

POWE v. COMMISSIONER 44 T.C.M. 933
Tax Ct. Mem. Dec. (CCH) 39,293(M), (P-H) ¶82,488 (Timber issues only)

Editor's Summary

Key Topics

Basis

- Adjusted
- for basis or depletion allowable
- Allocation

CAPITAL ASSET

- Defined

Depletion Allowance

- Capital recoverable
- Timber account, procedures for maintaining

Outright Sale--Capital Gain v. Ordinary Income

- Factors to be considered
- "Primarily for sale" discussed
- Timber

Facts

The taxpayer, a retired businessman, acquired as an investment extensive holdings of timberland over a period of more than 30 years. In 1958 the taxpayer transferred over 13,000 acres of this land to a trust created for the benefit of his family. Between 1958 and 1972 the Trust made timber sales in 12 of the years, providing \$252,794 in revenue. Between 1960 and 1972 Mr. Powe made timber sales in 8 years, providing \$30,518 in revenue. In 1973 Mr. Powe made three timber sales providing \$163,167 in revenue. In addition, Mr. Powe and the Trust sold all of the existing timber and surface rights for a 60 year period on approximately 9,000 acres of timberland for \$320,000.

Mr. Powe was an active investor. He maintained an office in his home to oversee his approximately one-half million dollar brokerage account, his timberland, and other investments. His living expenses were paid primarily from the dividends generated by his brokerage account. Neither Mr. Powe nor the Trust, of which he was a trustee, maintained business cards, invoices, or stationery connected in any way with their dealings in timberland.

Issue 1

On its 1973 tax return the Trust reported a basis of \$476,652 for the timber sold. The government contended that the basis was only \$51,395. The Trust had made no allocation of basis between the land, timber and other assets upon acquisition of any of the numerous tracts, and kept no detailed records of the amount of timber cut on the tracts. Timber depletion allowances had not been claimed with respect to the previous sales.

Issue 2

On its 1973 tax return the Trust and Mr. Powe reported their respective share of the proceeds as capital gains. The government disallowed this treatment, contending that the timber was not a capital asset as defined by Sec. 1221, but was property held primarily for sale to customers in the ordinary course of a trade or business.

Tax Court

Issue 1

HELD: For the Government. The taxpayers did not sustain their burden of proof in showing that the government's determination of the basis of the timber sold was incorrect. The Court rejected an attempt by the taxpayer's expert witness to make an allocation in 1973 of basis by estimating the quantity of timber existing on the tracts when purchased between 1948 and 1972, noting that the "accuracy of such an estimation ... would be purely coincidental." Since Treas. Regs. §1.1016-3(a)(1)(ii) provides that basis is reduced by the amount of a depletion deduction allowable, the basis of the timber as of 1973 could not reflect the depletion attributable to previous sales.

Issue 2

HELD: For the Taxpayer. At the time of the sale in 1973 the taxpayers held the timber as a capital asset. The Court noted that determination of capital asset status is a question of fact for which many factors, their interactions and their relation to a particular taxpayer must be considered. Regarding Mr. Powe's status, the Court noted that the timber was originally acquired as an investment, that timber income averaged \$2,348 since 1959 when he started to make timber sales, and that some sales were made to retire debt on other tracts and some as a matter of good forestry practices. Regarding the Trust's status the Court noted :that many of its timber sales were made for similar reasons, while others were necessitated by hurricane damage. The 1973 sale was over three times as large as previous ones and according to the Court represented "the realization of appreciation in value accrued over a substantial period of time," *Commissioner v. Gillette*, 364 U.S. 130, 134 (1960). The Court distinguished *Biedenharn Realty Co. v. United States*, 526 F2d 409 (5th Cir. 1976), in which capital gains treatment was denied on the sale of subdivided real estate, where the taxpayer had sold a substantial number of lots, had vigorously improved the subdivision, and had engaged in extensive sales efforts.

Case Text

IRWIN, Judge: In these consolidated cases, respondent determined the following deficiencies in petitioners' Federal income taxes:

William A. Powe Trust, Docket No. 10704-78

| Year | Deficiency |
|------|--------------|
| 1973 | \$153,365.07 |
| 1974 | \$1,187.54 |

William A. Powe. Docket No. 10705-78

| Year | Deficiency |
|------|-------------|
| 1972 | \$485.16 |
| 1973 | \$78,904.40 |
| 1974 | \$6,703.70 |

After concessions, the issues remaining for our decision are:

1. Whether petitioner William A. Powe is entitled to capital loss carryovers in 1972, 1973 and 1974 as the result of the confiscation of certain assets by the Cuban government in 1960;
2. Whether petitioner William A. Powe Trust has a basis in timber sold to Crown-Zellerbach Corporation in 1973 in excess of that allowed by respondent; and
3. Whether the sale of timber by Mr., Powe and the Trust to Crown-Zellerbach Corporation in 1973 was a sale of a capital asset or a sale of property held primarily for sale to customers in the ordinary course of their trade or business.

