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such information constitute the basis upon which such acreage was leased.

RECOMMENDED CONCLUSION OF LAW

Upon the foregoing findings of fact and opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, and judgment is entered to that effect, with the determination of the amount of recovery to be reserved for further proceedings under Rule 47(c) in accordance with this opinion.

U.S. GOVERNMENT PRINTING OFFICE: 1969

In the United States Court of Claims

No. 443–65

(Filed APR 24 1969)

AMERICAN SMELTING AND REFINING COMPANY—CONSOLIDATED v. THE UNITED STATES

REPORT OF COMMISSIONER TO THE COURT*

Fred W. Peel, attorney of record for plaintiff. *Clarence T. Kipps, Jr.*, of *Miller & Chevalier*, of counsel.

Gilbert W. Rubloff, with whom was *Assistant Attorney General Mitchell Rogovin*, for defendant. *Philip R. Miller*, of counsel.

OPINION

FLETCHER, *Commissioner:* This is an action to recover Federal income taxes paid by plaintiff for the calendar year 1959. The issues presented involve the deductibility and the proper method of computation of a loss claimed under section 165 of the Internal Revenue Code of 1954.[1] The facts are set forth at length in the findings below, and here they will be summarized only to the extent necessary to explain the basis for the conclusion reached that plaintiff is entitled to recover.

American Smelting and Refining Company—Consolidated (hereinafter referred to either as "ASARCO" or "plaintiff") is a New Jersey corporation whose principal business is exploring for and mining, smelting, refining, and selling cop-

* The opinion, findings of fact, and recommended conclusion of law are submitted under the order of reference and Rule 57(a).

[1] All citations to Code sections hereinafter are to the Internal Revenue Code of 1954.

339–802—69——1

per, silver, lead, zinc, and other minerals. ASARCO and its affiliated companies filed a consolidated Federal income tax return on the accrual basis for the calendar year 1959 and timely paid the tax shown thereon. Thereafter, the Commissioner of Internal Revenue assessed a deficiency against plaintiff for 1959, which deficiency plaintiff paid on or about December 2, 1964. ASARCO timely filed a claim for refund in the amount of $680,513.67 for 1959 and asserted therein that the Commissioner of Internal Revenue erroneously disallowed, among other things, a loss deduction in the amount of $843,459.72. Upon the subsequent disallowance of plaintiff's refund claim, timely suit was brought in this court.[2]

Prior to 1957, ASARCO had located a porphyry copper deposit in an area known as the Mission Mine, which lay south of what later became known as Tracts 1, 2, and 3 of the San Xavier Indian Reservation (hereinafter also referred to as the "Indian lands") located near Tucson, Arizona. ASARCO's exploration activities conducted in the Mission Mine area suggested a pattern of mineralization extending from the Mission Mine northerly and northwesterly into the Indian lands. Furthermore, several mineral outcrops were observed on particular areas of the lands.

In April 1957, the United States Department of the Interior, Papago Indian Agency, publicly solicited bids for the competitive sale of exclusive prospecting permits with options to lease lands designated in 142 individually owned allotments and 160 acres of tribal land located in San Xavier Indian Reservation in Pima County, Arizona.[3] For purposes of bidding and leasing, the Department of the Interior divided these Indian lands into three tracts as mentioned above. The lands described as Tracts 1, 2, and 3 by trust patent had been allotted by the United States to individual Indians under the General Allotment Act of February 8, 1887, 24 Stat. 388 (25 U.S.C. § 331, *et seq.*). Under 25 U.S.C. § 396, the allottee (or his devisees or heirs) could lease the

[2] Percentage depletion and legal expense deduction issues have been settled administratively. During this proceeding, defendant has increased the amount of the disallowed loss deduction to $888,583.60 and has reduced the amount refunded to plaintiff under the depletion issue settlement by the resulting increase in tax and interest.

[3] Hereinafter, for convenience, the Indian lands are sometimes referred to as comprising 143 individual allotments.

number of acres in the tract to obtain a per acre rate. The number of acres not leased in each tract was then multiplied by such per acre rate. The allocation of the costs for direct drilling was made on the basis of whether or not holes were drilled on land later leased. The allocation of the costs for indirect drilling was determined by allocating that expense between lands leased and lands not leased in the same ratio as direct drilling expense.

30. Plaintiff leased only part of the lands designated in each of the following allotments: #64, #86, #121, #123, and #176. The part of the bonus payments allocated by plaintiff to acreage not leased in those allotments was $32,229.11. The direct drilling expense physically incurred on the acreage not leased in those allotments was $5,625.87. The indirect drilling expense allocated by plaintiff to the acreage not leased in those allotments was $2,206.88. The other costs allocated by plaintiff to the acreage not leased on those allotments was $3,020.09.

31. For the tax year 1959, ASARCO did not make any election under Section 614 of the Internal Revenue Code of 1954 to aggregate any of the lands in any of the allotments in any of the three tracts. ASARCO deducted $888,583.60, that portion of its total expenditures regarding the three tracts which it had allocated to the lands in which it relinquished all interest, as a loss in 1959 under section 165 of the Internal Revenue Code of 1954.

The Commissioner of Internal Revenue disallowed $843,459.72 of the aforesaid loss deduction, and defendant has, by offset, increased to $888,583.60 the amount of the deduction so disallowed.

Ultimate Findings of Fact

32. The land in the 142 allotments and the 160 acres of tribal land (comprising Tracts 1, 2, and 3) constituted 143 separate properties. The prospecting and option contracts described in finding 10, *supra*, resulted in ASARCO's acquisition of 143 separate property interests.

33. Geological and geophysical information obtained from exploration of the acreage in which ASARCO relinquished its interests in 1959 did not contribute to the discovery of ore deposits on the acreage which ASARCO actually leased, nor did

elements [7] comprising the $1,658,532.01 and the parts thereof allocated by ASARCO to the acreage not leased:

	Total Costs	ASARCO's Allocation to Acreage Not Leased
(1) Bonuses	$1,066,007.04	$743,766.60
(2) Other costs of acquiring prospecting permits and option rights	28,765.87	24,021.83
(3) Surveying and mapping	38,049.73	29,927.64
(4) Geophysical examination	41,339.10	31,652.85
(5) Miscellaneous costs of acquiring permits	227.25	190.20
(6) Direct drilling expense	353,085.29	42,726.70
(7) Indirect expense of drilling	128,183.36	16,297.78
(8) Mining lease costs	2,874.37	0
	1,658,532.01	888,583.69

27. Plaintiff allocated $743,766.60 of the total bonuses it paid to the acreage in which it relinquished its interest in 1959, by multiplying the acreage not leased in each of the tracts (4,560 acres in Tract 1, 3,188.63 acres in Tract 2, and 5,120 acres in Tract 3) by a per acre bonus payment for the prospecting and option rights on the lands in each of those tracts ($55.27 per acre for Tract 1, $146.05 per acre for Tract 2, and $5.08 per acre for Tract 3).

28. Plaintiff allocated $24,212.03 of the costs it incurred to acquire prospecting permits and option rights (other than bonuses paid) to the acreage in which it relinquished its interest in 1959. This allocation was made by taking the total outlay for each tract and dividing it by the number of acres in the tract to obtain a per acre rate. The number of acres not leased in each tract was then multiplied by such per acre rate.

29. With regard to exploration costs,[8] plaintiff allocated $29,927.64 of the costs it incurred for surveying and mapping, $31,652.85 of the costs it incurred for geophysical examinations, $42,726.70 of the costs it incurred for direct drilling, and $16,297.78 of the costs it incurred for indirect drilling to the acreage in which it relinquished its interest in 1959. The allocation of the costs for the first two items was made by taking the total outlay for each tract and dividing it by the

[7] The amounts set forth were reflected in ASARCO's accounting records by tracts and not by individual allotments.

[8] See items (3), (4), (6), and (7) in finding 26, *supra*.

land designated in his allotment for mining purposes for any term of years as may be deemed advisable by the Secretary of the Interior. Each of the three contiguous tracts was composed of eight sections of land, was generally rectangular in shape, and contained approximately 5,120 acres. The lands in Tracts 1, 2, and 3 were a small part of an area covered by a preliminary reconnaissance-type air magnetic survey made by plaintiff prior to 1957, no part of the cost of which is involved in this suit.

The Department of Interior's Notice of Competitive Sale provided, in pertinent part:

> Each permit grants an exclusive right to prospect for minerals other than oil and gas, with an option to lease. * * * Each tract will be bid on separately, and a separate permit will be drawn for each tract * * * The allotted tracts are offered subject to the approval of the individual Indian owners. The tribal tract is offered subject to the approval of the tribal council.
>
> * * * * *
>
> The successful bidder is required to obtain the signature of the Indian permitters. Acreage for which signatures cannot be obtained is excluded from the permit and the bonus bid reduced proportionately. If after showing the exercise of reasonable diligence and that he is unable to obtain the signatures of the landowners for at least 80 percent of one block of 2,560 acres lying anywhere within the tract, the successful bidder may withdraw his bid and recover any moneys paid to the superintendent incident to the bid except the bidder's proportionate share of the cost of advertising. The superintendent shall hold in a special fund any bonus paid by the successful bidder. Should the superintendent determine that the required signatures have been obtained, he shall within 30 days after return of the executed permit deposit to the credit of the signing landowner the bonus that remains in a proportion that the acreage they have signed for bears to the whole acreage signed for within the tract.
>
> * * * * *

ASARCO was the successful bidder for Tracts 1, 2, and 3, and paid bonuses of $283,000 (which amounted to $55.27 per acre), $757,022.04 (which amounted to $146.05 per acre), and $26,005 (which amounted to $5.08 per acre), respectively, for prospecting and lease option rights in each tract. Pursuant

to the requirement of the Notice of Competitive Sale, plaintiff obtained the requisite signatures of all the individual Indian allottees on prospecting permits. At the time ASARCO submitted its bids, it believed that the right to prospect the acreage in the three tracts had no value apart from the right to lease acreage within the tracts.

By the three prospecting and option contracts that were executed, the Indian landowners[4] authorized the Commissioner of Indian Affairs, or his authorized representative, to sign, execute, and deliver on their behalf mining leases. ASARCO could lease all or any part of the lands designated in an individual allotment. Under the terms of each of the contracts, however, ASARCO could exercise its option to take preference mineral leases on not more than 2,560 acres in each tract plus such additional acreage as the Secretary of the Interior determined to be fringe acreage necessary for a successful mining operation. Plaintiff could exercise its options without additional payment for the acreage leased.

The bonus payments made by ASARCO were paid to the Bureau of Indian Affairs and delivered to the Superintendent of the Papago Agency at Sells, Arizona. In accordance with the Notice of Competitive Sale and applicable regulations, the bonuses were deposited and credited to the individual Indian money accounts (hereinafter referred to as "IIM accounts") of the Indian allottees in proportion to the acreage owned by each allottee in Tracts 1, 2, and 3, at the rates of $55.27, $146.05, and $5.08 per acre, respectively.

ASARCO mapped and surveyed the surface of all the lands in the three tracts at the same time in an operation administered as one project, laying out a grid pattern extending across all three tracts without breaks at the boundaries between the tracts. ASARCO also conducted gravity surveys, ground magnetic surveys, and electromagnetic surveys on various portions of the tracts. Relying in part on the surveys which had been performed, ASARCO formulated its drill hole pattern and proceeded to begin drilling on September 14, 1957. The rock samples gathered from some of the initial drill holes indicated the presence of ore bodies, while the

[4] Under the terms of the contracts, the allottees and the devisees and heirs of deceased allottees were designated as the Indian landowners.

use any available remedy in law or equity for breach of this contract by the lessee.

* * * * *

22. By exercising its options to lease, ASARCO retained its mineral rights in lands designated in 19 complete allotments (1,915.49 acres), the 160 acres of tribal land, 80 acres of land designated in allotment #121, 80 acres of land designated in allotment #123, 40 acres of land designated in allotment #176, 78.88 acres of land designated in allotment #64, and 200 acres of land designated in allotment #86.

23. During 1959, ASARCO relinquished all its right, title, and interest in acreage in allotments #21, 22, 23, 24, 25, 156, 159, 170, 171, 173, 174, 175, 176, 177, 178, 179, 180, 182, 184, 189, 190, 191, 192, 193, 197, 198, 204, 205, 211, 212, 213, 214, 215, 216, 217, 225, 226, 227, 228, 229, 239, 240, 241, 242, 243, 244, 245, 252, 253, 258, and 288 in Tract 1 and all its right, title, and interest in 40 acres in allotment #121 and 80 acres of allotment #123 in Tract 1, comprising a total of 4,560 acres.

24. During 1959, ASARCO relinquished all its right, title, and interest in acreage in allotments #41, 56, 57, 58, 59, 65, 66, 74, 75, 76, 77, 78, 79, 88, 89, 94, 96, 101, 110, 111, 112, 114, 127, 128, 129, and 172 in Tract 2 and all its right, title, and interest in 157.34 acres in allotment #64 in Tract 2, comprising a total of 3,188.63 acres.

25. During 1959, ASARCO relinquished all its right, title, and interest in the lands designated in all allotments in Tract 3, comprising a total of 5,120 acres.

26. ASARCO expended $1,658,532.01 with respect to the lands in the three tracts prior to taking mining leases on 2,554.37 acres and the termination of its rights in the remaining lands. Of these costs, $888,583.60 was allocated by ASARCO to the lands it did not lease, which lands were designated in 118 allotments and parts of five allotments in which it terminated all of its rights in 1959. The following table sets forth the cost

other than oil and gas, the land described as follows subject to valid existing rights:

* * * * *

4. In consideration of the foregoing, the lessee agrees:

(a) ROYALTY.—To pay, or cause to be paid, to the Superintendent, Papago Agency, for the use and benefit of the Indian landowners, a royalty as follows:

* * * * *

* * * Each landowner, having land covered by a lease, shall receive such proportion of all royalties as his acreage bears to the total acreage covered by the lease.

(b) ANNUAL RENTAL.—* * * Each landowner, having land covered by a lease, shall receive such proportion of all rent as his acreage bears to the total acreage covered by the lease.

(c) MINIMUM ROYALTY.—* * * Each landowner, having land covered by a lease shall receive such proportion of the minimum royalty as his acreage bears to the total acreage covered by the lease.

