***Strutzel v. Commissioner, 60 T. C. 969 (1973)***

Payments received under a mineral property transfer agreement are taxable as capital gains if the transferor does not retain an economic interest in the minerals in place.

**Summary**

In Strutzel v. Commissioner, the Tax Court determined that payments received by the Strutzels and Millers from American Exploration and Mining Co. (Amex) under a "Mining Lease and Option to Purchase" agreement were capital gains, not ordinary income. The agreement transferred unpatented mining claims for a term with fixed annual payments and an option to purchase. The court held that the petitioners did not retain an economic interest in the minerals, thus classifying the agreement as a sale of capital assets. The decision hinged on the fact that the petitioners' return on investment was not dependent on mineral production, and Amex assumed full control and responsibility of the claims.

**Facts**

In 1964 and 1965, Joseph Strutzel and Mark Miller filed 14 unpatented mining claims in California. On November 15, 1966, they entered into a "Mining Lease and Option to Purchase" agreement with American Exploration and Mining Co. (Amex). The agreement granted Amex exclusive possession and mining rights over the claims until December 1, 1976. Amex was obligated to pay annual fixed payments starting at $25,000 and increasing by $5,000 each year, totaling $500,000 over the term. Additionally, Amex had the option to purchase the claims for $500,000 at any time during the lease term, with all payments offsetting the purchase price. Amex also agreed to pay production royalties if minerals were extracted, but none were paid as no marketable quantities were extracted by the time of trial.

**Procedural History**

The Strutzels and Millers filed joint tax returns for the years 1966, 1967, and 1968, reporting the payments received from Amex as capital gains. The Commissioner of Internal Revenue determined deficiencies, asserting that the payments were ordinary income subject to depletion. The cases were consolidated due to common issues and tried before the U. S. Tax Court. The court ruled in favor of the petitioners, classifying the payments as capital gains.

**Issue(s)**

1. Whether the "Mining Lease and Option to Purchase" agreement constituted a sale of capital assets or a lease, thus determining if the payments received by the petitioners were taxable as capital gains or ordinary income.

**Holding**

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1. Yes, because the petitioners did not retain an economic interest in the minerals in place, and the agreement's substance indicated a sale rather than a lease.

**Court's Reasoning**

The court applied the economic interest test from depletion cases to determine capital gains eligibility. It found that the petitioners did not retain an economic interest as they did not need to look to mineral production for a return on their investment. The fixed annual payments were guaranteed regardless of production, and Amex had full control and responsibility over the claims. The court distinguished this case from others where production royalties were crucial, noting that here, the total purchase price was fixed and unaffected by production. The court rejected the respondent's argument that the agreement's language should control its tax consequences, emphasizing that substance over form determines tax treatment. The court cited Ima Mining Co. v. Commissioner as precedent, where similar circumstances led to a finding of sale rather than lease.

**Practical Implications**

This decision clarifies that when mineral property transfers are structured with fixed payments and options to purchase, without reliance on mineral production for return on investment, they may be treated as sales of capital assets for tax purposes. Legal practitioners should structure such agreements carefully to achieve desired tax outcomes. The ruling impacts how mining companies and property owners negotiate and draft agreements, ensuring clarity on economic interests and tax implications. Subsequent cases have cited Strutzel in analyzing the tax treatment of mineral property transfers, reinforcing its significance in this area of law.

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