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to the owner of the servitude is an enforcement of the adequate development covenant, and this is almost impossible due to the fact that it could not be enforced prior to the expiration of the primary term of the lease, but would have to be enforced before the accrual of the prescription on the servitude. Another fact that would make the remedy less available to the servitude owner is that he would have to show that he had received a bona fide offer of lease from a third party, and it would be difficult for him to secure any such contract in view of the fact that he owns only a fractional portion of the mineral rights. Such a result is indicative of the myriad problems with which the court has been faced in construing the laws formed under the rule of capture to fit the conservation policy. In spite of the reluctance of the court to overturn any prior mineral law decision due to the fact that they establish rules of property, it is apparent that a reconsideration of the *Hunter-Shell* decision is necessary.

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Tax Consequences from Dispositions of Carved Out Oil Payments—Ordinary Income or Capital Gain?

Classification of a particular item of income as either ordinary income or capital gain is a matter of considerable concern in terms of the amount of tax to be paid. One source of income which has posed a difficult problem in regard to its nature for income tax purposes is the "oil payment." For federal income tax purposes, an oil payment[1] has been defined as a right to oil and gas in place that entitles its owner to a specified fraction of his transferor's share of production from the property, limited by a certain sum of money or a specified number of units of oil or gas.[2] Oil payments are used extensively in the industry, thereby making the classification of income from transfers of such payments particularly important.

The problem of distinguishing between ordinary income and capital gain is not a new one, nor in many areas has it been ade-

1. Breeding & Burton, Taxation of Oil and Gas Income 25 (1954).
2. The law relative to gas payments is the same as that relative to oil payments. For the sake of simplicity, references in the text will mention only the oil payment; however, the discussion is equally applicable to gas payments.

quately solved.[3] Despite myriad decisions and several legislative reforms,[4] a certain lack of clarity persists. It has been suggested that, if there were some clear legislative intent as to whether ordinary income and capital gain were to be considered as two parallel but mutually exclusive classifications, or whether one category is an exception to the other, the problem would be less difficult for the courts.[5] If one were an exception to the other, any doubtful case could be resolved in favor of the dominant category. This was the approach followed by Mr. Justice Clark in the *Corn Products* case.[6] Capital gain was considered as the exception and ordinary income the general rule.[7] However, many recent tax court and court of appeals cases have been, where doubtful, resolved in favor of capital gain treatment,[8] which would seem to indicate a feeling contrary to that of the Supreme Court. However, the Supreme Court has thus far denied certiorari in all of these cases.[9]

While it must be admitted that the policy behind the capital gain provisions is not clear, there are some underlying reasons behind the capital gain notion that merit examination. One such reason given for affording certain transactions capital gain treatment is that of mitigating the burden on the taxpayer of having to pay in a single year at the progressive ordinary income rates a tax on gain from property which has increased in value over a number of years.[10] In other words, the owner of property that increases in value over a period of years actually "earns" a portion of the increase in each of the several years during which the property has been held, but without having "realized"

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3. See Proceedings of panel discussions, reported in FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY 307 *et seq.* (printed for the use of the Joint Committee on the Economic Report, 84th Cong., 1st Sess., Dec. 12, 1955).

4. For a discussion of the general problem of distinguishing ordinary income from capital gains, see Dakin, *The Capital Gains Treasure Chest*, 14 LOUISIANA LAW REVIEW 505 (1954). See also Miller, *The "Capital Asset" Concept: A Critique of Capital Gains Taxation*, 59 YALE L.J. 837, 1057 (1950).

5. Note, 69 Harv. L. Rev. 737, 738 (1956).

6. Corn Products Refining Co. v. Commissioner, 350 U.S. 46 (1955).

7. *Id.* at 52, with its predecessor, Hort v. Commissioner, 313 U.S. 28 (1941), stand alone for the proposition that capital gain is the exception.

8. E.g., Caldwell v. Campbell, 218 F.2d 567 (5th Cir. 1955); Commissioner v. Ray, 210 F.2d 390 (5th Cir. 1954), cert. denied, 348 U.S. 829 (1954); Commissioner v. McCue Bros. & Drummond, Inc., 210 F.2d 752 (2d Cir. 1954), cert. denied, 348 U.S. 829 (1954); Commissioner v. Golonsky, 200 F.2d 72 (3d Cir. 1952), cert. denied, 345 U.S. 939 (1953); McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946), cert. denied, 330 U.S. 826 (1947).

