14 T.C. 1236 (1950)

Commissions paid by a lessor to secure oil and gas leases are considered capital expenditures, not ordinary business expenses, and are generally not deductible as cost depletion when percentage depletion has already been claimed.

Summary

The Munger case addresses whether a commission paid by a partnership for securing oil and gas leases on its own property is a deductible business expense or a capital expenditure. The Tax Court held that the commission was a capital expenditure and not a deductible business expense. Furthermore, having taken percentage depletion on the bonus received from the lessee, the lessors were not entitled to claim cost depletion for the commission paid. The court reasoned that obtaining the leases created an income-producing asset, and allowing both percentage and cost depletion would result in an impermissible double deduction.

Facts

The partnership of Munger and Nix, in which the petitioners held a one-half interest, owned land in Andrews County, Texas. In 1944, the partnership executed two oil and gas leases with Hunt Oil Co., receiving $40,160.45 as consideration. The leases had a primary term of five years, subject to termination if drilling operations did not commence within one year, unless delay rentals were paid. The partnership paid a $4,000 commission to procure the leases and deducted this amount as a business expense on their 1944 tax return. The partnership also claimed and was allowed statutory depletion at a rate of 27 1/2% on the $40,160.45. No oil or gas was produced during the lease term. The Commissioner disallowed the deduction for the commission, arguing it was a capital expenditure.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax for 1944, disallowing their share of the partnership's deduction for the commission paid to secure the oil and gas leases. The petitioners contested this determination before the Tax Court. The cases were consolidated for hearing. The Tax Court ruled in favor of the Commissioner.

Issue(s)

1. Whether the commission paid by the partnership for securing oil and gas leases on property it owned was a capital expenditure or a deductible business expense?

2. If the commission was a capital expenditure, whether the partnership was entitled to cost depletion on it over the term of the leases, in addition to claiming percentage depletion on the bonus received?

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Holding

1. Yes, the commission paid to secure the oil and gas leases was a capital expenditure because it was incurred to acquire an income-producing asset.

2. No, the partnership was not entitled to cost depletion on the commission because it had already claimed and been allowed percentage depletion on the bonus received for the leases; allowing both would be an impermissible double deduction.

Court’s Reasoning

The Tax Court relied on established precedent that commissions paid by a lessor to secure a lease are capital expenditures. The court distinguished the leases from short-term leases, noting the

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