

LYSEK v. COMMISSIONER
34 CCH Tax Ct. Mem. 1267,
1975 P-H Tax Ct. Mem. ¶75,293 (1975)

Editor's Summary

Key Topics

VALUATION

- Fair Market Value of Timber
- How Determined

Facts

In 1966 the taxpayer reported a long-term capital gain under Section 631(a). He claimed that approximately 660,000 gross board feet of timber was cut on his property during 1966, and that the timber had a value of about \$30 per thousand board feet. The Commissioner contended that the standing timber had a value of \$17 per thousand board feet and this value applied only to the extent of 491,620 board feet of net merchantable logs obtained from the timber cut. The taxpayer based his valuation on (a) the average price offered for timber on a contiguous property, (b) upon two timber trespass awards, one awarded to him and the other assessed against him, and (c) taxpayer's personal opinion and the opinion of his tax adviser, neither of whom qualified as timber valuation experts. The Commissioner presented two qualified timber valuation experts, one of which used the "conversion return" approach, and the other who had inspected and appraised the timber on the contiguous property. In addition, both experts presented photographs and testified concerning sales prices for five comparable timber sales.

Tax Court

Held: For the Commissioner. The Commissioner's evaluation of the timber was held correct. The court rejected taxpayer's valuation since the taxpayer and the professional tax adviser were not qualified timber valuation experts and the value of timber sold on adjacent lands was based on higher grade timber. In addition, timber trespass awards under California law are Presumptively greater than fair market value since they are punitive and not remedial. The court also held that the Commissioner's finding on the amount of timber in question was correct since 168,380 board feet of defective timber cut but "left in the field" was not "sold or exchanged" within the meaning of Section 1.631-1(d).

Case Text

[Timber issue Only]

Memorandum Findings of Fact and Opinion

Hoyt, Judge: The respondent determined deficiencies in income tax and additions thereto for the

petitioners as follows:

Year	Income Tax Deficiency	Additions to the Tax Section 6653(a)
1964	\$ 1,057.25	\$ 52.86
1965	6,708.21	335.41
1966	14,618.00	730.90

Several concessions having been made, the issues remaining for our consideration are:

* * * * *

(6) The fair market value of standing timber on January 1, 1966, cut and sold by petitioner during 1966, for section 631(a) purposes.

* * * * *

Findings of Fact

The Tara property was also used by petitioner during 1965 and 1966 for raising cattle and during 1966 for timber logging operations. Petitioner's Tara property adjoined the Jackson State Forest. In November, 1965, a sale of timber (known as "Hare Creek Sale Number 1") took place in the State Forest from a tract contiguous to the northern boundary of petitioner's property. This sale consisted of 58 percent old-growth, large-diameter timber, and the selling price was \$30 per thousand board feet.

Petitioner's property had been logged at the turn of the century and in the late 1950's by the prior owners before it was acquired by petitioner. Petitioner's property on January 1, 1966, contained small-diameter redwood and Douglas fir trees which had not been logged as yet and were not attractive to logging companies due to their small size.

In 1966, petitioner hired choppers who cut approximately 660,000 board feet of predominately second-growth small diameter timber on the property, of which 49 percent was redwood, 49 percent Douglas fir and 2 percent hemlock and other woods. Of this timber, 491,620 board feet was trucked to a sawmill which paid petitioner \$24,255.51. The remaining chopped timber, approximately 168,390 board feet, consisted of defective timber left in the field, breakage, trim and waste. Timber companies attribute no value to such elements, paying only for net merchantable logs delivered to the mill.

Sales of timber were made which were comparable to the timber cut and sold in 1966 by petitioner on the dates and for the prices as follows:

Description	Sale Date	Price	
		Redwood	Douglas Fir
Berry Gulch #2	1/19/65	\$ 8.00	\$15.00
Mitchell Creek #1	3/18/65	18.00	18.00
Masonite	6/27/66	15.00	20.00
Walthem to Aborigine	1965	11.00	19.00
Walthem to Aborigine	1965	12.00	20.00

* Price per thousand board feet of net merchantable logs.

During the period in question petitioner was involved in two timber trespass awards. A "timber trespass" occurs when one party cuts timber on another party's property without permission. Often this occurs through inadvertence when an owner engaging in logging his own property mistakenly cuts trees across the boundary line of an adjoining property. In such instances the trespasser is legally obligated to compensate the property owner for the trees cut. Such compensation, when determined by a court, is referred to as a timber trespass award. Timber trespass awards determined by courts are generally higher than amounts which would be paid property owners by logging contractors since the court does not consider logging costs and because such court awards are punitive in nature and include the trespasser's profit as well as the value of the standing timber, in the two timber trespass cases in which petitioner was involved (one as trespassor and the other as the owner whose property was trespassed upon) the trespass awards were made on the basis of \$30 per thousand board feet.

* * * * *

6. Fair Market Value of Standing Timber for Section 631(a) Purposes

On his 1966 return, petitioner reported a long-term capital gain (\$20,325), income from the sale of timber (\$24,255,51) and a deduction for "stumpage" (\$20,325). By so doing he elected the benefits of section 631(a). Sec. 1.631-1(c), Income Tax Regs. This section allows certain taxpayers to treat the difference between the basis of certain timber cut during the taxable year and its fair market value on the first day of such year as again or loss from a sale or exchange of a capital asset under section 1231. This fair market value then becomes taxpayer's cost for such timber for computing gain or loss upon its subsequent sale. The gain or loss resulting from such sale is ordinary in character.

In the statutory notice respondent eliminated the capital gain and the stumpage deduction for failure to establish entitlement to section 631 treatment. However, in view of the facts presented at trial, the section 631 election was allowed, and the only remaining issue relates to the fair market value of the standing timber on January 1, 1966, which was cut and sold by petitioner during 1966.

