15 T.C. 22 (1950)

For purposes of calculating percentage depletion under Sections 23(m) and 114(b)(4) of the Internal Revenue Code, 'gross income from the property' excludes all rents and royalties paid, including those for the use of mining plant and equipment.

Summary

Leechburg Mining Company leased coal mining property, paying 25 cents per ton mined as 'royalty,' allocated as 15 cents for plant rental and 10 cents for coal extraction. The Tax Court addressed whether the 15-cent plant rental was excludable from gross income when calculating percentage depletion. The court held that the entire 25 cents was excludable because the statutory language requires the exclusion of 'any rents or royalties paid…in respect of the property,' and the leased plant and equipment constituted part of the 'property'. This decision clarifies the scope of excludable rent/royalty payments in percentage depletion calculations.

Facts

Leechburg Mining Company leased the Foster and Armstrong coal mines, including the plant and equipment, agreeing to pay 25 cents per ton of coal mined. The lease allocated 15 cents of this payment to the plant and equipment rental and 10 cents to coal royalty. During the tax year, Leechburg used only the lessor's plant and equipment to extract coal.

Procedural History

Leechburg claimed percentage depletion on its income tax return, calculating gross income without deducting the 15 cents per ton paid for plant and equipment rental. The Commissioner of Internal Revenue determined a deficiency, arguing that the rental payment should have been excluded from gross income. Leechburg then petitioned the Tax Court for redetermination of the deficiency.

Issue(s)

Whether, in calculating gross income from leased coal mining properties for percentage depletion under sections 23(m) and 114(b)(4) of the Internal Revenue Code, the taxpayer must exclude rental payments made for the use of the lessor's plant, machinery, and equipment.

Holding

Yes, because Section 114(b)(4)(A) explicitly excludes from gross income 'an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property,' and the definition of 'property' includes the mineral deposit, the

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development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction.

Court's Reasoning

The court relied on the statutory language of Section 114(b)(4)(A), which mandates excluding 'any rents or royalties paid…in respect of the property' from gross income when calculating percentage depletion. The court emphasized that the term 'property' includes not only the mineral deposit but also 'the development and plant necessary for its extraction.' Citing prior case law like *Helvering v. Jewel Mining Co.*, the court affirmed the established definition of 'property' in the context of mineral extraction. The court rejected Leechburg's argument that the 15-cent rental payment was not 'in respect of the property,' holding that the plant and facilities were integral to the mining operation and therefore part of the 'property'. The court stated, "Here we have the question of determining the basis upon which the statutory allowance for percentage depletion is to be computed…If the latter elects to use this method, the formula provided by the statute must be followed and petitioner as lessee, in the computation, must 'exclude' from gross income an amount equal to the rents or royalties he is required to pay 'in respect of the property.'" The court found irrelevant the fact that the lessor might recover its investment in the plant through depreciation, as the focus was on calculating the proper basis for percentage depletion as prescribed by statute.

Practical Implications

This case clarifies that when calculating percentage depletion for mineral properties, all payments characterized as rents or royalties, including those for the use of plant and equipment essential for extraction, must be excluded from gross income. This decision reinforces a strict adherence to the statutory formula for percentage depletion, preventing taxpayers from selectively excluding certain rental payments to maximize their depletion allowance. It has implications for lessees in the mining industry, requiring them to accurately allocate and exclude all such payments to comply with tax regulations. Subsequent cases and IRS guidance continue to emphasize the broad definition of 'property' in this context, including all assets integral to the mining process.

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