15 T.C. 697 (1950)

For capital gains purposes, the “disposal” of timber under Internal Revenue Code Section 117(k)(2) occurs when the owner enters into a cutting contract, not when the timber is actually cut.

Summary

Springfield Plywood Corp. acquired timberland and, within six months, contracted with a lumber company for the removal of timber on a royalty basis. The Tax Court addressed whether the income from this timber, cut more than six months after acquisition, qualified for capital gains treatment. The court held that the “disposal” of timber occurred when the cutting contract was signed, not when the timber was cut. Because the contract was executed within six months of the timber’s acquisition, the income was classified as ordinary income, not capital gain.

Facts

In January 1943, Springfield Plywood Corp. acquired timber property. On May 14, 1943, Springfield entered into an agreement with D. & W. Lumber Co., stipulating the agreement “contemplated the disposal” of certain classes of timber on the land. The contract referred to Springfield as the vendor and D. & W. Lumber as the vendee. Payments were structured as royalties based on the amount of timber cut. The contract mandated continuous cutting at a rate of 45,000 feet per day, terminating two years from the contract date. Springfield retained the right to have fir logs suitable for plywood delivered to them at O.P.A. prices, less loading costs. The contract stated that the vendee would purchase and pay for all standing and down timber within two years, regardless of whether it was cut.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies against Springfield Plywood Corp. for the tax years 1942 and 1943. Springfield challenged the assessment, arguing that income from timber cut after six months of ownership should be treated as capital gains. The Tax Court reviewed the case under Rule 30, focusing on whether the timber was “disposed of” at the time of the cutting contract.

Issue(s)

Whether, under Section 117(k)(2) of the Internal Revenue Code, Springfield “disposed of” the timber when it entered into the cutting contract within six months of acquiring the timberland, or only when the timber was actually cut and removed, thereby determining whether the income qualified for capital gains treatment.

Holding

No, because the Tax Court found that the “disposal” of timber occurred upon signing the cutting contract, not upon the actual cutting of the timber. Therefore, because the contract was signed within six months of acquiring the timberland, the income was deemed ordinary income.

Court's Reasoning

The Tax Court emphasized that the statute uses the term "disposal," which is broader than "sale." The court cited *Phelps v. Harris, 101 U.S. 370 (1879)*, stating, "The expression 'to dispose of' is very broad, and signifies more than to sell. Selling is but one mode of disposing of property." The court found that the cutting contract, which granted the lumber company the right to cut and remove timber, constituted a "disposal" of the timber. Key factors influencing this determination included that the lumber company was obligated to pay for all timber within two years, regardless of whether it was cut; bore the risk of loss from fire or natural disasters; and was responsible for paying taxes on the real property. The court also relied on Treasury Regulation 111, Section 29.117-8, which states that a "disposal under the contract shall be considered to be a sale of such timber." The court reasoned that Congress did not intend to exclude cutting contracts from the scope of "disposal of timber…under any form or type of contract by virtue of which the owner retains an economic interest."

Practical Implications

This case clarifies the meaning of "disposal" in the context of timber sales and capital gains. It establishes that the date of the cutting contract, not the date of actual cutting, is the critical event for determining whether timber was held for more than six months before disposal. Attorneys advising clients in the timber industry must consider this timing rule when structuring timber sales to ensure that their clients can avail themselves of favorable capital gains treatment. Taxpayers should be aware that entering a cutting contract shortly after acquiring timberland may disqualify them from claiming capital gains on subsequent timber sales. Later cases and IRS guidance would need to be consulted to determine how this principle applies under evolving tax law.

