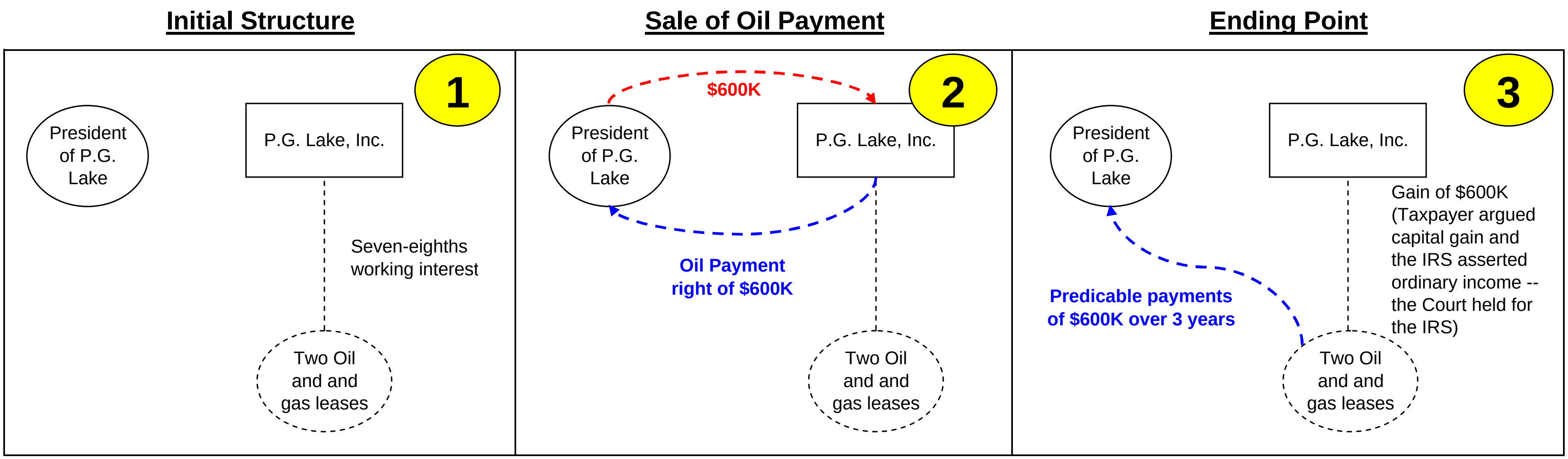
Commissioner v. P.G. Lake, Inc.
356 U.S. 260 (1958)

No Capital Gain on Sale of Right to Receive Ordinary Income



P.G. Lake ("Lake") is a corporation engaged in the business of producing oil and gas. It has a seven-eighths "working interest" in two commercial oil and gas leases. In 1950 for consideration of $600,000 Lake assigned to the president of P.G. Lake an "oil payment right" in the amount of $600,000. At the time of the assignment it could have been estimated with reasonable accuracy that the assigned oil payment right would pay out in three or more years. It did in fact pay out in a little over three years. In its 1950 tax returns Lake reported the oil payment assignment as a sale of property producing a profit of $600,000 and taxable as a long-term capital gain. The Commissioner determined a deficiency, ruling that the purchase price was taxable as ordinary income.

The Court assumed that oil payments are interests in land. The purpose of the capital gains provisions was "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." This exception has always been narrowly construed so as to protect the revenue against artful devices. The Court did not see any conversion of a capital investment. The lump sum consideration seemed essentially a substitute for what would otherwise be received at a future time as ordinary income. The payout of these particular assigned oil payment rights could be ascertained with considerable accuracy. The substance of what was assigned was the right to receive future income. The Court held that the gain was taxable as ordinary income.