

**PEEBLES v. COMMISSIONER**  
**5 T.C. 14 (1945); Acq. 1945 C.B. 6.**

*Editor's Summary*

*Key Topics*

OUTRIGHT SALE--CAPITAL GAIN v. ORDINARY INCOME

- Single sale by lawyer-landowner

*Facts*

The taxpayer, a lawyer, accumulated timberland through periodic purchases. After unsuccessful attempts to sell the timber to a logging company, he entered into a contract with one Krepps. Krepps was granted the right to cut and remove timber from a portion of the land during a specified period. He was required to deliver the timber to one of four purchasers. The purchasing company paid one-third of the price it had negotiated with Krepps or a stipulated amount per thousand board feet whichever was higher, directly to the taxpayer. Title to the timber remained in taxpayer until he received payment, and the contract was not assignable. At the time of the trial, the taxpayer had made no other sales. The Commissioner contended that the profit realized by the taxpayer was ordinary income on the ground that the timber was held by taxpayer primarily for sale to customers in the ordinary course of his trade or business and thus did not qualify as a capital asset under section 117 (a).

*Tax Court*

**Held: For the taxpayer.** The evidence established that the taxpayer held the timber primarily for sale, but he did not hold it for sale to customers in the course of any trade or business conducted by him. He engaged in only one transaction, that with Krepps. The business operation belonged to Krepps and the ultimate purchasers of the timber from him were not customers of the taxpayer. The timber was a capital asset in the hands of the taxpayer. The Court found it unnecessary to determine whether section 117(k) (2) was applicable.

*Case Text*

The respondent has determined an income tax deficiency against petitioner for the year 1941 in the amount of \$2,102.56. Two questions are presented: (1) Whether profit realized by the petitioner from the sale of certain timber should be included in his gross income as ordinary income, or as capital gain; and (2) whether the gain realized from the sale of certain other timber was his gain rather than that of his wife and minor son.

## FINDINGS OF FACT

The petitioner resides in Augusta, Georgia. He is a lawyer and, in addition to conducting a general law practice, has for the past ten years been county attorney for Richmond County, Georgia. He filed his 1941 income tax return with the collector of internal revenue for the district of Georgia.

Through periodic purchases in 1931, 1933, and 1936 petitioner acquired approximately 2,000 acres of land, known as the Walkinshaw Place, located about 17 miles from Augusta, on the Savannah River. This property was in the main timber land, only a small portion being under cultivation. Shortly after acquiring the full property, the petitioner began trying to sell it. As early as 1937 he tried to interest the Leigh Banana Case Co. in the purchase of the timber. His contact with the company was the vice president, H. J. Linder, who advised that his company was not interested. On some Undisclosed date or dates, possibly in 1941, he placed an advertisement in the Atlanta Journal and had inquiries from several parties. In the spring of 1941 he again approached Linder, offering the timber on the entire tract for \$35,000. Linder sent a man to go over the timber, but still did not show any interest in its purchase. In the meantime, a man by the name of Krepps had indicated a desire to purchase a portion of the timber. Since the Leigh Banana Case Co. had gone to the expense of checking the property, the petitioner advised Linder of Krepps' offer to buy a part of the timber, and asked if the Leigh Banana Case Co. was interested in making a purchase. Linder advised the petitioner that his company was not interested and it was satisfactory with them for him to deal with Krepps.

On some undisclosed date in July of 1941, the petitioner and Krepps entered into a contract covering the timber on 225 acres of the above land. By the terms of the agreement, the petitioner, in consideration "of mutual covenants," agreed to and did grant, bargain and sell to Krepps "only the right to cut and remove until January 1st, 1943 \* \* \* all and singular, the timber now measuring fourteen (14") inches or more in diameter, eighteen (18") inches from the ground" on the 225 acres, "more or less," thereafter described. Krepps agreed to deliver all of the timber which might be cut Under the agreement to either the Savannah River Veneer Co., North Augusta, South Carolina, the Augusta Hardwood Co., Augusta, Georgia, the Leigh Banana Case Co., Ellenton, South Carolina, or the Vestal Lumber Co., Sardis, Georgia, and to pay to the petitioner, 'on Monday of each week, "for all timber delivered said lumber companies during the preceding week," one-third of the price at which the timber so delivered should be sold by Krepps to any one of the companies named. It was provided, however, that, regardless of the price at which Krepps sold the timber cut by him, the petitioner should receive as a minimum for all timber cut and removed certain specified amounts per thousand board feet, ranging from \$8.66 2/3 for No. 1 ash logs and blocks of certain sizes down to \$3 per thousand board feet for certain other timber. Failure to make the weekly payments prescribed would terminate the agreement; otherwise, the agreement was to extend to January 1, 1943, except that petitioner had the right to terminate it at any time upon 60 days notice in writing. Title to the timber was to remain in the petitioner until it was paid for. Krepps was to notify, the four lumber companies above named of the agreement before delivering any timber to any of them, and was to make arrangements with the said companies "to remit to the party of the first part [the petitioner] each week upon the above schedule of prices." The contract was nonassignable. It constituted the only contract, agreement or understanding that existed between the petitioner and Krepps with respect to the

