20 T.C. 573 (1953)

A taxpayer who cuts timber on land owned by another, under a contract providing compensation for services, is not entitled to capital gains treatment under Section 117(k)(1) of the Internal Revenue Code because they do not have a proprietary interest in the timber.

Summary

The Tax Court addressed whether a partnership engaged in logging timber on land owned by others could treat income from cutting timber as capital gains under Section 117(k)(1) of the Internal Revenue Code. The partnership had contracts to log timber, receiving compensation based on the market price of the timber less stumpage fees and a service charge. The court held that the partnership was not entitled to capital gains treatment because it did not own the timber or have a proprietary interest in it, acting merely as a service provider.

Facts

Arthur McKay and John Carlen formed a partnership to log timber in Washington state. The partnership contracted with Neuskah Timber Company (later E.K. Bishop Lumber Company) to cut timber on land owned by Rayonier Incorporated. The partnership was responsible for all logging operations, including cutting, yarding, loading, and trucking. The partnership received the net cash returns from the sale of logs, minus stumpage fees and a service fee deducted by E.K. Bishop Lumber Company, which handled all sales and collections. The contracts specified that title to the logs remained with Neuskah/Bishop until sold, and the partnership was described as an independent contractor.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the income tax of Arthur and Cathryn McKay, and John and Helga Carlen for the tax years 1947-1950. These deficiencies stemmed from the Commissioner’s disallowance of capital gains treatment for income derived from timber cutting contracts. The taxpayers petitioned the Tax Court for review, arguing they were entitled to capital gains treatment under Section 117(k)(1) of the Internal Revenue Code. The Tax Court consolidated the cases.

Issue(s)

Whether the taxpayers, as partners in a logging business cutting timber on land owned by others under contract, are entitled to treat the cutting of timber as a sale or exchange of timber, thereby qualifying for capital gains treatment under Section 117(k)(1) of the Internal Revenue Code.

Holding

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No, because the taxpayers did not own the timber, nor did they have a proprietary interest in the timber that would allow them to sell it on their own account; they were merely providing a service for compensation.

Court’s Reasoning

The court reasoned that Section 117(k)(1) applies to taxpayers who either own the timber they cut or have a contract right to cut timber for sale or use in their own trade or business. The court found that the partnership did not own the timber, as the contracts between Rayonier and Neuskah/Bishop constituted a sale of the timber to those entities. The court emphasized the absence of language in the agreements between the partnership and Neuskah/Bishop suggesting a sale of timber to the partnership. The court also noted that the partnership’s business was

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