

JORDAN v. UNITED STATES
62-1 USTC ¶ 9370; 9 AFTR 2d 1359 (S.D. Ala. 1962).

Editor's Summary

Key Topics

OUTRIGHT SALE--CAPITAL GAIN v. ORDINARY INCOME

- Sales of stumps by investor in timberland

Facts

The taxpayers purchased cut-over timberland with the objective of growing timber. At the time of the purchase there was a substantial quantity of stumps on the land. No part of the purchase price was allocated to the stumps. The taxpayers were investors. They were not in the stump business and they were not timber operators. After holding the property for a number of years, during which time they made one or two sales of standing timber, the taxpayers learned that the stumps were saleable, and sold them for over \$20,000. They reported the proceeds from the sale of the stumps as capital gain, but the Commissioner contended that the stumps had been held primarily for sale and thus were not capital assets.

District Court

Held: For the taxpayers. On a jury verdict, the taxpayers were found not to have held the stumps primarily for sale.

Case Text

COMPLAINT

THOMAS, District Judge: 1. This is an action of a civil nature which arises under the Internal Revenue Code of the United States (Title 26, U.S.C. Section 1, et seq.) and is brought under Section 1346(a)(1) of the Judicial Code of the United States (Title 26 U.S.C. Section 1346(a)(1)).

2. E. L. Jordan and Martha Annie Jordan (husband and wife), the Plaintiffs, reside at Jordan, in the County of Washington, State of Alabama; and they are citizens of the United States of America.

3. The Plaintiffs' claim is for a refund of United States income tax, and interest thereon, paid by them to the District Director of Internal Revenue for the District of Alabama, at Birmingham, Alabama, for the taxable year which ended on December 31, 1955, as a result of the action of the Commissioner of Internal Revenue in assessing an alleged deficiency in such tax for the said taxable year as hereinafter set forth.

4. The Plaintiffs filed a joint United States individual income tax return (IRS form 1040) for the said taxable year and paid the income tax which was thereon shown to be due, being the sum of Twenty Thousand Two Hundred Sixty-Seven and 21/100 Dollars (\$20,267.21), to the said District Director. After said return was filed, the Plaintiffs discovered an error in the said return and filed an amended United States individual income tax return (IRS form 1040) for the said taxable year, which showed an overpayment of income tax for said taxable year in the sum of Four Thousand Two Hundred Forty-Three and 93/100 Dollars (\$4,243.93) and directed that said overpayment be credited against estimated United States income tax for the taxable year ending December 31, 1956. Said returns were filed on or before April 15, 1956, and within the time required by law, with the Office of the said District Director. The Plaintiffs duly and correctly reported their income for the said taxable year on the said amended return. The Commissioner of Internal Revenue, upon auditing the said returns, made certain adjustments in the computation of the Plaintiffs' taxable income and, by giving effect to such adjustments, determined an alleged deficiency in income tax against the Plaintiffs and caused the Plaintiffs to be notified on, to-wit, December 26, 1957, that it appeared that they owed additional income tax for the said taxable year 1955 in the sum of Six Thousand Two Hundred Twenty-Seven and 44/100 Dollars (\$6,227.44), plus interest thereon. Although the Plaintiffs directed on the said amended return that the said overpayment be credited against estimated income tax for the taxable year 1956, the said Commissioner, in March of 1958, applied the said overpayment against the said alleged deficiency for the taxable year 1955. The remaining balance of the alleged deficiency was the sum of One Thousand Nine Hundred Eighty-Three and 51/100 Dollars (\$1,983.51). Thereafter, and pursuant to said determination, the amount of the said remaining balance of the alleged deficiency was assessed by the Commissioner of Internal Revenue against the Plaintiffs and, in April of 1958, there was delivered to the Plaintiffs a notice of such assessment and demand for the payment of the said balance of the alleged deficiency in the sum of One Thousand Nine Hundred Eighty-Three and 51/100 Dollars (\$1,983.51), together with interest thereon in the sum of Two Hundred Twenty-Five and 36/100 Dollars (\$225.36), or the aggregate Sum of Two Thousand Two Hundred Eight and 87/100 Dollars (\$2,208.87). Pursuant to the said notice and demand, the Plaintiffs on, to-wit, April 22, 1958, paid to the said District Director the said sum of Two Thousand Two Hundred Eight and 87/100 Dollars (\$2,208.87).