timber.

Krepps cut timber under the above agreement in 1941 and 1942. The profits realized by the petitioner therefrom were reported by him in his 1941 and 1942 income tax returns as capital gains.

Shortly after the deal with Krepps, the petitioner again got in touch with Linder to see if the Leigh Banana Case Co. was interested in acquiring the remainder of the timber. That company was sufficiently interested to have a cruise of the timber made by H. M. Spain & Co., from which it received a report under date of October 6, 1941. By letter dated November 16, 1941, petitioner made further inquiry of Linder, but received no reply. Later, he did talk with Linder by telephone and on some undisclosed date, probably between November 16 and December 1, 1941, petitioner offered the remaining timber to the Leigh Banana Case Co. for \$30,000. On December 8, 1941, Linder went through the timber with some of his men for further inspection.

Catharine Hall Peebles, petitioner's wife, looked upon the property as partly hers. She had understood for a long time that the petitioner was going to give portions of the property to her and their minor son. Prior to December 1, 1941, the petitioner drew up deeds purporting to give to his wife and their son interests in the timber. Before executing them, however, he consulted Victor Markwalter, a certified public accountant, who appeared for him in this proceeding and who is petitioner's adviser on tax matters, with respect to the instrument or instruments so drawn. He had made provision that the expenses of his son's education might be paid from proceeds from the sale of the timber covered by the said deed. Upon Markwalter's advice another instrument, hereinafter described, was drawn up and the original instrument was never executed. On December 8, 1941, the petitioner executed two instruments, denominated deeds of gift; one to his wife individually, and the other to her as trustee for their son, Isaac Hall Peebles, each covering a 14 percent undivided interest in the timber suitable for sawmill purposes on the Walkinshaw Place., exclusive of the 225 acres covered by the Krepps contract. The deeds covered timber which when cut was to measure 14 inches in diameter and up, 18 inches from the ground. Warranty of title to the interests in the timber covered by the said deeds was made. The words of grant were that petitioner "has this day given, granted, alienated and conveyed, and does by these presents give, grant, alienate and convey unto the said CATHERINE HALL PEEBLES, her heirs and assigns, Fourteen one-hundredths (14/100), or fourteen ( 14% ) percent undivided interest in and to all of the timber suitable for sawmill purposes," the dimensions being as previously stated. The grant to Mrs. Peebles as trustee for the son contained identical language. It was further provided that the donee, her heirs and assigns, in the case of the wife individually, and in the case of the grant to trust, her successor trustee, should have the right to cut and remove the undivided interest in the timber conveyed until December 31, 1945, when all rights, both as to the timber and the right of ingress and egress over or upon any portion of the land upon which the timber stood, should terminate.

In the deed to Mrs. Peebles as trustee for the son, it was provided that the undivided interest in the timber and any proceeds derived therefrom should be held in trust by the trustee until the son reached the age of 21 years, and that no portion thereof could be used for the benefit of the donor; but if the donor died before the son reached 21 years of age, the trustee could then use any or all

of such portion of the timber proceeds or net income therefrom for the support and education of the son, as the trustee might deem necessary. It was also provided that the proceeds from the sale of the trust property might be invested in stocks of certain named companies. Companies specifically named were American Telephone & Telegraph Co., United States Steel Co., Georgia Railroad & Banking Co., and Coco-Cola Co. of Delaware, The trustee was to have uncontrolled discretion of the price at which the timber might be conveyed or sold by her, and it was understood between the donor and the trustee that the value of the timber conveyed by the instrument was \$4,000.