9. See note 8 *supra*.

10. SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS 1938-1861, 362-63 (1938).

any gain for income tax purposes until the property is disposed of.[11] Hence, by denominating the income from this disposition capital gain, it is taxed at a rate considerably lower than the rate applied to ordinary income,[12] the theory being that the tax burden imposed by the capital gain rate on the entire amount of the transaction will approximate the tax which would have been levied each year on that year's increment at the ordinary income rate.[13] However, certain inroads have been made in this notion of averaging "bunched" income. This is evidenced particularly by the fact that the period for which an asset must be held in order to merit long term-capital gain treatment has been reduced to only six months.[14] The result is that it is now more common to offer a second explanation for capital gain treatment: that the taxation of capital transactions at a lower rate will encourage taxpayers to risk funds in capital investments and to be more willing to dispose of their capital assets, thereby maintaining a more fluid economy.[15] The current rules as to capital gain treatment are to a great extent the result of the efforts of pressure groups, especially in the securities and investment areas, who desire to be encouraged to risk their funds.[16] Such pressures will remain as long as the great disparity between rates on ordinary income and capital gain remain. These two theories cannot be reconciled, yet they are both, to some extent, the basic explanations for the present capital gain concept.

Generally speaking, capital gain results when a capital asset, which has been held six months or longer, is sold.[17] According to

11. Section 61(a) of the Internal Revenue Code of 1954 defines gross income as "all income from whatever source derived, including . . . (3) gains derived from dealings in property." Taxable income (gross income less deductions), defined in § 63, is taxed to individuals at progressive rates ranging from 20% to 91% under § 1. If there is an excess of net long-term capital gain, from the sale or exchange of capital assets held longer than six months, over net short-term capital loss, § 1202 allows a deduction amounting to 50% of such excess to determine the taxable income to which the § 1 rates are to be applied. Alternatively, the taxpayer may choose to have the capital gain component taxed at a flat rate of 25% under § 1201. In the case of corporations, § 11(b)(2) imposes a normal tax of 25% on gross income. In addition, § 11(c) imposes a surtax of 22% on gross income in excess of $25,000.00. Corporate capital gain is taxed at a flat rate of 25%.

12. See note 11 *supra*.

13. See Miller, *The "Capital Asset" Concept: A Critique of Capital Gains Taxation*: II, 59 YALE L.J. 1057, 1058 and authorities cited therein (1950).

14. INT. REV. CODE OF 1954, § 1222(3).

15. *Hearings Before the Committee on Ways and Means, General Revenue Revision*, 83d Cong., 1st Sess, at 965 (1953).

16. Dakin, *The "Capital Gains" Treasure Chest*, 14 LOUISIANA LAW REVIEW 505, 506 *et seq.* (1954).

17. INT. REV. CODE OF 1954, §§ 1201-223.

Section 1221 of the Internal Revenue Code, the term "capital asset" means property held by the taxpayer, whether or not held in connection with his trade or business.[18] This is the general rule from which certain specific items of property are excepted.[19] Thus, the question of whether an item of income should be treated as ordinary income or capital gain seems to turn on whether property not within one of the named exceptions is involved. However, the problem of construing "property" for purposes of Section 1221 is not a simple one.

While the problem of differentiating between ordinary income and capital gain has been apparent throughout the income tax law, it has been particularly acute in the area involving the transfer of oil and gas payments.[20] One of the primary questions to be considered is whether the oil payment is "property" as defined in Section 1221 of the Internal Revenue Code and as such subject to capital gain treatment. Since many transfers of oil payments can be characterized either as sales of property or as payments received in lieu of income, they could, under a literal construction of the Code, be treated as resulting either in ordinary income or capital gain. Litigation in this area has been extensive, and somewhat unproductive in the sense that it has failed to produce any consistent pattern upon which one can speculate with any degree of accuracy as to how the next case will be decided. A brief look at the nature of the oil payment should prove of some assistance at this point.

