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Memorandum

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subject: Generic Chief Counsel Advice - Adjusted Current Earnings for Certain Mining Property

This Chief Counsel Advice responds to your request for assistance dated June 15, 2006. Specifically, you have asked our office to address whether § 56(g)(4)(C)(i) of the Internal Revenue Code applies to mining property placed in service before 1990. This advice may not be used or cited as precedent.

ISSUE

In computing its adjusted current earnings under § 56(g), is a taxpayer with mining property placed in service in a taxable year beginning before January 1, 1990, subject to the adjustment under § 56(g)(4)(C)(i) for the mining property.

CONCLUSION

A taxpayer with mining property placed in service before January 1, 1990, must take into account the adjustment under § 56(g)(4)(C)(i) in computing adjusted current earnings if the taxpayer deducts an amount under § 611(a) that is in excess of the adjusted basis of the mining property for cost depletion purposes.

FACTS

A taxpayer has mines that were placed in service before January 1, 1990. For the tax years involved in this memorandum, the taxpayer's adjusted basis for cost depletion purposes, as determined under § 612, is zero and the taxpayer uses percentage depletion in computing its allowable deduction under § 611(a). In addition, the taxpayer incurs mining development costs, and for regular tax purposes, deducts those costs under § 616(a). The taxpayer is required to reduce its § 616(a) deduction by 30 percent and amortize that 30 percent amount over 60 months under § 291(b).

For alternative minimum tax purposes, the taxpayer, under § 56(a)(2), capitalized the § 616(a) development costs and will amortize those costs over a period of ten years. In each of the tax years involved, for purposes of calculating its § 57(a)(1) depletion preference, the taxpayer included in the adjusted basis of the mining property the development costs incurred in the year but capitalized under § 56(a)(2).

In computing pre-adjustment alternative minimum taxable income (AMTI) in each of the years involved, the taxpayer reduced the amount of its § 611(a) deduction by the depletion preference computed under § 57(a)(1). However, because the capitalized development costs were included in the adjusted basis of the mining property for purposes of computing the § 57(a)(1) depletion preference, the taxpayer's depletion preference did not completely offset its § 611(a) deduction. Thus, in computing pre-adjustment AMTI, the taxpayer deducted an amount under § 611(a) even though its adjusted basis for cost depletion purposes was zero in those years. The issue for consideration, therefore, is whether the taxpayer has an adjustment under § 56(g)(4)(C)(i) in computing adjusted current earnings (ACE) since the taxpayer's pre-adjustment AMTI includes a deduction under § 611(a) that is in excess of the § 611(a) amount allowable in computing earnings and profits.

LAW AND ANALYSIS

Section 55 imposes an alternative minimum tax (AMT) equal to the excess (if any) of the tentative minimum tax (TMT) for the taxable year, over the regular tax for the taxable year. The TMT equals the AMT rate applied to the excess of AMTI for the taxable year over an exemption amount, reduced by the AMT foreign tax credit for the taxable year.

Section 55(b)(2) defines AMTI as the taxable income of the taxpayer for the taxable year, determined with the adjustments provided in §§ 56 and 58, and increased by the items of tax preference provided in § 57.

Section 56(g)(1) requires corporations to take into account an ACE adjustment in computing their AMTI. The ACE adjustment is equal to 75 percent of the difference between the corporation's adjusted current earnings and its pre-adjustment AMTI (AMTI determined without regard to the ACE adjustment and the AMT net operating loss

deduction). Under § 56(g)(3), ACE is equal to AMTI for the year, determined with the adjustments provided in § 56(g)(4), and without regard to the ACE adjustment and the AMT net operating loss deduction.

Section 56(g)(4)(C)(i) provides that, in computing ACE, a deduction is not allowed for any item that is not deductible for any taxable year for purposes of computing the corporation's earnings and profits.

