

§ 1.616-3

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treated as from the sale or exchange of a capital asset or property treated under section 1231 (except coal or iron ore to which section 631(c) applies), the deferred development expenditures shall be allocated between the interest sold and the interest retained in proportion to the fair market value of each interest as of the date of sale. The amount allocated to the interest sold may not be deducted, but shall be a part of the basis of such interest for the purpose of determining gain or loss upon the sale thereof.

(d) *Losses from abandonment.* Section 165 and the regulations thereunder contain general rules relating to the treatment of losses resulting from abandonment.

(e) *Effect of election.* (1) The election to defer development expenditures shall apply only to expenditures for the taxable year for which made. However, once made, the election shall be binding with respect to the expenditures for that taxable year. Thus, a taxpayer cannot revoke his election for any reason whatsoever.

(2) The election shall be made for each mine or other natural deposit by a clear indication on the return or by a statement filed with the district director with whom the return was filed, not later than the time prescribed by law for filing such return (including extensions thereof) for the taxable year to which such election is applicable.

(f) *Computation of amount of deduction.* The amount of the deduction allowable during the taxable year is an amount A, which bears the same ratio to B (the total deferred development expenditures for a particular mine or other natural deposit reduced by the amount of such expenditures deducted in prior taxable years) as C (the number of units of the ore or mineral benefited by such expenditures sold during the taxable year) bears to D (the number of units of ore or mineral benefited by such expenditures remaining as of the taxable year). For the purposes of this proportion, the *number of units of ore or mineral benefited by such expenditures remaining as of the taxable year* is the number of units of ore or mineral benefited by the deferred development expenditures remaining at the end of the year to be recovered from the mine

or other natural deposit (including units benefited by such expenditures recovered but not sold) plus the number of units benefited by such expenditures sold within the taxable year. The principles outlined in § 1.611-2 are applicable in estimating the number of units remaining as of the taxable year and the number of units sold during the taxable year. The estimate is subject to revision in accordance with that section in the event it is ascertained, from any source, such as operations or development work, that the remaining units are materially greater or less than the number of units remaining from a prior estimate.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6841, 30 FR 9307, July 27, 1965]

§ 1.616-3 Time for making election with respect to returns due on or before May 2, 1960.

In the case of any taxable year beginning after December 31, 1953, and ending after August 16, 1954, the income tax return for which is due not later than May 2, 1960, the time to deduct or defer development expenditures for such a year under section 616 (a) or (b) shall expire on May 2, 1960.

§ 1.617-1 Exploration expenditures.

(a) *General rule.* Section 617 prescribes rules for the treatment of expenditures paid or incurred after September 12, 1966, for ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral for which a deduction for depletion is allowable under section 613 (other than oil or gas) paid or incurred by the taxpayer before the beginning of the development stage of the mine or other natural deposit. Such expenditures hereinafter in the regulations under section 617 will be referred to as exploration expenditures. The development stage of the mine or other natural deposit will be deemed to begin at the time when, in consideration of all the facts and circumstances (including the actions of the taxpayer), deposits of ore or other mineral are disclosed in sufficient quantity and quality to reasonably justify commercial exploitation by the taxpayer. For example, core drilling expenditures paid or incurred

by the taxpayer to ascertain the existence of commercially marketable ore are exploration expenditures within the meaning of this section. Also, expenditures for exploratory drilling from within a producing mine to ascertain the existence of what appears (on the basis of all of the facts and circumstances known at the time of the expenditures) to be a different ore deposit are exploration expenditures within the meaning of this section. Expenditures paid or incurred in connection with core drilling to further delineate the extent and location of an existing commercially marketable deposit to facilitate its development are development expenditures. Under section 617(a), a taxpayer may deduct exploration expenditures paid or incurred for the exploration of any deposit of ore or other mineral subject to the limitation of section 617(h). Under section 617(b), a taxpayer shall recapture the exploration expenditures previously deducted under section 617(a) either through including in income an amount equal to the amount of the adjusted exploration expenditures (as defined in section 617(f)) or through disallowance of the deduction for depletion under section 611. Certain rules are provided in section 617(c) for recapture of exploration expenditures made with respect to property for which the taxpayer later receives a bonus or royalty. Under section 617(d), gain from dispositions of mining property, with respect to which exploration expenditures have been previously deducted, is to be recognized notwithstanding certain other provisions of the Code.