* * * * *

9. RELINQUISHMENT OF SUPERVISION BY THE SECRETARY OF THE INTERIOR.—Should the Secretary of the Interior, at any time during the life of this instrument, relinquish supervision as to all or part of the acreage covered hereby, the relinquishment does not bind the lessee until the Secretary has given 30 days' written notice. Until the requirements are fulfilled, lessee shall continue to make all payments due under subsection 4 (a), (b), and (c). After notice of relinquishment has been received by lessee, this lease is subject to the following further conditions:

(a) All rentals and royalties accruing to the unrestricted lessor shall be paid directly to lessor or his successors in title.

* * * * *

18. CANCELLATION AND FORFEITURE.—When, in the opinion of the Secretary of the Interior, there has been a violation of any of the terms or conditions of this lease before restrictions are removed, the Secretary of the Interior has the right at any time after 30 days' notice to the lessee, specifying the terms and conditions violated, and after a hearing, if the lessee shall so request within 30 days of receipt of notice, to declare this lease void, and the lessor may then take immediate possession of the lands. After restrictions are removed, the lessor may

results of other test drillings eliminated certain areas from consideration. Although every hole drilled by ASARCO in the course of its exploration activities conducted on the Indian lands provided meaningful geological data and information, only a portion of the holes drilled provided information relevant to the ore bodies on the lands subsequently leased.

Eight areas of interest were located on the acreage contained in the three tracts. Four of these areas of interest were located by ASARCO prior to the placing of its bids in 1957. The remaining four were identified from geophysical data derived from the exploration work carried out in 1957. Of the eight areas of interest, all but two were eliminated by drilling. Of the six areas thus eliminated by drilling exploration, four areas had been identified initially through geophysical data and were located on acreage in which ASARCO subsequently relinquished its interests in 1959. The two ore deposits that were found on the acreage leased by plaintiff were in vicinities where, prior to any exploration in 1957–1959, plaintiff had already decided to do exploratory drilling, and these deposits were located by early drill holes in September and October 1957. The lateral extent of each of the two ore deposits on the acreage subsequently leased by ASARCO was delineated by drill holes on such acreage only. The data derived from drilling on the lands in which ASARCO subsequently relinquished its interests, in combination with the geophysical surveys previously performed, indicated that such lands did not warrant further exploration or leasing.

In 1959, ASARCO exercised its option rights under its contracts and leased 560 acres of the lands designated in Tract 1 and 1,994.37 acres of the lands designated in Tract 2. Thereafter, all payments under the leases were made to the Superintendent, Papago Agency, for credit to the Individual Indian Money (IIM) account of each Indian whose allotment covered acreage leased. ASARCO chose not to take any mineral lease in the lands designated in Tract 3. By exercising its options to lease, ASARCO retained its mineral rights in lands designated in 19 complete allotments, portions of five allotments, and the 160 acres of tribal land. At the same time, plaintiff relinquished all its right, title, and interest in acre-

age comprising 118 complete allotments, and portions of five allotments.

ASARCO expended $1,658,532.01 with respect to the lands in the three tracts prior to taking mining leases on 2,554.37 acres and relinquishing its rights in the remaining lands. ASARCO allocated $743,766.60 of the total bonuses it paid to the acreage in which it relinquished its interests in 1959, by multiplying the acreage not leased in each of the three tracts by a per acre bonus payment for the prospecting and option rights on the lands in each of those tracts. Plaintiff allocated $24,212.03 of the costs it incurred to acquire prospecting permits and option rights (other than bonuses paid) to the acreage in which it relinquished its interest in 1959, also on a proportionate acreage basis within a given tract. With regard to exploration costs, plaintiff allocated $29,927.64 of the costs it incurred for surveying and mapping, $31,652.85 of the costs it incurred for geophysical examinations, $42,726.70 of the costs it incurred for direct drilling, and $16,297.78 of the costs it incurred for indirect drilling, all to the acreage in which it relinquished its interest in 1959. The allocation of the costs for surveying, mapping, and geophysical examination was, again, on a proportionate acreage basis within each tract, while direct drilling costs were allocated on the basis of whether or not holes were drilled on land later leased, and indirect drilling costs were allocated in the same ratio as direct drilling expense.

The part of the bonuses it paid which plaintiff allocated to acreage not leased in those allotments where only a portion thereof was leased amounted to $32,229.11. Consistent with the methods of computation discussed above, plaintiff allocated $5,625.87 of direct drilling expense, $2,206.88 of indirect drilling expense, and $3,020.09 of the other costs, to the acreage not leased in such so-called "split-allotments."

ASARCO deducted $888,583.60, that portion of its total expenditures regarding the three tracts which it had allocated to the lands in which it relinquished all its interest, as a loss in 1959 under section 165 of the Code. The Commissioner of Internal Revenue disallowed $843,459.72 of the aforesaid loss deduction, and defendant has, by offset, increased to $888,583.60 the amount of the deduction so disallowed.

that such lands did not warrant further exploration or leasing.

18. In 1959, ASARCO exercised its option rights under its contract and leased 560 acres of the lands designated in Tract 1. The mining lease, dated August 31, 1959, covered lands designated in three complete allotments (240 acres) and 160 acres of lands designated in allotment #92, 80 acres of lands designated in allotment #121, and 80 acres of lands designated in allotment #123. Thereafter, all payments under the lease were made to the Superintendent, Papago Agency, for credit to the IIM account of each Indian whose allotment covered acreage leased, and none was for the account of the Indians whose allotments did not cover acreage leased.

19. In 1959, ASARCO exercised its option rights under its contract and leased 1,994.37 acres of the lands designated in Tract 2. This lease, dated August 31, 1959, covered lands designated in 15 complete allotments (1,435.49 acres), the 160 acres of tribal land, the 80-acre balance of lands designated in allotment #92, 78.88 acres of lands designated in allotment #64, 40 acres of lands designated in allotment #176, and 200 acres of lands designated in allotment #86. Thereafter, all payments under the lease were made to the Superintendent, Papago Agency, for credit to the IIM account of each Indian whose allotment covered acreage leased, and none was for the account of the Indians whose allotment did not cover acreage leased.

20. In 1959, ASARCO chose not to take any mineral lease in the land designated in Tract 3.

21. Each of the two leases mentioned in findings 18 and 19 provided, in pertinent part:

> THIS INDENTURE OF LEASE is made and entered into in sextuplicate on this 31st day of August, 1959, between Harry W. Gilmore, Superintendent, Papago Agency, Sells, Arizona, for and on behalf of the Indian landowners as shown on the ownership schedule, * * * hereinafter called the lessor, and American Smelting and Refining Company * * * hereinafter called the lessee.
>
> * * * * *
>
> 1. Lessor * * * grants and leases unto lessee for the sole purpose of prospecting for and mining minerals,

and interpreting other available geologic information. In a number of instances, plaintiff drilled on past the depth at which it had been determined that no mineralization existed in order to obtain further geologic data and information. On certain occasions, plaintiff drilled test holes to evaluate an aeromagnetic survey that had been conducted in 1956. By obtaining rock samples in the course of drilling, ASARCO was also able to make susceptibilities measurements to correlate the geophysical data for most of the area within the three tracts, including areas which were not subsequently leased. Geologic maps showing the geology of all the lands embraced in the three tracts were prepared by plaintiff on the basis of information obtained from the drilling program.

17. Although every hole drilled by ASARCO in the course of its exploration activities conducted on the Indian lands provided meaningful geological data and information, only a portion of the holes drilled provided information relevant to the ore bodies on the lands subsequently leased.

Eight areas of interest were located on the acreage contained in the three tracts. Four of these areas of interest were located by ASARCO prior to the placing of its bids in 1957.[6] The remaining four were identified from geophysical data derived from the exploration work carried out in 1957. Of the eight areas of interest, all but two were eliminated by drilling. Of the six areas thus eliminated by drilling exploration, four areas had been identified initially through geophysical data and were located on acreage in which ASARCO subsequently relinquished its interests in 1959.

The two ore deposits that were found on the acreage leased by plaintiff were in vicinities where, prior to any exploration in 1957–1959, plaintiff had already decided to do exploratory drilling, and these deposits were located by early drill holes in September and October 1957. The lateral extent of each of the two ore deposits on the acreage subsequently leased by ASARCO was delineated by drill holes on such acreage only.

The data derived from drilling on the lands in which ASARCO subsequently relinquished its interests, in combination with the geophysical surveys previously performed, indicated

[6] See finding 5, *supra*, for further detail.

The Separate Property Issue

The threshold issue in this suit requires a determination of the nature of the property interests acquired by ASARCO in the three tracts under the prospecting and lease option permits it received as high bidder in 1957. ASARCO contends that the land in each of the 143 allotments contained in the three tracts was a separate property, and that, accordingly, plaintiff's interest in each allotment constituted a separate property interest. Thus, plaintiff continues, it is entitled to deduct as a loss under section 165 that portion of the bonus payments properly allocable to the individual properties in which it relinquished its rights in 1959. The Government responds that the bonus payments incurred by ASARCO constituted a single investment in the three tracts,[5] which investment continued to have value after ASARCO leased portions of the tracts in 1959.[6] Consequently, it is defendant's position that ASARCO did not sustain a tax-recognizable loss in 1959. In my opinion, the Government's position is not well taken.

There can be little doubt that the acreage in each allotment constituted separate property individually owned by a particular Indian allottee, his devisee or heir. In *Barclay* v. *United States*, 166 Ct. Cl. 421, 333 F. 2d 847 (1964), this court was called upon to define the nature of the interests held by individual Indian allottees in allotted land. Timber, growing on both allotted and unallotted Indian lands, was advertised for sale by the Indian Service under Interior Department regulations. The taxpayers, being the highest bidders, were awarded a sales contract for such timber, which contract was later transferred to a corporation organized by them for the purpose of milling and selling the timber. One issue resulting from this transaction was whether the taxpayers' holding period of their right to cut timber on allotted lands began to run when the Secretary of the Interior approved the sales contract or whether the period ran only

[5] Although defendant's theory is that ASARCO made a single investment in the Indian lands which constituted one property, defendant does suggest in summary that, alternatively, the Indian lands constituted three properties at most.

[6] At the same time, of course, ASARCO relinquished its rights in the unleased portions of the tracts.

from the time the separate contracts covering the individual allotted lands were signed. The court held that the timber from the *allotted* Indian land was not effectively sold to the taxpayers until the sales contracts had been executed with the consent of the individual Indian allottees. In discussing the status of timber on allotted land, the court emphasized the ultimate ownership rights possessed by individual Indian allottees, stating at pages 441–43:

> * * * We see, therefore, that the Secretary had no statutory authority to sell the timber that stood on allotments; his office was merely to approve or disapprove of such sales as the allottees might make. *Only the allottee could transfer the ownership of the timber on his land.*
>
> * * * * *
>
> * * * Nevertheless, if the Government had no right to dispose of the allotted timber—indeed was statutorily prohibited from disposing of it—then its acts were of no effect until the various allottees agreed to sell it. * * *
>
> * * * * *
>
> * * * The fact remains, however, that any allottee could have refused to make such a contract, and if this had been done, plaintiffs could not have become the owners of or disposed of the timber of any dissident Indian. The fact that the Indian's refusal to sell his timber would have amounted to an act of commercial insanity does not alter the picture; *his agreement remained a prerequisite to any ownership vesting in plaintiffs.* (Emphasis supplied.)

More recently, in *Poafpybitty* v. *Skelly Oil Company*, 390 U.S. 365 (1968), the question presented was whether petitioners, who were Comanche Indians, had standing to sue under an oil and gas lease approved by the Department of the Interior for use on land held by such Indians under trust patents issued by the United States, as here, under the General Allotment Act of 1887, *supra*. The Supreme Court held that the Indian lessors, as owners of the allotted lands, had the capacity to maintain an action seeking damages for an alleged breach of an oil and gas lease thereon. The Court described the Indians' rights in allotted land under the 1887 Act, as follows:

> * * * [T]he allotment system was created with the Indians receiving *ownership rights in the land* while the United States retained the power to scrutinize the var-

> additional 2,000 acres for construction of improvements and disposition of waste materials.

In the first two examples, plaintiff would have the unfettered right under the preference provision to lease the acreage actually containing the ore bodies, i.e. 2,000 acres in (a) and 2,400 acres in (b). Under the contracts, plaintiff would also have the right to lease "such additional acreage as the Secretary may determine as fringe acreage necessary for a successful mining operation." In the third example, all of the ore body acreage would have to be leased to meet the "reasonably proven productive" contract requirement. Thus, any lease under example (c) would appear to be entirely subject to the Secretary's discretion under the "successful mining operation" clause.

15. ASARCO mapped and surveyed the surface of all the lands in Tracts 1, 2, and 3 at the same time in an operation administered as one project, laying out a grid pattern extending across all three tracts without breaks at the boundaries between the tracts. The surveys conducted by ASARCO included:

> (a) Uniformly distributed gravity surveys of all the lands in tracts 1 and 2, and a narrow strip along the west margin of tract 3;
>
> (b) Ground magnetic surveys of the lands in the southern portions of tracts 1 and 2; and
>
> (c) Electromagnetic surveys along traverses in tracts 1 and 2 extending north from the south line for slightly over two miles.

16. Relying in part on the surveys which had been performed, ASARCO formulated its drill hole pattern and proceeded to begin drilling on September 14, 1957.[5] The rock samples gathered from some of the initial drill holes indicated the presence of ore bodies, while the results of other test drillings eliminated certain areas from consideration. As is commonplace, ASARCO's geologists located and spaced the drill holes in such a fashion that they could deduce what lay between the holes (and to some extent beyond the holes) by analyzing the rock samples obtained from the test holes

[5] The ore bodies on lands subsequently leased were discovered and generally delineated by drill holes which would have been drilled in the same general places even if no geophysical surveys had been performed. See finding 5, *supra*.

ments on which ore was subsequently discovered. ASARCO could lease all or any part of the lands designated in an individual allotment. However, under the terms of each contract, plaintiff could exercise its option to take preference mineral leases on not more than 2,560 acres in each tract plus such additional acreage as the Secretary of the Interior determined to be fringe acreage necessary for a successful mining operation.[3] Plaintiff could exercise its options without additional payment for the acreage leased.