An oil payment is either "retained" or "carved out."[21] It is said to be retained if the owner of any interest in an oil property assigns his interest and retains an oil payment, payable out of future production from the property interest assigned.[22] An oil payment is said to be carved out if the owner of any inter-

18. *Id.* § 1221.

19. *Id.* § 1221(1)-(5). The excepted items are: (1) inventory, stock in trade and items held for sale to customers in the ordinary course of trade or business; (2) property used in a trade or business subject to depreciation under § 167 or real property used in the trade or business (gains on these items being taxed at capital gain rates while losses are permitted to be deducted as ordinary losses under § 1231); (3) copyrights, literary, musical, or artistic compositions, or similar properties held by the creator or his donee; (4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in the first exception; (5) certain short-term government securities.

20. For additional discussion of the tax problems developing from the use of oil payments, see Comment, 10 Sw. L.J. 302 (1956); Note, 104 U. Pa. L. Rev. 1088 (1956).

21. Breeding & Burton, Taxation of Oil and Gas Income 63-64 (1954).

22. *Id.* at 63.

est in any oil property assigns an oil payment to another person but retains his interest in the property from which the oil payment is assigned.[23] While the retained oil payment and the carved out oil payment are basically similar, the tax consequences from the use of the two devices are considerably different.

In the case of the retained oil payment, there is no real problem since the person retaining the oil payment cannot be said to have anticipated ordinary income.[24] In such cases, the holder of the retained oil payment does not receive the value of the oil payment in one lump sum, but in fact receives it periodically during the life of the oil payment. The assignor or vendor of an oil property who retains an oil payment will be required to allocate the income tax basis of the property prior to the assignment between the interest assigned and the oil payment retained in proportion to their respective fair market values.[25] The reason for this allocation is that the holder of the oil payment who receives a share of production in the form of income is entitled to a depletion allowance.[26] The cost so allocated to the retained oil payment will then become the basis for depletion and for computation of gain or loss on the sale.[27] If the retained oil payment is subsequently sold, any gain would be treated as capital gain unless the seller is a dealer in such properties.[28]

In the area of carved out oil payments, there has been some confusion in applying the law; the tax consequences of using carved out oil payments are consequently by no means clear. The carved out oil payment has been successfully used as a means of financing the development of new oil properties.[29] In such cases

23. *Id.* at 64.

24. In the case of a "retained" oil payment, the transaction is one resulting in capital gain or loss to the assignor. The law seems clear on this point. See Commissioner v. Fleming, 82 F.2d 324 (5th Cir. 1936).

25. Columbia Oil & Gas Co. v. Commissioner, 41 B.T.A. 38 (1940), acq. on other issues, 1940-1 CUM. BULL. 2 and 1943 CUM. BULL. 5, aff'd, 118 F.2d 459 (5th Cir. 1941); American Liberty Oil Co. v. Commissioner, 127 F.2d 262 (5th Cir. 1942); G.C.M. 23623, 1943 CUM. BULL. 313.

26. INT. REV. CODE OF 1954, §§ 611-614; Commissioner v. Rowan Drilling Co., 130 F.2d 62 (5th Cir. 1942); Lee v. Commissioner, 126 F.2d 825 (5th Cir. 1942); Ortiz Oil Co. v. Commissioner, 102 F.2d 508 (5th Cir. 1939), cert. denied, 308 U.S. 566 (1939).

27. Murphy Oil Co. v. Burnet, 15 B.T.A. 1195, 55 F.2d 17, 287 U.S. 299 (1932); Lee v. Commissioner, 126 F.2d 825 (5th Cir. 1942).

28. McLean v. Commissioner, 120 F.2d 942 (5th Cir. 1941), cert. denied, 314 U.S. 670 (1941); Cullen v. Commissioner, 118 F.2d 651 (5th Cir. 1941); Hammonds v. Commissioner, 106 F.2d 420 (10th Cir. 1939); Commissioner v. Fleming, 82 F.2d 324 (5th Cir. 1936).

