***Weaver v. Commissioner, 70 T. C. 629 (1978)***

A taxpayer has an economic interest in minerals in place, entitling them to depletion deductions, if they have a capital interest in the mineral deposit and have made investments necessary for its exploitation.

**Summary**

In Weaver v. Commissioner, the court examined whether Lloyd Weaver, a self-employed contractor, had an economic interest in sand, stone, and gravel extracted from properties under three separate agreements, entitling him to depletion deductions. The court found that Weaver had an economic interest under the Munroe and Newson agreements but not under the Coe agreement post-June 1, 1972. The decision hinged on whether Weaver's investments were tied to the mineral deposits and whether he had a capital interest in the minerals in place. This case clarifies the requirements for claiming depletion deductions based on economic interests in mineral leases.

**Facts**

Lloyd Weaver operated as Lloyd Weaver Construction Co. , extracting and selling sand, gravel, and stone. He entered into agreements with the Newsons, Munroe, and the Coes to extract minerals from their properties. Under the Newson agreement, Weaver had exclusive rights to extract minerals until exhaustion, subject to cancellation with 120 days' notice. The Munroe agreement granted exclusive extraction rights until April 1, 1975, without a minimum extraction requirement. The Coe agreement allowed extraction from November 1, 1971, to June 1, 1972, with a first option to renew. Weaver made significant investments in surveying, site preparation, and equipment to facilitate extraction. He claimed depletion deductions for 1972 and 1973, which the Commissioner disallowed, prompting this case.

**Procedural History**

Weaver filed a petition with the Tax Court challenging the Commissioner's disallowance of depletion deductions for minerals extracted from the Newson, Munroe, and Coe properties. The Tax Court heard the case and issued its opinion on the matter.

**Issue(s)**

1. Whether Weaver had an economic interest in the minerals extracted from the Newson property, entitling him to depletion deductions.
2. Whether Weaver had an economic interest in the minerals extracted from the Munroe property, entitling him to depletion deductions.
3. Whether Weaver had an economic interest in the minerals extracted from the Coe property, entitling him to depletion deductions.

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## Holding

1. Yes, because Weaver's exclusive right to mine until exhaustion, subject to 120 days' notice, and his substantial investments in the property satisfied the economic interest requirement.
2. Yes, because Weaver's exclusive right to mine until April 1, 1975, and his substantial investments in the property established an economic interest.
3. Yes, for minerals extracted before June 2, 1972, because Weaver's rights and investments were sufficient to establish an economic interest during the term of the agreement. No, for minerals extracted after June 1, 1972, because Weaver's rights were subject to immediate termination at the Coes' discretion.

## Court's Reasoning

The court applied the two-prong test from Palmer v. Bender to determine if Weaver had an economic interest in the minerals in place. The first prong requires an investment in the mineral in place, which does not need to be a direct investment but can be an investment necessary for its exploitation. The second prong requires that the taxpayer look to the income from extraction for a return of investment. The court found that Weaver's investments in surveying, site preparation, and equipment met the second prong for all properties. For the first prong, the court examined each agreement separately.

Under the Newson agreement, Weaver's exclusive right to mine until exhaustion and his substantial investments satisfied the first prong, despite the 120-day cancellation clause, which was deemed more than nominal notice. The court cited cases like Commissioner v. Southwest Exploration Co. and Food Machinery & Chemical Corp. v. United States, where similar investments were held to establish an economic interest.

The Munroe agreement's fixed term until April 1, 1975, and Weaver's substantial investments were sufficient to establish an economic interest, even without a direct investment in acquiring the lease.

The Coe agreement allowed depletion deductions until June 1, 1972, as Weaver's rights and investments during that period met the economic interest test. However, after June 1, 1972, the Coes could terminate the agreement at will, negating any economic interest.

The court also considered the controversy over termination clauses, referencing cases like Parsons v. Smith and Mullins v. Commissioner. It concluded that a 120-day notice period under the Newson agreement was not nominal and allowed for significant extraction, thus not precluding an economic interest.

## Practical Implications

This decision clarifies that depletion deductions are available to taxpayers who have

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a capital interest in minerals in place and have made investments necessary for their exploitation, even if those investments are not directly in acquiring the mineral rights. Practitioners should focus on the nature of the taxpayer's interest and the sufficiency of their investments in relation to the mineral deposit when advising clients on depletion deductions.

The ruling also provides guidance on the impact of termination clauses in mineral leases. A notice period longer than nominal can still allow for an economic interest, depending on the specific circumstances of the case, such as the potential for significant extraction during the notice period.

Subsequent cases have built upon this decision, refining the understanding of what constitutes an economic interest in mineral deposits. For example, Victory Sand & Concrete, Inc. v. Commissioner extended the principle to state-owned minerals, and Paragon Jewel Coal Co. v. Commissioner clarified the distinction between economic interests and mere economic advantages.

Businesses involved in mineral extraction should carefully structure their agreements to ensure they meet the criteria for claiming depletion deductions, considering both their legal rights and the practical investments they make in the extraction process.

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