***Manahan Oil Co. v. Commissioner, 8 T.C. 1159 (1947)***

An oil payment interest in a leasehold is a separate property from a working interest (outright ownership) in the same leasehold for the purpose of computing depletion allowances.

**Summary**

Manahan Oil Co. acquired both a working interest (outright ownership of a portion of the leasehold) and an oil payment interest (right to receive proceeds from oil production) in two separate oil and gas leases. The IRS argued that both interests in each lease should be treated as a single property for depletion purposes, which would limit the deductions Manahan could take. The Tax Court held that the working interest and the oil payment interest are distinct properties, allowing Manahan to calculate depletion separately for each, which could result in a higher overall deduction. The court reasoned that the interests are inherently different and that treating them separately reflects economic reality.

**Facts**

Manahan Oil Co. acquired an undivided one-half ownership in the Stumps lease and an in-oil payment interest in the remaining undivided one-half. It also acquired an undivided one-third ownership in the Warner lease and an in-oil payment interest in the remaining undivided two-thirds. Manahan deducted intangible drilling costs as expenses. It also sought to offset oil payments against expenditures it considered recoverable through those payments, arguing those expenditures were essentially a loan, not capital investments.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in Manahan Oil Co.’s income tax. Manahan Oil Co. petitioned the Tax Court for a redetermination. The Tax Court reviewed the Commissioner’s determination and issued its opinion.

**Issue(s)**

1. Whether, for the purpose of computing depletion allowances, Manahan’s working interest (outright ownership) and its oil payment interest in each leasehold constitute one property or two separate properties.
2. Whether expenditures recoverable through oil payments constitute a loan, or the purchase price of a capital asset recoverable only through depletion allowances.

**Holding**

1. Yes, the working interest and the oil payment interest are two separate properties for depletion purposes because they are inherently different in

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character and there is no merger of title.
2. No, the expenditures recoverable through oil payments constitute the purchase price of a capital asset, recoverable only through depletion allowances, because the oil payment interest is an economic interest in the oil in place.

**Court’s Reasoning**

The court reasoned that the working interest and the oil payment interest are inherently separate and different. One is outright ownership, while the other is a lesser interest. There is no merger of titles. The court emphasized the practical reality of treating them as separate properties, aligning with previous cases like *Black Mountain Corporation, 5 T.C. 1117*. The court distinguished *Hugh Hodges Drilling Co., 43 B. T. A. 1045*, because that case addressed depletability, not whether the interests should be treated as one property. The court stated:

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