13. The applicable regulation effective at the time these contracts were executed provided:

> A lessee may acquire more than one lease but no single lease shall be granted for mining purposes on Indian tribal or restricted Indian lands, exclusive of Osage and Quapaw lands, in excess of the following acreage except where the rule of approximation applies:
>
> (a) For oil and gas and all other minerals, except coal, 2,560 acres. (25 C.F.R. 186.9) (1957 Supp.), made applicable to allotted lands by 25 C.F.R. 189.13 (1957 Supp.)).[4]

14. ASARCO actually did not expect to find an ore body on any of the tracts which would require the leasing of more than 2,560 acres in a tract, and therefore the acreage limitation was of no particular concern to ASARCO's management. It was possible, however, that certain types of unexpected discoveries by plaintiff could result in an application to the Secretary for permission to lease more than 2,560 acres in order to carry on a successful mining operation. Such types of discoveries included:

> (a) A 2,000 acre high-grade ore body, which would have required at least another 2,000 acres for construction of improvements and disposition of waste material;
>
> (b) Two 1,200 acre ore bodies, neither of which was sufficient without the other to make a successful mining operation and which required leasing an entire tract; or
>
> (c) A 3,000 acre low-grade ore body, all of which would have to be mined in order to have a successful mining operation and which would require at least an

[3] The acreage limitation provision was drafted and inserted by the Bureau of Indian Affairs.

[4] The regulatory passages referred to were promulgated by amendment to the existing regulations on February 28, 1957. On December 24, 1957, these amended regulations were renumbered as Sections 172.13 and 171.9.

> ious transactions by which the Indian might be separated from that property. At 369.
>
> * * * * *
>
> [T]he federal restrictions preventing the Indian from selling or leasing his allotted land without the consent of a governmental official do not prevent *the Indian landowner, like other property owners, from maintaining suits appropriate to the protection of his rights.* * * * Although the approval of the Secretary is required, *he is not the lessor* and he cannot grant the lease on his own authority. At 372. (Emphasis supplied.)

The Government has no quarrel with these decisions. It contends, however, that they have no relevance to the central issue here which, in the Government's view, turns not on the basis of Indian ownership rights in the allotted lands, but rather on the nature of ASARCO's investment in those lands. The Government correctly points out that the Indian Bureau, for purposes of advertising, bidding, and leasing, divided the lands into three tracts; that ASARCO bid one sum for the prospecting and lease option rights offered in each tract; that, while required to obtain the consents and signatures of all the individual Indian allottees, ASARCO did not directly negotiate with the Indians regarding the terms of the contract covering each tract; and finally that the exploration of the three tracts was conducted by ASARCO as a single venture. Defendant incorrectly concludes, however, that such activities, in some talismanic way, transformed 143 individually owned separate property interests in the hands of Indian allottees into one property interest (or at most into three property interests) in the hands of ASARCO.

The procedures utilized by the Indian Bureau can only be described as administrative in function. Having no proprietary interest, the Bureau clearly was not empowered to alter or merge the separate property interests of the Indian landowners into one property. Nor did the Indians merge their separate allotments into one, or even three properties. The record clearly shows that, with the Bureau's cooperation, plaintiff took all the necessary action to ascertain the names and locations of the numerous Indian allottees, and consulted with each owner individually for the purpose of persuading each to sign the contract covering his land. ASARCO's

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acquisition of prospecting and lease option rights in a particular allotment was entirely dependent upon ASARCO's success in obtaining the written consent of the pertinent Indian landowner. Any such landowner was free to withhold his consent in which event, of course, no portion of the bonuses paid in respect to lands of consenting owners would be credited to the withholding owner's account. Upon the exercise of ASARCO's option to lease, moreover, only those Indian landowners whose individual allotments were actually leased became entitled to receive, in addition to the prior bonus payments, rent and royalty payments. It is clear that the integrity of each Indian allottee's ownership rights in his respective allotment was maintained at all times and provided the basis upon which plaintiff acquired a separate property interest in each of the several allotments comprising the three tracts.

In further support of its position, ASARCO justifiably points to pertinent provisions of the Treasury Regulations which deal with the question of what constitutes a separate interest in property. Treas. Reg. § 1.614–1(a) (1954) provides in pertinent part:

> (1) *For purposes of subtitle A of the Code*, in the case of mines, wells, and other natural deposits, the term "property" means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land.
>
> (2) The term "interest" means an economic interest in a mineral deposit. * * *
>
> (3) The term "tract or parcel of land" is merely descriptive of the physical scope of the land to which the taxpayer's interest relates. It is not descriptive of the nature of his rights or interests in the land. All contiguous areas (even though separately described) included in a single conveyance or grant or in separate conveyances or grants at the same time from the same owner constitute a single separate tract or parcel of land. *Areas included in separate conveyances or grants* (whether or not at the same time) *from separate owners are separate tracts or parcels of land even though the areas described may be contiguous.* (Emphasis supplied.)

This regulation, *by its own terms*, is applicable to all provisions under subtitle A of the Internal Revenue Code which encompasses all the income tax provisions therein, including

> 3. REMOVAL OF ORES.—No ores shall be removed except samples for examination and experimental purposes and the removal of such samples shall be subject to the approval of the Superintendent of the Papago Agency.
>
> * * * * *

By virtue of paragraph "A." of each of the above-mentioned contracts, the Indian landowners authorized the Commissioner of Indian Affairs or his authorized representative to sign, execute, and deliver on their behalf Modified Form 5–154 mining leases.

11. The bonuses were paid by plaintiff to the Bureau of Indian Affairs and delivered to the Superintendent of the Papago Agency at Sells, Arizona. In accordance with the Notice of Competitive Sale and applicable regulations, the bonuses were deposited and credited to the individual Indian money accounts of the Indian allottees, and devisees and heirs of deceased allottees, except for the bonus paid with respect to the 160 acres of tribal land which was deposited and credited to the tribal account. The Individual Indian Money accounts (hereinafter referred to as "IIM accounts") were internal accounts kept by the Bureau of Indian Affairs. While under the control of the Bureau of Indian Affairs, the IIM accounts belonged to the individual Indians, and they had the right to withdraw funds from their accounts.

In return for granting ASARCO the prospecting rights and option to lease, each allottee, or devisee or heir of a deceased allottee, of land designated in Tracts 1, 2, and 3 was entitled to have his proportionate share of the bonus money credited to his IIM account in accordance with the Notice of Competitive Sale and the applicable regulations, at the rates of $55.27, $146.05, and $5.08 per acre, respectively.

12. Under the terms of each of the contracts, plaintiff could prospect on all the acreage designated in an allotment if it could obtain the signature of the Indian allottee, or the devisees or heirs of a deceased allottee. Accordingly, to assure itself that it could lease any specific allotment on which it might discover ore, plaintiff obtained the signatures of all the Indian allottees, or their devisees or heirs, and paid the appropriate bonus. It thereby acquired the right under the permits to prospect on all the land, and to lease those allot-

THIS AGREEMENT is made and entered into this 17th day of May, 1957, by and between certain Indian owners, as named on the ownership schedule marked "Exhibit A" attached hereto and by this reference made a part hereof, party of the first part, hereinafter called Permitter, whose address is Sells, Arizona, and American Smelting & Refining Co. whose address is 120 Broadway, New York, N.Y., party of the second part, hereinafter called the Permittee.

In consideration of the bonus of $____ paid to the Superintendent, Papago Agency, the receipt of which is hereby acknowledged, and the covenants, stipulations, and conditions hereinafter contained it is agreed:

A. Permitter hereby grants the Permittee, subject to limitations hereinafter stated, an exclusive right for a period of two (2) years from the date of approval of this permit by the Commissioner of Indian Affairs or his authorized representative to prospect for minerals other than oil and gas, and does also hereby grant and give to the Commissioner of Indian Affairs or his authorized representative full power and authority to sign, execute, and deliver a mining lease, pursuant to the terms and conditions of this permit, upon the following-described lands of Permitter, subject to valid existing rights, consisting of approximately 5,120 acres. * * *

B. The permit is granted upon the following express terms, covenants, and conditions:

1. PREFERENCE.—Permittee shall have the right, exercisable at any time during the term of this permit, to a lease on not more than 2,560 acres of land embraced by this permit, and such additional acreage as the Secretary may determine as fringe acreage necessary for a successful mining operation. * * * The permittee shall include in the lease only such acreage as is reasonably proven productive, supported by factual information, together with that additional acreage which is necessary for its mining operations. Mining operations shall include areas for open-pit, construction of improvements, and disposition of waste material. During the life of a lease, it shall be developed diligently and no acreage may be dropped from the lease.

* * * * *

2. DILIGENCE AND DEVELOPMENT.—The land described herein shall not be held by the permittee for speculative purposes, but in good faith for prospecting minerals. The permittee shall expend annually in prospecting and exploration work, a sum which shall amount to not less than five dollars ($5) per acre. * * *

section 165. Defendant's contention that the property concept embodied in the regulation is restricted to the computation of the depletion allowance is not only contrary to the regulation's language but is also inconsistent with the legislative history of section 614 of the Code. The House Bill containing section 614 originally provided that a taxpayer could elect to aggregate two or more separate operating mineral interests owned by him, and treat such aggregation as one property only for the purpose of computing the percentage depletion allowance. The Senate Finance Committee amended this provision by making such election to aggregate effective for all income tax purposes. In explaining the change, the Finance Committee stated:

> * * * The effect of this amendment is to make the definition of property consistent so as to be applicable to the computation of both cost and percentage depletion, and to the computation of gain or loss upon a sale or exchange. S. Rep. No. 1622, 83d Cong., 2d Sess., 334 (1954).[7]

In any event, the Government argues, ASARCO did not acquire 143 separate property interests in the Indian lands because Treas. Reg. § 1.614–1(a)(3), *supra*, requires the execution by separate owners of "separate conveyances or grants," whereas here the Indians signed three prospecting contracts by affixing their individual signatures thereto. Such a literal application of the regulation's words, however, seems unduly to exalt form over reality. The obvious thrust of the regulation is that for various mineral interests to be considered separate property interests, they must have been acquired from separate owners. In speaking of "separate conveyances," the regulation merely recognizes the fact that, in an ordinary business acquisition from "separate owners," the transaction would usually be accomplished by "separate conveyances." When read in context with the immediately preceding sentence in the regulation, it is clear that the separate tract definition is pitched on the question of whether one owner or several owners are involved in the particular transaction, rather than upon the employment of a given conveyancing technique.

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[7] For further evidence that the property concept under discussion is not restricted to the depletion allowance computation see, also, Treas. Reg. § 1.614–

At the risk of repetition, it must be reemphasized that the many Indian allottees were the separate owners of their individual allotments. As separate owners, they signed prospecting and lease option contracts granting to ASARCO certain identical rights in their respective lands. That for purposes of convenience, the signatures of the owners were affixed to three documents, rather than to 143 separate documents, is surely irrelevant to the issue involved. The reality remains that ASARCO acquired rights in 143 separate properties from the separate owners thereof, and ASARCO's rights in each allotment constituted a separate property interest. Consequently, under section 165 plaintiff sustained a tax-recognizable loss with respect to those properties in which it relinquished its interests during 1959.

The Bonus Allocation Issue

ASARCO paid bonuses totaling $1,066,007.04, and related costs totaling $28,993.12, for the prospecting and lease option rights it acquired in the Indian lands. On its tax return for 1959, the amounts included by ASARCO in its loss deduction for such bonuses and related costs of acquiring the property interests relinquished in 1959 were $743,766.60 and $24,212.03, respectively. Each of these amounts was determined by taking the total outlay for each tract and dividing it by the number of acres in the tract to obtain a per acre rate. The number of acres not leased in each tract was then multiplied by such per acre rate.

The Government asserts, however, that even accepting plaintiff's concept of separate property interests, its bonus payments and related costs must be allocated to the maximum acreage which it had the right to lease and not to the total acreage from which it could select. Under the Government's construction of the prospecting contracts, ASARCO's right to

6(d) (1954) governing the allowance of abandonment and casualty losses on aggregated mineral properties. In cases where mineral interests have been aggregated or combined into one property, this regulation prohibits the allowance of abandonment losses until such time as the entire combined property is abandoned. From this rule, the inference is permissible that loss on a separate property, not aggregated with others, should be allowed on abandonment of that separate property. The parties have stipulated in this case that ASARCO did not elect to aggregate any of the properties on the San Xavier reservation.

(b) Bonuses totaling $757,002.04 (which amounted to $146.05 per acre) for prospecting and option rights in lands designated in allotments and in the 160 acres of tribal land located in Tract 2, which contained approximately 5,183 acres; and

(c) Bonuses totaling $26,005 (which amounted to $5.08 per acre) for prospecting and option rights in lands designated in allotments located in Tract 3, which contained approximately 5,120 acres.

At the time plaintiff submitted its bids, it believed that the right to prospect the acreage in the three tracts had no value apart from the right to lease acreage within the tracts.

9. To obtain the prospecting and option rights on lands designated in an allotment, plaintiff was required to employ attorneys to examine United States and other records to ascertain the names and locations of the Indian allottees, or devisees or heirs of deceased allottees, and to spend months in locating and persuading them to sign the contract covering their respective lands. The Indian Bureau assisted in this regard.[1] Prospecting and option rights could not be obtained on land designated in an allotment unless the allottee, or his devisees or heirs, signed the contract granting such rights, except that the Papago Indian Agency signed for minors, incompetents, and undetermined or unlocated devisees or heirs of deceased allottees, and the Tribal Chairman of the San Xavier group of Papago Indians signed for the 160 acres of tribal land.

10. ASARCO acquired the prospecting and option rights on all the acreage in Tracts 1, 2, and 3 for total amounts of $283,000, $757,002.04, and $26,005, respectively, under three contracts dated May 17, 1957, identical in form except for the names of the Indian landowners,[2] the description of the lands, and the amounts payable. Each contract provided, in pertinent part:

[1] While the Papago Indian Agency did not assume responsibility for obtaining the signatures of the Indian allottees or devisees or heirs of deceased allottees, it fully cooperated with ASARCO by supplying the names, and to the extent the Agency had such information, the locations of Indian allottees or devisees or heirs of deceased allottees, whose consent was necessary.

[2] Under the terms of the contracts, the allottees and the devisees and heirs of deceased allottees, were designated as the Indian landowners.

termine that the required signatures have been obtained, he shall within 30 days after return of the executed permit deposit to the credit of the signing landowner the bonus that remains in a proportion that the acreage they have signed for bears to the whole acreage signed for within the tract.

* * * * *

The permit will grant an exclusive right for a period of two (2) years from the date of approval by the Commissioner of Indian Affairs or his authorized representative to prospect for all minerals except oil and gas. The Permittee may lease at any time during the term of the permit up to 2,560 acres of the lands embraced in the permit, and such additional acreage as the Secretary may determine as fringe acreage necessary for a successful mining operation. The permittee shall include in the lease only such acreage as is reasonably proven productive, supported by factual information, together with that additional acreage which is necessary for its mining operations. Mining operations shall include areas for open-pit, construction of improvements, and disposition of waste material. The area covered by a lease shall be in a reasonably compact body and shall conform to the system of public land surveys. During the life of the lease, each lease shall be developed diligently and no acreage may be dropped from the lease.