29. For a general discussion of the various uses of this financing device, see Jackson, *Tax Planning Before Drilling: The Operator's Problem*, 27 TUL. L. REV. 21, especially at 27 *et seq.* (1952).

the transactions are not taxable ones at the time of the transfer, since they are treated for tax purposes as pooling or sharing arrangements.[30] The real problems have developed as a result of holders of working interest[31] or larger oil payments disposing of the periodic income they are receiving from such interest in order to obtain an immediate lump sum and have such sum taxed at the lower capital gain rate.[32] A brief review of some of the recent cases, Internal Revenue Service rulings, and amendments to the Internal Revenue Code will graphically point up the problem.

While some earlier rulings of the Internal Revenue Service dealt with the subject of dispositions of carved out oil payments,[33] General Counsel's Memorandum 24849 represents the basic position of the Commissioner and the Service.[34] It was the opinion of the Chief Counsel that consideration, not pledged for development, received for the assignment of a short-lived oil payment carved out of any type of depletable interest in oil and gas in place, including a larger oil payment, is, in the hands of the assignor, ordinary income subject to the depletion allowance.[35] However, in the same memorandum, the Chief Counsel refused to express an opinion with respect to the status of oil payments extending over a substantial portion of the life of the depletable economic interests from which they are carved.[36] Four years later, the Internal Revenue Service, in I.T. 4003 amended their prior position and ruled that the assignment of any oil payment, not pledged for development, which extends over a period less than the life of the depletable property interest from which it is carved, is essentially the assignment of expected income from the property interest.[37] Therefore the assignment, for a considera-

30. Appleman, *Sales and Assignments of Leases and Other Interests in Oil and Gas*, FIRST OIL AND GAS INSTITUTE, SOUTHWESTERN LEGAL FOUNDATION 427, 457-63 (1949); Williams, *Assignment of Leasehold, Royalty and Oil Payment*, SECOND OIL AND GAS INSTITUTE, SOUTHWESTERN LEGAL FOUNDATION 469, 502-15 (1951). See Ortiz Oil Co. v. Commissioner, 102 F.2d 508 (5th Cir. 1939), cert. denied, 308 U.S. 566 (1939).

31. BREEDING & BURTON, TAXATION OF OIL AND GAS INCOME 22 (1954): "The working interest, for federal tax purposes, is an interest in oil and gas in place that is burdened with the cost of development and operation of the property."

32. The taxpayer is not to be condemned for this, since he has the right to take any legal course with his property or business which lightens or lessens his tax load. See Caldwell v. Campbell, 218 F.2d 567, 573 (5th Cir. 1955), and authorities cited therein.

33. I.T. 3693, 1944-CUM. BULL. 272.

34. G.C.M. 24849, 1946-1 CUM. BULL. 66.

35. *Ibid.*

36. *Ibid.*

37. I.T. 4003, 1950-1 CUM. BULL. 10, 11.

tion, of any such oil payment results in the receipt of ordinary income by the assignor which is taxable to him when received or accrued. In the same ruling, the Commissioner extended the rule covering donative assignments of carved out oil payments,[38] ruling that they too were assignments of future income.[39] The rule announced in I.T. 4003 does not apply where the assigned oil payment constitutes the entire depletable interest of the assignor in the property, or a fraction extending over the entire life of the property.[40]

While these rulings express the Internal Revenue Service's position on the problem, the courts have not been willing to follow them in most of the cases dealing with this point. The first case to deal squarely with the problem of how to treat, for income tax purposes, the disposition of a carved out oil payment was that of *Lester A. Nordan*,[41] which involved a donation of a carved out oil payment to a church, with a reversion to the taxpayer after the church had received a certain amount from the oil payment. The tax court allowed Nordan a charitable deduction for the fair market value of the gift at the time it was made. The court said that the taxpayer had made more than a mere assignment of income to the church, and had in fact transferred property which subsequently produced income.[42] In 1954, the tax court decided the case of *John D. Hawn*,[43] citing the *Nordan* case.[44] In the *Hawn* case the tax court, by a split decision, held the oil payment which Hawn had transferred to be a capital asset which had been held for more than six months and the gain was therefore taxable as long term capital gain.[45] The facts of the case were that Hawn transferred to a contractor an oil payment that he had held for some time. The contractor agreed to build a house for Hawn and, when the contractor had received a certain amount of income from the oil payment, the oil payment would

