Haas v. Commissioner, T.C. Memo. 1955-2 (1955)

A taxpayer cannot deduct intangible drilling costs if the drilling is undertaken by another party who is obligated to do so, even if the taxpayer's funds are used to finance the drilling.

Summary

The petitioner, Haas, sought to deduct intangible drilling costs related to fractional operating rights he acquired in an oil and gas property. The Tax Court denied the deduction, finding that the drilling was undertaken by the assignor, Yasen, in fulfillment of his own obligations, not by Haas. The court emphasized that Haas paid for the fractional interest, and Yasen was independently obligated to continue drilling. Therefore, Haas did not "undertake" the drilling within the meaning of the relevant regulations. The court distinguished this from situations where the taxpayer directly contracts for the drilling or where the drilling costs are clearly severable from the purchase price of the interest.

Facts

Haas acquired fractional operating rights in an oil and gas property from Yasen. Yasen, under the assignment contract, was obligated to continue drilling a well on the property. Haas paid cash for these fractional interests. Yasen used these funds to pay for the drilling costs. Haas then sought to deduct these costs as intangible drilling costs.

Procedural History

Haas petitioned the Tax Court for a redetermination of a deficiency in his income tax. The Commissioner disallowed the deduction for intangible drilling costs. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether Haas can deduct intangible drilling costs when the drilling was contractually obligated to be undertaken by Yasen, even though Haas's funds indirectly financed the drilling.

Holding

No, because the drilling was undertaken by Yasen in discharge of his own obligations, not by Haas. Thus, Haas did not "undertake" the drilling costs directly or through a contract as required by the regulations.

Court's Reasoning

The court focused on the amended regulations governing the deduction of intangible

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drilling costs, particularly the requirement that the drilling costs be “undertaken (directly or through a contract) by an operator.” The court found that Yasen, not Haas, was obligated to do the drilling under the contract. The court stated,

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