The permittee shall spend annually for prospecting on each tract not less than five dollars ($5) per acre.

Leases will be for ten (10) years and so long thereafter as minerals are produced on the lease in paying quantities. While any of the leased land is under Federal jurisdiction, the royalty provisions of the lease are subject to adjustment by the Secretary of the Interior or his authorized representative at the end of the first and each successive ten (10) year period, such adjustments being based upon market conditions as supported by evidence from the field. Annual rate of rental will be $1 for each acre.

* * * * *

8. ASARCO was the successful bidder for Tracts 1, 2, and 3, bidding as follows:

(a) Bonuses totaling $283,000 (which amounted to $55.27 per acre) for prospecting and option rights in lands designated in allotments located in Tract 1, which contained approximately 5,120 acres;

lease was restricted to 2,560 acres per tract, being one-half the total acreage therein. From this starting point, the Government computes the percentage of land actually leased by ASARCO to that which it had the right to lease at 22.09 percent for Tract 1, 78.12 percent for Tract 2, and zero percent for Tract 3. By applying those percentages to the bonus payments and related costs, the Government concludes that, in no event, could ASARCO's loss exceed $343,500, as opposed to the claimed loss of $767,978. In my judgment, this conclusion cannot be accepted because, as will be seen, it leads to a distortion of well established concepts used in the computation of tax basis.

Section 165(a) states the general rule regarding losses that "there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise." Section 165(b) provides that the amount of the deduction shall be the adjusted basis of the property, such basis being defined by sections 1011–1012 as the cost of the property. As shown above, ASARCO acquired a separate property interest in each of the 143 separate properties comprising the Indian lands. It thereby acquired a basis in each property measured by such property's cost, which was necessarily the sum paid by ASARCO for credit to the particular Indian landowner.

The defendant objects that the Indian Bureau's uniform per acre bonus rate should not be the measure of ASARCO's cost basis because it does not accurately reflect the actual land values involved. It is apparent, the argument goes, that had ASARCO negotiated the amount of bonus directly with each individual landowner, it would have paid more for option rights in some areas than in others. This assertion is based upon an acknowledgment by ASARCO's officials that there were "areas of interest" within the reservation which showed more mineral promise than other areas therein. This type of speculation has no place in arriving at the basis of property under section 1012 of the Code. It is true that the Indian Bureau, acting for the benefit of the Indians, was responsible for the formula by which bonus payments were credited at a uniform per acre rate to the IIM accounts of the landowners in each tract. This formula was acknowledged, however, in

the bid notice[8] and was agreed to by the landowners themselves. ASARCO's use of it in computing basis was entirely proper.

The fact that ASARCO's basis in each allotment must be the price paid by it for the credit of the particular Indian landowner is not affected by the acreage limitation provision contained in the contracts. Contrary to defendant's contention, that provision did not limit plaintiff's lease option rights to no more than 2,560 acres in each tract. Rather, the limitation for each tract was 2,560 acres, *plus* such additional acreage as the Secretary of the Interior might determine to be fringe acreage necessary for a successful mining operation. Clearly, by virtue of the discretion exercisable by the Secretary, there was no way to foretell at the time ASARCO's bids were accepted precisely what number of acres in each tract ASARCO might become entitled to lease.

In further support of its method of allocation, the Government urges that, since not more than one-half of the acreage in each tract could be leased, ASARCO's formula has the illogical result of automatically creating a loss of at least 50 percent of its bonus payments when its bids were submitted. Despite the first-blush appeal of defendant's argument, it cannot withstand meaningful analysis. As noted above, there was really no way in which the restrictive effect of the acreage limitation provision could have been accurately determined at the time ASARCO acquired its rights in the Indian lands. More important, however, is the fact that the likelihood of a substantial loss deduction resulting from ASARCO's activities is neither unusual in itself, nor dependent upon the construction of the limitation provision. The record contains uncontroverted testimony to the effect that ASARCO did not expect to retain, nor did it in fact retain, anywhere near 50 percent of the acreage which it explored.[9] Thus, by the very nature of its prospecting procedures, and

[8] The bid notice states in this respect: "* * * Acreage for which signatures cannot be obtained is excluded from the permit and the bonus bid reduced proportionately. * * * Should the Superintendent determine that the required signatures have been obtained, he shall within 30 days after return of the executed permit deposit to the credit of the signing landowner the bonus that remains in a proportion that the acreage they have signed for bears to the whole acreage signed for within the tract."

[9] As a general rule, ASARCO's exploration activities do not result in a 50 percent rate of retention in the lands explored.

allotment #92. Tract 2 encompassed all the lands designated in 41 allotments, 160 acres of tribal land, 40 acres in allotment #176, 80 acres in allotment #92, 200 acres in allotment #86, and 40 acres in allotment #41. Tract 3 encompassed all the lands designated in 42 allotments plus 80 acres in allotment #86 and 240 acres in allotment #41.

Each of the three contiguous tracts was composed of eight sections of land, was generally rectangular in shape, and contained approximately 5,120 acres. The eight sections which comprised Tract 2 were not perfect squares, hence, the northern boundary of the tract was not parallel to the southern boundary and the acreage in the tract was slightly greater (by 63 acres) than that in the other two tracts.

The lands in Tracts 1, 2, and 3 were a small part of an area covered by a preliminary reconnaissance-type air magnetic survey made by plaintiff prior to 1957, no part of the cost of which is involved in this case.

7. The Department of Interior's Notice of Competitive Sale provided, in pertinent part:

> Each permit grants an exclusive right to prospect for minerals other than oil and gas, with an option to lease.
>
> * * * Each tract will be bid on separately, and a separate permit will be drawn for each tract. * * * The allotted tracts are offered subject to the approval of the individual Indian owners. The tribal tract is offered subject to the approval of the tribal council.
>
> Permits will be sold to the qualified bidder who offers the highest money bonus for the tract. * * *
>
> * * * * *
>
> The successful bidder is required to obtain the signature of the Indian permitters. Acreage for which signatures cannot be obtained is excluded from the permit and the bonus bid reduced proportionately. If after showing the exercise of reasonable diligence and that he is unable to obtain the signatures of the landowners for at least 80 percent of one block of 2,560 acres lying anywhere within the tract, the successful bidder may withdraw his bid and recover any moneys paid to the superintendent incident to the bid except the bidder's proportionate share of the cost of advertising. The superintendent shall hold in a special fund any bonus paid by the successful bidder. Should the superintendent de-

fund for 1959. Upon this disallowance, timely suit was brought in this court.

4. The percentage depletion deduction issue and the legal expense deduction issue have been settled administratively. During this proceeding, defendant has increased the amount of the disallowed loss deduction to $888,583.60 and has reduced the amount refunded to plaintiff under the depletion issue settlement by the resulting increase in tax and interest.

5. Prior to 1957, ASARCO had located a porphyry copper deposit in an area known as the Mission Mine, which lay south of what later became known as Tracts 1, 2, and 3 of the San Xavier Indian Reservation. ASARCO's exploration activities conducted in the Mission Mine area suggested a pattern of mineralization extending from the Mission Mine northerly and northwesterly into Tract 2. In addition, one outcrop in the southwestern corner of Tract 1 and two small outcrops in the west-central part of Tract 1 were identified as having characteristics common to areas located near low-grade disseminated copper deposits. At this time, plaintiff considered it possible that the southern area in Tract 2 and the two outcrops in the west-central part of Tract 1 were connected and might represent a single copper zone or that the gap between them was ore-bearing. An outcrop in Tract 3 was also located.

6. In April 1957, the United States Department of the Interior, Papago Indian Agency, publicly solicited bids for the competitive sale of exclusive prospecting permits with options to lease lands designated in 142 individually owned allotments and 160 acres of tribal land located in San Xavier Papago Indian Reservation in Pima County, Arizona. For purposes of bidding and leasing, the Department of Interior divided such land into the three tracts mentioned above. The lands described as Tracts 1, 2, and 3 by trust patent had been allotted by the United States to individual Indians under the General Allotment Act of February 8, 1887, 24 Stat. 388 (25 U.S.C. Section 331, *et. seq.*). Under 25 U.S.C., Section 396, the allottee (or his devisees or heirs) could lease the land designated in his allotment for mining purposes for any term of years as may be deemed advisable by the Secretary of Interior. Tract 1 encompassed all the lands designated in 55 allotments plus 40 acres in allotment #176 and 160 acres in

wholly apart from any acreage lease limitation, ASARCO could reasonably have anticipated a loss deduction that might well exceed 50 percent of its bonus payments.

Finally, the method of bonus allocation urged by defendant is erroneous because it contravenes fundamental principles of income tax law. Under defendant's method, ASARCO's basis in each separate property clearly would not be its cost as required by section 1012. To the contrary, adoption of the Government's theory would mean that the bonuses paid with respect to relinquished properties must be capitalized against retained properties to the end that ASARCO acquired no basis whatever in the relinquished properties and instead had an artificially constructed basis in the retained properties. The net effect is an unauthorized shift of basis from one property to another. Clearly, this would be improper. See, for example, *William H. Krahl*, 9 T.C. 862 (1947). Consequently, the method of allocation utilized by plaintiff, whereby it acquired a basis in each separate property measured by the bonus payment received by the particular Indian landowner, was the proper method.

The Exploration Cost Issue

ASARCO spent $79,388.83 to survey, map, and conduct a geophysical examination of the three tracts, and claimed as a deductible loss $61,580.49 of the amount expended. The allocation of the costs for these items was made by taking the total outlay for each tract and dividing it by the number of acres in the tract to obtain a per acre rate. The number of acres not leased in each tract was then multiplied by such per acre rate. In addition, ASARCO spent $481,268.65 in direct and indirect drilling activities on the three tracts, and claimed as a deductible loss $59,024.48 of this amount. The allocation of the costs for direct drilling was made on the basis of whether or not the holes were drilled on land later leased. The allocation of the costs for indirect drilling was determined by allocating that expense between lands leased and lands not leased in the same ratio as direct drilling expense. Plaintiff contends that the exploration costs it incurred in connection with each of the properties relinquished in 1959 were properly capitalized against each of such prop-

erties, respectively, and are deductible as part of its loss. The Government takes the position that the exploration costs incurred by ASARCO were capital outlays which are nondeductible without regard to the number of separate property interests acquired by it. Again, in my opinion, the Government's position is not well taken.

It is settled, and there is no dispute here, that exploration costs are capital expenditures and are not deductible as business expenses. *Louisiana Land and Exploration Co.*, 7 T.C. 507 (1946), affirmed on other issues, 161 F. 2d 842 (5th Cir., 1947). There is disagreement, however, as to the property against which plaintiff's exploration costs should be capitalized and, consequently, as to the timing of any loss deduction attributable thereto. Implicit in the position taken by defendant is that reliance upon the theory that ASARCO acquired a single property interest in the Indian lands is not necessary to a denial of a loss deduction for these costs. Instead, defendant relies upon I.T. 4006, 1950-1 C.B. 48, wherein the Internal Revenue Service ruled that, "[I]f property is *acquired or retained on the basis of data obtained from exploration*, costs of exploration attributable to that property should be capitalized as part of the cost of such property." [10] (Emphasis supplied.) Plaintiff argues that I.T. 4006 expressly allows the disputed loss deduction and, in any event, to the extent that it disallows such deduction the ruling is invalid as it unduly authorizes a shift in basis from abandoned property to retained property. It is unnecessary to discuss plaintiff's argument for recovery based on the invalidity of the ruling because its initial argument is dispositive. I.T. 4006 expressly allows the disputed loss deduction.

By way of elaboration upon the general rule of I.T. 4006 mentioned above, the ruling states in parts pertinent to this suit:

> * * * If two or more areas of interest are located or identified within the original project area, the entire cost of the reconnaissance-type survey must be allocated equally among the various areas of interest. Depending

[10] It should be noted that defendant's paraphrase of the Service's ruling is incomplete; the phrase critical to the relationship between the exploration activities and the property retained (as italicized above) is not mentioned.

ular land surface and the subsurface minerals attributable thereto. The evidence clearly shows that a closed and completed transaction took place when ASARCO relinquished its rights in acreage having a readily allocable basis. No future benefit could be realized by ASARCO from the relinquished land or from any subsurface minerals attributable thereto. *Cf. Henley* v. *United States*, *supra*. Accordingly, it is concluded that plaintiff sustained a tax-recognizable loss upon its relinquishment of all rights in parts of five individual allotments, and the amount of such loss was properly allocated and deducted by plaintiff under section 165.

On the basis of the above opinion, ASARCO is entitled to recover with the amount of recovery to be determined pursuant to Rule 47(c).

FINDINGS OF FACT

1. American Smelting and Refining Company—Consolidated (hereinafter referred to either as "ASARCO" or "plaintiff") is a New Jersey corporation with its principal office at 120 Broadway, New York, New York. ASARCO's principal business is exploring for and mining, smelting, refining and selling copper, silver, lead, zinc, and other minerals.

2. Plaintiff and its affiliated companies filed a consolidated Federal income tax return on the accrual basis for the calendar year 1959 and timely paid the tax shown thereon (less two credits) in the amount of $7,626,396.45. Thereafter, the Commissioner of Internal Revenue assessed a deficiency against plaintiff in the amount of $1,137,835.44 for 1959, which amount (plus $321,773.63 interest thereon) plaintiff paid on or about December 2, 1964.

3. Plaintiff timely filed a claim for refund in the amount of $680,513.67 for 1959 and asserted therein that the Commissioner of Internal Revenue erroneously disallowed:

> (a) A loss deduction in the amount of $843,459.72;
> (b) A percentage depletion deduction in the amount of $194,363.69; and
> (c) A legal expense deduction in the amount of $6,543.29.

The Commissioner of Internal Revenue, by statutory notice dated October 26, 1965, disallowed plaintiff's claim for re-

> nized this rule by allowing a part of the loss. [Citations omitted] A lump sum purchase price should be allocated to the several leases for the purpose, *inter alia*, of computing loss upon termination of a lease, unless such allocation is wholly impracticable. [Citations omitted] Here, a definite part of the 1914 cost of all of the leases is easily and properly identified as a part of the cost of the Pettit lease.

To the same effect, see *L. B. Maytag*, 32 T.C. 270, 277–278 (1959).

