33 T.C. 47 (1959)

Annual payments received under a timber lease agreement are considered ordinary income, not capital gains, for tax purposes if the landowner does not retain an economic interest in the timber.

Summary

The Estate of James M. Lawton entered into a 66-year lease agreement with Union Bag and Paper Corporation, granting the company exclusive use of the land for timber farming. The agreement stipulated an annual rental payment, regardless of whether timber was cut. The Tax Court addressed whether these annual payments should be taxed as ordinary income or as capital gains. The court held that the payments were ordinary income because Lawton did not retain an economic interest in the timber, as the payments were not contingent on the sale or severance of the timber. The court emphasized that the agreement was a lease, not a sale, and the income was rent rather than proceeds from the sale of a capital asset.

Facts

James M. Lawton owned timberland in Georgia. In 1952, he entered into a 66-year lease agreement with Union Bag. Union Bag was granted exclusive use and control of the land for timber farming and could cut a maximum amount of pulpwood annually. The agreement required Union Bag to pay a fixed annual rental, irrespective of timber harvesting. In addition, Union Bag made a lump-sum payment for the right to cut and remove a specific amount of timber. The Commissioner of Internal Revenue determined that the annual payments were ordinary income. The Estate of James M. Lawton contested this determination.

Procedural History

The case involved deficiencies in income tax for 1953 and 1954. The Tax Court heard the consolidated cases and ruled in favor of the Commissioner, finding that the annual payments under the lease were to be treated as ordinary income. The petitioners were seeking capital gains treatment for the payments.

Issue(s)

1. Whether the annual payments received by the taxpayer under the timber lease agreement are to be treated as long-term capital gains or ordinary income.

Holding

1. No, because Lawton did not retain an economic interest in the timber.

Court’s Reasoning

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The court’s primary focus was whether the taxpayer retained an

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