Buse v. Commissioner, 72 T. C. 777 (1979)

Ownership of timber for the purposes of IRC Section 631(a) election does not revert to the state during the interim period between the end of the initial contract and the execution of an extension agreement if the intent of the parties was to extend the timber cutting rights continuously.

Summary

In Buse v. Commissioner, the Tax Court determined that Buse Timber & Sales, Inc. had continuously owned or held the right to cut timber on the Gilbert Creek tract under IRC Section 631(a), despite delays in formal execution of extension agreements. The court rejected the IRS's argument that ownership reverted to the state between contract periods, focusing instead on the intent of the parties. Additionally, the court established the fair market values of the timber for the years 1971, 1972, and 1973, emphasizing the use of comparable sales adjusted for various factors. This decision clarifies the continuous ownership requirement for Section 631(a) elections and the methodology for determining timber's fair market value.

Facts

Buse Timber & Sales, Inc. , a subchapter S corporation, entered into a contract with the Washington State Department of Natural Resources on May 29, 1969, to purchase and remove timber from the Gilbert Creek tract. The original contract allowed timber removal until December 31, 1971. Buse requested extensions, which were granted, extending the removal period to December 31, 1972, and then to December 31, 1973. The IRS challenged Buse's IRC Section 631(a) election, claiming the timber ownership reverted to the state during the periods between the end of the original contract and the execution of the extensions. Buse cut significant volumes of timber in the years in question, and the fair market values of the timber were contested.

Procedural History

The IRS issued deficiency notices to the Buse family members, who then filed a petition with the Tax Court. The court addressed two main issues: whether Buse continuously owned or held the right to cut the Gilbert Creek timber under IRC Section 631(a), and the fair market values of the timber for the years 1971, 1972, and 1973. The case proceeded to trial, where evidence was presented regarding the contract extensions and timber valuations.

Issue(s)

1. Whether Buse Timber & Sales, Inc. owned or held the right to cut the Gilbert Creek timber for the requisite 6-month period under IRC Section 631(a).
2. What is the fair market value of the section 631(a) timber as of May 1, 1971, May 1, 1972, and May 1, 1973?

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Holding

1. Yes, because the intent of the parties was to continuously extend the timber cutting rights, and the extension agreements were executed in a customary manner.
2. The court determined specific fair market values for the timber, adjusted for various factors including comparable sales and the highest and best use of the property.

Court’s Reasoning

The court focused on the intent of the parties in the contract extensions, emphasizing that the sole purpose was to extend the timber removal period. The court found that the timber did not revert to the state during the interim periods, as the extensions were requested before the original contract expired and were granted in a customary manner. The court cited Washington state law and case law to support its interpretation of the contract. For the valuation issue, the court used the comparable sales method, adjusting for factors such as quality, quantity, accessibility, and location. The court considered expert testimonies but ultimately made its own determination of fair market values, rejecting some adjustments proposed by the parties’ experts.

Practical Implications

This decision clarifies that for IRC Section 631(a) elections, the continuous ownership or contract right to cut timber is determined by the intent of the parties and the customary practices in executing extension agreements. Practitioners should ensure that extension requests are made before the original contract expires and that the intent to extend continuously is clear. The court’s valuation methodology provides guidance on using comparable sales and adjusting for various factors, which is crucial for similar cases involving timber valuation. This case may impact how timber companies and tax professionals approach Section 631(a) elections and the valuation of timber assets. Subsequent cases may reference Buse when addressing similar issues of continuous ownership and timber valuation.

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