

MURPHY v. UNITED STATES
Memorandum of Law, 60-1 USTC ¶ 9275 (W.D. Wash. 1960);
Findings of Fact and Conclusions of Law, 60-1 USTC ¶ 9246;
5 AFTR 2d 784 (W.D. Wash. 1960).

Editor's Summary

Key Topics

CUTTING AS A SALE OR EXCHANGE

- Ownership of timber
- Effect of agreement to resell timber to the grantor of the timberland

FAIR MARKET VALUE OF TIMBER

- Evaluation of expert testimony

Facts

Issue No. 1

Upon acquiring certain timberlands, the taxpayer agreed to sell a portion of the timber back to his grantors. This agreement was made in good faith and not for the purpose of avoiding income tax liability. The taxpayer elected to treat his cutting of the timber as a sale or exchange under section 117(k)(1). The Commissioner contended that the taxpayer was neither the owner of the timber nor the holder of a contract right to cut it and was thus not qualified to make an election under section 117(k)(1).

Issue No. 2

In computing his gain under section 117(k)(1), the *taxpayer* reported the fair market value of the timber as \$20 per thousand board feet. The Commissioner contended that the fair market value per thousand board feet was only \$13.35. At the trial, the taxpayer contended for a value of \$40, arguing that his original estimate of \$20 was erroneous. Both the taxpayer and the Commissioner presented expert witnesses to support their computations.

District Court

Issue No. 1

Held: For the taxpayer. The taxpayer was indisputably the owner of the timber. A purported purchase of timber in which no actual, genuine *transfer* of title occurred could readily be found a sham or subterfuge. However, nothing of that kind nor any suggestion of it appears in the evidence.

Issue No. 2

Held: For the Government. The taxpayer's valuation of \$40 per thousand board feet is not

supported by the evidence. The experts presented by the Government had a more realistic, satisfactory and convincing approach than did those presented by the taxpayer, in order to give the taxpayer the full advantage of the best of the evidence from his point of view, the Court finds the fair market value of the timber to be the maximum testified to by the Government's expert witnesses.

Case' Text

BOLDT, District Judge: (Whereupon, there was oral argument given by counsel.)

THE COURT: Now, I take it that this question presents a new point of law not passed on in any of the previous cases. Do you agree or not? If you do not agree, please cite the cases you think bear on this question.

MR. BOWDEN: I think there are no cases directly on this point because there is, in my opinion, no substantive issue.

THE COURT: Do you agree that there is no pertinent case?

MR. MAGNUSON: I have found no case directly in point, your Honor.

THE COURT: Several of the cases that are now the authority in the interpretation and application of 117(k)(1), Code of 1939, were tried in this court. My memory is that the question now presented has never been dealt with before.

The statute grants capital gains treatment to the taxpayer "who owns or has a contract right to cut such timber." Under the proof it is indisputable that the taxpayer did own the timber in question in this case. True, at the time of acquiring that ownership by deed, he contracted, originally orally and later in writing, to sell a portion of the timber owned by virtue of the deed back to the grantor of the timber lands. Nevertheless, the conditions specified in the statute, at least insofar as the facts of this particular case are concerned, are thus fully met. I underscore that interpolated clause for the reason that a purported sale transaction could readily, be found a sham or subterfuge, in which situation no actual, genuine transfer of title to the timber would have occurred. Nothing of that kind nor any suggestion of it appears in the evidence before me.

Accordingly, on this point I find that the taxpayer was entitled to 117 (k) (1) treatment on the tracts in question.

(Whereupon, there was further oral argument of counsel.)

THE COURT: Almost always it is important for the Court in deciding a given issue of fact or law to consider the approach to the problem which the circumstances require. In a trial of this kind, the Court in effect is reviewing a decision of an administrative authority; namely, the Commissioner. It is well settled that the rulings of the Commissioner are presumed to be correct. The presumption of law is that the findings of the Commissioner on the fact questions here involved were well founded. Whether or not this presumption gives any greater strength to the

position of the government than would be the case if the litigation were here *ab initio* is a nice point, decision of which does not appear to be required.

What has been said thus far merely points out that the burden does rest upon the taxpayer to present a preponderance of evidence sustaining the taxpayer's contentions on the fact issue.

Query: Is there such preponderance of evidence?

Parenthetically, I should mention that in the *Cascade* case¹ the fact issue there was presented to the Court largely, if not wholly, on two utterly divergent theories of market value. In that case the government's witnesses contended that market value should be judged almost wholly upon the basis of the state sales, whereas, the taxpayer contended that the issue should be decided wholly upon the basis of the Indian land Sales.