Defendant correctly points out that, in the case of oil and gas leases, the abandonment of a portion of the leased property, such as abandonment of an individual oil well, does not give rise to a loss deduction. See *Witherspoon Oil Co.*, 34 B.T.A. 1130 (1936) and *Frank Lyons*, 10 T.C. 634 (1948). The rationale underlying this rule is discussed in *Driscoll* v. *Commissioner*, 147 F. 2d 493 (5th Cir., 1945), wherein the issue involved was the application of the bonus restoration rule to a partially abandoned oil and gas lease. In deciding that the bonus restoration rule was applicable only upon the abandonment or termination of the entire lease, the court stated at page 495:

> Depletion of oil and gas should not be measured on the acreage basis, for it is possible for one well on a small fraction of one acre to deplete gas and oil on many surrounding acres. * * *
>
> Depletion, synthetic or real, is not measured on an acreage basis, nor can it be said that the grant of mineral rights has expired, terminated, or been abandoned so long as the privilege or lease exists and activity under such grant looking to production may reasonably be expected.

Because of the migratory characteristics of oil and gas, and the obvious impossibility of any meaningful allocation of basis between acreage retained and acreage relinquished, it is reasonable that tax consequences should await final termination of the entire property interest. Until such time there is no closed and completed transaction.

The facts in this case, however, present a situation easily distinguishable from that involved in the typical oil and gas arrangement. Here, with hard minerals involved, there is no potential disparity in the relationship between a partic-

> upon the final disposition of the area of interest to which it is allocated, each allocated part of the cost of the reconnaissance-type survey will be treated as a capital expenditure under section 24(a)(2) of the Internal Revenue Code or as a loss under section 23 (e) or (f) of the Code. If, from the data obtained by the reconnaissance-type survey, no areas of interest are located or identified within an original project area, the entire cost of the reconnaissance-type survey may be deducted as a loss under section 23 (e) or (f) of the Code for the year of abandonment of that particular project.
>
> Where a detailed (intensive) survey is conducted with respect to a particular area of interest, if a property is acquired or retained within or adjacent to that area on the basis of the data so obtained, the entire cost of that detailed survey plus that portion of the cost of the previous reconnaissance-type survey allocated to such area must be capitalized as a part of the cost of the property so acquired or retained. Where more than one property is so acquired or retained within or adjacent to an area of interest, it is proper to allocate, on an acreage basis, the entire cost of the detailed survey plus that portion of the cost of the previous reconnaissance-type survey allocated to such area among the properties so acquired or retained. * * * At 50.

The record in this suit clearly reveals that ASARCO's activities were of the type encompassed by the above-quoted language. The lands in Tracts 1, 2, and 3 were a small part of an area covered by a preliminary reconnaissance-type air magnetic survey made by plaintiff prior to 1957. As previously mentioned, eight areas of interest were located on the acreage contained in the three tracts. Four of these areas of interest were located by ASARCO prior to the placing of its bids in 1957. The remaining four were identified from geophysical data derived from the exploration work carried out in 1957. Of the eight areas of interest, all but two were eliminated by drilling. Of the six areas thus eliminated by drilling, four areas had been identified initially through geophysical data and were located on acreage in which ASARCO subsequently relinquished its interests in 1959.

The two ore deposits that were found on the acreage leased by plaintiff were in vicinities where, prior to any exploration in 1957–1959, plaintiff had already decided to do exploratory drilling, and these deposits were located by early drill holes

339-802—69——3

in September and October 1957. The lateral extent of each of the two ore deposits on the acreage subsequently leased by ASARCO was delineated by drill holes on such acreage only. The data derived from drilling on the lands in which ASARCO subsequently relinquished its interests, in combination with the geophysical surveys previously performed, indicated that such lands did not warrant further exploration or leasing.

In short, the evidence strongly supports the conclusion that the geological and geophysical information obtained from exploration of the acreage in which ASARCO relinquished its interests in 1959 did not contribute to the discovery of ore deposits on the acreage which ASARCO actually leased, nor did such information constitute the basis upon which such acreage was leased. Consequently, the exploration costs plaintiff incurred in connection with each of the properties relinquished in 1959 were properly capitalized against each of such properties, respectively, and are deductible as a loss under the principles enunciated in I.T. 4006, *supra*.

The Split Allotment Issue

ASARCO leased only part of the lands designated in five individual allotments. The part of the bonus payments allocated by plaintiff to acreage not leased in these allotments was $32,229.11. In addition, with respect to such unleased acreage, plaintiff incurred $5,625.87 of direct drilling expense, and allocated $2,206.88 of indirect drilling expense and $3,020.09 of other costs. The total, $43,081.95, constituted part of the $888,583.60 loss deduction claimed by ASARCO on the theory that it is entitled to such deduction under section 165 because all its rights in specific portions of these five allotments were completely relinquished in 1959. The Government responds that ASARCO's position in this respect is completely inconsistent with its main argument that each of the 143 allotments constituted a separate property in each of which ASARCO acquired a mineral interest. Now, says the Government, ASARCO goes one step further by taking a position which, if accepted, would be tantamount to treating plaintiff's investment *in each acre* of land as a separate investment.

The Government's charge of inconsistency is not justified. There is nothing novel in ASARCO's argument that a taxpayer

may realize gain or sustain loss upon a disposition of only part of his property. See, for example, Treas. Reg. § 1.61–6(a) which provides, *inter alia:*

> When a part of a larger property is sold, the cost or other basis of the entire property shall be equitably apportioned among the several parts and the gain realized or loss sustained on the part of the entire property sold is the difference between the selling price and the cost or other basis allocated to such part.

With respect to the issue under consideration, the record shows that plaintiff relinquished all its right, title, and interest in specific acreage contained in the five allotments. It has already been decided, moreover, that ASARCO's basis in each allotment is allocable to acreage therein in equal amounts. Consequently, the conclusion that ASARCO sustained a tax-recognizable loss as to the relinquished acreage in the five allotments is not inconsistent with its position that the Indian lands comprised 143 separate properties. It may be that defendant has been led to charge inconsistency because of its erroneous characterization of the transaction as merely a reduction in value of property, whereas it was, in fact, a total relinquishment of rights in property constituting a closed and completed transaction. See, *United States* v. *White Dental Co.*, 274 U.S. 398, 401 (1927). *Cf. Henley* v. *United States*, 184 Ct. Cl. 315, 396 F. 2d 956 (1968).

Irrespective of whether ASARCO's investment in the relinquished acreage was lost, defendant asserts that the unrecovered cost of a partially abandoned property interest is not deductible until the rights in all of the land comprising the interest are terminated. The cases relied upon by defendant for this proposition, however, do not support it. In *Oliver Iron Mining Co.*, 13 T.C. 416 (1949), for example, the question presented was whether the taxpayer sustained a tax-recognizable loss upon the termination of only one of several leases all acquired in one transaction at the same time for a lump sum price. The Tax Court held that the unrecovered cost of the one lease was deductible when the lease was terminated, saying at 13 T.C. 418:

> The unrecovered cost of a lease is deductible as a loss when a lease is terminated under circumstances similar to those here present, and the Commissioner has recog-

MR. JOHN KINNISON

Dear John -
With warm appreciation - the attached opinion should make you feel very happy!
Regards,
Bob Richter

AMERICAN SMELTING AND REFINING COMPANY

COMPTROLLER'S DEPARTMENT - TAX SECTION

A-6-59
New York, N.Y.
April 29, 1969

U.S. Court of Claims -
San Xavier Indian Lands

MEMORANDUM TO MR. H. Q. STRINGHAM

You will find attached a copy of the report of Commissioner Fletcher to the U.S. Court of Claims concerning Asarco's claim for refund in connection with the deduction in its 1959 Federal income tax return of approximately $888,000 with respect to the San Xavier Indian allotments on which the Company did not take a lease.

Commissioner Fletcher divided the case into 4 separate issues as follows:

1) The Separate Property Issue.

2) The Bonus Allocation Issue.

3) The Exploration Cost Issue.

4) The Split Allotment Issue.

Commissioner Fletcher rendered an opinion favorable to the Company on all 4 issues and the entire amount in dispute was held to be deductible by Asarco .

Mr. Fred Peel who is our attorney in this matter has advised that the Government has 15 days to request review of Commissioner Fletcher's findings by the 5 judges on the U.S. Court of Claims. Mr. Peel feels that the Government will do this but that the judges will support Commissioner Fletcher's findings because they respect him as a sound tax man.

If, as expected, the judges of the U.S. Court of Claims uphold Commissioner Fletcher's opinion, the Government will then have 90 days from the time the Court of Claims has entered its judgment to file for a Writ of Certiorari to the U.S. Supreme Court.

It is, of course, to be fervently hoped that this decision will be final. We would be remiss in thoughtfulness if we did not mention the invaluable assistance given in this case by Mr. T. A. Snedden and Mr. John E. Kinnison who testified on

the Company's behalf during 2 days of trial about a year ago. Mr. Peel and his associate Mr. Clarence T. Kipps, Jr. of Miller and Chevalier, our attorneys, have also done a splendid job.

R.R.

ROBERT RICHTER

RR;jw
cc: CFBarber
FGHamrick
CFPollock
CENelson
AJGillespie, Jr.
TASnedden
JEKinnison

copy

Jt. Ex. 17(b)

IN THE
UNITED STATES DEPARTMENT OF THE INTERIOR
BUREAU OF INDIAN AFFAIRS

In the Matter of AMERICAN SMELTING AND REFINING COMPANY, a corporation, Applicant	APPLICATION FOR A PERMIT TO PROSPECT FOR MINERALS WITH PREFERENCE RIGHT TO LEASE

TO: Mr. Harry W. Gilmore, Superintendent, and
The Papago Tribal Council,
Sells, County of Pima, State of Arizona.

American Smelting and Refining Company, a corporation, hereby respectfully makes application to the Superintendent and Tribal authorities for a two year permit to prospect for minerals with a preference right to a mining lease or leases upon the following lands situate within the San Xavier Indian Reservation, Pima County, Arizona, to-wit:

Sections 10, 11, 12, 13, 14, 15, 22, 23, 24, 25, 26 and 27 in Township 16 South, Range 12 East; and — all Tr 1

Sections 18, 19 and 30 in Township 16 South, Range 13 East. — part Tr 2

Applicant represents that it is a corporation duly organized and existing under and by virtue of the laws of the State of New Jersey, and for many years last past has been, and now is, duly licensed and qualified to transact business within the State of Arizona, and in support thereof, files herewith:

1. A certified copy of its Articles of Incorporation;

2. A Certificate from the Arizona Corporation Commission showing that it is duly authorized to transact business in the State of Arizona as a foreign corporation;

3. A financial statement; and

4. A Certificate of authority of its officers executing this application.

JE 19(b)

Applicant further represents that for some time past it has been, and now is, engaged in the development of an open pit mining project in lands immediately south of and adjoining the San Xavier Reservation, and contemplates, by this application, an extensive and comprehensive prospecting and development program within the lands above described situate within the reservation.

Applicant further represents that if the prospecting permit is granted to the company, carrying an option to enter into a mining lease or leases upon said lands or portions thereof, a substantial exploration program will be undertaken immediately by it and diligently prosecuted in efforts to find ore bodies containing copper and other metals. This program will involve and include the following exploration procedures to be conducted and carried on by the company's staff of geologists, engineers and geophysicists, including:

1. A geological survey;

2. Geophysical surveys, using a variety of techniques; and

3. Prospect drilling of a considerable number of diamond and churn drill holes drilled to test rock formations at depth.

In the event this exploration is successful, mine development and ore production will follow.

Reference is hereby made to an Application on file herein dated July 2, 1955, to Mr. Albert L. Hawley, Superintendent, for a mineral prospecting permit, signed by Ben C. Hill, attorney for applicant, and a Supplemental Application thereto of December 16, 1955, to the Superintendent of Sells Indian Agency, for additional lands, signed by Ben C. Hill, attorney for the company.

IN WITNESS WHEREOF, applicant has caused its corporation name to be hereunto subscribed and its corporate seal to be hereunto affixed and attested by its duly authorized officers this 28th day of May, 1956.

AMERICAN SMELTING AND REFINING COMPANY,
By Adin A. Brown
Vice President

Seal

ATTEST:
Harold Howe
Secretary

Ben C. Hill
Its Attorney
216 North Main
Tucson, Arizona

(1)

AMERICAN SMELTING AND REFINING COMPANY
MINING DEPARTMENT
120 BROADWAY, NEW YORK 5

L. H. HART
CHIEF GEOLOGIST

March 30, 1956

8378

Mr. H. F. Larkin, Minerals Officer
Bureau of Indian Affairs
General Services Building - Room 4349
Washington, D. C.

Dear Mr. Larkin:

Mr. C. J. Williamson called yesterday and reported that he had talked with you relative to leasing mineral rights upon a part of the San Xavier Reservation, which I believe is under the Papago Tribal Council in southwest Arizona.

As you may know, our Company is active in the exploration and development of metal mines and we are now engaged in testing an area south of the south boundary of the San Xavier Reservation. For your information, this particular work is being done upon property, part of which we hold under lease from the State of Arizona, and another part which we hold by lode mining locations on the public domain. Also, it may be useful for you to know that we are operating the Silver Bell Copper Mine, which is about 20 miles northwest of the San Xavier Reservation.

In the course of our work in this general area, we have decided that we would like to thoroughly investigate a portion of the San Xavier Reservation, if arrangements may be completed making this possible. We would start our work by conducting a careful geological survey of the leased area, after which we would undertake diamond or churn drilling, if sufficient, favorable indications are disclosed. Such exploration and drilling would probably require a period of two or more years, depending upon the size and extent of any mineral zones which might be found. Following this, we would wish to undertake production upon any commercial ores proven and for this purpose, a lease would be necessary extending over a period of perhaps 20 years, renewable for one or more 20-year periods (providing we continue to be actively engaged in production from the leased property).

We have filed an application for such a lease to apply to 25 sections in the San Xavier Reservation, described as follows:

File Ref.
247-56

JE 14

Mr. H. F. Larkin, Minerals Officer
Bureau of Indian Affairs
Washington, D. C.

March 30, 1956

NE of Sec 1 & unsurveyed W½

Township 16 South - Range 12 East
Sections: 1 to 4 inclusive
9 "16 "
21 "28 "

1 section tier N & W sides of Tr 1 plus all Tr 1

Township 16 South - Range 13 East
Sections: 6, 7, 18, 19, 29 and 30.

