32 T.C. 161 (1959)

For timber sales to qualify for capital gains treatment, the seller must be the owner of the timber and retain an economic interest after its disposal, or the timber must be a capital asset held for more than six months.

Summary

In *Jantzer v. Commissioner*, the United States Tax Court addressed whether income from timber sales qualified for long-term capital gains treatment under the 1939 Internal Revenue Code. The Jantzer Lumber Company partnership had assigned a timber contract to a new partnership (Trail Creek Lumber Company). The court determined the original contract did not constitute a present sale of the timber, that the new partnership did not hold the timber for more than six months before its sale. The court also examined whether an oral arrangement between the partnership and a corporation, which cut timber, qualified for capital gains treatment. The court held that the arrangement did not represent a sale of a capital asset.

Facts

George L. Jantzer and other petitioners were partners in the George L. Jantzer Lumber Company. In 1946, the lumber company entered into a contract (the Dwinnell contract) with Stanley W. Dwinnell for the purchase of timber. The contract specified the timber species and price per board foot and required the purchaser to manufacture the timber into lumber. The contract stipulated the timber was not to be considered owned by the purchaser until manufactured and paid for. The lumber company assigned the Dwinnell contract to the Trail Creek Lumber Company partnership, which included most of the same partners. The partnership then entered into an oral arrangement with the Trail Creek Lumber Company, Inc. to cut and sell timber. The partnership claimed the income from the timber sales qualified for capital gains treatment, while the Commissioner of Internal Revenue determined the income was taxable as ordinary income. The timber was cut and manufactured by the corporation, and sold to customers in the ordinary course of business.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax for the years 1952 and 1953. The petitioners challenged this determination in the United States Tax Court.

Issue(s)

1. Whether the partnership's receipts from the sale of timber under the Dwinnell contract and from the Onn tract qualified for long-term capital gains treatment under Section 117(k)(2) of the Internal Revenue Code of 1939.

2. Whether the oral arrangement between the partnership and the corporation constituted sales of the Dwinnell contract or timber such that they qualified for long-term capital gains treatment under Section 117(a) of the Internal Revenue Code of 1939.

Holding

1. No, because the contract did not convey present title to the timber, and the timber was not held for the requisite six months.

2. No, because the oral arrangement did not amount to a sale of a capital asset.

Court's Reasoning

The court first addressed whether the income qualified under Section 117(k)(2). To qualify, the partnership had to be the owner of the timber, dispose of the timber after holding it for more than six months, and retain an economic interest in the timber. The court held that the Dwinnell contract, while an agreement to purchase timber, did not convey present title to the timber. The court distinguished the Dwinnell contract from the contract in the *L.D. Wilson* case based on the lack of a definite time limit for cutting and removing the timber, and a lack of a clear indication that the purchaser was paying for the timber itself, rather than the manufactured product. Therefore, the partnership did not own the timber for more than six months. As to the Onn tract timber, the court found the partnership did not retain an economic interest in the timber after disposal, because the oral agreement with the corporation was terminable at will. The court reasoned that the agreement did not constitute a contractual disposal. The corporation took no risk, provided no consideration, and was under no obligation to cut any amount of timber, therefore the partnership retained no economic interest in the timber.

The court then examined whether the income qualified under Section 117(a). The court held that the arrangement with the corporation did not amount to a sale of the Dwinnell contract or the Onn timber because the partnership was primarily in the business of selling timber. Since the timber was held for sale in the ordinary course of business, it was not a capital asset.

Practical Implications

This case emphasizes the importance of carefully structuring timber sale agreements to achieve favorable tax treatment. The *Jantzer* court examined several details in the Dwinnell contract to conclude that the partnership did not acquire ownership of the timber until it was cut, and therefore, it did not meet the requirements for capital gains treatment under the IRC. The ruling underscores the need for a detailed and comprehensive contract. The decision also illustrates the importance of the "economic interest" requirement, especially when dealing with related parties. If the seller has no control and no economic interest over the timber after the transaction, it is less likely to qualify for capital gains treatment. This case also shows the importance of the ordinary course of business test: if a taxpayer is primarily in the business of selling timber, then the timber is not a capital asset.

Future tax attorneys must take note of the factors that the court weighed in its analysis. Contract language matters, particularly provisions regarding the passage of title, the presence of a definite time limit, and the allocation of risks between the parties. If a taxpayer wishes to claim capital gains treatment, then they must demonstrate that all the statutory requirements have been met.

This case continues to be cited for the principles of “economic interest” and capital asset definitions in the context of timber sales. For example, it was cited in *Timber Products Sales Co. v. Commissioner*, 205 F.2d 650 (9th Cir. 1953), in discussing the economic interest requirement.