Since petitioner allocated no portion of the purchase price of the Tara property to the standing timber, he had no basis therein. Therefore, he realized a capital gain in an amount equal to the fair market value of the timber which he cut in 1966, valued as it stood on January 1, 1966. This value may also be claimed by petitioner as the cost ("stumpage") of this timber upon its later sale in 1966. Petitioner claims that approximately 660,000 gross board feet of timber was cut on the Tara property during 1966, and that it had a total value of \$20,325, or about \$30 per thousand board feet. Respondent's position is that the standing timber had a value of \$17 per thousand board feet, and this value applied only to the extent of 491,620 board feet of net merchantable logs obtained from the timber cut, or a total value of \$8,357.

Petitioner based his valuation upon the average price offered for timber from the Hare Creek Sale Number 1 at Jackson State Forest, contiguous to the northern boundary of petitioner's tract; upon two timber trespass awards, the first awarded petitioner and the other assessed against him when one of his choppers inadvertently crossed the property line and cut on the adjoining property; and upon petitioner's personal opinion and that of Watkins, his "tax adviser", the man who prepared his tax returns.

Petitioner did not attempt to qualify himself as a timber valuation expert, and his testimony was, no doubt, affected by his desire to minimize his taxes. The testimony of Watkins on the issue of valuation was likewise of virtually no assistance to the Court in making its factual determination of value. He did not state the factors considered, the comparables relied upon or the method used to arrive at his conclusion. By comparison, respondent presented two well-qualified timber valuation experts and questioned them in detail as to the basis for their determinations. The Court was satisfied with their qualifications and, although petitioner disputes the value of their testimony on the grounds that they were non-independent employees of respondent, we found their testimony to be helpful and soundly based.

In proving the value of petitioner's timber, one expert, May, used the conversion return approach.¹⁰ He also valued the timber based upon personal inspection of the taxpayer's property, his extensive experience in the timber industry and consideration of many comparable properties, all discussed at length in the record. The other expert, Rueger, while employed in private industry, had actually inspected and appraised the timber in the Hare Creek Sale Number 1 area when it was offered for sale in 1965. He also personally inspected petitioner's timberlands on the Tara property. In addition, both men presented more than a dozen photographs illustrating the relative sizes of the timber on the Hare Creek and Lysek properties. These vividly illustrated the differences between the logs cut, since it could easily be seen that most of the trees left standing on the Hare Creek property were the size of the ones cut on the Lysek property. Respondent's experts also testified concerning five timber sales during 1965 and 1966 in which timber comparable to petitioner's sold at prices ranging from \$8 to \$18 per thousand board feet for redwood and \$15 to \$20 per thousand for Douglas fir.

Based upon the entire record and the testimony of respondent's two expert witnesses, we have found that the fair market value of petitioner's timber as it stood on January 1, 1966, which he cut and sold during 1966, was \$14 per thousand board feet for redwood and \$20 per thousand board feet for Douglas fir, an average of \$17 per thousand board feet of net merchantable logs delivered

to the mill. In reaching this figure we gave careful attention to the factors enumerated in section 1.611-3(f)(1) and (2), Income Tax Regs., entitled "Determination of fair market value of timber property."

Although this finding of fair market value is at variance with the \$30 per thousand board feet price which was paid in the Hare Creek Sale (for timber on property adjoining petitioner's) and in two timber trespass awards in which petitioner was involved, there are several reasons Why such \$30 price is not representative of fair market value for purposes of this case. Respondent's experts proved to the Court's satisfaction that the Hare. Creek sale consisted chiefly of old-growth timber which provided a higher grade of lumber than the second-growth timber of small diameter taken from petitioner's property. Thus, the prices secured for the Hare Creek timber were of limited value as a comparable sale in determining the value of petitioner's timber,

The record does not indicate the manner in which the \$30 timber trespass awards, relied upon by petitioner, were arrived at. In the absence of evidence to the contrary, we must conclude that such awards represented more than just the fair market value of the standing timber, Under California law timber trespass awards are punitive in nature and not remedial. See Cal Civ. Code section 3346 (West's 1970); *Drewry v. Welch*, 236 Cal. App. 2d 159, 46 Cal. Rptr. 65 (1965); *United States v. Vollweiler*, 229 F. Supp. 558 (N.D. Cal., 1964). California law clearly establishes that the landowner is entitled to recover the *pro. fit* made by the trespasser *in addition to* the value of the timber cut. *Crofoot Lumber, Inc. v. Ford*, 191 Cal. App. 2d 238, 12 Cal. Rptr. 639 (1961). Thus, the \$30 price involved in the two timber trespass awards is not necessarily determinative of the fair market value of the outstanding timber.

Based on the 491,620 board feet of net merchantable logs, which are the only logs which can be considered as sold or exchanged, sec. 1.631-1(d) (1), Income Tax Regs., petitioner had a long-term capital gain of \$8,357 for the year 1966, This sum is also the amount of his stumpage deduction. Taxpayer cannot include the 168,380 board feet of defective timber left in the field and not trucked to the mill, as this cannot be considered as sold and exchanged during the year. This is clear from a reading of the regulation just cited and from industry practice. The record shows that timber companies attribute no value to the defective logs left in the field and pay only for logs delivered on a net merchantable log scale basis.

10 The so-called "conversion return" approach is a common method of estimating fair market value of standing timber by starting with the price at which the togs could be sold at the mill and reducing this by the estimated costs of cutting, loading and transportation, and by a percentage factor (in this case, 13 percent) for profit and risk.