Findings of Fact

Some of the facts have been stipulated and are so found. The stipulated facts and attached exhibits are incorporated herein by this reference.

Petitioner William A. Powe Trust (hereinafter Trust) was created in 1958 under the laws of the State of Mississippi. The trustees, William A. Powe, William A. Powe, Jr., and Robert T. Jackson, were residents of Hattiesburg, Mississippi, at the time the petition was filed in Docket No. 10704-78. The Trust filed Federal fiduciary income tax returns and amended Federal fiduciary income tax returns for the years 1973 and 1974 with the Internal Revenue Service Center in Chamblee, Georgia.

Petitioner William A. Powe was a resident of Hattiesburg, Mississippi, at the time the petition was filed in Docket No. 10705-78. Mr. Powe filed his Federal income tax returns for 1972, 1973 and 1974 with the Internal Revenue Service Center in Chamblee, Georgia.

Timber. At the recommendation of friends in Hattiesburg, Mr. Powe began purchasing tracts of timberland in Mississippi for investment purposes in the late 1930's. As Mr. Powe resided in Havana, Mr. E. Wheeler Bryant, a friend experienced in the timber business in Mississippi, acted

as his agent for purchasing and managing timber property. Mr. Bryant ¹³ was given a power of attorney to make timberland purchases and was paid either a 10-percent commission or given a 10-percent interest in such land purchased for Mr. Powe. Mr. Powe was able to obtain tracts of timberland during this period of time for as little as \$6 per acre. At the time of trial some of these tracts were worth in excess of \$1,500 per acre. Occasionally, some tracts that had been farms were purchased and trees were planted on the acreage. Mr. Powe did not sell any timber or any of these tracts of land before his return from Cuba in 1959.

Mr. Powe considers himself a retired businessman but remains active in his personal investments. ¹⁴ He maintains an office in his home for the purpose of overseeing his dealings in stocks, bonds, timberland and other investments. The value of his brokerage accounts is approximately one-half million dollars, Mr. Powe pays his living expenses primarily with dividends generated from these accounts. Mr. Powe has been a member and director of the Mississippi Forestry Association for approximately 15 years, and was previously a member of the American Tree Farm Association. He is also a member of the Board of Directors of a bank in Hattiesburg and is the editor of the "Sugar Journal," a technical magazine for sugar technologists.

Mr. Powe and the Trust do not maintain any printed business cards, invoices or stationary which has any connection with their dealings in timberland. Other than Mr. Bryant (who made purchases of land while Mr. Powe resided in Cuba), neither Mr. Powe nor the Trust has ever employed a timber buyer. In addition, Mr. Powe and the Trust do not own any sawmills or lumber yards.

The William A. Powe Trust was created on April 22, 1958, Mr. Powe as trustor, named his wife and children as its beneficiaries. The Deposit Guaranty Bank of Jackson, Mississippi. was the original trustee. After the resignation of the Bank as trustee in 1962, the present trustees, William A. Powe, William A. Powe, Jr., and Robert T. Jackson were substituted. The following tracts of timberland totaling 13,065.2 acres were transferred by Mr. Powe to the trust upon its creation:

| Tract | Year Acquired | Acres | Mineral Interest Acquired | Cost per Acre | Total Cost |
|-----------------------------|----------------------|--------------|----------------------------------|----------------------|-------------------|
| Clayton and Walter Mitchell | 1945 | 2,460 | All | \$6.00 | \$14,700 |
| J.O. Barron | 1948 | 1,205 | 1/2 | \$20.00 | \$24,100 |
| Lee Estate | Unknown | 169 | All | Unknown | Unknown |
| Stevens | 1953 | 800 | 1/2 | \$16.00 | \$12,800 |
| Gavin | 1954 | 3,280 | 1/4 | \$10.00 | \$32,800 |
| Sartin | 1955 | 1,668.2 | 1/2 | \$35.00 | \$58,387 |
| Black & Hathorn | 1956 | 1,116 | None | \$25.00 | \$27,900 |
| G.H. Williams | 1957 | 2,007 | 1/4 | \$50.00 | \$100,350 |
| Fornea | 1957 | 360 | 1/2 | \$65.00 | \$23,400 |

Additional property transferred to the Trust in 1958 included mineral rights, royalty interests, livestock, farm equipment and a large parcel of real property known as the Pinehill Ranch. The

Trust subsequently acquired additional timberland. In 1960, the Trust purchased equipment, including tractors, trucks and loaders, for use in cutting timber.