38. I.T. 3935, 1949-1 CUM. BULL. 39.
39. I.T. 4003, 1950-1 CUM. BULL. 10, 11.
40. *Ibid.* The fraction assigned that runs for a time concurrent with the life of the property assigned would be an overriding royalty.
41. Lester A. Nordan, 22 T.C. 1132 (1954).
42. The court was of the opinion that no income from the property had accrued at the date of the transfer by gift of oil, gas, and minerals in place, and that the income accrued from the production of oil after the petitioners had conveyed the property. *Id.* at 1134.
43. John D. Hawn, 23 T.C. 516 (1954). As will be pointed out later, the *Hawn* case was reversed by Commissioner v. Hawn, 231 F.2d 340 (5th Cir. 1956).
44. Lester A. Nordan, 22 T.C. 1132 (1954).
45. John D. Hawn, 23 T.C. 516 (1954), reversed, 231 F.2d 340 (5th Cir. 1956).

revert to Hawn. Hawn claimed that the gain from the transfer of the oil payment, which paid out in nineteen months, was long term capital gain.[46] The Commissioner, citing G.C.M. 24849 and I.T. 4003[47] argued that the gain realized was ordinary income. It was the contention of the Commissioner that this transaction was nothing more than the anticipation of ordinary income on the part of Hawn, especially in view of the fact that the payment paid out in such a short period of time. However, there was no jurisprudence which squarely supported the Commissioner's position, while on the other hand, Hawn cited to the court several cases involving different issues but still standing for the proposition that an oil payment is an interest in the oil in place and therefore entitled to capital gain treatment.[48] It should be noted that six judges dissented in the *Hawn* case and were of the opinion that the oil payments constituted ordinary income to the petitioner, Hawn.[49]

Before the *Hawn* case reached the Court of Appeals for the Fifth Circuit, that court handed down a decision in *Caldwell v. Campbell*,[50] which involved a sale of carved out oil payments to a tax exempt foundation. The court rejected the Commissioner's position that the transactions resulted in anticipation of ordinary income and found that there was in fact a sale of property interests and that capital gain resulted therefrom. One judge dissented, being of the opinion that the transaction involved an anticipation of ordinary income.[51] A plethora of decisions in the tax court followed in the wake of the *Hawn* and *Caldwell* decisions, with all of them resulting in capital gain treatment for oil payments.[52] The developing pattern of cases was broken when the *Hawn* case reached the Court of Appeals for the Fifth Cir-

46. *Ibid.*
47. G.C.M. 24849, 1946-1 CUM. BULL. 66; I.T. 4003, 1950-1 CUM. BULL. 10.
48. Lester A. Nordan, 22 T.C. 1132 (1954); T.W. Lee, 42 B.T.A. 1217, aff'd, 126 F.2d 825 (5th Cir. 1942).
49. Hawn, 23 T.C. 516, 523 (1954). In his dissent, Judge Arundell was of the opinion that one vested with the right to receive income cannot "escape the tax by any kind of anticipatory arrangement, however skillfully devised, by which he procures payment of it to another, since, by the exercise of his power to command the income, he enjoys the benefit of the income on which the tax is laid."
50. Caldwell v. Campbell, 218 F.2d 567 (5th Cir. 1955).
51. *Id.* at 573.
52. John Wrather, T.C. Memo. 55-104 (1955); R. B. Cowden, T.C. Memo. 55-128 (1955); William Fleming, 24 T.C. 818 (1955); A. J. Slagter, Jr., 24 T.C. 935 (1955); W. F. Weed, 24 T.C. 1025 (1955); P. G. Lake, Ins., 24 T.C. 1016 (1955); O'Connor v. Scofield, 143 F. Supp. 240 (W.D. Tex. 1956).

cuit. In reversing the decision of the tax court, the court was careful to distinguish it from the decision in the *Caldwell* case.[53] The ground of distinction used by the court in these two cases has become the test for classifying oil payments as producing ordinary income or capital gain: the substantiality of the payment in regard to time and amount.[54]

