

ALLEN LOGGING & VENEER CO. v. UNITED STATES
73-2 U.S.T.C. ¶9691, 32 AFTR 2(t 73-5310 (W.D. Wash., 1973)

[Ed. Note: This case was previously digested at 10 T.T.J. 136. It has come to our attention that the previous digest incorrectly presented the facts of this case. A correct digest of the case appears below.]

Editor's Summary

Key Topics

CUTTING AS A SALE OR EXCHANGE

- Contract right to cut
- Date of acquiring

OWNERSHIP OF STANDING TIMBER

- Date of acquiring ownership or contract right to cut

Facts

On June 29, 1965, the taxpayer, Allen Logging and Veneer Company, was declared the successful bidder at an auction of specified timber and forest products conducted by the Washington State Department of Natural Resources -- the Red Creek Sale. The result of this sale was reported to the Department on June 29, 1965, and the taxpayer received a copy of the report on that day. On July 12, 1965, the State Commissioner of Public Lands formally confirmed the sale, as he was required to do by State statute; The parties subsequently executed a Bill of Sale and a Contract relating to payment for and removal of forest products.

On June 28, 1966, the taxpayer was again declared the successful bidder at an auction of specified timber and forest products conducted by the Department of Natural Resources -- the Winfield Ridge Sale. The result of this sale was reported on June 28, 1966, and the taxpayer received a copy of the report on that day. The Commissioner of Public Lands formally confirmed the sale on July 11, 1966, The parties subsequently executed a Bill of Sale and a Contract relating to payment for and removal of forest products.

During 1966 and 1967, the taxpayer cut other timber eligible for treatment under section 631(a) from various areas in the State of Washington and elected to treat such cutting as a sale or exchange of timber pursuant to section 631(a). Taxpayer also included and elected to treat the cutting of timber from the Red Creek and Winfield Ridge sales as a sale or exchange of timber pursuant to section 631(a). In filing its return for each year, the taxpayer computed the fair market value, as of the first of the year, of the eligible timber cut.

The Commissioner assessed deficiencies against the taxpayer for 1966 and 1967 based upon the determination that the reported fair market value of the eligible timber cut by the taxpayer was

incorrect for both years. The Commissioner also contended that the taxpayer should not have included the timber acquired in the Red Creek and Winfield Ridge sales in its 1966 and 1967 returns, contending that the taxpayer did not own, or hold a contract right to cut, this timber for six months prior to the beginning of the respective taxable years since the sales were not approved until July 12 and July 11, respectively.

U.S. District Court

Held: For the Commissioner. The Court accepted the Commissioner's contention that the taxpayer did not own or have a contract right to cut the timber from the Washington sales for 6 months prior to the beginning of the taxable year in which it was cut, and was therefore not eligible for treatment under section 631(a). According to the Court, the question of whether a taxpayer has owned, or held a contract right to cut, timber for 6 months prior to the beginning of the year in which the timber is cut, which is a prerequisite for section 631(a) treatment, must be determined by State law. The Court, citing *Caffall Bros. Forest Products v. State*, 79 Wash. 2d 223, 484 P.2d 912 (1971), held that, under Washington law, the taxpayer had not owned, or held a contract right to cut, the timber on the Red Creek and Winfield Ridge Sale areas for 6 months prior to the start of the taxable year in which the timber was cut. In *Caffall Bros. Forest Products*, the Supreme Court of Washington held that a sale must be confirmed by the Commissioner of Public Lands before it will be considered binding. Consequently, the six-month holding period provision of section 631(a) was not fulfilled and the cutting of timber from the Red Creek and Winfield Ridge areas could not be treated as a sale or exchange of a capital asset.

Case Text

Goodwin, District Judge: This action came duly on for trial before the undersigned Judge of this Court, sitting without a jury, on April 5 and 6, 1973. Plaintiff appeared by its attorneys, Ben J. Gantt, Jr., and William V. Vetter of Graham, McCord, Dunn, Moen, Johnston & Rosenquist, Seattle, Washington. Defendant appeared by Roger M Olsen, Attorney, Tax Division, United States Department of Justice. Evidence on behalf of Plaintiff and Defendant was introduced. The Court, having considered the testimony of the witnesses, the exhibits, stipulations, briefs and argument of counsel, rendered its oral decision on April 6, 1973, finding that Plaintiff herein is entitled to a judgment against the Defendant; and the Court being fully advised in the premises, hereby makes its Findings of Fact and Conclusions of Law as follows.