Part Tr 2

It is my understanding that ownership to this land was assigned to individuals around the year 1890. Since there has been no active development upon these individual holdings, it is my belief that the entire area is now used by the Tribal Council itself for grazing purposes. We are advised that since these lands are now being used for the common good of the Tribal Council, an effort will be made to have these individual holdings re-assigned to the tribe and I believe the feeling is that this may be accomplished. I am also advised that the mineral rights within this Reservation were granted to the tribe only about a year ago. Whether or not this has any bearing on mineral rights reverting to the former individual owners, is a legal question which I cannot answer.

I think that I have answered the particular questions which Mr. Williamson indicated you had outlined to him, but if there is any additional information which I can provide, I will be very pleased to do so. Also, if anything could be gained in a direct meeting, discussing this problem, I will be glad to make any arrangements convenient to you.

Very truly yours,

L. H. HART

41704 allotted

Not entered as evidence by defendant.

APR 13 '66

AMERICAN SMELTING AND REFINING COMPANY

ASARCO

UNITED STATES MINING DEPARTMENT

P. O. BOX 5795, TUCSON, ARIZONA 85703

April 11, 1966

C. E. N. APR 13 1966

J. G. P. APR 13 1966

MINING DEPT.
U.S. MAIL NOTED
CEN
HMD
JGP
LMJ
TAS
TAW
CPP
KR

T. A. SNEDDEN
GENERAL MANAGER

1150 NORTH 7TH AVENUE
TELEPHONE 602-792-3010

Mr. C. E. Nelson, Vice President
Asarco - New York Office

San Xavier North Ore Body
Evaluation - Royalties

Dear Mr. Nelson:

Attached is a copy of an evaluation sheet and concentrate liquidation sheets showing the net smelter return on the 0.40 cut-off grade and the return on 0.30 cut-off grade for the San Xavier North ore body.

The following tabulation shows the operating cost and outcome on both cut-off grades.

	0.40 Cu Cut-off Grade	0.30 Cu Cut-off Grade
Mining Ore	$0.240	$0.240
Mining Waste (3.27 x 22/20)	.654	0.486 (2.43 x 22/20)
Mining Indirect	.235	.134
Milling	.600	.600
Milling Indirect	.220	.220
Operating Cost		$1.68
Net smelter return per ton ore		$2.97
Less royalty		.30
Less operating cost		1.68
Net Operating Return per ton		$
Total Tonnage Ore	30,412,000	51,033,000
Gross Royalty	$10,644,200	$15,309,900
Gross Operating Return	$36,190,000	$50,523,000

According to Keith Whiting's memo of August 18, 1964 to Pollock, the Colville Indian Agency in Okanogan County, Washington approved a sliding-scale royalty that would have applied 4 1/2 and 5 percent royalty, respectively, to the above net smelter returns.

The final ore reserve calculations may slightly modify the grade and tonnage figures for this ore body. The above tabulation is sufficiently accurate to formulate royalty proposals. I believe we should proceed at an early date on negotiations with the Indians for additional land for waste disposal, relocation of roads, unitization of Tracts 1 and 2 and on revised royalties.

Very truly yours,

T. A. Snedden

T. A. Snedden
General Manager

TAS:dh
Attachment (Please attach attachments from March 25, 1966 letter.)

cc: CFBarber
RBMeen

J. E. K.

New York, February 18, 1957

APR 01 1968

See Pg 4 New Xavier

CONFIDENTIAL

Memorandum for: Mr. D. J. Pope

THE EAST PIMA PROJECT AND ITS RELATION TO GENERAL PIMA DISTRICT ACTIVITIES

The following notes pertain to the East Pima ore resources, generally, in relation to neighboring properties. The study includes general notes on ore resource possibilities for East Pima, Pima Mining Company, Banner Mining Company and possible extensions into the San Xavier Reservation. While "possible" tonnages set out are not estimates, they are based on strong indications and are considered reasonable assumptions. Each of these groups is considered separately.

I. East Pima Project

A. High Grade-

Drilling in the east portion of the East Pima ore area has disclosed high-grade copper intercepts in 15 of 24 holes completed. These high-grade intercepts average 50.2 feet thick and 3.1% copper. Assuming 12-1/2 cubic feet per ton of ore, one square foot of area contains four tons of ore. The high-grade area is roughly 1,500 feet square, but this total area is discounted 60% in accordance with the ratio of high-grade holes to total holes drilled. Thus, within the discounted area, 5,400,000 tons of 3.1% ore is indicated.

The "high-grade" area is open to the south across its full width of 1,500 feet and it is approximately 1,500 feet from this boundary, southerly, to DH 114, in which an important ore column was disclosed. Thus, there is reason to believe that much additional tonnage of high-grade ore will be found in this extension area, and for purposes of general appraisal, an assumption of 2,000,000 tons of possible ore is proposed for this area.

Northwesterly from the "high-grade" area, three high-grade holes have been drilled in a distance of 1,600 feet from its north boundary to DDH 105. There is some evidence that the ore zone is narrowing in this direction. Nevertheless, having three ore holes, it is conservative to assume 2,000,000 tons of possible ore within this area.

In summary these units are:

Indicated Ore	Possible Extension Ore (Southeasterly)	Possible Extension Ore (Northwesterly)
5,400,000 tons -3.1%	2,000,000 tons - 3.1%	2,000,000 tons - 3.1%

Thus, perhaps more than 10,000,000 tons of 3%+ copper ore may be developed within Section 31, which is held by Federal lode locations, owned by or optioned to American Smelting and Refining Company.

(Possible High Grade Mining Program)

If above assumptions are confirmed, underground mining could produce 2,000 tons per day from the zone described above, for at least 14 years, using trackless haulage and either conventional room and pillar, or benching mining methods. Since most of this area appears to be workable by open pit mining, the high-grade intercepts could be extracted with associated lower grade ore to yield maximum metal recovery with the most flexible grade control, and presumably with the lowest pound cost available by any mining method. Therefore, it is preferable to consider the high-grade ore as a part of the very much greater total open-pit reserve (possibly 30,000,000 - 40,000,000 tons of 1.0%+ within the area under consideration). Perhaps the only condition supporting underground mining in preference to open pit methods, would be the possible short-term advantage of a lower initial capital outlay.

B. Low-Grade - Open Pit Ore-

1. Main Zone: Under date of January 9, 1957, Mr. K. E. Richard submitted a general ore reserve estimate for the East Pima project as follows: 84.8 million tons 0.84% copper with a stripping ratio of 2.87:1.

2. Easterly Extension: It was noted above that possibly 30,000,000 tons of 1% ore will be developed east of the zone included in Mr. Richard's estimate.

(a) Southeasterly Extension on East Zone. This was briefly mentioned above and an estimate of 2,000,000 tons of possible high-grade ore was suggested. The ore column in DDH 114 is sufficient to produce 1,000,000 tons per acre, if all ore with greater than .65% copper is mined. However, this ore intercept is too deep to support open pit mining, although this may be a local condition. Further extensions southeasterly may exist and since we hold lode locations in this area, we must complete discovery holes to permit us to protect all mineral rights there. This will require expanding our drilling program considerably, but it is important to note that we are definitely vulnerable until we have completed this discovery work. Inasmuch as even deep discovery holes would cost no more than $10,000. each, it is apparent that the gamble is small in terms of the potential, as each full claim could contain millions of tons of ore. For purposes of general appraisal, this southeasterly extension area is assumed to contain 20,000,000 tons of possible ore which is classified as "open pit ore" although final information may require reclassifying part of this to "underground ore".

(b) Northwesterly Extension on East Zone. Although there are three holes presently within this general area, extending up to the San Xavier Indian Reservation, all of which contain commercial open pit ore, the area is too large to utilize these holes for more than a general indication. On this basis possible ore of 20,000,000 tons of 1% grade seems to be a reasonable expectation.

3. West Area: It is recalled that in DDH 42, at the westerly end of the Asarco property in State No. 1 Claim, an intercept of 57 feet assays 3.19% copper. Other holes in that vicinity contain good grade intercepts and it is quite probable that a substantial tonnage of ore, minable by underground methods, or a much larger tonnage of deep, open pit ore may be developed there. Much additional drilling will be required in the Jo-Jo 2, 3 and State 1 claims before this resource may be accurately appraised. By comparison, the high-grade ore zone described along the east end of the property exhibits a strong northwesterly trend and a similar trend is noted within the main pit area. Thus, it is possible that a parallel northwesterly trend may occur in this west area and if so, it is important to complete additional drilling in the near future, particularly on the Jo-Jo No. 2 Claim, since the Pima Mining Company has notified us of its intention to resume waste dumping there within the next few days. If open pit ore exists in this locality, we should know about it and attempt to negotiate some other arrangements for dumping. The potential of this area within Asarco property could easily exceed 25 million tons of pit ore.

Summarizing the above, within Asarco-held ground, there may be as much as 180,000,000 tons of ore, recoverable largely, if not entirely, by open pit methods. In addition to this, there is reason to anticipate underground ore which occurs in sections too deep to mine by open pit methods.

C. Deep (Underground) Ore-

(a) Southwest Main Zone. Mr. Richard did not include ore known to extend westerly beyond the line shown on his January 9 estimate. Westerly and southerly from the main pit area, the ore becomes very deep and it is not now known whether much or any of this will be recoverable by open pit methods. Nevertheless, it is quite likely that a portion will be recoverable by underground mining and arbitrary credit of 20,000,000 tons is proposed as possible under this classification.

(b) A similar situation is known to exist southeast of the easterly extension zone described above in DDH 114. An ore column capable of producing 1,000,000 tons per acre has been proven, but at depths far below probable open pit limits. With only one hole with which to base appraisal of this area, an arbitrary figure of 20,00,000 tons is considered possible. As will be noted below, the

results of drilling by the Pima Mining Company within its holdings west of DDH 114, lends some support to the general potential of this area.

(c) To date we have done nothing to investigate the full vertical section in the East Pima area. We have extended a few holes well into a basal limestone member, which is nearly barren. However, we do not know the thickness of this horizon, nor what formations lie below. It is reasonable to assume that for the most part, the source of mineralization is below the areas now known to be mineralized. Therefore, until we have extended one or two exploratory holes to a considerable depth below the lowest points tested to date, we will not be able to appraise this possibility. Certainly, however, it represents a promising long range possibility. It may be desirable to defer testing until it may be done from the bottom of some of the deeper pit openings. There are reasons which support completing preliminary deep testing now since the information would give us a better idea of the real potential of this project. This might be especially important bearing upon evaluation of surrounding property, for which we may wish to negotiate.

Combining all of the above, there is indicated a possible resource of more than 200,000,000 tons within the East Pima property.

II. Possible Tributary Reserves Within Pima District

A. San Xavier-

The northwesterly trend of the high-grade east ore zone projects into the Reservation, northwesterly, from our DDH 105. Since this drill hole contains one 89-foot intercept, averaging 2.58% copper, it is reasonable to anticipate at least some continuation of the high-grade zone into the Reservation, whose boundary is only 250 feet from this hole. Since this high-grade section makes 300,000 tons of ore per acre, it seems highly probable that at least 1,000,000 tons of equivalent grade (2.6% copper) will be found along the projected trend of the high-grade ore zone within the San Xavier Reservation. This projection is borne out further by the fact that the gravimetric anomaly continues to the Reservation boundary, on the north, and into Banner property on the west. On the basis of known projection of this anomaly, it is logical to assume a possible open pit resource of at least 5,000,000 tons, within the Reservation, at this point. On the basis of very preliminary geological interpretations, it appears that within the East Pima area there are three parallel mineral trends, the one just mentioned being the easternmost of these. The next westerly one enters Banner property from our main ore zone and it is possible that some portion of this will continue across Banner ground 1,200 feet into the Reservation. The

third and most westerly zone is disclosed in DDH 42, 50 and 73, and also in four holes completed by Banner. This area is approximately 1,700 feet from the Reservation boundary, but it is possible that some extension may continue into the Reservation. It might be assumed that each of these zones contains 5,000,000 tons of possible pit ore within the Reservation, or 15,000,000 tons, combined.

Other elements suggest probable mineralization within the Reservation. The most significant of these is the presence of live limonite-bearing outcrops, at a point 1-1/2 to 2 miles northwest of the boundary. A magnetic low which suggests a granite stock is about one mile west of this point, and exploration in this area is very promising.

B. Ore Possibilities in Banner Ground-

Extensions of ore known in the East Pima property into Banner ground occur as follows:

1. West of DDH 42. This area was described in the preceding paragraph. Without access to additional Banner drill results, we can only assume that important ore reserves will be proven in this area and 10,000,000 tons is proposed as possible.

2. North of DDH 77, 101, 94 and 102, Banner drilled six holes which incompletely defines possible ore here. In his letter of January 9, Mr. Richard estimated 9,500,000 tons of 0.61% copper in this area. Limits are obviously unknown, but 10,000,000 tons of open pit ore is assumed.

3. DDH 105, 200 feet east of Banner contains 89 feet averaging 2.56% copper, 42 feet of 1%, and 20 feet of 1.14%. This represents 300,000 tons of ore per acre. It is almost certain that this ore shoot will extend into Banner's Rhoda Claim. It is assumed that 3,000,000 tons may be possible in Banner ground.

Thus, approximately 25,000,000 tons of ore, all representing continuations of our East Pima ore zones, may exist in Banner ground. Also, the Pima ore body continues into Banner and it is assumed that 4,500,000 tons of 2% ore is available there. This might be considered to represent the equivalent of approximately 10,000,000 tons of 1% material, giving the possible Banner Mining Company resource (excluding the Mineral Hill operation in the western part of its property) a total of nearly 35,000,000 tons, of which more than 20,000,000 tons is considered probable open pit ore.

C. Pima Mining Company-

According to published reserve estimates, the Pima Mining Company has available, 9,000,000 tons of open pit ore averaging 2% copper, which it is now mining and delivering to its 3,000-ton-per-

day milling plant. Much additional drilling has been done east and north of this zone and there is every reason to believe that a very much larger tonnage of slightly under 1% material has been indicated. From the results which we have obtained along the south edge of our main ore body, it is not unlikely that our pit may merge with the expanded Pima pit. At this time, it is impossible to assign any accurate tonnage estimate to this resource, but for purposes of this review, an assumption of 25,000,000 tons of -1% copper ore is considered possible. Combining this with the published reserves (9,000,000 tons of 2% converted to an equivalent of 1%) the total Pima Mining Company resource would then become 43,000,000 tons.