(b) *Expenditures to which section 617 is not applicable.* (1) Section 617 is not applicable to expenditures which would be allowed as deductions for the taxable year without regard to section 617.

(2) Section 617 is not applicable to expenditures which are reflected in improvements subject to allowances for depreciation under sections 167 and 611. However, allowances for depreciation of such improvements which are used in the exploration of ores or minerals are considered exploration expenditures under section 617. If such improvements are used only in part for exploration during the taxable year, an allocable portion of the allowance for

depreciation shall be treated as an exploration expenditure.

(3) Section 617 is applicable to exploration 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 by the taxpayer. The expenditures attributable to the remaining fractional share shall be considered as the cost of his acquired interest and shall be recovered through depletion allowances. For example, taxpayer A owns mineral leases on unexplored mineral lands and agrees to convey an undivided three-fourths ($\frac{3}{4}$) interest in such leases to taxpayer B provided B will pay all of the expenses for ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral which will be incurred before the beginning of the development stage. B may elect to treat three-fourths of such amount under section 617. B must treat one-fourth of such amount as part of the cost of his interest, recoverable through depletion.

(4) Section 617 is not applicable to costs of exploration which are reflected in the amount which the taxpayer paid or incurred to acquire the property. Section 617 applies only to costs paid or incurred by the taxpayer for exploration undertaken directly or through a contract by the taxpayer. See, however, sections 381(a) and 381(c)(10) for special rules with respect to deferred exploration expenditures in certain corporate acquisitions.

(5) Section 617 is not applicable to amounts paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of oil or gas or of any mineral with respect to which a deduction for percentage depletion is not allowable under section 613. The purpose of the expenditure shall be determined by reference to the facts and circumstances at the time the expenditure is paid or incurred.

(c) *Elections*—(1) *Election to deduct under section 617(a).* (i) The election to deduct exploration expenditures under section 617(a) may be made by deducting such expenditures in the taxpayer's income tax return for his first taxable year ending after September 12, 1966,

for which the taxpayer desires to deduct exploration expenditures which are paid or incurred by him during such taxable year and after September 12, 1966. This election may be exercised by deducting such exploration expenditures either in the taxpayer's return for such taxable year or in an amended return filed before the expiration of the period for filing a claim for credit or refund of income tax for such taxable year. Where the election is made in an amended return for a taxable year prior to the most recent year for which the taxpayer has filed a return, the taxpayer shall file amended income tax returns, reflecting any increase or decrease in tax attributable to the election, for all subsequent taxable years affected by the election for which he has filed income tax returns before making the election. See section 617(a)(2)(C) and subparagraph (4) of this paragraph for provisions relating to extension of the period of limitations for the assessment of any deficiency for any taxable year to the extent the deficiency is attributable to an election or revocation of an election under section 617(a). In applying the election to the years affected, there shall be taken into account the effect that any adjustments resulting from the election shall have on other items affected thereby (such as the deduction for charitable contributions, the foreign tax credit, net operating loss, and other deductions or credits the amount of which is limited by the taxpayer's income) and the effect that adjustments of any such items have on items of other taxable years. Amended returns filed for taxable years subsequent to the taxable year for which the election under section 617(a) is made by amended return shall, where appropriate, apply the recapture rules of subsections (b), (c), and (d) of section 617. See §§ 1.617-3 and 1.617-4.

(ii) A taxpayer who makes or has made an election under section 617(a) shall state clearly on his income tax return for each taxable year for which he deducts exploration expenditures the amount of the deduction claimed under section 617(a) with respect to each property or mine. Such property or mine shall be identified by a description adequate to permit application of

the recapture rules of section 617 (b), (c), and (d).

(iii) A taxpayer who has made an election under section 617(a) may not make an election under section 615(e) unless, within the period set forth in section 615(e), he revokes his election under section 617(a). A taxpayer who has made and has not revoked an election under section 617(a) may not, in his return for the taxable year for which the election is made or for any subsequent taxable year, charge to capital account any exploration expenditures which are deductible by him under section 617(a); and he must deduct all such expenditures as expenses in computing adjusted gross income. Any exploration expenditures paid or incurred after December 31, 1969, which are not deductible by the taxpayer under section 617(a) solely because of the application of section 617(h) shall be charged to capital account.

