Webb Export Corp. v. Commissioner, 91 T. C. 131, 1988 U. S. Tax Ct. LEXIS 99, 91 T. C. No. 14 (1988)

Harvesting activities that are substantial in nature and generally considered production can disqualify a corporation from being classified as a DISC under the Internal Revenue Code.

Summary

Webb Export Corporation, established as a Domestic International Sales Corporation (DISC), engaged in purchasing standing timber and converting it into veneer logs for export. The central issue was whether these harvesting activities constituted "production" under tax regulations, which could affect Webb's DISC status. The Tax Court held that the harvesting was indeed production, as it involved substantial and generally recognized production activities. This led to the conclusion that the logs were not export property, causing Webb to fail the qualified export receipts test for 1978 and the qualified export asset test for 1977, 1978, and 1979, disqualifying it as a DISC for those years.

Facts

Webb Export Corporation was incorporated by its parent, David R. Webb Co. , Inc. , to function as a DISC. It purchased standing timber, which was then felled, delimbed, bucked, and skidded by its own logging crew to produce veneer logs for export to Europe. The harvested logs were primarily veneer-quality walnut, red oak, and white oak. The process was time-consuming and required skill, occurring seasonally from late September to early May. The logs produced were cataloged and shipped from Webb's log yard.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Webb's income tax for the years 1977, 1978, and 1979, asserting that Webb's harvesting activities disqualified it from being a DISC. Webb contested these deficiencies in the United States Tax Court. After a trial, the Tax Court ruled that Webb's activities constituted production, impacting its DISC qualification.

Issue(s)

1. Whether Webb's harvesting activities constituted "production" within the meaning of section 1. 993-3(c)(2), Income Tax Regs.
2. Whether the veneer logs produced by Webb and the assets used in their production qualified as "export property" under section 993(c)(1), I. R. C. 1954.
3. Whether Webb's standing timber constituted an export asset.
4. Whether Webb's qualified export receipts for 1978 equaled or exceeded 95 percent of its gross receipts for that year under section 992(a)(1)(A), I. R. C. 1954.
5. Whether the adjusted bases of Webb's qualified export assets equaled or

exceeded 95 percent of the adjusted bases of all its assets for the years 1977, 1978, and 1979 under section 992(a)(1)(B), I. R. C. 1954.

Holding

1. Yes, because Webb's harvesting activities were substantial in nature and generally considered to constitute production.
2. No, because the logs produced by Webb were not export property as they were produced by Webb itself, which was a DISC.
3. No, because standing timber held by Webb for production into logs was not held for direct sale outside the U. S.
4. No, because in 1978, Webb's qualified export receipts were less than 95 percent of its gross receipts.
5. No, because for 1977, 1978, and 1979, the adjusted bases of Webb's qualified export assets were less than 95 percent of the adjusted bases of all its assets.

Court's Reasoning

The court applied section 1. 993-3(c)(2) of the Income Tax Regulations, focusing on whether Webb's activities constituted "production. " The court found that the operations were substantial, involving trained personnel using specialized equipment in a time-consuming process to produce veneer logs. These activities were also generally considered production within the forest products industry, as supported by expert testimony and industry references to logs as products. The court emphasized that standing timber was not directly exportable, and its conversion into logs was a production process. The court also noted that the Tax Reform Act of 1976 did not change the requirement that export property must be held for direct sale outside the U. S. , which Webb's standing timber did not meet. The court's decision was influenced by policy considerations to ensure that DISCs primarily engaged in export sales rather than production.

Practical Implications

This decision clarifies that substantial harvesting activities can be considered production, which may disqualify a corporation from DISC status if it affects the corporation's qualified export receipts or assets. Legal practitioners advising clients on DISC formation should carefully assess any production activities, as they could impact tax benefits. Businesses in the forestry or similar sectors need to structure their operations to ensure compliance with DISC requirements if seeking such status. The ruling may affect how similar cases are analyzed, emphasizing the importance of the nature and industry perception of activities. Subsequent cases like *Dave Fischbein Manufacturing Co. v. Commissioner* have been distinguished based on the specifics of the activities involved, but the principles from *Webb Export* continue to guide the determination of what constitutes production for DISC purposes.

