Collins v. Commissioner, 56 T. C. 1074 (1971)

A landowner's sale of fill dirt from their property can be treated as a long-term capital gain if the sale constitutes a complete transfer of the dirt in place.

Summary

In Collins v. Commissioner, the U. S. Tax Court ruled that the sale of fill dirt by the Collinses to Berns Construction Co. was a completed sale of their entire interest in the dirt, qualifying the gain as long-term capital gain under section 1231. The Collinses sold 471,803 cubic yards of dirt from their land for a highway project, and the court found that the contract obligated the buyer to remove all dirt from specified areas, thus transferring the entire interest in the dirt. The decision clarified the tax treatment of such sales, focusing on the nature of the agreement and the intent of the parties.

Facts

Wayman and Helen Collins owned 155 acres of farmland in Yorktown, Indiana. In 1963, they sold 23. 5 acres to the State of Indiana for a highway right-of-way. Berns Construction Co. , contracted to build the highway, needed fill dirt and approached the Collinses. They entered into an agreement in November 1963 for Berns to buy approximately 500,000 cubic yards of fill dirt from specific areas of the Collinses' land at $0. 10 per cubic yard. The agreement stipulated that Berns would excavate and remove all dirt from the designated areas. Berns removed 471,803 cubic yards and paid $47,180. 30, which the Collinses reported as long-term capital gain on their 1964 tax return.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Collinses' income tax for 1964, 1965, and 1966, arguing that the profit from the dirt sale should be treated as ordinary income. The Collinses petitioned the U. S. Tax Court, which heard the case and issued its opinion on August 12, 1971.

Issue(s)

1. Whether the Collinses' gain from the sale of fill dirt to Berns Construction Co. should be treated as long-term capital gain under section 1231 of the Internal Revenue Code.

Holding

1. Yes, because the agreement between the Collinses and Berns constituted a completed sale of the fill dirt in place, transferring the Collinses' entire interest in the dirt, thus qualifying the gain as long-term capital gain under section 1231.

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Court’s Reasoning

The court applied the economic interest test, established in cases like Burnet v. Harmel and Commissioner v. Southwest Exploration Co. , which determines if the seller retains an economic interest in the minerals or materials sold. The key factor is whether the seller must look solely to the extraction of the materials for their profit. The court found that the agreement between the Collinses and Berns was not merely an option to purchase but an obligation to remove all dirt from specified areas, evidenced by the contract’s language and the parties’ intent. The court distinguished this case from others like Freund v. United States and Schreiber v. United States, where the agreements were more akin to leases without a fixed obligation to remove all materials. The court also noted that the Collinses did not participate in the excavation and the operation was completed in a short time, further supporting the classification as a completed sale. The court concluded that the Collinses sold their entire interest in the dirt, thus their profit was taxable as long-term capital gain.

Practical Implications

This decision impacts how similar transactions involving the sale of minerals or materials in place are analyzed for tax purposes. It emphasizes the importance of the contract’s terms and the parties’ intent in determining whether a sale is complete, thus affecting whether the gain is treated as capital or ordinary income. For legal practitioners, this case provides guidance on drafting agreements to ensure they qualify as completed sales for tax benefits. Businesses involved in similar transactions must carefully structure their agreements to meet the criteria for long-term capital gain treatment. Subsequent cases have cited Collins to clarify the distinction between sales and leases of materials in place, influencing tax planning and compliance in this area.

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