On December 8, 1941, the petitioner took the instruments described to his home and delivered them to his wife. Her acceptance of the trust is endorsed at the bottom of the trust indenture, in her own handwriting and in the following phraseology:

Georgia, Richmond County,

I, Catharine Hall Peebles hereby accept the foregoing trust 2:20 o'clock PM. on this the 8th day of December, 1941.

CATHARINE HALL PEEBLES

The petitioner next took the instruments to the office of the Clerk of the Superior Court for Richmond County, Georgia, where they were filed on December 8, 1941, at 2:35 p.m., and duly recorded.

When Mrs. Peebles received the deeds from the petitioner on December 8, 1941, she was aware of the limit on the time within which the timber might be cut and removed from the property.

On the morning of December 9, 1941, Linder went to the office of petitioner in Augusta, and a tentative agreement as to the price for the timber was reached: Certain restrictive provisions with respect to the cutting of the timber and its removal were demanded by the petitioner, however, and no sale of the timber was consummated at that time. Previously the petitioner had asked \$30,000 for the timber, while the Leigh Banana Case Co. had offered \$22,500 or \$25,000. Linder was advised of the grants made by petitioner to Mrs. Peebles individually and to her as trustee for her son, and that payment for their interests covered by those grants would be required in cash. He carried on no negotiations with Mrs. Peebles, but conducted all negotiations with the petitioner.

After his conference with petitioner on the morning of December 9, 1941, Linder returned to the office of his company, and during the afternoon a directors' meeting was held, at which the following resolution was adopted:

**RESOLVED:** That any two of the officers of this corporation named below, or their duly appointed or elected successors in office, be and they are hereby authorized and empowered in the name and on behalf of this corporation and under its corporate seal, to execute and deliver to Isaac S. Peebles, Ir., Augusta, Georgia, in any form agreed on between any two of the below named officers and Isaac S. Peebles, Jr., a timber contract or contracts together with any promissory note or notes pledged to the fulfillment of said

contract or contracts, and the same shall be binding on this corporation, its heirs and assigns.

FURTHER RESOLVED: That the officers referred to in the foregoing resolutions are as follows:

Carl G. Leigh,	President
C. M. Leigh,	Vice President
H, J. Linder,	Vice President
C. M. Leigh,	Secretary and Treasurer
J. D. Handegan,	Chief Clerk

The petitioner was anxious to make the sale of the timber in 1941, being of the opinion that higher income tax rates would result from the outbreak of the war on December 7, 1941. For that reason, he had advised Linder that purchase of the timber would have to be made by December 15, 1941, or he would not sell. After the conference on December 9, 1941, at which the price for the timber was tentatively agreed upon, discussions continued with reference to the agreements and restrictions covering the cutting and removal of the timber until December 15, 1941, when all matters had been agreed upon, and the agreements of sale were executed.

Catharine Hall Peebles, for herself individually and as trustee for her son, made a grant of a 28/100, or a 28 percent, undivided interest in the said timber to the Leigh Banana Case Co. for and in consideration of \$4,000 in cash paid to her individually and \$4,000 in cash paid to her as trustee for her son. The grant to the Leigh Banana Case Co. was in the same words as were the grants made by the petitioner to her individually and to her as trustee for their son, under date of December 8, 1941. The instrument also carried the same limitation as to the time within which the timber might be cut and removed.

The petitioner executed a contract of sale covering a 72/100 undivided interest in and to the timber suitable for sawmill purposes, and of the dimensions previously described. The consideration therefor was \$19,500; \$7,000 in cash and the promissory note of the Leigh Banana Case Co. for \$12,500, due and payable on December 31, 1942, and bearing interest at the rate of 6 percent. As security for payment of the note, the instrument provided that title to the timber should remain in the petitioner and that as logs were cut and removed from the land \$4 per thousand feet should be paid to the petitioner to be applied on the note. As further security for the note, the Leigh Banana Case Co. conveyed to the petitioner a 28/100 interest in the timber which had that day been conveyed to that company by Catherine Hall Peebles individually and as trustee for her son. It was further provided that upon payment of the note by the purchaser and compliance with the terms and conditions of the contract, the vendor should then give to the purchaser a warranty deed covering the timber sold. The contract contained various provisions coveting the manner and method of cutting and removing the timber from the premises. The agreement of sale between the petitioner and the Leigh Banana Case Co. and the instrument of conveyance executed by Mrs. Peebles on December 15, 1941, were filed in the office of the clerk of the Superior Court for Richmond County, Georgia, at 5:10 p.m. on December 15, 1941.

