Halquist v. Halquist, 33 T.C. 311 (1959)

For purposes of calculating percentage depletion, “gross income from the property” includes the income from the sale of the first commercially marketable mineral product, determined by considering the product’s suitability for its intended purpose and the taxpayer’s ability to market it profitably.

Summary

The Halquist partnership quarried and processed dolomite stone, producing crushed stone, flagstone, drywall stone, and dimension stone. The IRS sought to limit the partnership’s percentage depletion allowance by calculating “gross income from the property” based on the value of rough, uncut stone, rather than the sales price of the finished building stone. The Tax Court rejected the IRS’s “least-processing” theory, holding that the gross income for depletion purposes should reflect the sale of the first commercially marketable product. Since the building stone was the first commercially marketable product, it was appropriate to use the gross sales revenue of the processed stone. The Court also addressed the appropriate depletion rate, deciding the 10% rate for dolomite was correct over the 15% rate for chemical grade limestone.

Facts

Halquist Lannon Stone Co., a partnership, owned and operated two stone quarries in Wisconsin. They produced crushed stone for road surfacing and building or dimension stone for construction. The dimension stone was cut and shaped into various sizes and sold, primarily as house-veneer stone. The partners also produced flagstone and drywall. The partnership engaged in the purchase and resale of dimension stone. The IRS determined deficiencies in the partnership’s income tax for several years, partly due to a dispute over the calculation of percentage depletion. The IRS argued that the gross income from the property should be limited to the value of the stone prior to cutting and finishing, which resulted in the disallowance of depletion deductions. The partnership claimed the IRS determination was incorrect.

Procedural History

The IRS determined income tax deficiencies for the years 1951-1954, which led to the filing of a petition in the Tax Court. By an amended petition, the partners claimed overpayments of tax in 1951, 1952, and 1953. The Tax Court reviewed the facts and the law to determine the correct computation of depletion and the applicable depletion rates.

Issue(s)

1. Whether, for purposes of computing the percentage depletion allowance, the gross income from the property produced and sold by petitioners should be

© 2025 SCOTUSreports.com. All rights reserved.

determined by reference to the sales price of the fully processed stone or by reference to the actual or representative market price of the stone in a less processed form.

2. Whether, for the years 1951, 1952, and 1953, petitioners are entitled to a 10% depletion rate for dolomite or a 15% rate for chemical or metallurgical grade limestone under I.R.C. 1939 § 114(b)(4).

Holding

1. No, because the gross income from the property is the price of the fully processed stone, because it was the first commercially marketable product for the partnership.

2. Yes, because the rock quarried by petitioners was dolomite, and the 10% rate applied.

Court's Reasoning

The court addressed the definition of "gross income from the property" for the purpose of percentage depletion. It considered the 1939 and 1954 Internal Revenue Codes. The court reviewed the statutory definition and how "mining" included "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." The court rejected the Commissioner's argument that the first commercially marketable product was the "crudest, least processed product" with an existing market. The Court cited prior cases (Cannelton Sewer Pipe Co. and Iowa Limestone) that emphasized the importance of profit-making and the right of a taxpayer to market a mineral for its best suited use, irrespective of a broader national market for a lesser processed product. "The short answer to this is that we do not agree that it was intended that the depletion allowance for each mineral be reduced to the common denominator represented by a conceivable product most cheaply produced from each mineral." The court found that the dimension stone was the first commercially marketable product for the quarry, and the taxpayer had the right to utilize the stone for its best, most profitable use. The court determined the 10% depletion rate for dolomite was applicable over the 15% rate of chemical or metallurgical grade limestone. The court stated that the depletion base of a taxpayer is not limited to the gross income that would be produced by the sale of the most inferior grade of the mineral produced by him, but is the gross income that would be produced by the sale of the first commercially marketable products of the mineral produced for the purposes for which it, in its natural state, is best suited.

Practical Implications

This case is precedent for determining "gross income from the property" under the percentage depletion allowance. It emphasizes that the income from the sale of the first commercially marketable product determines the basis for depletion

© 2025 SCOTUSreports.com. All rights reserved.

calculations. An attorney should consider this case when advising clients in the mining and quarrying industries about the computation of percentage depletion. This case stands for the proposition that, the taxpayer can use the income from their most valuable product for calculation even if an inferior product has a wider market. The court's ruling is particularly useful in scenarios where a mining operation produces multiple products. This decision may be distinguished if the processing of the stone is a manufacturing process instead of a treatment process. Later cases may further define what constitutes ordinary treatment processes to obtain the commercially marketable mineral product.

© 2025 SCOTUSreports.com. All rights reserved.