Summary of Pima District Ore Resource
(Including: Proven, Probable, and Possible Ore)

	Open Pit Ore	Underground Ore
East Pima	180,000,000 tons	40,000,000 tons
Banner	20,000,000 "	15,000,000 "
San Xavier	15,000,000 "	?
Pima	43,000,000 "	?
	258,000,000 "	55,000,000 "

Combined Total - 313,000,000 tons

Regional Ore Possibilities

To date, we have failed to establish the probable source of mineralization producing the ore deposits of the Pima district. Widespread distribution of high-temperature minerals, diagnostic of a contact metamorphic environment, strongly suggests proximity of an intrusive body. Direct evidence of such a body has not yet been proven by drilling, but geophysics suggests a large blunt-nosed stock, southwesterly of the Pima Mine. Occasionally, margins of such stocks, especially those of constricted nature, may be important. Such a relationship provides the setting for Cuajone. The Pima district, from Mineral Hill through the East Pima property, may occupy a roof and border contact position in relation to a northeasterly constricted portion of an inferred stock. This could provide a favorable environment for widespread ore distribution, but in addition, other favorable outlayers may exist, such as that suggested by the magnetic low in Section 22, about a mile west of the well-mineralized outcrops known in Section 23 in the San Xavier Reservation. These magnetic anomalies were disclosed in the areal magnetometer survey completed under the direction of our Geophysical Department.

Thus, limits of the main Mineral Hill (Pima) ore area are still undetermined, but in addition, satellite mineral areas may occur nearby as noted in the San Xavier Reservation.

Problems Generated By Complex Ownership Relationships

The Ore Problem-

The possible ore potential of our East Pima holding, as indicated above, is complicated by the fact that ore bodies making up the reserve continue across East Pima property boundaries into neighboring ownerships, in four or more critical places. In fact, the main ore body extends across the common boundaries on the south, into Pima Mining Company property, and on the north, into Banner property. The westerly extension of the west ore body, and the northwesterly extension of the high-grade east ore body, extend into both Banner ground and the San Xavier Indian Reservation. Assuming that we could not trespass beyond any of these boundaries, in any case, the total ore reserve available to mining within the East Pima property would reduce our 180,000,000 ton resource by perhaps one third. If the ore bodies are worked by open pit mining to the East Pima vertical boundaries, then the area affected within the adjoining properties, would be as follows: (Also see attached plate)

Within Pima Mining Company ground:	a) Main Zone *	14.0 acres
	b) Southeast Zone **	16.3 "
" Banner ground:	a) West Zone	21.5 "
	b) Main "	47.4 "
	c) Northwest Zone	9.2 "
" San Xavier Res. ground:		17 "
	Total acres affected:	125.40

* (Main Zone) Probable Pima Mining Company area affected by maximum open pit operation extending to presently known southern ore boundaries, as ascertained by diamond and churn drilling in this area. (DDH's 55, 37, 117, 59, 123 and CDH's 1 and 5).

** (Southeast Zone) To compensate for surface slump in the event the area is mined by underground methods.

From these data it is evident that some working agreement with each of the three neighbors is necessary to permit orderly mining and accomplish a reasonably high recovery of East Pima reserves. It is also quite clear that an important tonnage of good grade ore will not be recoverable unless certain Reservation lands are available.

The Waste Problem-

East Pima with tributary Banner ore aggregating perhaps more than 200,000,000 tons, will produce 700,000,000 tons of waste, to be stored upon property controlled by Asarco. Pima Mining Company, with its tributary Banner ore, may require an additional 150,000,000 tons of storage capacity.

At present, Pima Mining Company controls dumping rights on surface which conflicts with East Pima mining. Presumably, it may be enjoined from continued use of this surface for dumping, but Asarco would be liable for full compensation for loss or extra costs sustained thereby.

Dumping by Pima Mining Company is actually in progress now and it is certain that part or perhaps most of this material must be rehandled by Asarco at some future date, or at a cost of not less than 10¢ a ton. If Pima Mining Company were to successfully demonstrate that it had intended to place all of its stripping waste on Sections 31 and 36, Asarco would be required to pay for its added cost in diverting waste to some other (presently unknown) place, even if the volume is only 100,000,000 tons (and it could be twice that) the cost to Asarco might be ten to twenty million dollars. It is not certain that any alternate disposal area is available at a cost differential of 10¢ a ton and therefore, an early solution to this problem is important.

Obviously, the Pima Mining Company waste disposal is only part of the problem since we must provide for storage of about four times as much waste from our own operations. To visualize the magnitude of this entire problem, one billion tons of waste piled to an average depth of 100 feet, would require approximately 4,000 acres.

Conclusions-

The East Pima property is one of major importance, but for Asarco to realize the maximum return from it, and tributary properties, long-range planning is necessary. It is evident that Pima Mining Company and Banner have been very active in setting up every possible block to our ready solution to our problems. The only way to combat this is to initiate a vigorous program to fully protect ourselves by acquiring sufficient property for all requirements.

1. Waste Disposal Area-

It appears that the Pima district will require storage area for up to one billion tons of waste. With an average thickness of 100 feet, 5,000 acres will be required for this purpose. By special means, a smaller area could accommodate the probable volume, but at added costs. With East Pima's unfavorable location and adverse rights by Pima Mining Company, it will become Asarco's obligation to handle all the district waste. The longer solution to this problem is deferred, the more costly it will become.

2. Working Agreements Affecting Sixty Million Tons Along our Property Boundaries-

Banner can dictate terms affecting our mining of perhaps 50,000,000 tons of ore. I believe the time has come for us to take the initiative and propose a working plan under which we will mine Banner ore. If we succeed in that, mining our ore will be incidental. If we fail, we may be forced to some arrangement providing that any ore mined by us in Banner ground, in the course of stripping for our own ore, would be delivered to Banner free. Under a mining agreement such Banner ore might become ours under a royalty or other settlement. The advantage to us could run to millions of dollars. Also, Banner has filed for mineral rights on much acreage which might be valuable to us for dumps. A mining agreement might unlock some of these areas.

3. Value of San Xavier Reservation in East Pima Plans -

Acquisition of Block 2 of the proposed Reservation lease would provide:

(a) Control of probable extension ore (DDH 105) and other possible ore.

(b) Possible waste storage area.

(c) Leverage in negotiating with Banner.

(d) Protection from a Pima-(or any other strong company) Banner gang-up which could cost East Pima millions of dollars.

Acquisition of Block 1 of the proposed Reservation lease would provide:

(a) A first-class exploration project based upon strong, known mineralization and a geophysical anomaly of great interest.

Att.

L. H. HART

SEC. 214. SPECIAL FUND FOR DISABILITY BENEFITS.—There is hereby created a fund which shall be known as the special fund for disability benefits to provide for the payment of disability benefits under sections 207 and 213 of this article.

1. For the purpose of accumulating funds for payment of benefits to the disabled unemployed, there is hereby assessed a contribution at the rate of two-tenths of 1 per centum of the wages paid during the period from January first, nineteen hundred fifty to June thirtieth, nineteen hundred fifty inclusive, to employees in the employment of covered employers on or after January first, nineteen hundred fifty, but not in excess of 12 cents per week as to each such employee, of which the employee shall contribute one-tenth of 1 per centum of his wages but not in excess of 6 cents per week, and the employer shall make an equal contribution. The contributions of the employee shall be deducted from his wages in the same manner as provided in section 209. * * *

Section 23(a)(1)(A) of the Internal Revenue Code provides in part that in computing net income there shall be allowed as deductions all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 23(c)(1) of the Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material.

It is held that the amounts deducted by the employer from the wages of employees, pursuant to the provisions of article 9 of the New York workmen's compensation law, do not constitute ordinary and necessary business expenses within the meaning of section 23(a)(1)(A) of the Internal Revenue Code, nor taxes within the meaning of section 23(c)(1) of the Code. Such contributions constitute personal expenses of the employees, and are not deductible in computing net income for Federal income tax purposes.

SECTION 29.24–1: Personal and family expenses.

INTERNAL REVENUE CODE

Uniforms and work clothing not specifically required as a condition of employment or which take the place of ordinary clothing. (See Mim. 6463, page 29.)

SECTION 29.24–2: Capital expenditures. (Also Section 23(e), Section 29.23(e)–1; Section 23(f), Section 29.23(f)–1.)

1950–8–1333
I. T. 400

INTERNAL REVENUE CODE

Geological and geophysical exploration costs constitute capital expenditures and are not deductible as business expenses under section 23(a)(1)(A) of the Internal Revenue Code. If a property is acquired or retained on the basis of geological and/or geophysical data obtained from an exploration project, the cost of the project should be capitalized as a part of the cost of the property acquired or retained. If no property is acquired or retained on the basis of such data, the cost of the project is deductible as a loss under section 23 (e) or (f) of the Code.

Advice is requested whether, for Federal income tax purposes geological and geophysical exploration costs constitute capital expenditures or ordinary and necessary business expenses.

It has been held that exploration costs are capital expenditures and are not deductible as business expenses under section 23(a)(1)(A)

of the Internal Revenue Code and corresponding provisions of prior revenue laws. (See *The Louisiana Land and Exploration Co.* v. *Commissioner*, 7 T. C. 507, affirmed on other issues, 161 Fed. (2d) 842; *Schermerhorn Oil Corporation et al.* v. *Commissioner*, 46 B. T. A. 151; *Rialto Mining Corporation* v. *Commissioner*, 25 B. T. A. 980; *G. E. Cotton* v. *Commissioner*, 25 B. T. A. 866; *Parker Gravel Co., Inc.*, v. *Commissioner*, 21 B. T. A. 51; *C. M. Nusbaum* v. *Commissioner*, 10 B. T. A. 664; and *Seletha O. Thompson* v. *Commissioner*, 9 B. T. A. 1342.) Such costs are incurred for the purpose of obtaining and accumulating data which will serve as a basis for the acquisition or retention of property. In this connection, the term "property" is used in the sense of "interest" in a mineral property, as provided in section 29.23(m)–1(*i*) of Regulations 111. Accordingly, if property is acquired or retained on the basis of data obtained from exploration, costs of exploration attributable to that property should be capitalized as part of the cost of such property.

It is customary in the search for mineral-producing properties for an explorer to conduct his exploration program by projects, each project covering only that territory which he has determined by analysis of certain variables, viz, the size and topography of the area to be explored, existing information with respect to that area and nearby areas, and the quantity of equipment, men, and money available, can be explored advantageously as a single integrated operation. After determination of its area, each project usually begins with a reconnaissance-type survey covering the entire area. The purpose of this relatively inexpensive survey is to locate those portions of the project area which have the greatest promise, thus enabling the explorer to most effectively concentrate the use of his money and equipment and the efforts of his men in those portions of the area. Each such separable, noncontiguous portion of the project area, identified by the reconnaissance-type survey as possessing sufficient mineral-producing potential to merit further exploration, is an area of interest. Where an exploration project is conducted without a preliminary reconnaissance-type survey, the project area and the area of interest are coextensive.

When the areas of interest in an original project area have been located by the reconnaissance-type survey, for the purposes of allocating and capitalizing costs of further exploratory operations, the original project is considered subdivided into as many smaller projects as there are areas of interest. Since each area of interest thereafter constitutes a separate project, further exploratory operations conducted with respect to one area of interest are completely independent of those conducted with respect to a different area of interest also within the original project area.

By further exploratory operations (detailed surveys) conducted with respect to each area of interest, the explorer seeks to ascertain the presence or absence of a mineral deposit in that area of interest. For that purpose, he employs such geological and geophysical exploration methods as will obtain subsurface data sufficiently accurate to afford a basis for a decision to acquire or retain properties within or adjacent to a particular area of interest, or to abandon the entire area of interest as unworthy of development by mine or well.

If, from the data obtained from the reconnaissance-type survey, only one area of interest is located or identified within the original project

area, the entire cost of the reconnaissance-type survey must be allocated to that one area of interest. If two or more areas of interest are located or identified within the original project area, the entire cost of the reconnaissance-type survey must be allocated equally among the various areas of interest. Depending upon the final disposition of the area of interest to which it is allocated, each allocated part of the cost of the reconnaissance-type survey will be treated as a capital expenditure under section 24(a)(2) of the Internal Revenue Code or as a loss under section 23 (e) or (f) of the Code. If, from the data obtained by the reconnaissance-type survey, no areas of interest are located or identified within an original project area, the entire cost of the reconnaissance-type survey may be deducted as a loss under section 23 (e) or (f) of the Code for the year of abandonment of that particular project.

Where a detailed (intensive) survey is conducted with respect to a particular area of interest, if a property is acquired or retained within or adjacent to that area on the basis of the data so obtained, the entire cost of that detailed survey plus that portion of the cost of the previous reconnaissance-type survey allocated to such area must be capitalized as a part of the cost of the property so acquired or retained. Where more than one property is so acquired or retained within or adjacent to an area of interest, it is proper to allocate, on an acreage basis, the entire cost of the detailed survey plus that portion of the cost of the previous reconnaissance-type survey allocated to such area among the properties so acquired or retained. Where, on the basis of data obtained from exploration conducted with respect to an area of interest, no property is acquired or retained within or adjacent to that area, the costs of exploration, including that portion of the cost of the reconnaissance-type survey allocated to that area of interest, may be deducted as a loss for the year in which that area of interest is abandoned as a potential source of mineral production.

SECTION 29.24-2: Capital expenditures.

INTERNAL REVENUE CODE

District of Columbia gross sales tax paid by purchasers with respect to property purchased for use in trade or business. (See I. T. 4004, page 35.)

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SECTION 41.—GENERAL RULE

SECTION 29.41-3: Methods of accounting. 1950-6-13314
(Also Section 42, Section 29.42-1; Section 43, Section 29.43-1.) Mim. 6475

Treatment of blocked foreign income for Federal income tax purposes.

Mimeograph 5297 (C. B. 1942-1, 84) modified.

