

## **21 T.C. 746 (1954)**

For purposes of calculating percentage depletion, the oil treatment of coal to reduce dust is not considered an “ordinary treatment process” when it is not a standard practice in the industry to obtain a commercially marketable mineral product.

### **Summary**

The United States Tax Court ruled against Black Mountain Corporation, which sought to include the proceeds from oil-treating its coal in its “gross income from the property” for the purpose of calculating percentage depletion. The Court found that oil treatment, while increasing marketability, was not an “ordinary treatment process” under the Internal Revenue Code because it was not universally applied in the industry to obtain the first marketable coal product. The decision emphasizes the importance of established industry practices in defining “ordinary treatment processes” for tax purposes, and in determining the scope of activities that fall under “mining” operations as opposed to subsequent processing activities.

### **Facts**

Black Mountain Corporation mined bituminous coal in Virginia and Kentucky. As part of its operation, the company cleaned, sized, and loaded its coal for shipment. A portion of the coal was also treated with oil to allay dust. This oil treatment involved spraying the coal with a fine mist of heated oil before loading. The purpose of the treatment was to make the coal more marketable, especially for domestic heating purposes, and to compete with oil and gas. While the corporation applied the treatment to around 40% of the coal it produced, statistics showed that this type of treatment was not used in the majority of mines, or even a significant percentage of coal mines in operation.

### **Procedural History**

The Commissioner of Internal Revenue determined deficiencies in Black Mountain Corporation’s income taxes. The deficiencies stemmed from the Commissioner’s disagreement with the inclusion of the income from the oil-treated coal in the calculation of “gross income from the property” for percentage depletion purposes. The case was brought before the United States Tax Court. The Tax Court ruled in favor of the Commissioner, and was not appealed.

### **Issue(s)**

1. Whether income derived from the oil treatment of coal constitutes income from an ordinary treatment process normally applied to obtain the commercially marketable mineral product within the meaning of Section 114 (b)(4)(A) and (B) of the Internal Revenue Code?

### **Holding**

1. No, because oil treatment of coal to reduce dust is not an ordinary treatment process to obtain the first commercially marketable product.

### **Court's Reasoning**

The court looked at the definitions within the tax code of “mining” and “ordinary treatment processes.” The court interpreted the phrase “ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products” as referring to the first commercially marketable product. The court analyzed the facts to determine what was “ordinary” within the coal industry. The court considered the statistics presented and determined that oil treatment was not the norm for allaying dust; in fact, only a small percentage of mines used this treatment, even though all mines cleaned and sized their coal. The court reasoned that the primary commercially marketable product was coal and that the oil treatment was a further process to make the product more saleable. The court highlighted that allowing the inclusion of income from oil-treated coal would be an anomalous result, and not what was intended in the statute.

The dissenting judge disagreed with the majority’s interpretation, arguing that the oil treatment was a common practice and necessary for the marketability of the coal, especially in the domestic market. The dissent emphasized that the statute was intended to be broadly construed and that oil treatment was used by mine owners to obtain a commercially marketable product.

“The oil treatment of coal is not an ordinary treatment process normally applied by mine owners or operators in order to obtain the first commercially marketable coal product.”

### **Practical Implications**

This case underscores the significance of industry standards and the definition of “ordinary treatment processes” in tax law. The case is a clear illustration of how courts evaluate the application of the Internal Revenue Code to specific industry practices. The decision highlights the importance of having evidence of industry practices, such as statistics on the percentage of mines using a particular process, in determining what can be included in gross income for percentage depletion calculations.

Attorneys advising clients on tax matters, particularly those related to mining and natural resources, must carefully consider how the tax code defines mining activities. This case illustrates that processes that enhance marketability may not be considered ordinary treatment processes. Businesses should also document their practices within the context of the broader industry.