpayer held the timberland as an investment and was therefore entitled to capital gains treatment on outright sales. In addition, the 1979 ruling held that the taxpayer was entitled to deduct timber sales expenses against his ordinary income (*Wilmington Trust Co. v. United States*, 16 TTJ 179, 196). In the current case, which involves 1972, the Government again raised both issues

The taxpayer argued that the holdings in *Wilmington Trust Co.* collaterally estopped the government from raising the issues of whether or not the timber constitutes a capital asset and whether the timber sales expenses can be deducted against ordinary income. The government argued that it was not collaterally estopped because the manner in which the timber activities are carried out had changed materially in 1972.

*Court of Claims*

**HELD: For the taxpayer.** Collateral estoppel applies since (1) the issues in the present case are the same as those resolved against the government in *Wilmington*, (2) the facts and legal principles have not changed, and (3) there are no special circumstances which justify the nonapplication of the doctrine. The Court rejected the government's contention that the taxpayer's activities had changed, noting that the types and amounts of deductions claimed in 1972 were very similar to those claimed in 1969-71.

### *Case Text*

SMITH, Judge: delivered the opinion of the court: This income tax case presents three issues, two of which we considered in *Wilmington Trust Co. v. United States*<sup>1</sup> (Wilmington), and one that we have not previously addressed. In *Wilmington*, we held that the present plaintiffs were entitled to report certain timber sales as capital gains, either under 26 U.S.C. §631 (b)<sup>2</sup> or under 26 U.S.C. § 1221<sup>3</sup> and that plaintiffs could deduct the related expenses against ordinary income.

Plaintiffs argue that the doctrine of collateral estoppel resolves the issues decided in *Wilmington* in their favor. Plaintiffs also argue that their prepayment of interest did not distort their income but, instead, only compensated for the unusually large capital gain they realized in the tax year in question, 1972.

Defendant argues that, while the facts surrounding the sale of plaintiffs' timber are virtually identical to those in *Wilmington*, a change in plaintiffs' activities in relation to their timberlands takes this case out of the realm of collateral estoppel.

We discuss first, application of the doctrine of collateral estoppel to federal income tax cases, and, upon examination of the facts and law in this case, we hold that defendant is collaterally estopped from challenging plaintiffs' treatment of their timber sales and related expenses (Part I).

\* \* \*

I. In *Wilmington*, we found that plaintiffs' timberlands in West Virginia and North Carolina, of which they own half and lease half, were held for investment purposes. Furthermore, we found that plaintiffs' expenses included frequent trips by Harry McMullan, Jr., to the property. We held in that case that plaintiffs properly reported their timber sales as capital gains and deducted their expenses against ordinary income in their 1969-71 tax returns. Plaintiffs argue that the holding in *Wilmington* collaterally estops defendants from claiming that plaintiffs' timber income and expenses should be treated differently in 1972.

The related doctrines of res judicata and collateral estoppel embody the concept that a "right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction \* \* \* cannot be disputed in a subsequent suit between the same parties or their privies."<sup>6</sup> Res judicata applies to repetitious suits involving the same Cause of action. It binds the parties and their privies "not Only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissable matter which might have been offered for that purpose."<sup>7</sup> However, collateral estoppel is more limited in the scope of bar applied. Collateral estoppel is appropriate when, upon a different cause of action between identical parties, a party attempts in the later case to contest an issue which was actually contested between the parties in a prior action and "upon the determination of which the finding or verdict was rendered."<sup>8</sup>

Since each year creates a new tax liability and a separate cause of action, we are concerned here with the application of collateral estoppel to the facts in this case, not res judicata. Collateral estoppel operates to free the Government and the taxpayer from "redundant litigation of the identical question of the statute's application to the taxpayer's status."<sup>9</sup> However, the doctrine

should be carefully applied in order to assure that it does not work to "create vested rights in decisions that have become obsolete or erroneous with time, thereby causing inequities among taxpayers." <sup>10</sup>

The applicability of collateral estoppel in this case depends upon three factors. First, are the issues in the present action the same as those resolved against the United States in *Wilmington*? Second, have the facts and legal principles which led to the holding in *Wilmington* changed in any significant manner? And third, are any special circumstances present in this case which justify the nonapplication of the doctrine? <sup>11</sup> We examine each of these factors in turn.

The issues raised by defendant here are the same as those which were "actually and necessarily determined" in *Wilmington*, <sup>12</sup> In *Wilmington*, the court upheld plaintiffs' claims that their timber property was maintained for investment purposes and, therefore, income from the property was entitled to capital gain treatment. Furthermore, the court directly addressed the issue of whether plaintiffs' forest management expenses were deductible against ordinary income and there also held for plaintiffs. It is clear that the first condition for the application of collateral estoppel had been met.

