

**BROADHEAD ESTATE v. COMMISSIONER**  
**391 F. 2d 841; 68-1 USTC ¶ 9249;**  
**21 AFTR 2d 851 (5th Cir. 1968).**

*Editor's Summary*

*Key Topics*

DEPLETION DEDUCTION

- When depletion deduction is taken

*Facts*

In 1955, the taxpayer purchased all the standing timber on a tract of timber. Prior to the expiration of six months, the taxpayer entered into agreements with contract cutters to have the timber cut. Although the agreements provided for payment on a per unit cut basis, the taxpayer did not qualify for capital gain treatment under Section 631(b). Timber was cut in both 1955 and 1956 with taxpayer receiving payments in both years. The total amount of the payments was less than the timber's adjusted basis for depletion, and hence the taxpayer had a loss on the transaction. The taxpayer deducted the full amount of the loss in 1956, the year the cutting terminated. The Commissioner of Internal Revenue did not allow the full deduction of the loss in 1956. Instead, he allocated the amount of the loss to both 1955 and 1956 according to the amount of timber cut in each of the two years.

*Tax Court*

**Held: For the Commissioner.** See Vol. 3 Timber Tax Journal 460 (1966) for the Editor's Summary and text of the Tax Court opinion.

*Court of Appeals*

**Held: Affirmed.** The Court agrees with the Tax Court's finding, supporting the Commissioner's determination that taxpayer's recovery of the cost of the timber through depletion should have occurred as the timber was cut. Hence, taxpayer's receipts should have been reported as received in 1955 and 1956 and the applicable depletion deduction should also have been taken in each of those years. [NOTE: Although the Court failed to cite it, Reg. §1.611-3(b)(1) provides that the "depletion of timber takes place at the time timber is cut..." That same section goes on, however, to state that "the amount of depletion allowable with respect to timber that has been cut may be computed when the quantity of cut timber is first accurately measured in the process of exploitation." Since the taxpayer in the instant case received payments for the timber in both 1955 and 1956, he could not take advantage of this last statement, as the fact that he received payment in 1955 indicated that some of the cut timber had been "measured in the process of exploitation" in that year.]

*Case Text*  
**TIMBER ISSUE ONLY**

Ainsworth, Circuit Judge: Taxpayer <sup>1</sup> has petitioned for review of an adverse decision of the Tax Court relating to federal income tax deficiencies assessed by the Commissioner of Internal Revenue for the taxable years 1956, 1958, 1959 and 1960.

Jurisdiction to review decisions of the Tax Court is conferred by 26 U. S. C. §7482, which provides that the review shall be in the same manner and to the same extent as decisions of the district court in civil actions tried without a jury, thus imposing the clearly erroneous standard of Rule 52(a), Federal Rules of Civil Procedure. *Cf. United States v. Snyder Brothers Company*, 5 Cir., 1966, 367 F. 2d 980, 984. The scope of review, however, is limited, *Imbesi v. C. I. R.*, 3 Cir., 1966, 361 F. 2d 640, 643; *C. I. R. v. Duberstein*, 363 U.S. 278, 80 S. Ct. 1190 (1960). If the findings are supported by substantial evidence upon the record as a whole, and not against the clear weight of the evidence or induced by an erroneous view of the law, they cannot be upset. *C. I. R. v. Riss*, 8 Cir., 1967, 374 F. 2d 161, 166. See also *J. Gordon Turnbull, Inc. v. C. I. R.*, 5 Cir., 1967, 373 F. 2d 87, 90. The Commissioner's deficiency assessments are presumptively correct and the burden is on the taxpayer to show that his determination is invalid; and where the taxpayer offers no substantial evidence to overcome the presumption of correctness, the Tax Court's findings must be affirmed. *C. I. R. v. Riss, supra*.

**[Net Loss on Timber Contracts]**

I. In 1955 taxpayer contracted with the owner to purchase all merchantable timber on certain Louisiana land for \$252,412.57. Later, in the same year, he executed a sales contract with a buyer to cut all of the merchantable pine and cypress on the tract. Also, in the same year, he contracted with another buyer to cut all of merchantable hardwood timber on this tract. The buyers were to pay for the timber at a stated rate per unit of measure as they cut the timber. Under these purchase contracts taxpayer received \$119,362.87 in 1955 and \$124,467.88 in the year 1956. Thus his net loss on the transaction was \$8,581.82 for which he claimed a deduction in the year 1956 when the transaction was concluded.

The Commissioner determined that the net loss of \$8,581.82 should be allocated by a deduction of \$5,328.10 in 1955 and \$3,253.72 in 1956 on the basis of depletion losses allowed as the timber was severed in each year. We agree with the Tax Court's finding, supporting the Commissioner's determination, that taxpayer's recovery of costs by depletion allowance should be made as the timber is cut and that a yearly depletion allowance based on timber severed in each year is proper under Section 611(a) of the Internal Revenue Code of 1954 (26 U. S. C. 1964 ed., §611 (a)) <sup>2</sup> and applicable regulations thereunder. See also Treas. Reg. (1954 Code) § 1.611-1 (a)(b). <sup>3</sup> Taxpayer's receipts should therefore have been reported in the years received and the depletion allowance applicable should also have been deducted in each of these years. See Section 451(a) of the Internal Revenue Code of 1954 (26 U. S. C. 1964 ed., §451(a)). <sup>4</sup>

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<sup>1</sup> Petitioners are Estate of Sam E. Broadhead, deceased, S. Norris Broadhead and Paul E.

Broadhead, executors, and Verdie Cox Broadhead, his widow, and for convenience we will refer to them in this opinion as "taxpayer."

## 2 §611. Allowance of deduction for depletion.

(a) General rule. - In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. For purposes of this part, the term "mines" includes deposits of waste or residue, the extraction of ores or minerals from which is treated as mining under section 613(c). in any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate (but not the basis for depletion) shall be revised and the allowance under this section for subsequent taxable years shall be based on such revised estimate.

## 3 §1.611-1 Allowance of deduction for depletion (in pertinent part):

(a) *Depletion of mines, oil and gas wells, other natural deposits, and timber* (1) *In general.* Section 611 provides that there shall be allowed as a deduction in computing taxable income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion. In the case of standing timber, the depletion allowance shall be computed solely upon the adjusted basis of the property, In the case of other exhaustible natural resources the allowance for depletion shall be computed upon either the adjusted depletion basis of the property (see section 612, relating to cost depletion) or upon a percentage of gross income from the property (see section 613, relating to percentage depletion), whichever results in the greater allowance for depletion for any taxable year. In no case will depletion based upon discovery value be allowed.

(b) *Economic interest.* (1) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because through a contractual relation he possess a mere economic or pecuniary advantage derived from production. For example, an agreement between the owner of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction or cutting does not convey a depletable economic interest; Further, depletion deductions with respect to an economic interest of a corporation are allowed to the corporation and not to its shareholders.

## 4 §451. General rule for taxable year of inclusion.

(a) General rule.-The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.