



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
GUSTAVE L. AND SYLVIA R. GOLDSTEIN)

For Appellants: Gustave L. Goldstein and
Sylvia R. Goldstein, in pro. per.

For Respondent: Crawford H. Thomas
Chief Counsel

Peter S. Pierson
Associate Tax Counsel

O P I N I O N

. . This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying \$109.91 of a claim of Gustave L. and Sylvia R. Goldstein for refund of personal income tax in the amount of \$1,686.00 for the year 1964.

In 1954, pursuant to an agreement for a reasonable fee, appellant Gustave L. Goldstein (hereafter alone referred to as "appellant") was retained as attorney by Alice F. Rozan. He was to represent her in proceedings involving divorce and a determination of her interest in property, including oil, gas, and mineral rights in lands located in North Dakota and Montana.

In 1958, the fee arrangement was modified by a written agreement providing, in part:

Goldstein [appellant] shall receive 25% of any and all money Client is and may be entitled to receive under the California judgment as accrued and unpaid alimony and child support until the North Dakota action is tried or settled ... and 25% of any moneys due and to become due Client from

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Stanolind Oil Purchasing Company now known as Indiana Oil Purchasing Company as to the Kvam property mentioned in the California judgment and in the N.D. action; and, 25% of any and all property and things other than money awarded Client under the California judgment. Should Client receive the items or any thereof enumerated in this subparagraph under any or by reason of any court proceedings other than aforementioned California proceedings, ... Goldstein shall be entitled to receive his aforementioned 25% as to such of above enumerated items on which he shall not previously have received his 25% thereof.

* * *

Client hereby grants Goldstein a lien on anything and everything Client is and shall be entitled to receive under the California judgment and as it may be established as a North Dakota judgment and as a judgment anywhere else and under aforementioned North Dakota proceedings.

In 1964 the courts concluded that Mrs. Rozan had a vested interest in the oil, gas, and mineral rights and, in that year, she gave appellant record title of his 25 percent interest .

In the original joint return filed by appellant and his wife for 1964, no depletion was deducted from accumulated royalties. In an amended joint return, appellant reported as taxable legal fees, his share of the accumulated royalties for the period 1954 to 1958, distributed to him in 1964. The balance of his share of the accumulated royalties, \$18,509, distributed at the same time for the period 1959 to 1964, he reported as royalty income. From this latter amount he deducted \$5,090 for depletion. The depletion deduction was disallowed by respondent on the basis that appellant did not have an economic interest in the oil, gas, and mineral properties prior to 1964.

The issue, therefore, is whether appellant is entitled to a deduction for depletion on the royalties accumulated during the period 1959 to 1964.

In the case of mines, oil and gas wells, other natural deposits and timber, there is allowed a deduction of an allowance for depletion according to the peculiar conditions in each case. (Rev. & Tax. Code, § 17681 et seq.)

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The depletion deduction is allowable to a person who has a capital investment in the minerals in place.. No particular form of legal interest is needed provided there is an economic interest in the minerals in place. (Palmer v. Bender, 287 U.S. 551 [77 L. Ed. 489].) Nevertheless, there must be more than a mere economic advantage derived from production through a contractual relation to the owner. (Helvering v. Bankline Oil' Co., 303 U.S. 362 [82 L. Ed. 897], Helvering v. O'Donnell, 303 U.S. 370 [82 L. Ed. 903].) Oil, gas, and minerals in place are recognized as wasting assets, The deduction is therefore permitted as an act of grace and is intended as compensation for the capital assets consumed in the production of income through the severance of the minerals. (Anderson v. Helvering, 310 U.S. 404 [84 L. Ed. 1277]; Helvering v. Bankline Oil Co., supra, 303 U.S. 362 [82 L. Ed. 897].)

In Allen v. Franchise Tax Board, 39 Cal. 2d 109 [245 P.2d 297], taxpayer, an attorney, was engaged to take legal steps to 'determine the interest of his client in an oil lease and, as compensation, was to receive one half of a claimed 5 percent oil royalty and the accumulations thereof when his client's title should be established. The taxpayer was held not entitled to a depletion allowance with respect to the accumulated compensation when the litigation was finally determined in favor of his client in 1940. It was concluded that the accumulated compensation was not paid to him as royalties on an interest presently owned by him, but was merely paid to him as compensation for services rendered. Only from and after the time of payment in 1940 was the attorney regarded as becoming the owner of an economic interest in the leasehold. (See also Leland J. Allen, 5 T.C. 1232, and Massey v. Commissioner, 143 F.2d 429.) A contrasting factual situation is shown in Thomas W. Blake, Jr., 20 T.C. 721, where the taxpayer was hired as an attorney to remove a cloud on the title of certain mineral properties under a contingent fee agreement which provided for a present sale and conveyance to the taxpayer of an undivided interest in *the* tract of land and in all "settlements, benefits and proceeds arising therefrom,"

Within the framework of all the above cited cases, we conclude that appellant did not acquire any depletable economic interest until 1964. The 1958 'written agreement did not refer to a present transfer or assignment of an interest in the oil, gas, and mineral properties. From the language of the agreement, it is reasonable to infer that any actual economic interest in the oil, gas, and minerals in place was to be acquired when the litigation was resolved. The words "shall receive," as contained in the agreement; indicate that pending completion of the professional services appellant

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merely acquired an "economic advantage derived from production through a contractual relation to the owner." (Helvering v. Bankline Oil Co., supra, 303 U.S. 362. [82 L. Ed. 897].) We believe appellant's situation closely-parallels the attorney's situation in Allen v. Franchise Tax Board, supra, 39 Cal. 2d 109 [245 P.2d 297]. Even though Mrs. Rozan's interest was vested in 1958, appellant's interest, in our opinion, was not. (See also, Edelman v. United States, 329 F.2d 950.)

The agreement did make a present grant of a lien and appellant urges that inasmuch as he was granted a lien in 1958 he, at that time, acquired an equitable interest in the mineral lands which amounted to a depletable economic interest. However, it is well settled that a lien is not an interest in the property to which it attaches. (Johnson v. Razy, 181 Cal. 342 [184 P. 657].) It only constitutes security for payment of a debt, (Huie v. Soo Hoo, 132 Cal. App. Supp. 787 [22 P.2d 808].) A lien, therefore, is not a depletable "economic interest." (Grimes v. United States, 295 F.2d 623.)

Accordingly, the claimed deduction for depletion on royalties accumulated during the years 1959 to 1964 was properly disallowed.

O R D E R

Pursuant to the views expressed by the opinion of the board filed in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying **\$109.71** of the claim of Gustave L. and Sylvia R. Goldstein for refund of personal income tax in the amount of \$1,686.00 for the year 1964, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of December, 1966, by the State Board of Equalization.

_____, Chairman

Paul R. Lyake, Member

John W. Lynch, Member

Robert Allen, Member

_____, Member

ATTEST: *[Signature]*, Secretary