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

A taxpayer who makes a one-time sale of timber to an independent contractor, retaining only the right to collect the selling price, is entitled to capital gains treatment because the timber is not held primarily for sale to customers in the ordinary course of the taxpayer's trade or business.

Summary

Peebles sold timber under a contract where he retained an economic interest. The Tax Court addressed whether the profits from the timber sale should be treated as ordinary income or capital gain. The court held that the timber was a capital asset because Peebles made a one-time transaction with an independent contractor, Krepps, and was not engaged in the trade or business of selling timber. The court also held that gifts of timber interests to Peebles' wife and son were valid, and proceeds from their subsequent sale were taxable to them, not Peebles.

Facts

Peebles owned land with timber. He contracted with Krepps, an independent contractor, to cut and sell the timber. Krepps paid Peebles a percentage of the sale price, or a minimum price specified in the contract, whichever was higher. Krepps was responsible for the timber operation. Peebles also gifted undivided timber interests to his wife and son shortly before a sale of the remaining interest. The wife and son later sold their interests.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Peebles' income tax, arguing that the timber sale proceeds were ordinary income and that the gifts to his wife and son should be disregarded for tax purposes. Peebles petitioned the Tax Court for a redetermination.

Issue(s)

1. Whether the timber sold by Peebles was property held primarily for sale to customers in the ordinary course of his trade or business, thus disqualifying it from capital asset treatment under Section 117(a) of the Internal Revenue Code.
2. Whether the $4,000 received by Peebles' wife individually and the $4,000 received by her as trustee for her son upon the sale of the timber were proceeds from valid gifts of undivided interests in the timber.

Holding

1. No, because Peebles engaged in a single transaction with an independent contractor and was not actively engaged in the trade or business of selling

timber.
2. Yes, because the gifts of timber interests to Peebles' wife and son were valid and complete, and the proceeds from their subsequent sale were properly reported by them.

Court's Reasoning

The court reasoned that Peebles' timber was a capital asset because he was not in the trade or business of selling timber. The court emphasized that Krepps was an independent contractor, not an employee or agent of Peebles. Krepps, not Peebles, was the one conducting the timber operation and selling to customers. The court distinguished *Boeing v. Commissioner*, noting that in that case, the logger was an employee of the taxpayer. As for the gifts to the wife and son, the court found the transfers to be valid gifts of timber interests, supported by the delivery of instruments of conveyance. The court emphasized the fact that the Leigh Banana Case Co. acquired the interests directly from Mrs. Peebles individually and as trustee and that the company paid Mrs. Peebles $8,000. 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…"

Practical Implications

This case clarifies that a one-time sale of timber, even when the seller retains an economic interest, does not necessarily constitute engaging in the trade or business of selling timber for capital gains purposes. The key factor is whether the taxpayer is actively involved in the timber operation and sales, or whether an independent contractor is responsible for those activities. It also reinforces that valid gifts of property interests, including timber, are recognized for tax purposes, and the subsequent sale of those interests is taxable to the donee, not the donor. This ruling impacts how timber sales are structured and how timber interests can be transferred for estate planning purposes. Later cases would distinguish it based on the level of activity of the taxpayer.