

STONE v. GRANDQUIST
60-1 USTC ¶9148; 5 AFTR 2d 304 (D. Ore. 1959).

Editor's Summary

Key Topics

CUTTING AS A SALE OR EXCHANGE

- Contract right to cut v. service contract
- Proprietary interest requirement
- Effect of limitation on taxpayer's right to sell

Facts

Under oral agreements in 1949 and 1954, the taxpayer purchased from DYW Corporation all of the timber on a certain tract. The parties agreed that Oregon-Washington Plywood Co. ("Plywood") had the right of first refusal on all logs cut from the timber, but their agreement also provided that the taxpayer was free to sell all logs to whomever would pay him the highest price. The right of first refusal in Plywood was created in 1946 through agreement between DYW's predecessor and Plywood's predecessor. Although the taxpayer was aware of this right of first refusal, he sold logs where he wanted to and to whomever would pay the most for them. The taxpayer carried unsold logs in his own inventory and he carried insurance on felled timber and logs, but *ad valorem* taxes were paid by DYW. Plywood was aware of the fact that the taxpayer was selling logs to whomever he desired. All parties concerned, including Plywood, considered that the taxpayer had the right to sell the logs on his own account. The taxpayer did not work as a logger for other persons. With respect to timber cut in 1952 and 1953 under the 1949 contract, and in 1955 under the 1954 contract, the taxpayer elected to treat the cutting as a sale or exchange under section 117(k)(1). The Commissioner disagreed, evidently on the theory that the taxpayer did not own or have a contract right to cut the timber because the right of first refusal in Plywood precluded the taxpayer from selling for his own account.

District Court

Held: For the taxpayer. Any right or option in Plywood to purchase the logs, or otherwise restricting the taxpayer's right to sell the logs, was waived. Plywood, and the other parties to the agreements, knew what the taxpayer was doing, permitted him to go ahead, and considered him the owner of the timber and logs cut therefrom. The taxpayer had a contract right to cut and was entitled to elect under section 117(k)(1) to treat his cutting as a sale or exchange.

Case Text

FINDINGS OF FACT AND CONCLUSIONS OF LAW

KILKENNY, District Judge: The above entitled action came on regularly for trial on the 17th day

of November, 1959, before the Honorable John F. Kilkenny, Judge of the above entitled court, plaintiffs appearing by Randall S. Jones of their attorneys of record herein and the defendant and intervenor appearing by Arthur L. Biggins, Attorney, United States Department of Justice, of their attorneys of record herein. Trial was had without the intervention of a jury, the jury after demand therefor by plaintiffs having been waived by stipulation of the parties hereto by their respective attorneys of record herein in the manner provided by Rule 39(a) of the Federal Rules of Civil Procedure. An order on pretrial was made and entered herein on the 17th day of November, 1959, witnesses were sworn and testified and exhibits were introduced in evidence, and based upon the facts stated and stipulations made in said pretrial order, the stipulations filed herein dated November 20, 1959, said testimony and evidence, after due consideration, the court makes the following

FINDINGS OF FACT

I. This is a civil action and arises under the laws of the United States of America providing for internal revenue and jurisdiction of this cause rests upon Title 28 United States Code, Section 1340.

II. During the calendar year 1955, and during all times mentioned herein prior thereto, plaintiffs were residents and inhabitants of the County of Tillamook and State of Oregon, and were then and now are citizens of the United States of America.

III. At all times from November 1, 1952 until sometime in 1959, the defendant R. C. Granquist was the duly commissioned, qualified and acting United States District Director of Internal Revenue for the District of Oregon.

IV. The intervenor, United States of America, is a corporation sovereign and body politic.

V. During the year 1955, and at all times mentioned here/n prior thereto, plaintiffs kept their accounts and filed their personal income tax returns on a calendar year and cash receipts and disbursements basis.

VI. On or about March 15, 1953, plaintiffs filed with the defendant, at his office in Portland, Oregon, plaintiffs' United States income tax return for the calendar year 1952 and paid the tax computed thereon. On or about March 15, 1954, plaintiffs filed with defendant, at his said office, plaintiffs' United States income tax return for the calendar year 1953 and paid the tax computed thereon, On or about April 15, 1956, plaintiffs filed with the defendant, at his said office, plaintiffs' United States income tax return for the calendar year 1955 and paid the tax thereon.

