26 T.C. 1197 (1956)

Whether timber sale proceeds qualify for capital gains treatment and the conditions under which depletion allowances can be revised based on changed estimates.

Summary

The U.S. Tax Court ruled that amounts received by Ah Pah Redwood Co. from the sale of timber were taxable as ordinary income because the company was in the business of selling timber, thus excluding it from capital gains treatment. Furthermore, the court held that a revision of the depletion allowance was not warranted because Ah Pah Redwood Co. did not ascertain the discrepancy between estimated and actual timber resources during the tax years in question, even though the information was readily available. The court affirmed the Commissioner's determination of tax deficiencies and additions to tax.

Facts

Ah Pah Redwood Co. (petitioner) purchased timber and land in Humboldt County, California, and entered into an agreement with Coast Redwood Co. (Coast) to allow Coast to cut timber and pay per thousand feet removed. Petitioner reported the income from timber sales as long-term capital gains and used a depletion basis. In 1952, it was discovered that the original timber estimate was significantly overstated. An actual cruise after logging operations ceased showed an overstatement of approximately double the actual amount. Petitioner sought to revise its depletion allowance for 1948 and 1949, citing an erroneous original estimate of timber resources.

Procedural History

The Commissioner determined deficiencies in income tax and additions to tax for 1948 and 1949 due to the petitioner's failure to file timely returns. The Tax Court considered the issues of whether the timber sale proceeds were capital gains or ordinary income and whether the depletion allowance could be revised.

Issue(s)

1. Whether the amounts received by petitioner in 1948 and 1949 from Coast Redwood Co. for timber cut are properly taxable as long-term capital gains.

2. Whether petitioner's depletion allowance for the taxable years 1948 and 1949 is properly to be adjusted subsequent to the close thereof by revision of the estimated amount of units of timber standing on petitioner's property during such years.

Holding

1. No, because the court determined that the amounts received were ordinary

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income, not capital gains.

2. No, because the court found that the petitioner did not ascertain the discrepancy between the estimated and actual timber resources during the taxable years.

Court’s Reasoning

The court analyzed whether the timber sales qualified for capital gains treatment under Section 117 of the Internal Revenue Code of 1939. The court concluded that the petitioner was engaged in the business of selling timber, thus excluding the timber from the definition of a capital asset. The court emphasized that

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