

and with whom and where the election was filed.

(d) *Effect of notification.* A taxpayer who has filed notice pursuant to this section may make an election under section 617(a) with respect to exploration expenditures paid or incurred after December 31, 1969, without revoking either his section 615(e) election or his notice under this section.

(e) *Time for filing notice.* A taxpayer may not file the notice described in paragraph (c)(1) of this section after the expiration of the 3-year period beginning with the date prescribed by section 6072 or other provision of law for filing the taxpayer's income tax return for the first taxable year in which the taxpayer pays or incurs after December 31, 1969, expenditures which would be deductible by him if he made the election under section 617(a). This 3-year period shall be determined without regard to any extension of time for filing the taxpayer's income tax return.

[T.D. 7192, 37 FR 12941, June 30, 1972]

§ 1.616-1 Development expenditures.

(a) *General rule.* Section 616 prescribes rules for treating expenditures paid or incurred during the taxable year by the taxpayer for the development of a mine or other natural deposit (other than an oil or gas well). Development expenditures under section 616 are those which are made after such time when, in consideration of all the facts and circumstances (including actions of the taxpayer), deposits of ore or other mineral are shown to exist in sufficient quantity and quality to reasonably justify commercial exploitation by the taxpayer. Under section 616(a), a taxpayer is allowed a deduction for development expenditures whether or not such expenditures are made in the development or production state of the mine or other natural deposit. Under section 616(b), the taxpayer may elect to defer development expenditures made in the development or producing stage and to deduct such expenditures ratably as the minerals or ores benefited are sold. While the mine or other natural deposit is in the development stage, the election applies only to that portion of the development expenditures which is in excess of net re-

ceipts from the mine or other natural deposit. See § 1.616-2 for rules with respect to the election to defer. It is not necessary that the taxpayer incur the development costs directly. He may engage a contractor to make the expenditures on his behalf.

(b) *Expenditures to which section 616 is not applicable.* (1) Section 616 is not applicable to development expenditures which are deductible for the taxable year under any other provision of the internal revenue laws.

(2) Section 616 is not applicable to expenditures which are reflected in improvements subject to allowances for depreciation under sections 167 and 611. However, allowance for depreciation of such improvements which are used in the development of ores or minerals are considered development expenditures under section 616. If such improvements are used only in part for development during a taxable year, an allocable portion of the allowance for depreciation shall be treated as a development expenditure.

(3) Section 616 is applicable to development expenditures paid or incurred by a taxpayer in connection with the acquisition of a fractional share of the working or operating interest to the extent of the fractional interest so acquired. The expenditure attributable to the remaining fractional share shall be considered as part of the cost of his acquired interest and shall be capitalized and recovered through depletion allowances. For example, taxpayer A owns mineral leases on undeveloped mineral lands. A agrees to convey an undivided three-fourths ($\frac{3}{4}$) interest in such leases to B, provided B will pay all of the expenditures incurred during the development stage of the deposits on these leases. B may deduct three-fourths ($\frac{3}{4}$) of such amount under section 616, but shall treat one-fourth of such amount as part of the cost of his interest, recoverable through depletion.

(4) The provisions of section 616 do not apply to costs of development paid or incurred by a prior owner which are reflected in the amount which the taxpayer paid or incurred to acquire the property. Such provisions apply only to costs paid or incurred by the taxpayer for development undertaken directly or

through contract by the taxpayer. See, however, section 381(a) and 381(c)(10) for special rules with respect to deferred development expenditures in certain corporate acquisitions.

(c) *Mine or other natural deposit.* Section 616 has reference to expenditures made for the development of a mine or other natural deposit. Within an aggregated property, as that term is defined in section 614 (b) and (c), or within a single tract or parcel of land, there may be more than one mine or other natural deposit. Where a property, as determined under section 614, contains more than one mine or other natural deposit, the taxpayer may deduct under section 616(a) the development expenditures made with respect to one of such mines or deposits, and may defer under section 616(b) the development expenditures made with respect to another of such mines or deposits. Where there is more than one mine with respect to a single underlying deposit, the taxpayer may deduct under section 616(a) the development expenditures made with respect to one of such mines, and may defer under section 616(b) the development expenditures made with respect to another of such mines. The taxpayer must treat consistently all development expenditures with respect to each such mine or other natural deposit in a taxable year. The taxpayer must make a separate determination of the units of minerals or ores benefited in a mine or other natural deposit (regardless of the computation of the depletion allowance) in order that deferred expenditures with respect to such mine or deposit may be deducted on a ratable basis. See paragraph (f) of § 1.616-2.

§ 1.616-2 Election to defer.

(a) *General rule.* In lieu of taking a deduction under section 616(a), in the taxable year when the development expenditures are paid or incurred, a taxpayer may elect under section 616(b) to treat such expenditures with respect to each mine or other natural deposit as deferred expenses to be deducted ratably as the units of the produced ore or minerals benefited by such expenditures are sold. Section 616(b) is applicable to development expenditures paid or incurred both in the development

and producing stage of the mine or other natural deposit. However, in the case of such expenditures made in the development stage, this election is applicable only to the excess of the amount of such expenditures over the net receipts from the ore or minerals from such mine or deposit received or accrued during the development stage and in the same taxable year as the expenditures were paid or incurred. Such development expenditures not in excess of such net receipts shall be subject to the provisions of section 616(a).

(b) *Producing stage; definition of.* The mine or other natural deposit will be considered to be in a producing stage when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine or other natural deposit is the production of developed ores or minerals rather than the development of additional ores or minerals for mining.

(c) *Expenditures made by the owner who retains a nonoperating interest.* (1) A taxpayer who elects to defer development expenditures and thereafter transfers his interest in the mine or other natural deposit, retaining an economic interest therein, shall deduct an amount attributable to such interest on a pro rata basis as the interest pays out. For example, a taxpayer who defers development expenditures and then leases his deposit, retaining a royalty interest therein, shall deduct the deferred expenditures ratably as he receives the royalties. If the taxpayer receives a bonus or advanced royalties in connection with the transfer of his interest, he shall deduct the deferred expenditures allocable to such bonus or advanced royalties in an amount which is in the same proportion to the total of such costs as the bonus or advanced royalties bears to the bonus and total royalties expected to be received. Also, in the case of a transfer of a mine or other natural deposit by a taxpayer who retains a production payment therein, he may deduct the development expenditures ratably over the payments expected to be received.

(2) Where a taxpayer receives an amount, in addition to retaining an economic interest, which amount is