VII. During each of the calendar years 1952, 1953 and 1955, plaintiff, Harold V. Stone, hereinafter called "Stone," cut and sold timber in Tillamook County, Oregon, and plaintiffs elected upon their return for each said year to have the cutting of the timber so cut during said year considered as a sale or exchange of such timber cut during such year, and reported in said returns for said years as long term capital gains, amounts equal to the difference between the sums stated as the fair market value of such timber and the adjusted basis for depletion of such timber in the

hands of the plaintiffs. The sums stated as the fair market value of said timber so cut were calculated by plaintiffs as of January 1 of each said year at the rate of \$18.00 per thousand board feet.

VIII. On April 25, 1958, plaintiffs filed with the defendant, at his said office, plaintiffs' claims for refund on account of Federal income taxes paid by plaintiffs, forms 843, which Claims for said years were in the amounts as follows:

1952	\$4,233.19
1953	39.90
1955	1,338.35

together with interest on each said amount as provided by law. In the claim for each said year, the timber cut during such year was revalued by the taxpayers at \$20.30 per 1000 feet board measure on January 1st of the year in which it was cut, and said claims are based upon the value last mentioned.

IX. More than six months had elapsed after said claims were filed before this action was instituted and the Commissioner of Internal Revenue had not notified plaintiffs of the allowance or rejection of said claims, or any of them.

X. No part of said sums of \$4,233.19, or \$39.90, or \$1,338.35, or any interest on any said sums, has been repaid to the plaintiffs.

XI. At all times hereinafter mentioned, C. R. Yankers, H. H. Wiecks and F. C. Dillard were co-partners, engaged in business under the name of Yunker & Wiecks, and are hereinafter called the "partnership"; and DYW Company, hereinafter called "DYW" was a corporation and its sole stockholders were said C. R. Yunker, H. H. Wiecks and F. C. Dillard. H. H. Wiecks was vice-president of DYW and general manager of its operations in the area of said county in which was located the timber so cut and sold by Stone, and F. C. Dillard was the secretary treasurer of DYW.

XII. On or about April 1, 1949, DYW and Stone entered into an oral agreement whereby DYW sold to Stone and he bought from DYW all of the timber cut and sold by Stone in 1952 and 1953 unless herein otherwise indicated, at the price of 20% of the gross selling price of the logs, and whereby it was understood and agreed that Oregon-Washington Plywood Company, a corporation, hereinafter called "Ore.-Wash. Plywood," had the right of first refusal at market prices of all the logs cut from the timber so purchased by Stone, but which oral agreement further provided that Stone was free to sell all such logs to whomever would pay to him the highest price for such logs. The oral agreement was confirmed on April 1, 1949 by a letter to Stone from DYW (plfs. Exhibit 9), a copy of which, less the heading, is as follows:

Mr. Harold V. Stone
Tillamook, Oregon
Dear Sir:

"Confirming our verbal agreement of this date April 1, 1949, we agree to sell you all the timber we own on the North side of Edwards Creek (namely in Sections 2, 3, & 10 in Township 2 S., R. 8 W. and the SW 1/4 of Section 26, T. 1 S. R. 7 W.

Payment of stumpage to be 20% of the gross selling price and to make certain that we each receive payment from the various mills, it is agreed that we will council with each other.

Very truly yours,
D. Y. W. CO., INC.
By H. H. Wiecks

Said oral agreement so confirmed by said letter is hereinafter sometimes called the "DYW-Stone 1949 contract." In March or April, 1954, DYW and Stone entered into another oral agreement whereby DYW sold to Stone and he bought from DYW all the timber cut and sold by Stone in 1955, except that referred to in paragraph XVI of these findings. The price of the logs and the terms of this agreement were the same as in the former agreement, except that the second agreement provided that the price of cedar would be \$5.00 per 1000 feet board measure.

XIII. Fifty (50) per cent of the long term capital gains referred to in paragraph VII of these findings were taken into account by plaintiffs in computing their taxable income. Included in the total gains realized by the plaintiffs were the sums set forth in column 2 below attributable to the cutting of timber during the years indicated in column 1 below, pursuant to said contracts between Stone and DYW, of which sums the amounts shown in column 3 below were taken into account in reporting taxable income:

1 Year	2 Gains Realized	3 Gains Taken Into Account As Taxable Income
1952	\$70,839.90	\$35,419.45
1953	63,358.95	31,679.47
1955	16,490.51	8,245.26

XIV. In their returns for the years 1952 and 1953 plaintiffs reported capital gains for said years in the amounts shown in column 2 below attributable to the disposal of timber held by them for more than 6 months under a contract between Tillamook County, Oregon and Stone, of which amounts the sums shown in Column 3 below were taken into account in reporting their taxable income:

1 Year	2 Gains Realized	3 Gain Taken Into Account as Taxable Income
1952	\$34,544.45	\$17,272.22
1953	23,780.63	11,890.32