COPY

SX-3.2.2

AMERICAN SMELTING AND REFINING COMPANY
Tucson Arizona

August 17, 1959

J. E. K.

MAR 27 1968

Mr. D. J. Pope, Assistant to Vice President
American Smelting and Refining Company
120 Broadway
New York 5, New York

SAN XAVIER
Tracts I and II
Ore Reserves

Dear Sir:

During the discussion of the above subject in my office August 11, I told you that I did not recall having written a letter giving ore reserve tonnages on the Reservation. Since then I have found my notes on ore tonnage data compiled in June, 1958, when we were nearly completed with the main phase of drilling, with the further notation that I had quoted the tonnages and grades to you on February 9, 1959. These quoted figures are the ones you doubtless had in mind, and for the record they are repeated, as follows:

Southern Tract II

Shallow Ore (classed as "Indicated Ore")

Mixed Oxide-Sulphide	4.0 mil. @ 1.70% Cu
Sulphide	6.0 mil. @ .80% Cu
Total	10.0 mil. @ 1.16% Cu

Waste/Ore Ratio ± 5:1

Deep Ore (classed as "Inferred Ore")
50 to 75 mil. @ .75% Cu

Central Tracts I-II

Shallow ore (classed as "Indicated Ore")
15 to 20 mil. @ .65% Cu
Waste/Ore Ratio ± 5:1

Due to property line limitations in the case of the Southern shallow ore body, and to incomplete drilling in the case of the Central ore body, the above figures are not firm. The Southern "ore" body would actually become ore only if the Mission open pit were to be extended through Banner ground. By itself -- that is, with a pit limited by the south edge of the Reservation -- this material would not be an ore body.

Due to its low average grade and high waste/ore ratio, the Central "ore" body of course is not a commercial proposition today. In fact, it would become a true ore body only under an exceptionally favorable copper market.

At the present time there is no occasion to do closer-spaced drilling or to make more precise ore reserve calculations for either of these potential

open pit ore bodies.

The Southern deep ore body eventually may be the most substantial resource on the Reservation; but it can only be considered as an underground mine at some time far in the future. The ore tonnage listed above is classed as "inferred" because it is penetrated by only five, wide-spaced holes, X213, X217, X224, X231, and X250.

Due to the depth it will be expensive to drill out this ore body. Certainly, there is no need for further drilling there at the present time.

Very truly yours,

/s/ K. Richard

KENYON RICHARD

KR/ds
cc: CPPollock
ACHall
WOSchubel
JHCourtright

(15)

J. E. K.

MAR 25 1968

New York, N. Y., June 20, 1958

Memorandum for File:

Re: San Xavier Indian Reservation
Prospecting Permits with Options to Lease

Messrs. Pope, Hart, and Barber met with Messrs. Utz, Larkin, Seitz, Caldwell, and Jones (Bureau of Indian Affairs), and Messrs. Turner and Paulus (U.S.G.S.), in Mr. Utz's office on June 19, 1958. The purpose of the conference was to review the results of exploration by the Company in the Permit areas as we now see the picture and to exchange views in a preliminary way on the problems which lie ahead, as outlined in Mr. Pope's letter of June 16th to Mr. Utz.

1. Exploration Results and Development Plans

Mr. L. H. Hart, Chief Geologist of American Smelting and Refining Company, reviewed the general geology of the area. He pointed out that the known mineralized area south of the Reservation trended northwesterly into the Reservation, and stated that this accounted for our very substantial interest in the Reservation property at the time of the bidding. He then reviewed the exploration program undertaken after the prospecting permits had been granted. On a sketch map he pointed out the results of aero-magnetic surveys which indicated deep lava flows extending over most of Tract 3 and projecting to the southwestern corner of Tract 2. Also ground electromagnetic and gravimetric surveys were completed throughout the three tracts. Simultaneously, extensive drilling through the alluvium was completed to determine the alteration characteristics on the bedrock. Highly altered areas were then core-drilled and copper mineralization of significance was discovered in two areas: (A) In the northest corner of Section 23 in Tract 1 extending easterly into Tract 2; (B) Along the southern boundary of Tract 2. Fringe drilling in both areas appears to have established the limits of important mineralization permitting the following rough estimates:

Area 1

15,000,000 tons - 0.65% copper - stripping ratio - 5:1 ?

Area 2

7,500,000 tons - 0.80% copper - stripping ratio - 5:1 ?

File under
247 - 52 - 320 Peyote
AEC

Mr. Hart stated that no significant mineralization had been disclosed in Tract 3, where drilling confirmed the geophysical evidence that thick volcanic deposits covered the area. He further stated that exploration of the three tracts has reached a point of near completion.

Mr. D. J. Pope, Assistant to the Vice-President in charge of the Mining Department, went on to review our thinking from an operating point of view as to the feasible approaches to exploitation of the mineralized area on the Reservation. He said we felt that neither of the mineralized areas in the Reservation were of sufficient tonnage and grade to support an independent mining operation. He added, however, that within the Asarco controlled East Pima Area adjacent to the Reservation on the south, an important ore body suitable for open pit mining had been drilled out. The ore in this deposit, which is now being developed by Asarco, was of a significantly higher grade than had been found on the Reservation. He indicated that we believe that the mineralization in the southerly portion of Tract 2 along the Reservation boundary (Area B, above) can profitably be mined as an extension of the open pit being developed south of the boundary. He stated further that it was our hope that eventually the mineralization in Area A could also profitably be mined, supported as it would be, by the mill and other installations constructed in connection with the major operation to the south.

Discussion then turned to various legal and practical problems which must be considered in connection with the mineralization found on the Reservation.

2. Due Diligence

As noted above, it now appears that the only feasible approach to development of the mineralized zone on the Reservation would be in conjunction with development of the higher grade ore body lying to the south. Mr. Pope indicated that this meant that the ore on the Reservation was unlikely actually to be mined until six to ten years from the date of the lease. We expressed the hope that so long as work goes forward in a workmanlike manner on the development of the ore body considered as a whole, and the work requirements for the leased property within the Reservation are met each year, no question would be raised by the Department of Interior as to our fulfilling the "diligence" requirement of the lease.

3. Waste Dumping Area

Mr. Pope pointed out the very large areas which would be required for waste dumping in connection with the project. These would include the sections lying to the east of the ore body both on and off the Reservation. It was pointed out that the southerly sections of Tract 3 were suitable for waste dumping but that no mineralization had been found on Tract 3. The question therefore arises as to how it is best to work out a lease on these sections.

After discussion two alternatives emerged:

A. Negotiate a business lease with the Indian allottees for the use of the surface only and for a term of 25 years, subject to renewal for a second 25 year term, under the authority conferred on the Secretary by 25 U.S.C.A. Sec. 415, and Sec. 131 of the Regulations. Presumably the terms of such a lease would follow those contained in the form for mineral leases, that is, a rental of $1.00 per acre per year, plus a payment of $25.00 per acre at such time as the land was used for waste dumping. It was recognized that minimum royalties and work requirements would not be involved in such a lease.

B. Construe the permit to provide for the issuance of a lease under the permit for purposes of waste dumping. It was noted that the division into three tracts was an arbitrary one and that the dumping on Tract 3 would be "mining operations" necessary to the removal of minerals. The permits refer to productive areas and "additional acreage" necessary for mining operations, and define "mining operations" to include waste dumping (Permit, Para. 1). This alternative would also require an administrative determination that since this portion of the lease was for the use of the surface only, minimum royalties and work requirements would not be involved.

Mr. Seitz suggested that it might be desirable to work out the lease on Tract 3 within the framework of the permit. He referred to some difficulties the Bureau had been having with the Papago Indians on the Papago Reservation and suggested that one could not be sure that it would be possible to sign up all the Indian allottees in the desired area as would be required for a new business lease covering the area in question.

It was left that Mr. Seitz in consultation with our Mr. Snedden and the team that signed up the Indian allottees in the first instance would consider the problem in the light of the individuals involved.

5. Royalties

It was pointed out that the 10% royalties provided in the lease were extremely high by any standards for the grade of ore found on the Reservation.

Mr. Utz pointed out that under the lease, royalty rates were subject to reasonable adjustment up or down at the end of the first ten-year period and noted that under our plan of development of the mine, as explained by Mr. Pope, our actual mining operations on the Reservation would probably just be getting well under way at the time royalty rates were up for reconsideration.

The alternative would be to drop our rights to a lease under the permit and at an appropriate time negotiate a new lease on revised royalty terms with the Indian allottees. It was recognized that this alternative presented many problems.

6. Minimum Royalties

It was suggested that there would be no problem in paying the stipulated minimum royalties on the entire acreage included within the lease, if, as is normally the case in commercial leases, they could be regarded as advance royalties and credited against actual royalties when due. Mr. Barber suggested that this would be a reasonable provision, where, as in this case, there would be a considerable period before actual mining of the ore commenced, at which time, mining operations on the Reservation would be on a very substantial scale. Mr. Larkin expressed doubts whether the Bureau would be free to so interpret the lease, referring to the language thereof which he felt left little scope for interpretation.

Alternatively, if the lease could be interpreted as requiring the payment of minimum royalties only with respect to "such acreage as is reasonably proven productive" (Permit, Para. 1), the payment of minimum royalties would not be an excessive burden on the project.

A third alternative would be to omit the waste dumping areas from the areas leased under the permits, and to negotiate separate business leases with respect to such acreage, as in the case of Tract 3.

7. Number of Leases.

Mr. Caldwell noted that the Department would issue separate leases on each tract. This would mean that there would be separate leases on Tracts 1 or 2. It was noted that two separate areas of mineralization would be involved in the lease or leases on Tract 2.

The hope was expressed that in administering the separate leases the Department would approach the questions of work requirements and due diligence in terms of the project as a whole, so that no question would arise as to due diligence in Tract 1, or in Area A of Tract 2, separate and apart from the question of due diligence in developing the entire property.

8. Water

Mr. Barber noted that under the lease we had the right to drill wells and draw water from the property but that unfortunately no favorable ground for the development of the required supplies of water occurred within the permit areas. Mr. Hart noted, however, that there was a favorable zone in the valley of the Santa Cruz River, a short distance to the east within the Reservation. Mr. Pope stated that our water requirements would be on the order of 3,000 gallons per minute, most of which would be returned to the ground. The only loss would occur through evaporation.

Mr. Seitz agreed that favorable ground was available and expressed the view that we would have no difficulty in negotiating an appropriate lease for the purpose. He suggested that we open negotiations for such a lease promptly. Our representatives are to discuss this with Mr. Seitz in Phoenix.

CC-DJPope
TASnedden

C.F.B.

AMERICAN SMELTING AND REFINING COMPANY
Tucson Arizona

April 23, 1957

PERSONAL/CONFIDENTIAL

Mr. L. H. Hart, Chief Geologist
New York Office

SAN XAVIER RESERVATION

Dear Sir:

In accordance with our discussions in the past, this is intended to give you my up-to-date opinion on the bidding situation. I presume that a final decision on this matter will have to be made within about 10 days or so in order that papers can be prepared to meet the May 13 deadline.

It seems unlikely that in the interim we will pick up any information on competitor activity which would be of sufficient importance to alter opinions. Everyone in the local exploration business is being suspiciously quiet. No significant new angles have developed; so your present information is more-or-less complete. There is no reason for me to go into detail herein, but I would like to emphasize some points which seem important to me, even though most of them will probably not be new to you.

Three factors are involved: (1) the exploration value to us, (2) the operating value to our present ore body, and (3) the possible value, operating as well as exploration, to competitors.

The exploration value of tracts 1 and 2 is high, for reasons which all of us have been aware of for some time and which have not changed in recent weeks.

The exploration value of tract 3 is low, because it is outside of the projected margin of the mineralized zone, but it is not entirely worthless because this projection has less validity to the north.

Tract 1 of course has no operating value to our present ore body. Tract 2 has a high value in this respect because the ore body indicated by holes 90 and 105 could be mined only by extending a pit into the Reservation, and because it offers convenient dumping area. Tract 3 has a modest value as dumping area. (Although not specified in the terms, I suppose the lessee would have a preferred position in obtaining dumping privileges.)

Tract 1 may have generally less exploration value to competitors than to us because, in my opinion, the competitive field men involved would not attach all of the significance we do to the two mineralized outcrops in tract 1 and the conglomerate of mineralized boulders at the base of Black Mountain to the north. (Kennecott and Phelps Dodge field men may be exceptions, to a certain extent.) This means that tract 1 represents the best opportunity for us more nearly to insure the acquisition of attractive exploration ground by making a substantial bid.

Tract 2 of course has the greatest exploration value to all competitors simply because it offsets the area of intensive drilling by us and by Banner. Periodic photographs obtained from a plane during the past two years would permit anyone to make a pretty good guess as to the size and position of our ore body by analyzing the sequence, spacing and depth of drill holes. Low-flying, sight-seeing planes have circled almost daily over our drilling area. My thought in this regard is that anyone using this system would be apt to over-estimate rather than under-estimate the tonnage of our ore body.

Tract 2 has especial value to the Pima Mining Company and Banner Mining Company, as compared to other competitors. With control of this tract, Pima could hem us in more effectively and strengthen their whole position in the district. Under present circumstances, Banner almost has to deal on our terms, eventually, in the matter of mining the ore in their ground adjacent to our ore body. This situation would become much less favorable to us if Banner were to gain a hold on tract 2.

The people at the Sells Agency have told us that over 20 mining companies have shown active interest in the area up for bids, and they have distributed notices to over 300. Following are comments on the principle competition.

Kennecott: Exploration office in Tucson; several competent men actively searching for, and drilling, alteration zones; rumored to be strongly interested in the Reservation.

Anaconda: Office in Tucson; field men have thorough knowledge of Pima mine geology.

Pima Mining Company: In better position than anyone else to guess the tonnage and grade of our ore body.

Phelps Dodge: Competent field men known to have checked our drilling operations from the air several times in the past two years.

Banner Mining Company: Probably unable to be serious financial competition without reorganization. However, their drill logs would be a valuable asset in a partnership with a company, say, like Phelps Dodge whose field men probably have little direct knowledge of the character of structure and mineralization in the district.

Kern County Land Company: Reputedly a wealthy California company with extensive experience in oil exploration; hold some large claim groups in the southern part of the Pima district; last year opened a mining exploration office in Tucson headed by a competent man who has a good knowledge of the Pima mine mineralization due to former connection with United Geophysical.

Cerro de Pasco: Opened Tucson exploration office last year; interest in Pima District unknown.

American Metals: Opened Tucson exploration office last year after their

chief geologist made a visit to the Pima District, but we know of no specific activities by them in the district.

Each of the above companies (Banner provisionally, as noted above) is capable technically, financially, and psychologically of placing serious bids. The 10% royalty on the leases may be a deterrent, as we all know, in which case they will make only nominal bids. Otherwise, they will look at our position and bid high.

The following are suggested as a minimum for us:

Tract 1	283
2	558
3	41
	882

In view of the fact that Mr. Courtright made the field discoveries which first directed our interest to the Reservation ground, and has been closely connected with all developments since, it should be noted that this letter is a reflection of his ideas as well as mine.

Yours very truly,

Original Signed By
K. Richard

KENYON RICHARD

KR/ds
cc: TASnedden - P/C
JHCourtright - P/C