The timber sales by the Trust between 1958 and 1972 are as follows:

| Year | Gross Sales Price |
|-------------|--|
| 1958 | \$75.84 |
| 1959 | \$5,790.98 |
| 1960 | \$79,401.03 |
| 1961 | \$25,584.38 |
| 1962 | \$5,044.01 |
| 1963 | - 0 - |
| 1964 | \$355.29 |
| 1965 | \$221.22 |
| 1966 | - 0 - |
| 1967 | - 0 - |
| 1968 | \$76,229.59 (erroneously reported on Mr. Powe's individual return) |
| 1969 | \$16,738.86 |
| 1970 | \$17,682.77 |
| 1971 | \$6,830.61 |
| 1972 | \$18,840.00 |
| | \$252,794.58 |

In 1964 the Trust claimed business expenses on its return for seedling and forestry supplies totaling \$631,05. In 1966 the Trust claimed business expense deductions for payments for pine seed, seedlings, caretaker and tree planting expenses of \$4,178.18. In 1969, the Trust claimed business expenses for clearing timber debris from hurricane damage of \$1,432.75 and \$19,757 for tree planting and contract labor.

The timber sales by Mr. Powe between 1960 and 1972 are as follows:

| Year | Gross Sales Price |
|-------------|--------------------------|
| 1960 | - 0 - |
| 1961 | - 0 - |
| 1962 | - 0 - |
| 1963 | \$1,998.92 |
| 1964 | \$4,171.50 |
| 1965 | \$4,445.09 |
| 1966 | \$781.92 |
| 1967 | \$14,270.30 |
| 1968 | \$141.00 |
| 1969 | - 0 - ¹⁵ |
| 1970 | - 0 - |

| | |
|------|-------------|
| 1971 | \$4,592.00 |
| 1972 | \$117.91 |
| | \$30,518.64 |

In 1973, Mr. Powe reported the following timber sales: ¹⁶

| | |
|------------------|--------------|
| Crown-Zellerbach | \$57,002.00 |
| Georgia Pacific | \$93,555.75 |
| Delta Pine | \$12,610.00 |
| | \$163,167.75 |

In 1964, Mr. Powe reported total farm expenses of \$3,837.30, including \$202.50 for pine seedlings, \$216.09 for supplies, \$250 for treated pine seed and \$1,129.75 for contract planting of pine seedlings, in 1964, he also sold for \$400 a used pulpwood truck which he had acquired in 1960. In 1965, Mr. Powe claimed farm expenses totaling \$6,035.08 for supplies, weed poisoning, seeds and plants and contract planting. In 1966 Mr. Powe claimed a deduction of \$16,401.44 for pine seedlings, contract planting, forestry and caretaker services. In 1968, a deduction of \$7,269 was claimed for similar items and services.

On January 1, 1973, Mr. Powe and the Trust entered into a Timber Sale Agreement and Surface Use Agreement with the Crown-Zellerbach Corporation. Under the terms of the agreement Mr. Powe and the Trust conveyed all existing timber, trees, and other forest products located on 8,960.54 acres of land in Mississippi to Crown-Zellerbach for \$320,000 paid as follows:

| | |
|-------|--------------|
| Trust | \$262,998.00 |
| Powe | \$57,002.00 |
| | \$320,000.00 |

The agreement also provided for a surface use agreement for an initial term of 60 years and for successive renewal periods of 15 years each.

The property of Mr. Powe subject to the Crown-Zellerbach agreement consisted of 1,078.59 acres located in Covington and Perry counties. The property of the Trust subject to the agreement consisted of 7,881.95 acres, as follows:

| Tract Name | County | Acres (to nearest acre) | Cost Basis Per Acre |
|------------|-------------|-------------------------|---------------------|
| Barron | Lamar | 611 | \$20.00 |
| Stevens | Perry | 774 | \$16.00 |
| Fornea | Pearl River | 263 | \$65.00 |
| Williams | Pearl River | 1,850 | \$50.00 |
| Gavin | Perry | 2,450 | \$10.00 |
| Knight | Perry | 30 | \$40.00 |
| Blackwell | Perry | 70 | \$100.00 |
| Holliman | Perry | 40 | No timber |

| | | | |
|----------|-----------|-----|----------|
| Ridgeway | Forrest | 904 | \$140.00 |
| Shoemake | Perry | 101 | \$100.00 |
| Mathis | Jackson | 120 | \$258.33 |
| Dearman | Perry | 60 | \$70.00 |
| Ward | Perry | 150 | \$100.00 |
| Masonite | Perry | 120 | \$16.00 |
| Kervin | Covington | 340 | \$131.00 |

The Barron tract was acquired by Mr., Powe in 1948 for \$20 per acre, In 1958, he transferred 1,205 acres of the Barron tract to the Trust. All merchantable timber was cut off this tract in 1960 and 1961. In 1967, Mr. Powe reported the sale of approximately 335 acres of the Barron tract for \$23,438. He claimed a basis in this tract of approximately \$35 per acre.

