***Peebles v. Commissioner, 5 T.C. 14 (1945)***

A taxpayer selling timber is entitled to capital gains treatment if the timber is not held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, and a valid gift of timber interests transfers the income tax liability for subsequent sales to the donee.

**Summary**

The petitioner, Peebles, sold timber under a contract and reported the profits as capital gains. His wife also sold timber interests she received as a gift from him, reporting those gains separately. The Commissioner argued the timber was held for sale in the ordinary course of business and that the wife's timber sale income should be attributed to Peebles. The Tax Court held that Peebles was entitled to capital gains treatment because he was not engaged in the timber business, and that the gifts of timber interests to his wife and son were valid, shifting the tax burden to them for their respective sales. The court focused on whether Peebles' activities constituted a trade or business and the validity of the timber interest gifts.

**Facts**

Peebles owned timberland and contracted with Krepps to cut and sell the timber. Krepps operated independently, selling the logs and paying Peebles a share of the proceeds based on either the selling price or a minimum price schedule. Krepps limited his sales to a few companies and directed them to pay Peebles his share directly. Peebles also gifted undivided timber interests to his wife and son. Subsequently, Mrs. Peebles, individually and as trustee for her son, sold these timber interests to Leigh Banana Case Co.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in Peebles' income tax, arguing that the timber sale profits were ordinary income and that the income from the sale of the gifted timber interests was attributable to Peebles. Peebles petitioned the Tax Court for a redetermination of the deficiency.

**Issue(s)**

1. Whether the profits from the timber sold under the contract were taxable as ordinary income or as capital gains.
2. Whether the proceeds from the sale of timber interests gifted to Peebles' wife and son were taxable to Peebles or to the donees.

**Holding**

1. No, the profits from the timber sale were taxable as capital gains because the timber was not held primarily for sale to customers in the ordinary course of

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Peebles' trade or business.
2. No, the proceeds from the sale of the timber interests gifted to Peebles' wife and son were taxable to the donees because valid gifts of property interests had been completed prior to the sale.

**Court's Reasoning**

Regarding the capital gains issue, the court emphasized that Peebles was not actively engaged in the timber business. Krepps operated as an independent contractor, purchasing the timber from Peebles and selling it on his own account. The court distinguished this from cases where the logger was an employee of the taxpayer. The court cited *Estate of M.M. Stark* and *John W. Blodgett* to support the capital gains treatment. As to the gifts, the court found that the deeds conveyed actual interests in the timber to Peebles' wife and son. The court observed that the purchasing company acquired nothing from anyone other than Mrs. Peebles individually and as trustee and that the interests purchased were the identical interests she had received from the petitioner. The court cited *McLendon Bros. v. Finch* for the proposition that a time limit for removing timber does not change the nature of the grant. The court stated, "With respect to the interests covered by those conveyances, the Leigh Banana Case Co. acquired nothing from anyone other than Mrs. Peebles individually and as trustee, and, further, the interests which it did acquire from her and for which it paid $8,000 in cash were the identical interests, no more or less, which she had received from the petitioner on December 8."

**Practical Implications**

This case clarifies the circumstances under which timber sales qualify for capital gains treatment. It emphasizes the importance of the taxpayer not being actively engaged in the timber business. The case also illustrates that valid gifts of property interests, including timber, can effectively shift the tax liability for subsequent sales to the donee, provided the gifts are completed before any sale agreement is reached. Attorneys advising clients on timber sales must carefully examine the taxpayer's level of involvement in the timber operation. Further, this case reinforces the principle that properly documented gifts of property interests will generally be respected for tax purposes, absent evidence of sham transactions or anticipatory assignments of income. This influences estate planning strategies where timberlands are involved, and demonstrates ways to optimize tax liabilities through gifting.

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