## *Pleasanton Gravel Co. v. Commissioner, 83 T. C. 33 (1984)*

Payments based on the quantity of minerals extracted are royalties, not rents, for personal holding company income classification under IRC §543(a).

### Summary

In Pleasanton Gravel Co. v. Commissioner, the Tax Court ruled that payments made by Jamieson Co. to Rio Gravel, Inc. for sand and gravel extraction were royalties, not rents, thus classifying Rio Gravel as a personal holding company under IRC §542(a). The court also upheld the IRS's right to assess the tax deficiencies within the extended statute of limitations, despite Rio Gravel's merger into Pleasanton Gravel. The decision hinged on the distinction between royalties and rents, with royalties being payments tied directly to the quantity of minerals removed, and on the validity of consents extending the statute of limitations post-merger.

### Facts

Rio Gravel, Inc. entered into an agreement with Jamieson Co. in 1959, allowing Jamieson Co. to extract sand and gravel from Rio Gravel's land in exchange for payments per ton extracted. Rio Gravel later merged into Pleasanton Gravel Co. , with Pleasanton becoming the successor in interest. The IRS determined deficiencies in Rio Gravel's tax returns for the years 1968-1972, asserting Rio Gravel was a personal holding company due to the nature of the payments from Jamieson Co. being royalties, not rents. The IRS issued a notice of deficiency in 1981, following multiple extensions of the statute of limitations.

### Procedural History

The IRS issued a notice of deficiency to Pleasanton Gravel Co. , as successor to Rio Gravel, Inc. , on June 4, 1981, asserting deficiencies for the tax years 1968-1972. Pleasanton Gravel contested the deficiency and the personal holding company status in the Tax Court. The case was submitted on stipulated facts, and the court ruled in favor of the Commissioner on both the classification of payments as royalties and the validity of the statute of limitations extensions.

### Issue(s)

1. Whether the payments received by Rio Gravel from Jamieson Co. were royalties under IRC §543(a)(3) rather than rents under IRC §543(a)(6), thus classifying Rio Gravel as a personal holding company.
2. Whether the IRS was barred from assessing and collecting the deficiencies due to the expiration of the statute of limitations.

### Holding

1. Yes, because the payments were tied directly to the quantity of minerals

extracted, which aligns with the definition of royalties rather than fixed and certain rents.
2. No, because the consents extending the statute of limitations were validly executed by Pleasanton Gravel as the successor in interest to Rio Gravel.

**Court’s Reasoning**

The court interpreted IRC §543(a)(6) as applying to rents, not royalties, based on legislative history and case law. The agreement between Rio Gravel and Jamieson Co. specified payments per ton of minerals extracted, which the court classified as royalties under IRC §543(a)(3). The court referenced prior cases like Logan Coal & Timber Association v. Commissioner to distinguish between rents and royalties, emphasizing that royalties vary with the use of the property. On the statute of limitations issue, the court found that the merger of Rio Gravel into Pleasanton Gravel did not invalidate the consents extending the assessment period. The court cited California law and prior Tax Court decisions to support the validity of the consents executed by Pleasanton Gravel as the successor corporation.

**Practical Implications**

This decision clarifies the distinction between royalties and rents for personal holding company income purposes, impacting how similar contracts are analyzed for tax classification. Corporations engaged in mineral extraction agreements must carefully structure their agreements to avoid unintended personal holding company status. The ruling also reaffirms that a successor corporation can extend the statute of limitations for pre-merger tax liabilities, providing guidance on corporate mergers and tax assessments. Subsequent cases have relied on this decision to classify payments in similar contexts and to uphold the validity of post-merger consents.

 