Pursuant to the terms of the sales made, the Leigh Banana Case Co. paid \$8,000 to Mrs. Peebles

and \$7,000 to the petitioner. Mrs. Peebles deposited \$4,000 in the Citizens & Southern National Bank, in Augusta, Georgia, to her individual credit, and \$4,000 to her credit as trustee for her son. The petitioner decided to invest some of his money in the stock of Georgia Railroad & Banking Co. of Augusta, and suggested to his wife that the stock would be a good investment for her. She purchased 31 shares of the said stock for the account of her son and a similar number of shares for herself individually, at \$128.75 per share. The stock purchased was evidenced by two certificates, one issued in the name of Catharine H. Peebles and one in the name of Catharine H. Peebles as trustee for Isaac Hall Peebles. The dividends thereafter paid on the stock were paid in the names in which the shares stood. The dividends received on the stock issued to Mrs. Peebles as trustee for her son were used regularly in the purchase of war bonds, and no other expenditures have been made therefrom other than for the payment of taxes attributable to the trust estate. The dividends received by Mrs. Peebles on the stock standing in her name have not been used for household expenses or other obligations of the petitioner.

On December 29, 1942, upon payment by the Leigh Banana Case Co. of all amounts due petitioner under their agreement of December 15, 1941, and on the note given pursuant thereto, the petitioner executed a deed to the Leigh Banana Case Co. covering a 72/100 undivided interest in the above timber, and at the same time quit-claimed his rights, title, and interest in and to the 28 percent interest which had been conveyed to him on December 15, 1941, by the Leigh Banana Case Co. as further security for the payment of its promissory note.

In determining the deficiency herein, the respondent determined that the gain realized upon the entire 100 percent of the timber sold to the Leigh Banana Case Co. on December 15, 1941, was the income of the petitioner, and increased petitioner's capital gain by the portions thereof which had been reported by his wife individually and by her as trustee for their son.

### OPINION

TURNER, Judge: The first question is whether or not the petitioner properly reported the profits realized on the sale of timber under the Krepps contract as capital gain, and the answer to that question is to be found by determining whether or not the timber sold was property held by the petitioner "primarily for sale to customers in the ordinary course of his trade or business," and not therefore a capital asset within the meaning of section 117 (a) of the Internal Revenue Code. In addition to the claim that the timber was a capital asset within the meaning of section 117(a), the petitioner argues that subsection (k)(2) of section 117, <sup>1</sup> added and given retroactive effect by the Revenue Act of 1943, is also applicable and that under its provisions the said gain was also properly reported as capital gain.

That the timber was held primarily for sale appears from petitioner's own testimony, but the evidence refutes, we think, any conclusion that it was held for sale, or sold, to customers in the course of any trade or business conducted or carried on by the petitioner. He made one transaction, and that with Krepps. Thereafter his only right or interest was the collection of the selling price of the timber. The operation was that of Krepps, who was an independent contractor, and not an employee, agent, partner, or coadventurer of petitioner. Cf. *Boeing v. Commissioner*, 106 Fed. (2d) 305, relied on by the respondent, wherein the logger was an employee of the

taxpayer and not a purchaser of the timber. In the instant case Krepps was the purchaser of alt timber cut by him in his own operation, and he was required to pay to petitioner, as the purchase price of such timber, one third of the price for which he sold the logs, or according to the scale of minimum prices specified in the contract, whichever should be the higher. The fact that Krepps, in order to make more secure the payment of the purchase price of the timber, agreed to limit his sales to a group of four concerns and to arrange with such of those concerns as did become his customers to transmit to petitioner so much of the price at which he sold the timber as was necessary to pay the petitioner, does not make of the transaction the operation of a business by petitioner, nor does it make the companies which purchased the timber from Krepps the petitioner's customers. As to the petitioner, the timber was a capital asset and the gain realized therefrom upon its sale was properly reported by him as capital gain. *Estate of M. M. Stark*, 45 B. T. A. 882, and *John W. Blodgett*, 13 B. T. A. 1388. See and compare *United States v. Robinson*, 129 Fed. (2d) 297. In view of the conclusion reached, it becomes unnecessary to determine whether section 1 I7(k)(2), *supra*, is applicable.