Findings of Fact

I. This is a timely commenced action for refund of income taxes and interest paid by Plaintiff under the Internal Revenue Laws of the United States pursuant to the Commissioner of Internal Revenue's Notice of Deficiency and is within the jurisdiction of this Court pursuant to 28 U.S.C. §1346(a)(1). Venue is properly laid in this Court.

II. Plaintiff, Allen Logging and Veneer Co. (hereafter called "Allen") is a Washington corporation with its lumber mill and principal place of business near Forks, Jefferson County, Washington. Allen's taxable year is the calendar year.

III. Allen timely filed its income tax returns for the years ending December 31, 1966, and December 31, 1967, and paid the tax of \$118,069.00 and \$37,796.00 shown as due on the respective returns.

IV. On November 15, 1971, Allen paid the deficiencies, as demanded by the Commissioner of Internal Revenue's statutory notice of deficiency dated August 24, 1971, together with interest thereon, as follows:

Year	Income Tax Deficiency	Interest	Total Paid
Calendar year 1966	\$ 28,485.00	\$ 7,870.83	\$ 36,355.83
Calendar year 1967	19,180.00	4,148.92	23,328.92

V. On January 18, 1972, Allen timely filed claims for refund of the tax and interest paid as shown in Finding IV which were disallowed in full on March 1, 1972.

VI. *Red Creek Sale*

A. On June 29, 1965, Allen was declared the successful bidder at a duly conducted auction of specified timber and forest products of the "Red Creek Sale" (Application No. 30013) held by the Washington State Department of Natural Resources (hereinafter called "Department") at Forks, Washington. On or before said date, Allen made all deposits and payments required of it to become the buyer of said timber.

B. The result of the Red Creek Sale auction was reported by Report of Sale of Valuable Material, dated June 29, 1965, to the Department, a copy of which was given to Allen on that day (Exhibit 6).

C. The State Commissioner of Public Lands (hereinafter "the Commissioner") formally confirmed the Red Creek Sale to Allen by Order dated July 12, 1965 (Exhibit 7). Allen and the State later executed a Bill of Sale and Contract to Pay for and Remove Forest Products and a Supplemental Agreement relating to such sale (Exhibits 8 and 10).

VII. *Winfield Ridge Sale*

A. On June 28, 1966, Allen was declared the successful bidder at a duly conducted auction of specified timber and forest products of the "Winfield Ridge Sale" (Application No. 31154) held by the Department at Forks, Washington. On or before said date, Allen made all deposits and payments required of it to become the buyer of said timber.

B. The result of the Winfield Ridge Sale auction was reported by Report of Sale of Valuable Material, dated June 28, 1966, to the Department, a copy of which was given to Allen on that day (Exhibit 16).

C. The Commissioner formally confirmed the Winfield Ridge Sale to Allen by Order dated July

11, 1966 (Exhibit 17). Allen and the State later executed a Bill of Sale and Contract to Pay for and Remove Forest Products and a Supplemental Agreement relating to such sale (Exhibits 18 and 20).

VIII. *Fair Market Value*

A. The sale of timber by St. Regis to Timber Traders, Inc., evidenced herein by Exhibits 37 and 40 and testified to by Plaintiff's expert witness, William A. Eastman, Jr., constitutes the best evidence of the fair market value as of January 1, 1966, of the timber cut by Allen in 1966.

B. The opinion of Mr. Eastman of the fair market value of the timber cut by Allen during the years 1966 and 1967, is supported by the preponderance of the evidence, and taking into account all of the factors relevant to the determination of fair market value as said term is defined in the Internal Revenue Code and Regulations issued thereunder; said opinion is hereby found to be and adopted as the actual fair market value of said timber. Said fair market value was the value reported on Allen's respective Income Tax Returns for said years.

IX. During 1966, Allen cut timber from six (6) State of Washington timber sale areas designated as State Application Numbers 28623, 29135, 29236, 29237, 29895, and 29927 which was eligible for treatment pursuant to §631(a) of the Internal Revenue Code of 1954, as amended. Allen properly elected to treat the cutting of said timber as a sale or exchange thereof pursuant to said section. The species, volume and fair market value of said timber is as follows:

Species	Eligible Bd. Ft. cut in 1966	FMV per MBd. Ft. as of 1/1/66	FMV of eligible timber cut during 1966
Hemlock & W. Fir	12,309,560	\$ 35.00	\$ 430,834.60
Spruce	4,513,500	35.00	157,972.50
Cedar	1,770,760	35.00	61,976.60
Douglas Fir	1,274,870	35.00	70,117.85
Total fair market value as of 1/1/66 of §631(a) eligible timber cut in 1966.			\$ 720,901.55