The Stevens tract was acquired by Mr. Powe in 1953 for \$16 per acre. Some timber had been cut from this tract before its acquisition. In 1958, the Stevens tract had natural nonmerchantable young growth of timber on it. In 1960 and 1961, some timber was cut off this tract. The Stevens tract also contained some swampland on which no timber stood.

The Fornea tract was acquired by Mr. Powe in 1957 for \$65 per acre. Mr. Bryant attributed 20 percent of the purchase price of the tract to minerals, The Fornea tract had natural nonmerchantable young growth on it in 1958. Timber was cut on this tract prior to the Crown-Zellerbach sale. The Fornea tract adjoins the Williams tract. The Williams tract was acquired by Mr. Powe in 1957 for \$50 per acre. Mr. Bryant attributed \$10 per acre of the purchase price to minerals.¹⁷ In 1958, the Williams tract had natural nonmerchantable young growth on it. Some timber was cut off this tract prior to the Crown-Zellerbach sale.

The Gavin tract was acquired by Mr. Powe in 1954 for \$10 per acre. He transferred 3,280 acres of this tract to the Trust in 1958. There was very little merchantable timber on this tract when purchased and there was not enough timber in 1960 and 1961 to make cutting profitable. The Trust sold two hundred acres in 1963 for \$50 per acre. The Trust made other land sales off this tract over the years.

The Knight tract consists of 30 acres in Perry County and was purchased by the Trust on September 13, 1963, for \$40 per acre. The Blackwell tract is located in Perry County and originally consisted of 80 acres. It was purchased by the Trust on September 23, 1965, for \$100 per acre. Ten acres of this tract were excluded from the Crown-Zellerbach sale.

The Holliman tract is located in Perry County. It consists of 40 acres and was purchased by the Trust on October 20, 1966. There has never been any merchantable timber on this tract.

The Ridgeway tract consists of 904 acres and was purchased by the Trust in 1967 for \$140 per acre. Substantially all of the timber on this tract was cut in 1968.¹⁸ Mr. Powe mistakenly reported this timber sale on his own 1968 Federal income tax return. In 1971, the Trust sold 10 acres of the Ridgeway tract for \$5,000 claiming a basis of \$150 per acre,

The Shoemake tract consists of approximately 10I acres and is located in Perry County and was purchased by the Trust on January 17, 1967, for \$100 per acre.

The Mathis tract consists of 120 acres and is located in Jackson county and was purchased by the Trust on May 26, 1967, for a total cost of \$31,000. Timber was cut on this tract prior to the Crown-Zellerbach sale.¹⁹

The Dearman tract is located in Perry County and was purchased by the Trust in 1968. It consists of 60 acres and was purchased for \$70 per acre.

The Ward tract is located in Perry County, consists of 150 acres and was purchased by the Trust in 1970 for \$100 per acre.

The Masonite tract, located in Perry County, consists of 120 acres and was acquired by the Trust in 1970 in exchange for approximately 80 acres of the Stevens tract also located in Perry County.

The Kervin tract, located in Covington County, consists of approximately 340 acres and was purchased by the Trust in 1970²⁰ for \$13I per acre.

There have been no detailed records maintained regarding which tracts of timberland were cut and no records were kept regarding basis in timberland were cut and no records were kept regarding basis in timber sold since the acquisition of the various parcels.

On its 1973 Federal income tax return, the Trust reported a capital loss from the sale of timber to Crown-Zellerbach Corporation in the amount of \$213,654, computed as follows:

| | |
|-------------------|----------------|
| Gross Sales Price | \$262,998.00 |
| Basis | \$476,652.00 |
| Loss | \$(213,654.00) |

In the notice of deficiency, respondent determined that the Trust realized ordinary income rather than a capital loss on this sale of timber. Respondent further determined that the Trust's basis in the timber sold to Crown-Zellerbach Corporation was \$51,395.92 rather than the reported amount of \$476,652, Petitioner-Trust has conceded that the reported amount of basis is incorrect and now maintains on brief that the correct basis is \$257,921.80.

