24 T.C. 374 (1955)

To claim a percentage depletion deduction for coal mining, a taxpayer must possess an "economic interest" in the coal in place, meaning they have acquired, by investment, an interest in the coal and derive income from its extraction, to which they must look for a return of their capital.

Summary

Weirton Ice & Coal Supply Co. (petitioner) contracted with National Steel Corporation (National) to strip mine coal from National's land. National directed the quantity of coal mined, and the contract could be terminated by either party with 90 days' notice. Petitioner was paid a fixed price per ton, with adjustments for labor costs. The Tax Court determined that petitioner did not have an "economic interest" in the coal in place, denying the percentage depletion deduction. The court reasoned that petitioner's profit depended on its service of mining and delivering the coal, not the extraction and sale of the coal itself. The court distinguished this from situations where the contractor has exclusive rights and compensation tied to the selling price.

Facts

- Petitioner engaged in strip mining of coal.
- Petitioner sold coal on the open market and to Weirton Steel Company, a subsidiary of National.
- Petitioner sold land to National and entered into a contract to mine coal on National's land.
- Under the contract, petitioner would mine coal as directed by National, clean it, and transport it to National's plants.
- Petitioner was paid a fixed price per ton of coal.
- The contract could be terminated by either party with 90 days' notice.
- Petitioner bore all mining expenses and provided equipment.
- Petitioner had no right to the coal beyond the contract's terms and received payments based on the service provided, not the market value of the coal.
- National paid all taxes on the land and coal.

Procedural History

The Commissioner of Internal Revenue disallowed petitioner's percentage depletion deduction. The Tax Court reviewed the case to determine whether petitioner had an "economic interest" in the coal in place. The Tax Court upheld the Commissioner's determination.

Issue(s)

1. Whether the petitioner possessed an "economic interest" in the coal in place.
2. Whether petitioner was entitled to a percentage depletion deduction under sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939.

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Holding

1. No, because the contract with National did not give petitioner an economic interest in the coal.
2. No, because without an economic interest, the percentage depletion deduction is not allowed.

Court's Reasoning

The court relied on the definition of "economic interest" established in *Kirby Petroleum Co. v. Commissioner*, 326 U.S. 599 (1946), and *Palmer v. Bender*, 287 U.S. 551, which requires an investment in the mineral in place and the derivation of income from extraction as a return of capital. The court also cited *Helvering v. Bankline Oil Co.*, 303 U.S. 362 (1938), emphasizing that an economic interest does not include a mere economic advantage derived from production by a contractor with no capital investment in the mineral. The court determined that Petitioner's compensation was based on its services (mining, cleaning, and delivering) rather than the sale of the coal. The court emphasized that the contract gave National control over the amount of coal mined and the right to terminate the contract at will. The court distinguished this from cases where contractors had exclusive rights to mine all of the coal, with compensation tied to the sale proceeds. The court stated, "But the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit."

Practical Implications

This case clarifies the requirements for claiming a percentage depletion deduction in coal mining. Attorneys should advise clients that:

- Contractors must have more than a contractual right to provide services.
- The "economic interest" test requires an investment in the coal in place, and the possibility of profit dependent on its extraction and sale.
- Control over the mineral and the right to profit from its sale are crucial elements.
- Contracts that grant the right to mine only what the owner directs, where payment is for services and not linked to the market value of the extracted coal, will likely not create an economic interest.

This case, and those it cites, guide the analysis of agreements in the coal industry and are used to distinguish contractors with an economic interest from those that do not. Later cases continue to apply the economic interest test, focusing on the substance of the economic relationship.

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