5. (a) The principal adjustment so made by said Commissioner arose from his determination that the gain from the sale of stumps, which were on the real property at the time of acquisition thereof, was gain from the sale of assets held for sale to customers in the ordinary course of trade or business instead of gain from the sale of capital assets held for more than six months, the disallowance of the deduction for one-half of the excess of the net long-term capital gain over the net short-term capital loss for said taxable year under Section 1202 of the Internal Revenue Code of 1954, and the imposition of the self employment tax under Section 1401 of the Internal Revenue Code of 1954.

(b) Such adjustments so made by the said Commissioner, his determination of said deficiency based thereon, his assessment of same against the Plaintiffs, and the collection of said alleged deficiency, with interest thereon, as aforesaid, by the said District Director were erroneous, illegal and in complete and total disregard of the facts and applicable law, provisions of the Internal Revenue Code of 1954 and administrative rules and regulations promulgated under such code provisions.

6. The said Commissioner's action in making said principal adjustments for the said taxable year 1955 based upon his refusal to recognize said gain as gain from the sale of a capital asset held for more than six months, in determining and assessing said alleged deficiency based on said principal adjustments and the said District Director's collection of said amount from the Plaintiffs all as aforesaid, resulted in the Plaintiff's overpayment of federal income tax for the said taxable year 1955 in the sum of Six Thousand Two Hundred Twenty-Seven and 44/100 Dollars (\$6,227.44), plus interest in the sum of Two Hundred Twenty-Five and 36/100 Dollars (\$225.36), or the aggregate sum of Six Thousand Four Hundred Fifty-Two and 80/100 Dollars (\$6,452.80). The Plaintiffs are entitled to a refund of said sum of Six Thousand Four Hundred and Fifty-Two and 80/100 Dollars (\$6,452.80), plus interest from the dates of payment of the same to-wit, April 15, 1956, and April 22, 1958.

7. On, to-wit, December 18, 1958, Plaintiffs duly filed, with the said District Director, their formal claim for refund (IRS form 843) of the said amount so paid to said District Director by the Plaintiffs, together with interest thereon from the said dates of payment of the same. A photocopy of said claim for refund, with statement on "Exhibit A" attached thereto, is attached hereto, marked "Exhibit 1" [not reproduced herein] for the purpose of identification and made a part of the allegations hereof by express reference thereto. No part of said claim has been refunded to the Plaintiffs and they were given written notice, dated March 11, 1959, by registered mail, that their said claim for refund had been disallowed.

WHEREFORE, the Plaintiffs demand judgment against the Defendant for the sum of Six Thousand Four Hundred Fifty-Two and 80/100 Dollars (\$6,452.80) and such other and additional sum as the Plaintiffs may be entitled to receive, together with interest thereon according to law from the dates of payment as hereinabove stated, to-wit, April 15, 1956, and April 22, 1958, and for the costs and disbursements by the Plaintiffs in this action; and the Plaintiffs pray that the Court will grant to them any other, further or different relief to which they may be entitled, the premises considered.

EXHIBIT "A"

This is Exhibit "A" referred in and attached to the claim for refund of E. L. Jordan and Martha Annie Jordan. The taxpayers, E. L. Jordan and Martha Annie Jordan, duly and correctly filed their Federal Income Tax Return for the taxable year which ended on December 31, 1955, and an amended Return for the said taxable year 1955, both of said Returns were filed on or before April 15, 1956, and within the time required by law, with the District Director of Internal Revenue for the District of Alabama, at Birmingham, Alabama. The taxpayers duly and correctly reported their income for the said taxable year and paid to the said District Director the amount of tax shown to be due on the said Returns.

A number of years ago, the taxpayers purchased some large quantities of acreage, which was in a cut-over condition with some young timber growth present and located in Washington County, Alabama, and elsewhere. The taxpayers purchased the property and held it for investment purposes, looking toward its enhancement in value principally for the purpose of growing timber.

On one or more occasions since the property was acquired, the taxpayers have sold timber from such property. At the time that the taxpayers acquired such property, there was a substantial quantity of stumps, commonly referred to as lightwood stumps or pinestumps, on such property. No part of the cost of such property was allocated to the stumps at the time of the said purchase.

In the said taxable year 1955, it developed that the stumps, which were on such property at the time of acquisition by the taxpayers and in substantially the same condition as they were at the time of acquisition, had a salable value, and the taxpayers sold these old stumps for the sum of \$20,710.92. As no part of the cost of the acreage was allocated to the stumps, the gross proceeds received by the taxpayers in the said taxable year 1955 from the sale of such stumps was reported on their Federal Income Tax Return for the said taxable year as capital gain.