The property of Mr. Powe subject to the January 1, 1973, agreement with Crown-Zellerbach Corporation consisted of several parcels totaling 1,078.59 acres.

| County | Acres |
|-----------|----------|
| Covington | 40.00 |
| Perry | 1,038.59 |

on Mr. Powe's 1973 Federal income tax return, he reported a capital gain from the sale of timber

of \$54,897, computed as follows:

| | |
|-------------------|------------------------|
| Gross Sales Price | \$57,002.00 |
| Basis | 2,105.00 ²¹ |
| Capital Gain | \$54,897.00 |

In the notice of deficiency respondent determined that Mr. Powe's reported gain from the timber sale was ordinary income rather than capital gain.

Opinion

Trust's Basis in Timber Sold to Crown-Zellerbach in 1973. On its 1973 Federal income tax return the Trust reported a basis of \$476,652 in timber sold to Crown-Zellerbach for \$262,998 in that year. Respondent determined that the correct amount of basis remaining in the timber located on the 7,881.95 acres subject to the sale was only \$51,395.92, and accordingly, disallowed the claimed capital gain. At trial, petitioner-Trust conceded that the amount of basis stated on its 1973 return was in error and now maintains that its correct basis in the timber is \$257,921.80. Petitioner bears the burden of proving that respondent's basis determination is in error. Rule 142(a).

The 7,881.95 acres subject to the 1973 timber sale consist of 15 distinct parcels which were acquired over the course of three decades. These parcels were either purchased by Mr. Powe and subsequently transferred to the Trust or were acquired directly by the Trust. The Trust made no determination of basis allocation among the land, mineral rights and timber upon acquisition of the parcels and kept no detailed records of the amount of timber cut on the various tracts during the intervening years. The record reflects that timber has been cut on many, if not all, of the parcels and that certain of the tracts were depleted of their first growth prior to 1973. The Trust's reported timber sales since its creation in 1958 total approximately \$250,000.²²

Timber is an asset subject to an allowance for depletion.²³ Section 611(a). The capital recoverable through depletion allowances in any year is the taxpayer's adjusted basis in the timber, Section 612; section 1.611-3(a), Income Tax Regs. A taxpayer's basis for the cost depletion of timber is his cost basis adjusted as provided by section 1016. Section 1016(a)(2) provides that cost basis shall be reduced for depletion to the extent of the amount allowed as a deduction in computing taxable income but not less than the amount allowable. The depletion of timber takes place at the time it is cut. Section 1.611-3(b)(1), Income Tax Regs. Therefore, even though the Trust did not claim depletion allowances at the time of the various cuttings, the basis remaining in the timber must be determined by decreasing the cost basis²⁴ of the timber by the amount of depletion allowable under section 611. A taxpayer is not permitted to take advantage in a later year of his prior failure to claim a depletion allowance. Section 1.1016-3(a)(1)(ii), Income Tax Regs. In order to sustain its burden of proving its adjusted basis consistent with these rules, the Trust must first establish what portion of the cost of each parcel of timberland was properly allocable to timber existing²⁵ at the time of acquisition and then reduce that figure by the amount of timber cut from the tract prior to the 1973 sale.

On brief, petitioner-Trust maintains that the correct adjusted basis figure available to it as of January 1, 1973, is \$257,921.80. This figure is computed by taking the total cost basis of the tracts (\$421,675)²⁶ and allocating approximately 78 percent of that figure to timber (\$328,754.80) and allocating' the remaining 22 percent to the land itself (\$92,920.20). The purported initial timber basis is then decreased by \$70,833 which was the amount of basis claimed on the sale of timber from the Ridgeway tract in 1968.²⁷

Petitioner-Trust states that this computation is based on the testimony of Robert Hatcher, its timber appraisal expert. The Trust introduced into evidence a document prepared by Mr. Hatcher in 1975 which provides a similar allocation of the initial cost basis of each parcel to timber and land. While we sympathize with the near impossibility of the creation of accurate basis records at this late date we are unable to accord Mr. Hatcher's testimony and appraisal more than minimal weight.

The parcels were purchased between the years 1948 and 1972 and the determinative time for allocation of a portion of the cost basis to existing timber was at the respective dates of their acquisition. Although Mr. Hatcher had some information as to cuttings on the various parcels we believe that the accuracy of an estimate made in 1973 as to the quantity of timber existing on each parcel at the time it was acquired would be purely coincidental. In addition, no basis was allocated to mineral interests acquired with the land. Finally, as we have discussed, even if we were to accept petitioner's cost basis figure, that amount would have to be reduced by the allowable depletion (i.e., the total timber sales from those parcels) even though no depletion allowance was claimed. Section 1016(a)(2). We note that the maintenance of proper records as required by respondent's regulations would have obviated this controversy. Section 1.611-3(e)-(h), Income Tax Regs. Thus, we must conclude that petitioner-Trust has not met its burden of proof, and accordingly, we sustain respondent's determination on this issue.