I did not wholly accept either theory, merely finding the facts upon the evidence then presented to me, which is all the Court can ever do. However satisfactory or inadequate the evidence in a given case may be, the judge can only do the best he can with such evidence as the parties submit to him. In the *Cascade* case I found and held that a preponderance of the evidence presented to me indicated that the taxpayer's contentions as to market value of the particular timber in question had to be accepted as the fact.

I am well satisfied that the evidence in the Present record shows no preponderance against the Commissioner's findings. To put it at a minimum, I must find that the taxpayer has failed in the burden of proof. I hesitate to put it merely at the minimum, however, because to be fully frank in expressing my views, I must say that the approach to the question of fair market value presented by the government's witnesses seems to me far more realistic, satisfactory, and convincing than the approach used by the witnesses for the taxpayer.

It happens that I have had a considerable acquaintance with Mr. Jacobson's work. We have never had any personal or business relationship, but I have heard him testify before, and I know of his impressive background and character. His integrity, ability, and experience in some particulars are almost unmatched in this Part of the country, and in his field he is very highly regarded. I regard him so, and am satisfied that he would not willfully misstate a fact or falsely express an opinion.

On the other hand, I have never met or heard of either Mr. Newman or Mr. Price, although they are well and long qualified by practical experience in this vicinity. However, I am very favorably impressed with the care with which they approached the matter of the market value of timber and with the apparent fairness and reasonableness of the conclusions they reached. Whether in a case of this kind, in a condemnation case or in any other case, where the issue of fair market value is involved, the same difficulty in appraising the so-called comparable sales arises. We refer to the sales as "comparable" even though in many instances they turn out to have little, if any, comparability. Many factors have to be weighed in considering the effect to give each purported "comparable" sale, and an extended discussion of those factors is not necessary.

Suffice it to say that I am well satisfied that the position taken by forestry and timber experts presented by the defendant in this case is the sounder view of the facts as to market value of the

timber cut by plaintiffs. At a minimum, the evidence of the taxpayers does not preponderate to show the Commissioner in error.

Incidentally, I recall that originally the taxpayer himself put a \$20 figure on the market value of his timber. It is suggested that that was done in error and withdrawn for that reason. I cannot help but feel that the taxpayer, or those advising him at the time, had a much more realistic view of market value in the original estimate than as now contended for.

To give the taxpayer the full advantage of the best that the evidence offers from his point of view, the Court will find the fair market value at the maximum per thousand as testified to by either Mr. Newman or Mr. Price. Those figures are of record.

It is so ordered.

(Whereupon, there was further argument of counsel.)

THE COURT: Strictly speaking, it may be doubted whether the payment of interest as specified in Section 294(d)(2) is a penalty, although commonly and for ready usage so referred to. It seems to me that this section simply provides that if a taxpayer under-estimates his tax according to the formula prescribed by the statute, he must then pay interest on account of the delay in tax payments 'by reason of the under-estimate. Whether you want to call such interest payment a penalty or not is, at least, open to debate. The taxpayer who pays his estimated tax on a more realistic estimate as and when required in quarterly payments, of course, loses the use of his money from the time of payment. Whereas, the taxpayer who substantially underestimates has the use of his money for a longer period and presumably is required to make up for it by way of the interest payment prescribed by the Section 294(d)(2).

In any event, the section referred to, stripped of those portions not applicable to our case, reads as follows, "This paragraph shall not apply," omission, "to the taxable year in which the taxpayer makes a timely payment of estimated tax within or before each quarter,"! omission, "of such year," omission, "in an amount at least as great as though computed," omission, "on the basis of the taxpayer's status with respect of the personal exemption and credit for dependents on the date of the filing of the declaration for such taxable year," omission, "but otherwise on the basis of the facts shown on his return .for the preceding taxable year."

As applied to the particular case now before me, the only words of the quoted language that conceivably can raise a question of fact or law are the words "timely" and "facts." As for the latter, neither counsel suggests an issue, and I pass it, assuming there is none. This narrows the question for my decision down to the meaning of the word "timely" as used in the statute. First, we observe that the quoted sentence is an exception to the general Proposition stated in the preceding sentence of sub-section 294(d)(2). As such, it should be strictly construed under general principles applicable to the construction of statutes.

What then is a "timely payment of estimated tax within or before each quarter"? Undoubtedly the taxpayer is required to make a reasonable appraisal of his tax liability at the commencement of the tax year, file a fair estimate thereof and make payments thereon quarterly as provided by the

Statute.