Section 1.312-6(c)(1) of the Income Tax Regulations provides that in the case of a corporation in which depletion or depreciation is a factor in the determination of income, the only depletion or depreciation deductions to be considered in the computation of the total earnings and profits are those based on cost or other basis without regard to the March 1, 1913, value. In computing earnings and profits for any period beginning after February 28, 1913, the only depletion or depreciation deductions that are to be considered are those based upon cost or other basis, if the depletable or depreciable asset was acquired after February 28, 1913. For mines and oil and gas wells, percentage depletion is not to be taken into consideration in computing the earnings and profits of a corporation. Thus, under § 1.312-6(c)(1), only depletion deductions based upon cost depletion are deductible in computing earnings and profits.

Finally, § 56(g)(4)(F)(i) provides that “the allowance for depletion with respect to any property placed in service in a taxable year beginning after December 31, 1989, shall be cost depletion determined under section 611.”

Under the present facts, the taxpayer's adjusted basis in the mining property for purposes of cost depletion is zero. Consequently, the taxpayer's § 611(a) deduction for purposes of computing earnings and profits is zero. However, the taxpayer's pre-adjustment AMTI includes amounts deducted under § 611(a). Thus, in accordance with § 56(g)(4)(C)(i), the taxpayer must increase its ACE by the amount of its § 611(a) deduction included in pre- adjustment AMTI.

Taxpayers have argued that § 56(g)(4)(C)(i) does not apply to percentage depletion deductions. Foremost, taxpayers argue that there is an ACE adjustment item specifically for percentage depletion (§ 56(g)(4)(F)) and it applies only to property placed in service after December 31, 1989. Thus, taxpayers argue, it was the intent of Congress that there be no ACE adjustment for percentage depletion attributable to mining property placed in service before January 1, 1990. According to taxpayers, the rules of statutory interpretation demand that the IRS not apply § 56(g)(4)(C)(i) to mines placed in service before January 1, 1990 because, of the two provisions potentially applicable to the present facts (§ 56(g)(4)(C)(i) and § 56(g)(4)(F)), § 56(g)(4)(F) is the more specific provision and it applies only to property placed in service after December 31, 1989.

While it is clear that § 56(g)(4)(F) applies only for mining property placed in service after

December 31, 1989, there is nothing in § 56 or its legislative history suggesting that § 56(g)(4)(C)(i) is not applicable with respect to mining property placed in service before January 1, 1990. First, § 56(g)(4)(C)(i) includes no exception for depletion in the case of property placed in service before January 1, 1990. Thus, the literal language of § 56(g)(4)(C)(i) applies when a taxpayer, for its mining property placed in service before January 1, 1990, deducts an amount under § 611(a) in computing pre-adjustment AMTI and the taxpayer has a zero basis in the mining property for cost depletion purposes. Further, when Congress added § 56(g)(4)(F)(ii), which made § 56(g)(4)(F) not applicable for independent oil and gas producers and royalty owners, it provided that both §§ 56(g)(4)(F)(ii) and 56(g)(4)(C)(i) are not applicable to the percentage depletion deduction of certain producers. If the taxpayers' argument that § 56(g)(4)(C)(i) has no application to percentage depletion deduction had merit, there would have been no need to add the reference to § 56(g)(4)(C)(i) in § 56(g)(4)(F)(ii). Apparently, therefore, Congress believed that, for purposes of computing ACE, § 56(g)(4)(C)(i) could also operate to disallow percentage depletion deductions for ACE purposes, which we agree is the correct position.

In addition, the rule of statutory construction requiring the application of specific provisions over general provisions is of no relevance to the present discussion. A basic tenet of statutory construction provides as follows: "Where there is no clear intention otherwise, a specific statute will not be controlled or nullified by a general one, regardless of the priority of enactment." *Morton v. Mancari*, 417 U.S. 535 (1993). To further explain, "Where one statute deals with a subject in general terms, and another deals with [the subject] in a more detailed way, the two should be harmonized if possible; but if there is any conflict, the latter will prevail, . . ." Singer, Norman J., Sutherland on **Statutory Construction** § 51.05 (6th ed. 2000).

