Eck v. Commissioner, 99 T. C. 1 (1992)

The sale of Christmas trees on a "choose and cut" basis does not qualify for long-term capital gains treatment under Section 631(b) of the Internal Revenue Code.

Summary

In Eck v. Commissioner, the taxpayers operated Christmas tree farms and argued that their sales of trees qualified for long-term capital gain treatment under IRC Section 631(b). The Tax Court held that the transactions did not involve a retained economic interest as required by Section 631(b), and thus the gains were ordinary income. The court reasoned that the sale of each tree was a simple, integrated transaction that did not fit the legislative intent of Section 631(b), which was designed for timber industry contracts involving retained economic interests over time.

Facts

Gerald and G. Marlene Eck owned and operated two Christmas tree farms in Kansas. Customers would select a tree, signal to an employee to cut it, or cut it themselves. The tree's price was on attached tags, one labeled as a "Tree Cutting Permit. " Upon selection, the customer's name was written on the tags, and the tree was cut and paid for at a barn. The Ecks reported these sales as long-term capital gains on their tax returns, claiming they retained an economic interest in the trees until payment.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Ecks' taxes, asserting that the sales of Christmas trees should be treated as ordinary income, not capital gains. The case was submitted to the U. S. Tax Court on a stipulated record, focusing on whether the gains from the Christmas tree sales qualified for long-term capital gains treatment under Section 631(b).

Issue(s)

1. Whether the sale of Christmas trees on a "choose and cut" basis constitutes a disposal of timber under a contract by which the seller retains an economic interest, qualifying for capital gains treatment under IRC Section 631(b).

Holding

1. No, because the court found that the Ecks did not retain an economic interest in the Christmas trees as required by Section 631(b), and the transactions did not fit the legislative intent behind the statute.

Court's Reasoning

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The court analyzed Section 631(b) in the context of its legislative history, which aimed to address the taxation of gains from timber cutting contracts where the owner retained an economic interest. The court found that the Ecks' sales of Christmas trees did not resemble such contracts. The court emphasized that the transactions were simple sales completed within minutes, not involving the kind of long-term economic interest retention contemplated by the statute. The court cited *Burnet v. Harmel* to contrast the nature of the transactions in question, and referenced Rev. Rul. 77-229, which similarly concluded that "choose and cut" sales of Christmas trees do not qualify for Section 631(b) treatment. The court rejected the Ecks' argument that writing the customer's name on a tag created a contract with a retained economic interest.

Practical Implications

This decision clarifies that sales of Christmas trees on a "choose and cut" basis are treated as ordinary income, not capital gains, under Section 631(b). Practitioners advising clients in the Christmas tree farming industry should guide them to report such sales as ordinary income. This ruling reinforces the narrow scope of Section 631(b), intended for timber industry transactions involving long-term retained interests. It also underscores the importance of aligning tax treatment with the specific nature and duration of transactions. Subsequent cases and IRS guidance have followed this interpretation, solidifying the distinction between timber contracts and immediate sales like those in the Christmas tree industry.

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