It seems clear to me that the plaintiff taxpayers did not do so in this instance. No question of intent is involved. It is merely a question of whether or not a timely payment of tax, estimated as required by statute, was made within or before each quarter. The record clearly shows that even if plaintiff's estimate be considered as accurately predicated on the facts of their return for the previous year, the statute regulations required a considerably greater quarterly' payment, in each of the quarters as required than in fact was made. By that default plaintiffs became liable, for interest as specified in Sec. 294(d)(2).

Accordingly, I must find that the contentions of the government with respect, of the imposition of interest as provided by the cited section are well taken, and recovery in accordance therewith is required. It is so ordered.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

BOLDT, District Judge: The: above entitled cause having been heard on January 4th and 5th, 1960, by the Court, Messrs. Clodfelter & Bowden, Allen A. Bowden, and Burton W. Lyon, Jr., of counsel for the plaintiffs, and Charles P. Moriarty, United States Attorney, Seattle, Washington, Charles Billinghamurst, Assistant United States Attorney, Tacoma, Washington, Charles K. Rice, Assistant Attorney General, Washington, D. C., James P. Garland, Fred J. Neuland, and Charles H. Magnuson, Washington, D. C., for defendant; the Court now makes the following:

FINDINGS OF FACT

1. This is an action for the recovery of \$10,464.20, plus interest as provided by law, which is alleged by the taxpayers to be an overpayment of their income taxes for the taxable years ending December 31, 1951, and 1952. The taxpayers contest the action of the commissioner of Internal Revenue in assessing deficiencies in income taxes for the taxable years 1951 and 1952. The deficiencies were based in part upon a determination that the taxpayers did not properly determine the fair market Value of timber cut by them during the years of 1951 and 1952, that the taxpayers were not entitled to apply the provisions of section 117(k)(1) of the Internal Revenue Code of 1939 to certain timber cut during the year 1952, and that the taxpayers were required to pay an additional tax for the substantial underestimation of estimated tax for the taxable year 1951.
2. The District Court has jurisdiction of the action and of the parties hereto by virtue of Title 28, U. S. C., Section 1346(a)(1) and 1340.
3. The taxpayers are husband and wife, residing at Eatonville, Washington, and within the jurisdiction of this Court.
4. The oral memorandum decision of the Court rendered in this cause on January 5, 1960, is by this reference incorporated into and made a part of these findings of fact to the same effect as if such a decision were fully set forth herein. The findings of fact expressed by the Court in such memorandum decision, as well as the weight and value to be given to the evidence in the record

of the trial, are hereby expressly adopted and incorporated herein by this reference as if fully set forth in this paragraph.

5. Taxpayers filed a joint federal income tax return for the calendar year 1951, reporting and paying the tax shown due thereon of \$3,609.00.

6. Taxpayers had in prior years elected to apply the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, in their federal income tax returns.

7. Taxpayers filed a declaration of estimated tax for the taxable year 1951 on March 8, 1951, paying \$25 therewith. On June 19, 1951, taxpayers paid a subsequent installment thereon in the amount of \$75. On January 11, 1952, taxpayers filed an amended declaration of estimated tax and paid \$1,200 therewith.

8. In their federal income tax return filed by taxpayers for the year 1951, taxpayers reported the cutting of 800,684 board feet of timber subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, claiming a fair market value therefore of \$20 per thousand board feet as of January 1, 1951, and claiming a deduction for depletion therefore in the amount of \$16,013.68.

9. By letter dated May 27, 1957 (90 day letter), the Commissioner proposed a deficiency in tax for the year 1951 of \$7,351.96, based in part on his determination that taxpayers had cut 807,020 board feet of timber subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, having a fair market value as of January 1, 1951, of \$13.35 per thousand board feet, thereby reducing the depletion claimed by taxpayers from \$16,013.68 to \$10,773.71. In the same letter the Commissioner proposed an addition to tax of \$559.95 for the substantial understatement of estimated tax.

10. The Commissioner assessed a deficiency of \$10,355.28 against taxpayers on September 30, 1957, for the year 1951. This amount, together with interest thereon of \$432.19, was paid by taxpayers on June 9, 1958.

11. On September 8, 1958, taxpayers filed a claim for refund for the year 1951.

12. More than six months time has elapsed since the filing of taxpayers' claim for refund.

13. Taxpayers filed a joint federal income tax return for the calendar year 1952, reporting and paying the tax shown due thereon of \$2,629.06.