Sale of Timber by Mr. Powe and the Trust. The final issue for our decision is whether the sale of timber by Mr. Powe and the Trust to Crown-Zellerbach, Corporation in 1973 was the sale of a capital asset thus entitling petitioners to capital gain treatment on the taxable proceeds²⁸ Section 1221 provides in relevant part as follows:

SEC. 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-

(1) 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.

Respondent determined that for both Mr. Powe and the Trust the sale of the existing timber constituted a sale of property held "primarily for sale to customers in the ordinary course of [petitioners'] trade or business" within the meaning of section 1221(1), thus subjecting the taxable

proceeds to ordinary income treatment²⁹ The term "primarily" as used in section 1221(1) has been interpreted to mean "of first importance" or "principally" and not merely a substantial purpose. *Molar v. Riddle*. 383 U.S. 569,572 (1966). Additionally, section 1221(1) has been held to encompass those sales which are part of the everyday operation of a business but not the realization of an increase in value which has accrued over a substantial period of time. *Malat v. Riddle, supra*; *Bynum v. Commissioner*, 46 T.C. 295,302 (1966) (concurring opinion by Judge Tannenwald).

Once again the burden of proof is on the taxpayer to prove that the subject timber was held by each of them as a capital asset and not as determined by respondent. *Welch v. Helvering, supra*; Rule 142(a). In addition, we note that because the capital gains provisions are an exception to the normal tax rates they are to be construed narrowly. *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 53 (1955).³⁰

The question of whether property is held as a capital asset or primarily for sale to customers in the ordinary course of a trade or business ultimately turns on the unique combination of facts in each case. *Crosby v. United States*, 414 F.2d 822, 826 (5th Cir. 1969); *Bauschard v. Commissioner*, 279 F.2d 115, 117 (6th Cir. 1960), affg. 31 T.C. 910 (1959); *McManus v. Commissioner*, 65 T.C. 197 (1975). aff'd 583 F.2d 443 (9th Cir. 1978). The impossibility of formulating and applying a clearly defined test which would produce predictable results was noted by the Court of Appeals for the Fifth Circuit in *Biedenharn Realty Co, v. United States*. 526 F.2d 409,415 (5th Cir. 1976):

No one set of criteria is applicable to all economic structures. Moreover, within a collection of tests, individual factors have varying weights and magnitudes, depending on the facts of the case. The relationship among the factors and their mutual interaction is altered as each criteria increases or diminishes in strength, sometimes changing the controversy's outcome. As such, there can be no mathematical formula capable of finding the X of capital gains or ordinary income in this complicated field.

Factors most often considered in determining whether property is held as a capital asset include the (1) nature and purpose of the acquisition of the property and how long it was subsequently held; (2) a characterization of the taxpayer's attempts to sell the property; (3) the number, extent, continuity and substantiality of sales; (4) the amount of development and advertising of the property for sale; (5) the Use of a business sales office; (6) the type and extent of control exercised by the taxpayer over any representative selling the property; and (7) the time and effort the taxpayer customarily devoted to the sales. *United States v. Winthrop*, 417 F.2d 905,910 (5th Cir. 1969); *McManus v. Commissioner, supra* at 211. There is little dispute about the underlying facts in this case. Petitioners and respondent differ only as to the implications and conclusions drawn there-from.

Although we have found as a fact that the tracts of timberland were originally acquired by petitioners as investments, we note that such purpose "has no built-in perpetuity nor a guarantee of capital gains forever more. *Biedenharn Realty Co, v. United States, supra* at 421. While the purpose for which the timberland was acquired has evidentiary weight the "end question is the purpose of the 'holding' at the time of the sale or sales." *Bynum v. Commissioner, supra* at 299.

However, ordinary income treatment is not mandated "merely because, as is usually true, [a taxpayer's] principal intent at the exact moment of disposition is sales. Rather [Capital gains treatment will be denied] in those instances where over time there has been such a thorough change of purpose * * * as to make untenable a claim either of twin intent or continued primacy of investment purpose." *Biedenharn Realty Co, v. United States. supra* at 423 (footnote reference omitted).

Petitioners contend that the timber sold to Crown-Zellerbach in 1973 continued to be held as an investment or, in the alternative, was not held primarily for sale to customers. After consideration of the entire record we agree with petitioners that the subject timber retained its status as a capital asset.

