32 T.C. 974 (1959)

Transportation costs incurred in shipping minerals after the completion of ordinary treatment processes are not includible in the "gross income from the property" for the purpose of calculating percentage depletion under the Internal Revenue Code.

Summary

The Winnsboro Granite Corporation and its subsidiary, Rion Crush Stone Corporation, challenged the Commissioner's determination regarding their income tax liabilities. The central issue was whether transportation costs from the quarry to the railhead (for Winnsboro) or jobsite (for Rion) could be included in the gross income used to calculate percentage depletion. The Tax Court held that these transportation costs were not includible because the ordinary treatment processes had already been completed before transportation. The court also addressed the basis of Rion's depletable property, ruling that it must be reduced by the amount of depletion allowances previously taken, whether cost or percentage depletion.

Facts

Winnsboro Granite Corporation extracted granite and shipped it by rail. The granite underwent no further processing after it was loaded for shipment at the quarry. Winnsboro billed customers f.o.b. Rockton, including freight in the sales price. Rion Crush Stone Corporation crushed stone into aggregates, often selling f.o.b. jobsite with the transportation costs included. Both corporations calculated percentage depletion under the Internal Revenue Code of 1939. The Commissioner disallowed the inclusion of certain transportation costs in the calculation of gross income from the property for depletion purposes. Rion had recovered the basis of its property through prior depletion allowances.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the income tax of Winnsboro Granite Corporation and Rion Crush Stone Corporation. The corporations petitioned the United States Tax Court, which consolidated the cases for consideration. The Tax Court reviewed the case, considering the relevant statutes, regulations, and facts presented to them.

Issue(s)

1. Whether transportation costs incurred by Winnsboro in shipping granite to the railhead are includible in "gross income from the property" for percentage depletion calculations.

2. Whether transportation costs incurred by Rion in shipping crushed stone to the jobsite are includible in "gross income from the property" for percentage depletion calculations.

3. Whether the basis of Rion's property must be reduced by the amount of depletion allowances, both cost and percentage, previously taken.

Holding

1. No, because the transportation costs were incurred after the completion of ordinary treatment processes and are not part of "gross income from mining."

2. No, because the transportation costs to the jobsite, like Winnsboro's transportation to the railhead, occurred after all ordinary treatment processes were completed, and thus were not includible.

3. Yes, because the basis of the property must be adjusted for depletion deductions, regardless of whether cost or percentage depletion was used.

Court's Reasoning

The court examined section 114(b)(4)(B) of the 1939 Code, which defines "gross income from the property" as "gross income from mining," including ordinary treatment processes and transportation of minerals to the plants or mills. The court focused on the phrase, "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals…from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto." Because no further processing occurred after the rough granite blocks were loaded at Winnsboro's quarry, or after the crushed stone was prepared at Rion's plant, the court determined that transportation costs to the railhead or jobsite were beyond the scope of the ordinary treatment processes, or transportation to those processes, and were therefore not includible in gross income from the property. The court cited the fact that, "the transportation allowance included in the "gross income from mining" is not predicated on the first commercially marketable product, but, rather, is for the purpose of transporting the mineral for additional processing so as to become commercially marketable." The court also noted the history of the statute, finding that Congress intended the gross income calculation to stop at the completion of the ordinary treatment processes. The court also held that the basis of Rion's property had to be reduced by the amount of depletion allowed, whether cost or percentage. The Court cited section 113(b)(1)(B) which stated, "the basis of property shall be adjusted for depletion to the extent allowed as a deduction in the computation of net income."

Practical Implications

This case is significant for mineral producers, particularly those with integrated operations. The ruling provides guidance on when transportation costs are included in the calculation of "gross income from the property" for depletion purposes. It clarifies that the critical point is the completion of ordinary treatment processes.

Legal practitioners advising clients in the mining or mineral extraction industries should carefully examine their operations to identify the point at which ordinary treatment processes end. This impacts the calculation of percentage depletion and potentially affects tax liability. Further, this case underscores the importance of adjusting the basis of depletable property for depletion deductions previously taken, even if those deductions did not fully offset taxable income. This case should also be considered alongside later rulings regarding the definition of "ordinary treatment processes", and any updates in the relevant statutes. Later cases have cited this case in their analysis.

