

RAY v. COMMISSIONER
283 F.2d 337; 60-2 USTC ¶ 9739;
6 AFTR 2d 5696 (5th Cir. 1960).
Affirming per curiam 32 T.C. 1244 (1959).

Editor's Summary

Key Topics

DISPOSAL WITH A RETAINED ECONOMIC INTEREST

- Effect of owner's retention of cutting rights

OUTRIGHT SALE

- Effect of ability to substitute other timber

Facts

The taxpayer's farming business included removal of turpentine from pine trees located on his land. When all of the turpentine had been extracted from a tree, he would cut and sell it as pulpwood. The taxpayer, as grantor, and Mengel Company, as grantee, entered into a contract which recited that the taxpayer sold to Mengel all of the pine trees on his lands. The contract contemplated the cutting and sale of 40,000 cords of pulpwood at the prevailing market price, against which Mengel made advance payment of \$40,000. The taxpayer was to cut and remove the timber, and Mengel was to have the right to cut only if the taxpayer defaulted in cutting. The actual cutting was done by the taxpayer's sons at his request. The taxpayer was required to pay taxes on the timber and to protect it from fires, theft and waste. The taxpayer did not elect under section 117(k)(1) to treat his cutting as a sale or exchange. He did contend that the \$40,000 payment from Mengel was taxable as capital gain under either section 117 (k)(2) or section 117(j). He argued that his contract with Mengel was a disposal under a contract pursuant to which he retained an economic interest in the timber. Alternatively he argued that the contract with Mengel represented a sale of trees used in his business within the meaning of section 117(j). The Commissioner contended that the contract with Mengel did not qualify as a disposal under section 117(k)(2) because the taxpayer retained the right to cut the timber himself. With respect to section 117(j), the Commissioner argued that the taxpayer had retained an economic interest in the timber under the contract with Mengel, thereby precluding the consummation of a sale.

Tax Court

[opinion at p. 275]

Held: For the Commissioner. The legislative history of section 117(k)(2) indicates that Congress intended to limit its benefits to transactions where a timber owner surrendered to another his cutting rights. Hence a disposal under that section must involve the surrender to another of the right to cut. The contract with Mengel, taken as a whole, convinces the court that the taxpayer in fact retained the primary cutting rights, and thus there was no disposal under section 117(k)(2). The taxpayer's alternative argument under section 117(j) fails because there was no sale of standing timber to Mengel. The taxpayer had the right to substitute other timber and was required to pay taxes and bore the risk of loss. The contract as a whole indicates the

intention that title remain in the taxpayer until cut. Thus, a sale occurred as and to the extent that timber was actually cut and paid for.

Court of Appeals

Held: Affirmed. The Tax Court's construction of the cutting contract was a correct determination of a question of law.

Case Text

PER CURIAM: The petitioner, Joe S. Ray, the owner of a substantial tract of timber land, entered into a written agreement in 1952 with Mengel Company under which it was to acquire 40,000 cords of pulpwood over a period of ten years at the market price prevailing at the time of cutting and delivery. At the time of the execution of the agreement, there was an advance from Mengel to Ray of \$40,000, stipulated as \$1.00 per cord for the pulpwood covered by file contract. The Petitioner contended that this advance was entitled to capital gains treatment, in computing his federal income tax, under the provision of Section 117(k) (2) of the Internal Revenue Act of 1939, as amended.¹ The Commissioner held that the payment should be taxed as ordinary income, and the Tax Court sustained this determination, 32 T.C. 1244. The Tax Court construed the contract as not making a "disposal of timber" so as to bring the transaction within Section 117(k) (2). We agree with the Tax Court's construction and affirm its decision.

A question as to the effect of the agreement to be ascertained by a construction of its terms, is a question of law. The determination of a question of law by the Commissioner is not entitled to any presumption of correctness. The Tax Court's opinion shows that the question was decided as a legal issue without benefit of any presumption, even though the last paragraph of the Tax Court's opinion² might suggest that it had indulged in such a presumption.

The judgment of the Tax Court is Affirmed.

1 In the case of the disposal of timber or coal (including lignite), held for more than 6 months prior to such disposal, by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber or coal, the difference between the amount received for such timber or coal and the adjusted depletion basis thereof shall be considered as though it were gain or loss, as the case may be, on the sale of such timber or coal, * * * 26 U.S.C.A. § 117(k) (2).

2 "We hold that petitioner has failed to meet the burden of proving error in respondent's determination. * * *"