XV. On November 26, 1958 the Commissioner of Internal Revenue, hereinafter called "Commissioner," determined that said contracts between DYW and Stone did not qualify the gains in 1952, 1953 and 1955 attributable to the timber cut under said contracts for long term capital gains treatment under section 117(k)(1) or any other section of the Internal Revenue Code of 1939, or under the provisions of section 631 (a) or any other section of the Internal Revenue Code of 1954, and that said contract between Tillamook County and Stone did not qualify the gains in 1952 and 1953 attributable to the disposal of timber under said contract for long term capital gains treatment under the provisions of section 117(k)(2) or any other section of the Internal Revenue Code of 1939, and the Commissioner decreased the plaintiffs' long term capital gains for said years and increased their ordinary income for said years as follows:

Year	Decreased Capital Gains	Increased Ordinary Income
1952	\$35,419.45	\$70,838.90
	17,272.22	34,544.45
1953	31,679.47	63,358.95
	11,890.32	23,780.63
1955	8,245.26	16,490.51

XVI. During 1953 Stone cut timber from the W 1/2 of Section 36, T. I S., R. 8 W. of the W. M. in Tillamook County, Oregon, which land plaintiffs owned at all times during the year 1953 and for more than six months before the beginning of such year. Plaintiffs reported capital gains of \$12,722.63, which total represented \$9,317.90 of timber Stone cut and returned at a valuation of \$18.00 per 1000 feet board measure and \$3,404.73 cut by other loggers and returned at approximately \$10.00 per 1000 feet board measure.

XVII. The Commissioner determined that the value of the timber cut by Plaintiffs in 1953 on the land described in paragraph XVI was not in excess of \$16.50 per 1000 feet board measure, and he decreased said capital gains of \$12,722.63 by \$816.19 and increased plaintiffs' ordinary income in the amount of \$1,632.37.

XVIII. On or about November 26, 1958, the plaintiffs were advised by the Commissioner by his duly authorized agent that the determination of their tax liability for said years disclosed deficiencies for said years as follows:

1952	\$36,104.74
1953	18,130.13
1955	<u>5,894.94</u>
	\$60,129.81

XIX. Based on said determination, on April 3, 1959, the Commissioner, or his duly authorized agent, assessed the following income tax and interest against the plaintiffs for the taxable years 1952, 1953 and 1955:

Year	Tax	Interest	Total
1952	\$36,104.74	\$13,110.47	\$49,215.21
1953	18,130.13	5,495.66	23,625.79
1955	5,894.94	1,050.02	6,944.96
			\$79,785.96

Said assessment was certified to the District Director of Internal Revenue, who, upon receipt, gave notice and demand for payment of such tax and interest to plaintiffs.

XX. No part of said assessments has been paid.

XXI. Except as otherwise stated herein, all of the facts set forth in plaintiffs' federal tax returns for the years 1952, 1953 and 1955 are accepted as correct and as proved in this action.

XXII. The fair market value of timber cut and sold by Stone during the years 1952, 1953 and 1955 was \$18.00 per 1000 feet board measure on January 1st of the year in which the timber was cut.

XXIII. Tillamook County, Oregon, hereinafter called "County," and the partnership entered into a written agreement (plfs. exhibit 22), dated February 28, 1946, concerning certain timber, including the said timber which DYW sold to Stone and he purchased from DYW. At the time this agreement was made, the County was the owner of all of said timber. This agreement, in part, provides that title to the logs shall remain in the County until the same have been fully paid for, and that the agreement shall not be assigned without the consent of the County. When this agreement was made, the County Court "figured" it had sold timber to the partnership, and regarded the contract as a sale.

XXIV. On or about April 29, 1946, the partnership and DYW entered into an agreement (plfs. exhibit 23) which, in part, provides that the partnership agrees to sell to DYW and it agrees to buy from the partnership all of the timber which the partnership is entitled to cut in the Trask River area under contracts with Ore.-Wash. Plywood and with the County (said area includes the timber referred to in paragraph XXIII above), and which, in effect, provides that DYW "agrees to comply with all terms of the aforesaid contracts with" Ore.-Wash. Plywood and with the County, "except for payment of stump-age prices which shall be made by" the partnership. The County Court knew about this sale of said timber from the partnership to DYW, had no objection thereto, was favorable to it and agreed thereto.