14. In their federal income tax return filed by taxpayers for the year 1952, taxpayers reported the cutting of 1,913,433 board feet of timber, claiming said timber to be subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, and claiming a fair market value therefore of \$20 per thousand board feet as of January 1, 1952 and claiming a deduction for depletion therefore in the amount of \$38,268.66.

15. By letter dated May 27, 1957 (90 day letter), the Commissioner proposed a deficiency in tax for the year 1952 of \$2,494.54, based in part on his determination that 220,797 board feet of timber was subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, having a fair market value as of January 1, 1952, of \$13.35 per thousand board feet, and that 1,672,447 board feet of timber was not subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, thereby reducing the depletion claimed from \$38,268.66 to \$2,947.64.

16. The Commissioner assessed a deficiency of \$3,174.21, on September 30, 1957, for the year 1952. This amount, together with interest thereon, as provided by law, was paid in the amount of \$1,000 on November 25, 1957, and the balance of \$2,270.62, including accrued interest, on May 1, 1958.

17. On September 8, 1958, taxpayers filed a claim for refund for the year 1952.

18. More than six months have elapsed since the filing of taxpayers' claim for refund.

19. During the taxable year 1951, the taxpayers cut 807,020 board feet of timber subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended.

20. During the taxable year 1952, the taxpayers cut 1,913,433 board feet of timber subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended.

21. The average unit fair market value per thousand board feet as of January 1, 1951, of the 807,020 board feet of timber cut by the taxpayers in the year 1951 and subject to Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, is \$17.94 per thousand board feet, and the total fair market value as of January 1, 1951, of the 807,020 board feet of the timber cut by the taxpayers in 1951 and subject to Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, is \$14,477.94.

22. That the average unit fair market value per thousand board feet as of January 1, 1952, of the 1,893,244 board feet of timber cut by the taxpayers in the year 1952, and subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, is \$11.86 per thousand board feet, and the total fair market value as of January 1, 1952, of the 1,893,244 board feet of the timber cut by the taxpayers in 1952 and subject to Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, is \$22,453.87.

23. The claim by the taxpayers that the timber cut during the year 1951 subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended, had a fair market value of \$40 per thousand board feet as of January 1, 1951, is not supported by the evidence presented during the trial, nor does the evidence presented by the taxpayers show a preponderance against the findings of the Commissioner of Internal Revenue for the year 1951; however, the proper fair market value per thousand board feet was \$17.94 rather than \$13.35 per thousand board feet as determined by the Commissioner of Internal Revenue.

24. The claim by the taxpayers that 1,893,244 board feet of timber cut during the year 1952 subject to the provisions of Section 117(k) (I) of the Internal Revenue Code of 1939, as amended, had a fair market value of \$40 per thousand board feet as of January 1, 1952, is not supported by the evidence presented during the trial, nor does the evidence presented by the taxpayers show a preponderance against the findings of the Commissioner of Internal Revenue for the year 1952. The fair market value thereof was \$11.86 per thousand board feet rather than \$13.35 as found by the Commissioner to be applicable to only 220,797 board feet of timber. The Commissioner's determination that 1,672,447 board feet of timber cut during the year 1952 was not subject to the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, was erroneous, and taxpayers were entitled to apply the provisions of that section to said timber cut during the year 1952 having a fair market value of \$11.86 per thousand board feet as of January 1, 1952.

CONCLUSIONS OF LAW

1. This Court has jurisdiction over the parties to the action and the subject matter of the action.
2. The Commissioner of Internal Revenue correctly determined that there were deficiencies in income taxes reported and paid by the taxpayers for the taxable years 1951 and 1952, but the Commissioner in computing such deficiencies incorrectly failed to allow the taxpayers to apply the provisions of Section 117(k)(1) of the Internal Revenue Code of 1939, as amended to 1,672,447 board feet of timber cut during the year 1952; and the correct fair market value per thousand board feet of timber cut during the year 1951 was \$17.94 per thousand board feet and \$11.86 per thousand board feet for the timber cut for the year 1952, with the result that the deficiencies assessed against the taxpayers and thereafter paid by the taxpayers exceeded the correct deficiency by \$1,977.23.
3. Taxpayers are entitled to judgment against the defendant for the sum of \$1,977.23, plus assessed interest thereon as provided by law, plus interest on said amount as provided by law.
4. All conclusions Of law expressed by the Court in its oral memorandum decision rendered in this cause on January 5, 1960, are hereby expressly adopted and incorporated herein by this reference, as if fully set forth in this paragraph.
5. The parties to this action shall each bear its own costs.