Timber Sale by petitioner-Powe. Mr. Powe began purchasing tracts of Mississippi timberland as an investment in the late 1930'S during his lengthy sojourn in Cuba, He transferred some of these tracts to the Trust upon its creation in 1958. No timber sales were made by Mr. Powe until after his return from Cuba in 1959. The total gross proceeds from timber sales realized prior to 1973 was \$30,518,64 or an average of \$2.348 yearly for those 13 years. ³¹

Mr. Powe testified that some of these sales were made: to retire a debt on a particular tract and others were made as a matter of good forestry management. For example, on certain tracts large trees were harvested in order to allow sunlight to reach younger growth. In August of 1969, Hurricane Camille passed over certain tracts. The removal of this storm-damaged timber was necessary to prevent insect infestation. Although respondent argues that such activities strongly suggest the running of a timber "business," we agree with petitioner that under these facts it is more logical to view them as reasonable actions undertaken to protect and increase the value of his investment. ³² Expenses were also incurred during the years 1964-1968 for the planting of seedlings, poisoning of weed trees, and other miscellaneous items. While the purchase of such items and services could under certain circumstances be indicative of a timber business we do not think that level was reached here.

In addition to his timberland Mr. Powe also owned stocks and bonds having a value of approximately one-half million dollars. Dividends generated from these accounts were used to pay his living expenses. Mr. Powe was 74 years old at the time of the Crown-Zellerbach sale.

On the facts presented we are unable to conclude that Mr. Powe was in the business of selling timber. Rather, we think Mr. Powe is what he claims to be, that is, a retired businessman who takes reasonable steps to protect and improve his investments. Accordingly, we hold that his sale of timber to Crown-Zellerbach in 1973 constituted the sale of a capital asset and accordingly he is entitled to capital gains treatment on the taxable proceeds.

Timber Sale by Petitioner-Trust. The Trust was created in 1958 and over 13,000 acres of timberland were transferred to it by Mr. Powe at that time. Other property transferred to it in 1958 included mineral rights, royalty interests, livestock, farm equipment and a large ranch.

Prior to the Crown-Zellerbach sale the Trust had sold a total of approximately \$250,000 worth of

timber. Mr. Powe testified that some of these sales were made to retire debts on the land and to purchase additional property. He testified that sales were particularly necessitated after the expropriation of his property in Cuba. We note that timber sales occurring during the years 1959-1961 totaled \$110,776.39. Sales of timber were also made when trees were thinned and timber damaged by storms was removed. We note that Hurricane Camille passed through Mississippi in August of 1969. Timber sales in 1969 and 1970 totaled \$34,421.63.

It is true, as respondent points out, that the Trust claimed business expenses from 1964-1968 on its fiduciary return for such things as seedlings, contract planting, and the clearing of timber debris from hurricane damage and that such expenses are indicative of a timber business. However, as with petitioner Powe, we do not believe that the activities of the Trust rose to the level of a timber business.

In the January I, 1973, sale to Crown-Zellerbach, the Trust sold the standing timber on 8,960.54 acres of land for \$262,998 and also gave the buyer a surface use agreement for an initial term of 60 years. This 1973 sale was over three times larger than any sale of timber previously made by the Trust and was, we believe, "the realization of appreciation in value accrued over a substantial period of time." *Commissioner v. Gillette Motor Transport, Inc.*, 364 U.S. 130, 134 (1960), and not the "profits and losses arising from the everyday operation of a business." *Corn Products Refining Co. v. Commissioner, supra*. Also, because we have found that the Trust was not in the timber business the sale was not an attempt to convert stock in trade into a capital asset.

Respondent places particular reliance on *Biedenharn Realty Co. v. United States, supra*. That case involved the question of the ordinary income treatment of profits arising from the sale of subdivided real estate. There the court held that where the taxpayer had sold a substantial number of lots, had vigorously improved the subdivisions and had engaged in extensive sales efforts, the sale of properties in the relevant tax years generated ordinary income and not capital gains. We see little similarity between the facts of that case and the instant one and thus we find it of limited help in resolving the issue before us.

After considering all the factors involved and the record as a whole, we conclude that petitioner-Trust's sale of timber to Crown-Zellerbach was not made in the ordinary course of its trade or business. Accordingly, we hold that the timber was not held by the Trust primarily for sale to customers in the ordinary course of its trade or business within the meaning of section 1221(1). Thus, the Trust's gain from this sale constitutes capital gain.

Decisions will be entered under Rule 155.

13 Mr. Bryant died in approximately 1967.

14 Mr. Powe was born in 1898 and was 81 years old at the time of trial.

15 Mr. Powe's 1969 Federal Income Tax Return was not introduced into evidence.

16 The status of the other timber sales in 1973 as capital transactions (i.e. to Georgia Pacific and Delta Pine apparently was not challenged by the respondent. Also on his 1973 return Mr. Powe reported ordinary income of \$6,139.05 relating to a payment by Crown-Zellerbach for the annual growth of timber.