X. During 1967, Allen cut timber from two (2) State of Washington timber sale areas designated as State Application Numbers 30013 and 30410 which was eligible for treatment pursuant to §631(a) of the Internal Revenue Code of 1954, as amended. Allen properly elected to treat the cutting of said timber as a sale or exchange thereof pursuant to said section. The species, volume, and fair market value of said timber is as follows:

Species	Eligible Bd. Ft. cut in 1967	FMV per MBd. Ft. as of 1/1/67	FMV of eligible timber cut during 1967
Hemlock & W. Fir	2,367,050	\$ 32.50	\$ 76,929.12
Spruce	337,600	42.50	14,348.00
Cedar	1,999,220	35.00	69,972.70
Douglas Fir	50	52.00	2.60
Total fair market value as of 1/1/67 of §631(a) eligible timber cut in 1967.			\$ 161,252.41

XI. The Commissioner of Internal Revenue's determination of the fair market value as of January 1, 1966, of said timber cut by Plaintiff in the year 1966, is erroneous.

XII. The Commissioner of Internal Revenue's determination of the fair market value as of January 1, 1967, of said timber cut by Plaintiff in the year 1967, is erroneous.

XIII. The Commissioner erroneously demanded and collected from Allen, for the years 1966 and 1967 respectively, the following amounts:

Year	Income Tax	Deficiency Interest	Total
1966	\$18,426.27	\$5,091.45	23,517.72
1967	3,997.93	864.81	4,862.74
Total erroneously collected			\$28,380.46

Allen is entitled to a refund of said erroneously collected amounts together with interest thereon at the legal rate from November 15, 1971, until paid.

From the foregoing Findings of Fact, the Court does hereby make the following:

Conclusions of Law

I. This Court has jurisdiction over this action, the parties hereto and the subject matter hereof.

II. The Plaintiff sustained its burden of proof by a preponderance of the evidence that the fair market value as of January 1, 1966, of the timber cut by Plaintiff in the year 1966, and eligible for election under 26 U.S.C. §631 (a), as determined by the Commissioner of Internal Revenue is erroneous and that the correct fair market value of said timber is as follows:

Species	Eligible Bd. Ft. cut in 1967	FMV per MBd. Ft. as of 1/1/67	FMV of eligible timber cut during 1967
Hemlock & W. Fir	2,367,050	\$ 32.50	\$ 76,929.12
Spruce	337,600	42.50	14,348.00
Cedar	1,999,220	35.00	69,972.70
Douglas Fir	50	52.00	2.60
Total fair market value as of 1/1/67 of §631(a) eligible timber cut in 1967.			\$ 161,252.41

III. The Plaintiff sustained its burden of proof by a preponderance of the evidence that the fair market value as of January 1, 1967, of the timber cut by Plaintiff in the year 1967, and eligible for election under 26 U.S.C. §631 (a), as determined by the Commissioner of Internal Revenue is erroneous and that the correct fair market value of said timber is as follows:

Species	Eligible Bd. Ft. cut in 1967	FMV per MBd. Ft. as of 1/1/67	FMV of eligible timber cut during 1967
Hemlock & W. Fir	2,367,050	\$ 32.50	\$ 76,929.12
Spruce	337,600	42.50	14,348.00
Cedar	1,999,220	35.00	69,972.70
Douglas Fir	50	52.00	2.60
Total fair market value as of 1/1/67 of §631(a) eligible timber cut in 1967.			\$ 161,252.42

IV. Insofar as the issue of when Allen obtained ownership of, or a contract right to cut the timber in the Red Creek Sale area and in the Winfield Ridge Sale area, this Court must follow the law of the State of Washington and especially the decision of the state Supreme Court in *Coffall Bros. Forest Prod. Inc. v. State*, 79 Wn. 2d 223, 484 P. 2d 912 (1971),

V. Plaintiff did not own, nor hold a contract right to cut, the timber cut from the Red Creek timber sale area during the year 1966 for a period of six (6) months or more prior to the beginning of 1966, therefore the cutting of said timber during said year may not be treated as a sale or exchange thereof pursuant to 26 U.S.C. §361 (a).

VI. Plaintiff did not own, nor hold a contract right to cut, the timber from the Winfield Ridge timber sale area during the year 1967 for a period of six (6) months or more prior to the beginning of 1967, therefore the cutting of said timber during said year may not be treated as a sale or exchange thereof pursuant to 26 U.S.C. § 631 (a).

VII. Plaintiff is entitled to judgment over and against Defendant in the sum of \$28,380.46, together with interest thereon at the rate of six percent (6%) per annum from November 15, 1971, until paid, together with Plaintiff's costs and disbursements herein to be taxed.