The second question is whether the \$4,000 received by petitioner's wife individually and the \$4,000 received by her as trustee for her son upon the sale of the timber herein to the Leigh Banana Case Co. were received by her as the selling price of two 14/100 undivided interests in timber previously acquired by her individually and as trustee by gift from the petitioner, or whether the said amounts were received as a gift or distribution of the proceeds which petitioner had realized from the sale of timber belonging to him. If we have the former of these two situations, the gain realized upon the sale of the two interests was properly reported by her individually and as trustee, and the gain realized by reason of such sale was not the income of the petitioner. But if we have the latter of the two situations, the respondent's determination is correct.

We do not understand that the respondent now argues that the sale of the timber to the Leigh Banana Case Co. had been made or agreed to on or prior to December 8, 1941, the date of the claimed gifts of undivided interests therein to Mrs. Peebles and her son. Furthermore, if such claim were made, it would definitely be in conflict with the evidence, and particularly the testimony of H. J. Linder, vice president of the purchasing company and respondent's own witness. And, since we know or no rule of law to the effect that a husband and father may not make, or does not have the power to make, valid and completed gifts of property or interests therein to his wife and child, the conclusion on the issue here must follow the answer to the question whether the things done by petitioner on December 8, 1941, effected a gift of the described interests in the timber later sold and, if they did effect gifts of the described interests, whether the proceeds here in question constituted the selling price of such interests by Mrs. Peebles for herself and for her son. We think they did.

In the first place, the words of the instruments delivered to Mrs. Peebles on December 8, 1941, were words of grant and conveyance of undivided interests in timber of specified sizes standing on certain described lands, and, since the timber in question was then standing on and attached to land owned and retained by petitioner, it is difficult to see how he might more effectively have made delivery of the subject matter of the gifts unless he should have taken it upon himself to cut and remove the timber and make physical delivery of the sawlogs and blocks themselves. It is true

that the donees were given only a limited time within which to cut and remove the timber covered by the conveyances made, but such a limitation does not change the nature, character, or effect of the grant. In *McLendon Bros. v. Finch*, 2 Ga. App. 421; 58 S. E. 690, the Court of Appeals of Georgia said: "The time limit within which the timber must be removed is not a limitation directly upon the estate owned in the timber, but upon the concurrent license of ingress and egress necessary to the use of the timber." It was also stated that such a time limit on the removal of timber conveyed did not make a timber deed a lease. That such was the practical effect as well as the legal effect of the December 8 conveyances is demonstrated by what actually occurred thereafter. With respect to the interests covered by those conveyances, the Leigh Banana Case Co. acquired nothing from anyone other than Mrs. Peebles individually and as trustee, and, further, the interests which it did acquire from her and for which it paid \$8,000 in cash were the identical interests, no more or less, which she had received from the petitioner on December 8, and no one, not even the respondent himself, questions the proposition that by such grant and conveyance the Leigh Banana Case Co. did on December 15, 1941, acquire those undivided interests in the said timber, as well as the 72/100 undivided interest admittedly acquired from petitioner. The proceeds from the sale of the two interests were received by Mrs. Peebles and retained by her individually and as trustee for her son, The gain realized on the said sale was properly reported by her, and the respondent was in error when in determining the deficiency herein he treated the said gain as capital gain realized by the petitioner. See and compare *Chisholm v. Commissioner*, 79 Fed. (2d) 14; certiorari denied, 296 U. S. 641; *Commissioner v. Court Holding Co.*, 324 U. S. 331; *Harrison v. Schaffner*, 312 U. S. 579; *Adolph Weil*, 31 B. T. A. 899; affd., 82 Fed. (2d) 561; certiorari denied, 299 U. S. 552; *Preston R. Bassett*, 33 B. T. A. 182; affd., 90 Fed. (2d) 1004; *Edson v. Lucas*, 40 Fed. (2d) 398.

*Decision Will be entered under Rule 50.*

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1 (k) GAIN OR LOSS UPON THE CUTTING OR TIMBER.

(2) In the case of the disposal of timber (held for more than six months prior to such disposal) by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber, the difference between the amount received for such timber and the adjusted depletion basis thereof shall be considered as though it were a gain or loss, as the case may be, upon the sale of such timber.