Thus, the statutory construction rule raised by the taxpayers involves two steps: first, a determination that there is an irreconcilable conflict between two statutes and then the resolution of such a conflict in favor of the specific provision over the general provision. In the present facts, however, the first step is missing - there is no conflict between the statutes at issue. For mines placed in service before January 1, 1990, it is clear that § 56(g)(4)(F) does not apply and, in our view, only § 56(g)(4)(C)(i) applies. Thus, for property placed in service before January 1, 1990, there is no inherent conflict between § 56(g)(4)(F) and § 56(g)(4)(C)(i). To the contrary, for tax years beginning in 1990 and subsequent years, the literal language of both §§ 56(g)(4)(F) and 56(g)(4)(C)(i) apply to a taxpayer that uses percentage depletion in computing pre-adjustment AMTI. Thus, in those years, the more-specific statute, § 56(g)(4)(F), should apply and § 56(g)(4)(C)(i) should not. In the present facts, however, the taxpayers' mines were placed in service before January 1, 1990, meaning that only § 56(g)(4)(C)(i) applies, there is no statutory conflict, and there is no need to employ the "specific over general" rule of statutory construction.

Taxpayers also argue that if § 56(g)(4)(C)(i) operated in the manner advocated by the IRS there would have been no need to enact § 56(g)(4)(F), which, according to the

taxpayers, is further authority for the position that § 56(g)(4)(C)(i) does not apply to depletion deductions. However, we are not persuaded by this argument for the reasons articulated above and because § 56(g)(4)(F) and § 56(g)(4)(C)(i) operate differently depending on a particular taxpayer's circumstances. Section 56(g)(4)(F) is a timing item intended to require taxpayers to include in ACE the difference between the amount the taxpayer deducts for percentage depletion purposes and the amount that is allowable for cost depletion purposes. To the contrary, § 56(g)(4)(C)(i) only accounts for permanent differences in the amount a taxpayer deducts in the current year and that it is entitled to deduct in the current year and any subsequent year. Section 1.56(g)-1(d) provides as follows:

> [N]o deduction is allowed in computing adjusted current earnings for any items that are not taken into account in determining earnings and profits for any taxable year, even if the items are taken into account in determining pre-adjustment alternative minimum taxable income. . . . An item of deduction is considered taken into account without regard to the timing of its deductibility in computing earnings and profits. Thus, to the extent an item is, has been, or will be deducted for purposes of determining earnings and profits, it does not increase adjusted current earnings in the taxable year in which it is deducted for purposes of determining pre-adjustment alternative minimum taxable income. . . . Thus, only deduction items that are never taken into account in computing earnings and profits are disallowed in computing adjusted current earnings under this paragraph (d).

Assume, for example, a taxpayer with a basis for cost depletion purposes of $10 takes a percentage depletion deduction of $8. If the taxpayer's cost depletion amount referred to in § 56(g)(4)(F)(i) is $3 (and § 56(g)(4)(F) applies to the taxpayer), the taxpayer must include $5 in its ACE under § 56(g)(4)(F). If the mining property was placed in service before January 1, 1990, the taxpayer would not, however, have an inclusion under § 56(g)(4)(C)(i) because the depletion amount deductible in computing pre-adjustment AMTI ($8) also is, or will be in future years, deductible for purposes of determining earnings and profits ($10 is deductible for cost depletion purposes in the current year or future years). Thus, we do not accept the taxpayers' argument that applying § 56(g)(4)(C)(i) to percentage depletion deductions makes § 56(g)(4)(F) obsolete.

In conclusion, it is our position that the enactment of § 56(g)(4)(F) does not preclude the IRS from applying § 56(g)(4)(C)(i) for mining property placed in service before January 1, 1990. Rather, the literal language of § 56(g)(4)(C)(i) applies when a taxpayer, for its mining property placed in service before January 1, 1990, deducts an amount under § 611(a) in computing pre-adjustment AMTI and the taxpayer has a zero basis in the mining property for cost depletion purposes.

In accordance with § 6110(k)(3), this document may not be used or cited as precedent.