The taxpayers are investors in lands and timber. They are not in the timber or stump business, nor are they processors of timber for stumps, nor are they timber operators. They do not hold stumps or timber for sale to customers in the ordinary course of a trade or business and they did not hold stumps for sale in the said taxable year 1955 to customers in the ordinary course of a trade or business. They neither owned nor operated a sawmill or stump plant in the said taxable year 1955, nor did they own any stock or other interest in any corporation or other entity or business which owned any such mill or plant.

The stumps which were sold by the taxpayers in the said taxable year 1955 constituted capital assets as defined by Section 1221 of the Internal Revenue Code of 1954; and were capital assets at the time that the taxpayers acquired them during the entire period that they held them, and at the time that they sold them in the said taxable year 1955. The taxpayers realized a gain on their investment in the said taxable year 1955 when they sold the stumps. The gain realized by the taxpayers constituted gain from the sale of capital assets held for more than six months, and the gain there from was properly reported by the taxpayers on their Federal Income Tax Return for the said taxable years 1955 as a long term capital gain.

In the alternative and in addition to the grounds for refund stated above, taxpayers claim that they are entitled to such refund because the gain from the sale of such stumps was gain from the sale of a capital asset held for more than six months and they were entitled to report the same as capital gain under the provisions of Section 631 of the Internal Revenue Code of 1954.

In the alternative and in addition to the grounds for refund stated above, taxpayers claim that they are entitled to such refund because the gain from the sale of such stumps was gain from the sale of a capital asset held for more than six months and they were entitled to report the same as capital gain under the provisions of Section 1231 of the Internal Revenue Code of 1954.

Judge Thomas: Miss Cannon and Gentlemen of the Jury, my charge in this case will be extremely short. This case presents a factual matter to be determined by you. It can be stated thusly: Did Mr. E. L. Jordan and his wife hold the stumps which were sold in 1955 primarily for sale to customers, in the ordinary, course of a trade or business. If they did, the Government is entitled

to a verdict if they did not, the Plaintiffs are entitled to a verdict. The burden of proof is on the Plaintiffs to establish their case by a preponderance of the evidence. The Revenue Code, that portion of it, with which you are interested, is Section 1221, under Capital Asset Defined. I am going to send all this up there with you. For the purpose of this subtitle, the term "Capital Asset" means property held by the taxpayer, (whether or not connected with his trade or business), but does not include (1) stock in trade of the taxpayer or other property of a kind which would properly be included in an inventory of the taxpayer if on hand at the close of the taxable year, or (2) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Now, the Plaintiffs have requested me to give you certain written charges, which I state to you are correct statements of the law. They are to be taken in connection with what I have already told you. I am going to give these to you. The Defendant has likewise requested that I give you certain written charges. They are correct statements of the law, but are to be taken by you in connection with what I have already instructed you.

Judge Thomas: Are there any exceptions to the Court's Oral Charge on behalf of the Plaintiffs?

Mr. Arendall: None, your Honor.

Judge Thomas: Are there any exceptions to the Court's Oral Charge on behalf of the Defendant?

Mr. Doster: No exceptions.

Judge Thomas: Here is my charge, the marked portion on the Internal Revenue Code of what I have read to you, and these are charges requested by both sides. Here is the complaint. Here is the answer.

Mr. Arendall: I think you better tell them about the form of their verdict.

Judge Thomas: Under your stipulation, they just return a verdict for the Plaintiffs or the Defendant. Your verdict must either be for the Plaintiffs or the Defendant. If it is for the Plaintiffs, you do not have to set out any figure. It can be mathematically computed. If you find for the Plaintiffs, you use this form, which reads "We, the Jury, find for the Plaintiffs, E. L. Jordan and Martha Annie Jordan." If you find for the Defendant, you use this form, which reads, "We, the Jury, find for the Defendant, United States of America." When you have arrived at a verdict, knock on the door, and I will receive it. Your verdict must be unanimous. Your first official duty will be to elect a foreman, and let him fill out whatever verdict you reach. Thereupon, the Jury retired at 4:10 P. M.

Thereafter, at 4:40 P. M. the jury reported, and the following proceedings transpired:

Judge Thomas: Has the Jury arrived at a verdict?

Foreman of Jury: Yes, sir.

Judge Thomas: Hand it to Mr. Shepard, please. Read it, Mr. Shepard.

Mr. Shepard: We, the Jury, find for the Plaintiffs, E. L. Jordan and Martha Annie Jordan.