XXV. Under date of January 4, 1946, the partnership and Nicolai Plywood Company, an Oregon corporation, therein and hereafter called "Nicolai," and Oceanside Lumber Company, Inc., an Oregon corporation, entered into a written contract (defs. exhibit E) which, in part, provides that Nicolai will purchase from the partnership and it will sell and deliver to Nicolai all No. 1 and No. 2 plywood logs cut or procured by the partnership from land owned or controlled by the County, described on a paper attached thereto, which timber is that referred to in paragraph XXIII above. On or about August 31, 1949, Ore.-Wash. Plywood acquired all the rights of Nicolai under this agreement.

XXVI. H. H. Wiecks acted for DYW in making the Stone-DYW 1949 contract. Prior to making it he consulted with C. R. Yunkers and F. C. Dillard about making the sale to Stone. No mention of any written contract or option was made to Stone prior to or at the time DYW and Stone entered into said contract. Prior to 1959 Stone knew nothing about the agreement mentioned in paragraph XXV above.

XXVII. June 19, 1952, F. C. Dillard left at Stone's office for Stone's signature, a form of contract (defs. exhibit B), which Mr. Dillard had alone signed as follows:

DYW COMPANY, INC.
By F. C. Dillard
Secretary & Treasurer

FIRST PARTY

Five or six weeks elapsed. Stone subsequently, at Mr. Dillard's request, signed this document. By its terms, this document is a contract of sale and confirms the letter of April 1, 1949 (plfs. exhibit 9) that DYW was selling to Stone the timber herein involved. This document contains a provision about delivering logs and provides that Stone agrees to comply with contracts between DYW, Ore.-Wash. Plywood, the County, and State Forestry Department insofar as they apply to lands, roads or timber, or the subject matter of this agreement, that Ore.-Wash. Plywood has an exclusive right and option to purchase all sawmill logs at ceiling or market prices and that if it should fail to exercise the option or to offer the ceiling or market price, whichever is lower, or if the option becomes ineffective, then DYW and Stone shall mutually decide what action shall be taken with respect to log sales, and further provides that DYW reserves the right to purchase all cedar logs, and that Stone shall comply with DYW contracts with the County that the logs must be milled therein. This document would bring notice to Stone of the contracts therein mentioned.

XXVIII. Neither DYW nor Stone ever acted under the document mentioned in paragraph XXVII above (defs. exhibit B). After it was signed by Stone, he continued to cut, sell and deliver logs from the timber he purchased from DYW in 1949 and to pay DYW for the same just as he had done before he signed said document. The business between Stone and DYW with respect to said timber was conducted after the document was signed exactly as it was conducted before it was signed.

XXIX. From 1949 until he sold out in 1955, Stone, at his own expense and with his own machinery, equipment and trucks, cut and logged the timber covered by the said contracts

between DYW and him, and loaded and delivered the logs to the buyers. DYW did not supervise this work and had no fight to do so. During said years, Stone maintained a gate across his road leading to the timber. He kept this gate locked nights and on weekends and DYW had no key to it. From June, 1946 to June, 1958, Robert Carroll worked for Ore.-Wash. Plywood as its log buyer. When he went to work for Ore.-Wash. Plywood, he was informed by the president of that company that it had the first right of refusal of market price of logs cut from certain timber, including that subsequently sold by DYW to Stone as aforesaid. Mills and plywood factories, including Ore.-Wash. Plywood sent their log price lists to Stone, and log buyers, including said log buyer for Ore.-Wash. Plywood, called on Stone to purchase logs. Stone sold logs cut by him from the timber covered by his said contracts with DYW to several purchasers, including Ore.-Wash. Plywood. He sold logs where he wanted to and to whomever would pay him the most for them. In addition to running his logging operation, Stone was log buyer for Tillamook Bay Lumber Company, hereinafter called "Tillamook Co.," in which he and his sister held stock and which operated a sawmill. He sold logs cut from the timber last mentioned to Tillamook Co. and used the logs cut from said timber as a logging inventory control for Tillamook Co. Stone carried the logs unsold at the year end cut from said timber in his own inventory. DYW did not carry any said logs in its inventories. Stone insured his felled timber and logs for his own protection only against damage by fire. The DYW-Stone 1949 contract and his 1954 contract with DYW provided that DYW would pay the severance and ad valorem taxes. DYW did so. The ad valorem taxes were Paid at a contract rate as timber was felled pursuant to said agreement between the County and the partnership (plfs. exhibit 22).