Under the substantiality test, if the court finds that the carved out oil payment will take a substantial portion of the life of the property to pay out or that it represents a substantial portion of the entire property, then it will be afforded capital gain treatment. Otherwise, the transaction will be held as anticipation of income and will be subjected to the ordinary income tax rates. It is of particular interest to note that one day prior to the decision of the *Hawn* case, the United States District Court for the Western District of Texas decided the case of *O'Connor v. Scofield,* which involved the sale of an oil payment with a reversionary clause providing for reconveyance to the original vendor when a stipulated amount had been received by the purchaser.[55] In ruling for the taxpayer and finding that the transaction involved the sale of a capital asset that resulted in capital gain rather than ordinary income, the court indicated that it, too, was applying the substantiality of interest test.[56] The court found that the property interest was substantial and real, and represented a substantial part of the grantor's royalty interest. While the payment was paid out in three years, the court noted that the oil payment would have taken an appreciably longer period to pay out had it not been for the fact that there was an increase in production and in the price of oil.[57] The *O'Connor* case has been appealed and argued before the Court of Appeals for the Fifth Circuit, but no decision has been handed down yet. It will be interesting to note how the court disposes of this case and whether and to what extent the court will narrow the gap between what has been found to be substantial and insubstantial.

All of the cases mentioned thus far have arisen in Texas, where the owner of a mineral interest is considered under Texas property law as having an interest in the oil in place.[58] No case

53. Commissioner v. Hawn, 231 F.2d 340, 345 (1956).
54. *Ibid.*
55. O'Connor v. Scofield, 143 F. Supp. 240 (W. D. Tex. 1956).
56. *Id.* at 242.
57. *Ibid.*
58. 1 SUMMERS, OIL AND GAS § 61, n. 8 (1954).

could be found involving property in Louisiana from which there had been a sale or gift of a carved out oil payment with a reversionary provision. However, considering the difference in the basic concept of ownership of minerals in Louisiana, some speculation as to the application of the principles announced in the *Hawn* and *Caldwell* cases would be in order. Under the ruling of *Milling v. Collector of Revenue*[59] the Supreme Court of Louisiana in reviewing the prior jurisprudence on the subject announced as well settled the proposition that the payment of a royalty under a mineral lease is the payment of rent.[60] This being the case, the Commissioner's anticipation of income argument would seem to be much stronger and would probably prevail relative to Louisiana property, especially in the light of the numerous cases dealing with anticipatory assignments of income in areas other than oil and gas.[61] However, in the case of *Palmer v. Bender*, the United States Supreme Court, in deciding a depletion problem held that under Louisiana law a retained royalty represented an economic interest in oil in place.[62] While this decision was handed down before most of the development of the mineral law of Louisiana, the United States Supreme Court has never reversed the *Palmer* case. Therefore, since the characterization of "an economic interest in oil in place" is the very term used by the Court of Appeals for the Fifth Circuit in deciding oil payment cases, it is quite possible that this proposition might be successfully urged before that court on the authority of *Palmer v. Bender*.

It is readily apparent that the substantiality of interests test leaves much to be desired. Primarily, the substantiality test fails to establish any rational basis for decisions. If, under the Internal Revenue Code, the basic requirement is the satisfaction of the property requirement of capital gain, then it would seem that all of these fact situations involving carved out oil payments should receive the same treatment, either as ordinary income or capital gain, assuming, in the case of capital gain, that the other

59. Milling v. Collector of Revenue, 220 La. 773, 57 So.2d 679 (1952).

60. *Ibid.*; Shell Petroleum Corp. v. Calcasieu Real Estate & Oil Co., 185 La. 751, 170 So. 785 (1936); Roberson v. Pioneer Gas Co., 173 La. 313, 137 So. 46 (1931); Board of Commissioners of Caddo Levee District v. Pure Oil Co., 167 La. 801, 120 So. 373 (1928).

61. Hort v. Commissioner, 313 U.S. 28 (1941); Harrison v. Schoffner, 312 U.S. 579 (1941); Helvering v. Horst, 311 U.S. 112 (1940); Lucas v. Earl, 281 U.S. 111 (1930); Hamlin's Trust v. Commissioner, 209 F.2d 761 (10th Cir. 1954); Rudco Oil & Gas Co. v. United States, 82 F. Supp. 746 (Ct. Cl. 1949).

