11 T.C. 192 (1948)

For purposes of calculating percentage depletion, a taxpayer's mining operations conducted under 'split-check' leases on a single tract of land can be considered a single 'property' when the taxpayer maintains significant control and consistently treats the income as such.

Summary

Cresson Consolidated Gold Mining & Milling Co. operated a gold mine, partly through direct operations and partly through 'split-check' leases. The Commissioner of Internal Revenue argued that the direct operations and lease operations constituted separate 'properties' for calculating percentage depletion. The Tax Court held that because Cresson maintained significant control over both operations within a single tract of land and consistently treated them as one property for depletion purposes, they should be considered a single property, allowing Cresson to calculate depletion based on the combined income.

Facts

Cresson owned approximately 85 acres of contiguous land containing a gold mine in Colorado. Cresson operated the mine through both direct operations and agreements known as 'split-check' leases. Under these leases, contractors were granted the right to mine specific areas adjacent to Cresson's shaft for a year. Cresson provided essential supplies, maintained the shaft and surface facilities, and supervised all mining operations. The contractors provided labor and some minor equipment. Cresson received approximately 51% of the net mill returns from the contract operations, and the contractors received the remaining 49%.

Procedural History

Cresson claimed percentage depletion on its 1940 tax return, treating all income from the mine as income from a single property. The Commissioner treated the direct and contract operations as separate properties and disallowed a portion of the claimed depletion. Cresson appealed to the Tax Court.

Issue(s)

Whether the mining operations conducted directly by Cresson and those conducted by contractors under 'split-check' leases should be treated as separate 'properties' for the purpose of calculating percentage depletion under Section 114(b)(4) of the Internal Revenue Code.

Holding

No, because Cresson maintained significant operational control over the contract operations, the operations occurred on a single tract of land, and Cresson consistently treated the income from both operations as income from a single property for depletion purposes.

Court's Reasoning

The court referenced Section 114(b)(4) of the Internal Revenue Code, which allows a percentage depletion deduction for metal mines. The court also cited Regulation 103, which defines 'the property' as the taxpayer's interest in any mineral property, stating that a taxpayer's interest in each separate mineral property is a separate 'property.' However, the regulation further states that multiple mineral properties included in a single tract may be considered a single 'property' if such treatment is consistently followed. The court distinguished this case from *Helvering v. Jewel Mining Co.*, where the taxpayer had relinquished control over the subleased property. Here, Cresson retained significant control over the contract operations through supervision and provision of essential resources. The court emphasized that the 'split-check' leases were essentially a method for Cresson to pay for the operating expenses of mining in certain areas, noting, "Although the agreements with the contractors are called 'split-check' leases, we are of the opinion that the terms of those agreements, and the facts and circumstances here shown as to how the parties operated under them, make it quite clear that the agreements are not leases and that the operations in the contract areas did not amount to the operation of separate properties." Because Cresson owned the fee, the plant, and other mining facilities, operated the mine consistently for 15 years, and included both operations within a single tract, the court held that the income could be combined for depletion purposes.

Practical Implications

This case clarifies that the definition of 'property' for percentage depletion purposes depends on the degree of control a taxpayer maintains over mining operations, even if those operations are conducted by contractors. If a taxpayer retains significant operational control, consistently treats income from all operations as a single property, and operates within a single tract, the IRS is less likely to successfully argue that separate operations constitute separate properties. This decision provides a framework for analyzing similar arrangements in the mining industry and highlights the importance of consistent tax treatment and maintaining operational control when seeking to maximize depletion deductions.