As to the second factor, defendant argues that plaintiffs' activities in relation to their timberlands changed significantly in 1972 and, therefore, defendant should not be collaterally estopped from challenging plaintiffs' treatment of their timber sales and related expenses. Defendant claims that this change in plaintiffs' relationship with the property is evidenced in several ways. First, Harry McMullan, Jr. (hereinafter the taxpayer), traveled extensively in 1972 to the property in order to confer with his agents and to negotiate timber sales. However, the amount of taxpayer's expenses which defendant points to for travel in 1972, \$3,230.17, is well within the range of those expenses taken in the tax years involved in *Wilmington*. <sup>13</sup> Second, defendant argues that the lease agreement between the taxpayer and its lessor indicates that the arrangement was a joint venture since it required the taxpayer to pay the lessor a certain percentage of the land's net profits. This claim also fails to show a substantial change in the surrounding facts since the agreement in question was in effect from January 1, 1965, long before the *Wilmington* tax years. Third, the taxpayer referred to the property in question as a "business" in his will. The term "business," standing alone, is a colloquialism for any activity entered into in order to produce income; the use of it, in and of itself, offers little weight to defendant's claim. Finally, defendant points to plaintiffs' inclusion of the property as a basis for entitlement to the payment of estate taxes in installments as allowed by Section 6166 of the code. <sup>14</sup> In order to come under the provisions of section 6166, a significant portion of the value of the taxpayer's estate must be related to the taxpayer's closely held businesses. Again, the weight which might be attached to plaintiffs' 1973 request for a section 6166 payment deferral is no different in 1972 than it was in the *Wilmington* tax years.

We conclude that the defendant has not made an adequate showing that the facts in the present case differ significantly from those in *Wilmington*. We do not see any evidence of special circumstances in the present case which would justify our not applying the doctrine and, since defendant does not argue that there was a change in statutory or case law, we hold that defendant is collaterally estopped from challenging plaintiffs' tax treatment of their timber sales and related expenses.

---

1 *Wilmington Trust Co. v. United States*, 221 Ct. Cl. 686, 610 F.2d 703 (1979) (*McMullan v. United States*, companion case) (en banc.).

2 Section 631(b) of 26 U.S.C. (1976) states, in part:

(b) Disposal of timber with a retained economic interest.

"In the case of the disposal of timber held for more than 9 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. \* \* \*"

3 Section 1221 of 26 U.S.C. (1976) provides:

"§ 1221. Capital asset defined

"For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include [section lists a number of exceptions, none of which are applicable to plaintiffs] \* \* \*"

6 *Southern Pac. R. R. v. United States*, 168 U.S. 1, 48-49 (1897).

7 *Cromwell v. County of Sac*, 94 U.S. 351,352 (1877).

8 *Id.* at 353. See also *Red Lake Band v. United States*, 229 Ct. Cl.--, 667 F.2d 73 (1981) (discussion of distinction between doctrines of res judicata and collateral estoppel).

9 *Tait v. Western Md. Ry.*, 289 U.S. 620, 624 (1933).

10 *Commissioner v. Sunnen*, 333 U.S. 591,599 (1948).

11 *Montana v. United States*, 440 U.S. 147, 155 (1979).

12 *Id.* at 153.

13 *Wilmington* concerned the tax years 1969, 1970, and 1971. As the table shows, plaintiffs' expenses for the timberlands in 1972 were in the ballpark of their expenses for the two previous years.

Expense	1970	1971	1972
Rent (land)	\$ 56,152.08	\$ 35,809.18	\$ 40,000.00
Taxes-Real Estate	5,978.67	6,502.11	6,250.94
Taxes-Other	803.18	756.79	960.68
Insurance	346.00	1,240.55	2,686.50
Forestry	27,129.99	20,854.00	18,797.05
Legal & Audit	2,708.14	5,660.40	2,275.00
Telephone	560.35	900.69	1,297.16
Travel	2,314.77	2,534.62	3,230.17
Cassity Office	6,172.18	1,301.54	4,986.51
Office	479.85		
Survey	259.05		
Vehicle Expenses		1,744.24	7,002.09
Miscellaneous	2,236.00	1,062.52	11,510.83
Totals	\$105,140.26	\$ 78,366.64	\$ 98,996.93

14 26 U.S.C. §6166 (1976) states, in part:

"(a) 5-year deferral; 10-year installment payment

"(1) In general

"If the value of an interest in a closely held business which is included in determining the gross estate of a decedent who was (at the date of his death) a citizen or resident of the United States exceeds 65 percent of the adjusted gross estate, the executor may elect to pay part or all of the tax imposed by section 2001 in 2 or more (but not exceeding 10) equal installments."