17 Originally the Williams tract consisted of 2,007 acres in Pearl River County, Mississippi; only 1,850 acres of the Williams tract was subject to the Crown-Zellerbach sale.

18 The Trust sold 1,770,819 board feet of timber from the Ridgeway tract for \$76,229.56.

19 The Mathis tract was the poorest tract of timber in the Crown-Zellerbach sale.

20 The parties stipulated that the Trust purchased the Kervin tract in 1974. The correct year, according to the purchase contract, is 1970.

21 Mr. Powe's basis in this timber is not disputed.

22 We note, however, that an undeterminable portion of these timber sales were from tracts of land not involved in the sale to Crown-Zellerbach.

23 SEC. 611. ALLOWANCE OF DEDUCTION FOR DEPLETION.

(a) General Rule. In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case: such reasonable allowance in all cases to be made under regulations prescribed by the Secretary * * *.

24 Although amounts in connection with the planting of timber would ordinarily be added to the cost basis, the Trust treated these expenses as deductions from income in the year incurred. Section 1.611-3(a), Income Tax Regs. Therefore, the Trust is not entitled to any upward adjustments to its cost basis for these items.

25 The Trust is not entitled to any basis in timber which is the result of natural growth since the acquisition of the land. See *Skinner Brothers Realty Co. v. Commissioner*, 17 B.T.A. 3641(1929).

26 According to petitioner's computation the total cost of all the parcels was \$421,675. This figure is overstated by \$21,456 because of the use of an incorrect price per acre for the Stevens and Masonite tracts. This total does not include the cost of the Holliman tract as it was stipulated that no timber existed on that parcel at the time of its acquisition.

27 This sale was erroneously reported on Mr. Powe's individual return for that year.

28 The agreement executed on January 1, 1973, between the petitioners and Crown-Zellerbach Corporation provides both for the sale of the existing timber on the subject lands and a Surface Use Agreement for an initial term of 60 years. The agreement provides a purchase price for the

existing timber of \$320,000 (\$262,998 to the Trust and \$57,002 to Mr. Powe). The agreement also provides for an annual payment to petitioners for the use of the subject lands. Only the income tax treatment of the initial payment in 1973 for the purchase of the existing timber is in issue here. Respondent does not argue that the \$320,000 payment exceeds the fair market value of the timber existing at the time of the execution of the contract. (See Rev. Rul. 62-81, 1962-1 C.B. 153).

29 Section 631(b) provides that a taxpayer who disposes of timber by contract but retains an economic interest in such timber is entitled to capital gains treatment on the proceeds regardless of whether the timber was held for sale to customers in the ordinary course of his trade or business. Section 1.631-2(a)(2), Income Tax Regs. Petitioners have conceded that section 631(b) is not applicable here because they did not retain the required economic interest in the timber sold to Crown-Zellerbach. Therefore, petitioners are only entitled to capital gains treatment if the subject timber was a capital asset within the meaning of section 1221.

30 In *Commissioner v. Gillette Motor Transport, Inc*, 364 U.S. 130, 134 (1960) the Supreme Court noted that:

This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year.

31 Respondent points out that on Mr. Powe's 1970 Federal income tax return the following statement appears:

This taxpayer is a tree farmer and owns many acres of timberland, He is very active in his work and looks after his business daily. No trees were cut or sold in 1970 but income will be recognized in future years. Also, on Mr. Powe's 1971 return the following statement appears:

I am a Tree Farmer and own many acres of Timberland. I am very active in this work and look after this business daily. Stumpage reported on this return was rather small, but will amount to considerable income in future years. These statements were included to explain a claimed deduction for home office expenses. Office expenses incurred in connection in investment activities were deductible under section 212 prior to taxable years beginning after December 31, 1975 and the enactment of section 280A. Mr. Powe testified that this office was also used to keep up with his dealings in stocks, bonds, and other investments. Thus, we find these statements deserving of little weight in resolving the issue of whether the timber sold in 1973 was a capital asset: Respondent also notes that Mr. Powe listed his occupation on certain of his income tax returns as "tree farmer." We note that on the returns for other years his occupation, where listed, was variously stated as "Retired," "investments," and "Editor." We find petitioner's stated occupation irrelevant to the issue before the Court.

32 It is unclear whether respondent objects to the process of thinning and the removal of storm-damaged trees themselves or the sale of the timber resulting from these practices. Certainly since we view these practices as being reasonable investment protection under the facts herein, a sale of such items seems an appropriate disposition.

