Neville Coal Co. v. Commissioner, 17 T.C. 1215 (1952)

When a property is operated by an agent for the benefit of the owner, the owner's gross income from the property for percentage depletion calculation is based on the gross sales, not merely the net amount received from the operator, allowing deduction of proportionate expenses.

Summary

Neville Coal Co. contracted with Oliver Mining Co. to operate its mines, selling the ore and remitting proceeds to Neville. Neville elected percentage depletion. The Commissioner calculated depletion based on the net amount Neville received from Oliver. Neville argued its depletion should be based on the gross sales price of the ore, treating Oliver as a mere operating agent. The Tax Court held that Neville's gross income should be calculated based on the gross sales price, not the net amount received, because Oliver acted as Neville's agent. The court also held that Neville was entitled to deduct the remaining cost basis in a lease that was terminated.

Facts

Neville Coal Co. owned mineral properties and contracted with Oliver Mining Co. to operate them. Oliver extracted and sold ore from Neville's mines. The contract stipulated that Oliver would remit the proceeds to Neville after deducting operating expenses and a commission. Neville elected to use the percentage depletion method for calculating deductions on its tax returns.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Neville's income tax, arguing that the percentage depletion deduction should be calculated based on the net amount Neville received from Oliver, not the gross sales price of the ore. Neville appealed to the Tax Court, challenging the Commissioner's determination. The Tax Court reviewed the operating contract and applicable tax law.

Issue(s)

1. Whether Neville's gross income from the property, for the purpose of calculating percentage depletion, should be based on the gross sales price of the ore sold by Oliver, or the net amount Neville received from Oliver after expenses and commissions.
2. Whether Neville was entitled to deduct the remaining cost basis in a lease that was terminated.

Holding

1. Yes, because Oliver acted as Neville's operating agent, and the gross income

from the property includes the total sales revenue before deducting expenses.
2. Yes, because Neville terminated the lease without any strings or conditions attached.

Court's Reasoning

The court reasoned that Oliver functioned as Neville's operating agent, selling ore on Neville's behalf. Therefore, Neville's gross income from the property should be the actual sale price of the ore, not merely the net amount remitted by Oliver after deducting expenses and commissions. The court distinguished cases where the operator was a co-owner or lessee, emphasizing that Oliver had no ownership interest in the property. The court cited precedent establishing that income from a property operated by an agent is income of the owner, regardless of the agent's independence. The court stated, "Income from a property operated by an agent is income of the owner, regardless of how independent the agent may be."

Regarding the lease termination, the court found that Neville had abandoned the lease without conditions and only later purchased the fee simple. This was a separate transaction, and Neville was allowed to recognize the loss from abandoning the lease. The court reasoned, "There was no connection between the acquisition of the fee and the termination of the lease which would prevent the loss from the latter transaction from being recognized for tax purposes."

Practical Implications

This case clarifies how to calculate gross income from mineral properties for percentage depletion when using an operating agent. It confirms that the owner's gross income is based on gross sales before deductions, not the net amount received from the agent. Attorneys and accountants should ensure that depletion calculations accurately reflect the gross sales price in agency arrangements. This ruling reinforces the principle that agency relationships pass income directly to the principal, affecting tax obligations. Later cases will likely cite Neville Coal for the proposition that using an agent to operate a mine does not alter how gross income from the property is calculated for depletion purposes.