XXX. Soon after the DYW-Stone 1949 contract was made, the County. Court was informed that Stone had purchased from DYW the timber thereby sold to DYW to Stone. The County had no objection to this sale, and thereafter considered Stone as the owner of said timber. Prior to this sale, the County regarded DYW as the owner of that timber. DYW intended to sell to Stone the timber it sold to him in 1949 and 1954 and considered it had done so, and after said sales considered Stone as the owner of said timber. 'Said log buyer for Ore.-Wash. Plywood considered that Stone was operating on his own and that Stone was the owner of the logs he sold to Ore.-Wash. Plywood. Said log buyer dealt directly with Stone and not with DYW in purchasing said logs. During the years herein involved, everyone who had anything to do with said timber, including the partnership, DYW and Ore.-Wash. Plywood, knew that Stone was selling the logs cut therefrom to whomsoever he desired, and that he was selling some of said logs to mills other than Ore.-Wash. Plywood, and considered Stone as the person who had the right to sell the timber on his own account; and the persons who purchased the logs from Stone, including Ore.-Wash. Plywood, considered Stone had the right to sell such logs on his own account and recognized such right. Stone used for his own benefit and account the money he received in payment of the logs he sold which he had cut from said timber. There is no evidence that during said years anyone questioned Stone's right to so sell said logs and to retain the net proceeds from the sale thereof. During said years, Stone did not work as a logger or do logging for anyone except himself.

XXXI. By reason of the facts herein stated, the County waived whatever restrictions are contained in any contract introduced in evidence herein against the partnership selling to DYW the timber mentioned in paragraph XXIII and against DYW selling to Stone the timber that it sold

to him in 1949 and 1954, and recognized the right of the partnership and DYW to make said sales.

XXXII. The County, Ore.-Wash. Plywood, the partnership and DYW by their said knowledge of what Stone was doing as aforesaid, by their said conduct and by permitting Stone to go ahead as he did, and by considering him as owner of said timber sold to him by DYW and the logs cut therefrom with the right to sell the same, waived all the contractual provisions mentioned in paragraphs XXIII, XXIV, XXV and XXVII of these findings giving Ore.-Wash. Plywood the right or option to purchase said logs and otherwise restricting the right to sell said timber or logs and also waived any and all other restrictions, if any, imposed by any document introduced in evidence herein with respect to whom, where or under what circumstances said timber or logs should be sold.

XXXIII. During the years 1952, 1953 and 1955, and prior thereto, Stone had the contract right under the DYW-Stone 1949 contract and his 1954 contract with DYW to cut the timber referred to in said contracts which he cut during said years as aforesaid, and he also had the right to sell on his own account all the timber which was cut by him under said contract.

XXXIV. The parties hereto stipulated and agreed as follows:

1. On account of adjustments made by the Commissioner, plaintiffs' ordinary income for the year 1952 should be increased by the net amount of \$4,125.06 and their ordinary income for the year 1955 by the net amount of \$445.53.
2. Plaintiffs are entitled to report and claim long-term capital gains on account of the sale by Stone of the timber referred to in paragraph XIV of these findings.
3. As a result of an arrangement between Stone and one Courtney for cutting certain timber in the years 1952 and 1953, the full long-term capital gains of plaintiffs for the year 1952 should be reduced by \$9,791.60 and their ordinary income for said year should be increased by said amount, and their full long-term capital gains for the year 1953 should be reduced by the sum of \$1,020.90 and their ordinary income for said year should be increased by said amount.

Based on the foregoing findings of fact, the Court makes the following:

CONCLUSIONS OF LAW

I. Plaintiffs are not entitled to recover any amount from the defendant on account of their said claims for refund.

II. By reason of the facts hereinbefore stated, the County waived whatever restrictions are contained in any contract introduced in evidence herein against the partnership selling to DYW the timber mentioned in paragraph XXIII and against DYW selling to Stone the timber that it sold to him in 1949 and 1954.

III. By reason of the facts hereinbefore stated, the County, Ore.-Wash. Plywood, the partnership and DYW waived all the contractual provisions mentioned in paragraphs XXIII, XXIV, XXV and

XXVII of these findings giving Ore.-Wash. Plywood the right or option to purchase said logs and otherwise restricting the right to sell said timber or logs and also waived any and all other restrictions, if any, imposed by any document introduced in evidence herein with respect to whom, where or under what circumstances said timber or logs should be sold.

IV. Stone had a contract right to cut and sell on his own account the timber which was cut and sold by him in 1952, 1953 and 1955 under his contracts of 1949 and 1954 with DYW.

V. That the determinations of the Commissioner referred to in paragraphs XV and XVII of the foregoing findings and said assessments to the extent they are based on said determinations were and are erroneous.

VI. The intervenor is entitled to judgment herein against plaintiffs based solely upon the uncontested adjustments referred to in paragraphs XXXIV, 1. and XXXIV, 3. of the foregoing findings of fact.

VII. No party hereto shall recover costs or disbursements from any other party hereto.