62. Palmer v. Bender, 287 U.S. 551 (1933).

requisites of capital gain are present.[63] Furthermore, it is not at all clear what length of time or amount of money or oil is necessary to constitute a substantial payment. Even if this were clearly delimited, changes in production or market price could make a planned transaction calculated to be substantial, insubstantial because the payment would pay out sooner than had been anticipated. Uncertainty is therefore inherent in the distinction.

On the other hand, if the carved out oil payment is not property within the meaning of the Internal Revenue Code, then it would seem that the income from the sale of such carved out oil payments would be ordinary income subject to depletion.[64] The legislative history of the capital gains provisions indicates that "real" property was meant to describe an interest greater than a mere right to receive income, even though the source of the income might be real property.[65] It could well be argued that a carved out oil payment cannot properly be considered property within the meaning of the capital gains provisions of the Internal Revenue Code.

If income from carved out oil payments is considered in the light of the theory that capital gain is grounded in the notion of granting relief to recipients of "bunched income,"[66] income from carved out oil payments should not be afforded capital gains treatment. Under the "bunched income" notion, the taxpayer who owns property that increases in value over a number of years cannot realize income for tax purposes each year as the yearly increment accrues, but must allow them to become "bunched," with the result that when he does sell the property all of the increase will be realized in one year for tax purposes. Under the present system of graduated income tax rates, the resulting tax burden might be confiscatory. On the other hand, the owner of an oil payment receives income periodically from the property, so that under the normal course of events his income from the property will not be realized in one lump sum. When the taxpayer sells an oil payment, he is voluntarily "bunching" periodic income into one lump sum. Therefore, the taxpayer has precipitated the "bunching" himself, and consequently there is no compelling reason for a lower tax rate.

63. INT. REV. CODE OF 1954, §§ 1201-1223.

64. See *id.* §§ 61(a), 611-14; MILLER, OIL AND GAS FEDERAL INCOME TAXATION 158 (1951).

65. See S. REP. No. 1631, 77th Cong., 2d Sess. 50, 119 (1942).

66. See note 13 *supra*.

The need for additional legislation is apparent. The Eighty-fourth Congress had on its calendar, when it adjourned, a bill which would have cleared up most of the trouble in this area.[67] It provided basically for treating the proceeds from the sale of a carved out oil payment as ordinary income subject to depletion.[68] Although the bill died in committee, it is highly probable that the same or a similar one will be offered in the present session of Congress.

Richard F. Knight

The Fictitious Payee Doctrine Under the Uniform Negotiable Instruments Law

When an instrument is payable to order, an endorsement by the payee or by one authorized by him to endorse is necessary in order for one to maintain an action on the instrument as holder.[1] Likewise, a valid endorsement of a check which is payable to order is necessary before the drawee may debit the drawer's account without incurring liability to the drawer for the amount of the check.[2] However, if the instrument is payable to bearer it need not be endorsed in order for one to maintain an action on it[3] or for the drawee to debit the drawer's account.[4] Usually it is obvious whether an instrument is payable to order or bearer, and hence, whether a valid endorsement is necessary. But the fictitious payee doctrine operates to make paper, ostensibly drawn to order, bearer paper. This doctrine, therefore, becomes important in determining whether a valid endorsement of an instrument which purports to be order paper is necessary and,

67. H.R. REP. 9559, 84th Cong., 2d Sess. (1956).

68. *Ibid.* The general provision of § 633 would have read: "(1) General Rule.—Except as provided in paragraph (2), the proceeds from the sale of an oil, gas, or production payment out of a larger property, as that term is defined in section 614(a), shall be considered income subject to a depletion allowance."

1. United Motor Car Co. v. Mortgage & Securities Co., 128 So. 307 (La. App. 1930).

2. The drawee bank assumes the duty of paying out the depositor's money only on the order of the depositor. If the drawee pays out money on instruments bearing a forged endorsement and debits the drawer's account, it has failed to pay according to the depositor's order and has thus breached its duty to the depositor. The depositor may require the drawee to recredit his account even if the drawee bank used all possible diligence in making payment. See BRITTON, BILLS AND NOTES § 142 (1943).

3. Hillman v. Kropp Forge Co., 340 Ill. App. 606, 92 N.E.2d 537 (1950).

4. Fidelity & Casualty Co. v. United States Fidelity & Guaranty Co., 81 So.2d 576 (La. App. 1955).