(2) *Time for making elections.* The election under section 617(a) may be made at any time before the expiration of the period prescribed for filing a claim for credit or refund of the tax imposed by chapter 1 for the first taxable year for which the taxpayer desires to deduct exploration expenditures under section 617(a).

(3) *Revocation of election to deduct.* (i) A taxpayer may revoke an election made by him under section 617(a) by filing with the Internal Revenue service center with which the taxpayer's income tax return is required to be filed, within the period set forth in subdivision (ii) of this subparagraph, a statement, signed by the taxpayer or his authorized representative, which sets forth that the taxpayer is revoking the section 617(a) election previously made by him and states with whom and where the document making the election was filed. A taxpayer revoking a section 617(a) election shall file amended income tax returns which reflect any increase or decrease in tax attributable to the revocation of election for all taxable years affected by the revocation of election for which he has filed income tax returns before revoking the election. See section 617(a)(2)(C) and subparagraph (4) of this paragraph for provisions relating to extension of the period of limitations for

the assessment of any deficiency attributable to an election or revocation of an election under section 617(a). In applying the revocation of election to the years affected, there shall be taken into account the effect that any adjustments resulting from the revocation of election shall have on other items affected thereby (such as the deduction for charitable contributions, the foreign tax credit, net operating loss, and other deductions or credits the amount of which is limited by the taxpayer's income) and the effect that adjustments of any such items have on items of other taxable years.

(ii) An election under section 617(a) may be revoked before the expiration of the last day of the third month following the month in which the final regulations under section 617(a) are published in the FEDERAL REGISTER. After the expiration of this period, a taxpayer who has made an election under section 617(a) may not revoke that election unless he obtains the prior consent of the Commissioner of Internal Revenue. Consent will not be granted where a principal purpose for the revocation of the election is to circumvent the recapture provisions of section 517 (b), (c), or (d). The request for consent shall be made in writing to the Commissioner of Internal Revenue, Attention T:I:E, Washington, DC 20224. The request shall include in detail:

(a) The reason or reasons for the revocation of election under section 617(a);

(b) An itemization of the taxpayer's deductions under section 617(a);

(c) A description of all properties and detailed information of the exploration activities with respect to which the taxpayer has taken deductions under section 617(a);

(d) A description of any development or production activities on all properties with respect to which exploration expenditures were deducted under section 617(a); and

(e) A recomputation of the tax for each prior taxable year affected by the revocation. A letter setting forth the Commissioner's determination will be mailed to the taxpayer. If consent is granted, a copy of the letter granting such consent shall be filed with the director of the Internal Revenue service center with which the taxpayer's in-

come tax return is required to be filed and shall be accompanied by an amended return or returns, if necessary.

(iii) If, before revoking his election, the taxpayer has transferred any mineral property with respect to which he deducted exploration expenditures under section 617(a), to another person in a transaction as a result of which the basis of such property in the hands of the transferee is determined in whole or in part by reference to the basis in the hands of the transferor, the statement submitted pursuant to subdivision (i) of this paragraph shall state that such property has been so transferred, shall identify the transferee, the property transferred, the date of the transfer, and shall indicate the amount of the adjusted exploration expenditures with respect to such property on such date.

(4) *Deficiency attributable to election or revocation of election.* The statutory period for the assessment of any deficiency for any taxable year, to the extent such deficiency is attributable to an election or revocation of an election under section 617(a), shall not expire before the last day of the 2-year period which begins on the day after the date on which such election or revocation of election is made; and such deficiency may be assessed at any time before the expiration of such 2-year period, notwithstanding any law or rule which would otherwise prevent such assessment.

[T.D. 7192, 37 FR 12942, June 30, 1972]

§ 1.617-2 Limitation on amount deductible.

(a) *Expenditures paid or incurred before January 1, 1970.* In the case of expenditures paid or incurred before January 1, 1970, a taxpayer may deduct exploration expenditures paid or incurred during the taxable year with respect to any deposit of ore or other mineral for which a deduction for percentage depletion is allowable under section 613 (other than oil or gas) in the United States or on the Outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented; 43 U.S.C. 1331).