## *Elk Lick Coal Co. v. Commissioner, 23 T.C. 593 (1955)*

Losses sustained from the abandonment or scrapping of mining equipment directly related to the mining and preparation of coal are deductible from gross income when calculating 'net income from the property' for percentage depletion purposes.

### Summary

Elk Lick Coal Company challenged the Commissioner's determination that losses from abandoned or scrapped mining equipment should be deducted from gross income to arrive at 'net income from the property' for calculating percentage depletion. The Tax Court upheld the Commissioner, reasoning that while gains from the sale of such equipment are not included in gross income for depletion purposes, losses are explicitly deductible under Treasury Regulations. The court emphasized the plain language of the regulations, which include 'losses sustained' as a deduction in the net income calculation, directly linking these losses to the mining operation.

### Facts

Petitioner, Elk Lick Coal Company, was engaged in mining, preparing, and marketing coal. In 1947, 1948, and 1949, the petitioner abandoned or scrapped various items of mining plant and equipment, including a tipple, head-house, slate dump building, machine shop, mine cars, and a sand dryer. These items were used either in extracting coal or in preparing it for market. The petitioner claimed deductions for these losses under Section 23(f) of the 1939 Internal Revenue Code, which were allowed by the Commissioner. However, in calculating percentage depletion, the petitioner did not deduct these losses from its gross income, arguing they should not be included in the 'net income from the property'.

### Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioner's income tax for 1947, 1948, and 1949. The central issue was whether losses from abandoned or scrapped mining equipment were deductible from gross income for the purpose of computing the percentage depletion allowance. The Tax Court reviewed the Commissioner's determination.

### Issue(s)

1. Whether losses sustained from the abandonment or scrapping of mining equipment used in the extraction or preparation of coal are deductible from 'gross income from the property' to determine 'net income from the property' for the purpose of calculating percentage depletion under Sections 23(m) and 114(b)(4)(A) and (B) of the Internal Revenue Code of 1939.

### Holding

1. Yes, because Treasury Regulations explicitly define ‘net income’ for percentage depletion purposes as ‘gross income from the property’ less allowable deductions attributable to the mineral property, including ‘losses sustained.’

## Court’s Reasoning

The court reasoned that while its prior decision in *Monroe Coal Mining Co.* held that gains from the sale of discarded mining equipment are not includible in ‘gross income from the property’ for depletion purposes, this did not imply that losses should be treated similarly. The court emphasized that the statute is silent on the definition of ‘net income’ in this context, but Treasury Regulations § 29.23(m)-1(g) explicitly define it. The regulation states that ‘net income’ means ‘gross income from the property’ less allowable deductions, including ‘losses sustained.’ The court stated, “We think it clear from the definition so spelled out that ‘net income’ is to be determined by deducting from gross income the losses in question here because they are directly related to the mining and preparation of coal.” The court found no basis to read ‘losses sustained’ out of the regulation and concluded that both depreciation and losses related to mining equipment are deductible when calculating net income for percentage depletion.

## Practical Implications

*Elk Lick Coal Co.* clarifies that while gains from the disposition of mining equipment do not increase ‘gross income from the property’ for percentage depletion, losses from abandonment or scrapping directly reduce it when calculating ‘net income from the property.’ This case highlights the importance of adhering to Treasury Regulations in tax law, especially where the statute is not explicitly defined. For mining companies and legal practitioners, this decision underscores that in calculating percentage depletion, a consistent approach must be taken: gains from equipment disposal are excluded from gross income, and losses from equipment abandonment/scrapping are deducted to arrive at net income. This case is regularly cited for the principle that ‘net income from the property’ is calculated by reducing ‘gross income from the property’ by various operating expenses and losses directly related to the mining activity, as explicitly detailed in the Treasury Regulations.