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Statutes (12 U.S.C. 61) to be acquired by such affiliate, or in excess of the taxable income for the taxable year computed without regard to the special deductions for corporations provided in part VIII (section 241 and following), subchapter B, chapter 1 of the Code. Nor may the aggregate of the deductions allowable under section 601 and the credits allowable under the corresponding provision of any prior income tax law for all taxable years exceed the amount required to be devoted under such section 5144 to the acquisition of readily marketable assets other than bank stock.

(b) Every taxpayer claiming a deduction provided for in section 601 shall attach to its return a supplementary statement setting forth all the facts and information upon which the claim is predicated, including such facts and information as the Board of Governors of the Federal Reserve System may prescribe as necessary to enable it, upon the request of the Commissioner subsequent to the filing of the return, to certify to the Commissioner the amount of earnings or profits devoted to the acquisition of such readily marketable assets. A certified copy of such supplementary statement shall be forwarded by the taxpayer to the Board of Governors at the time of the filing of the return. The holding company affiliate shall also furnish the Board of Governors such further information as the Board shall require. For the requirements with respect to the amount of such readily marketable assets which must be acquired and maintained by a holding company affiliate to which a voting permit has been granted, see section 5144(b) and (c) of the Revised Statutes (12 U.S.C. 61).

NATURAL RESOURCES

DEDUCTIONS

§1.611-0 Regulatory authority.

Sections 1.611-1 through 1.614-8, inclusive, are prescribed under the authority granted the Secretary or his delegate by section 611(a) of the Code to prescribe regulations under which a reasonable allowance for depletion and depreciation of improvements shall be allowed, according to the peculiar conditions in each case, in the case of

mines, oil and gas wells, other natural deposits and timber.

[T.D. 6965, 33 FR 10692, July 26, 1968]

§1.611-1 Allowance of deduction for depletion.

(a) Depletion of mines, oil and gas wells, other natural deposits, and timber—

(1) In general. Section 611 provides that there shall be allowed as a deduction in computing taxable income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion. In the case of standing timber, the depletion allowance shall be computed solely upon the adjusted basis of the property. In the case of other exhaustible natural resources the allowance for depletion shall be computed upon either the adjusted depletion basis of the property (see section 612, relating to cost depletion) or upon a percentage of gross income from the property (see section 613, relating to percentage depletion), whichever results in the greater allowance for depletion for any taxable year. In no case will depletion based upon discovery value be allowed.

(2) See §1.611-5 for methods of depreciation relating to improvements connected with mineral or timber properties.

(3) See paragraph (d) of this section for definition of terms.

(b) Economic interest. (1) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must look for a return of his capital. For an exception in the case of certain mineral production payments, see section 636 and the regulations thereunder. A person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because through a contractual relation he possesses a mere economic or pecuniary advantage derived from production. For example, an agreement

between the owner of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction or cutting does not convey a depletable economic interest. Further, depletion deductions with respect to an economic interest of a corporation are allowed to the corporation and not to its shareholders.

(2) No depletion deduction shall be allowed the owner with respect to any timber, coal, or domestic iron ore that such owner has disposed of under any form of contract by virtue of which he retains an economic interest in such timber, coal, or iron ore, if such disposal is considered a sale of timber, coal, or domestic iron ore under section 631 (b) or (c).

(c) *Special rules*—(1) *In general.* For the purpose of the equitable apportionment of depletion among the several owners of economic interests in a mineral deposit or standing timber, if the value of any mineral or timber must be ascertained as of any specific date for the determination of the basis for depletion, the values of such several interests therein may be determined separately, but, when determined as of the same date, shall together never exceed the value at that date of the mineral or timber as a whole.

(2) *Leases.* In the case of a lease, the deduction for depletion under section 611 shall be equitably apportioned between the lessor and lessee. In the case of a lease or other contract providing for the sharing of economic interests in a mineral deposit or standing timber, such deduction shall be computed by each taxpayer by reference to the adjusted basis of his property determined in accordance with sections 611 and 612, or computed in accordance with section 613, if applicable, and the regulations thereunder.

(3) *Life tenant and remainderman.* In the case of property held by one person for life with remainder to another person, the deduction for depletion under section 611 shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, shall be allowed to the remainderman.

(4) *Mineral or timber property held in trust.* If a mineral property or timber property is held in trust, the allowable deduction for depletion is to be apportioned between the income beneficiaries and the trustee on the basis of the trust income from such property allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a reserve for depletion in any amount. In the latter case, the deduction is first allocated to the trustee to the extent that income is set aside for a depletion reserve, and any part of the deduction in excess of the income set aside for the reserve shall be apportioned between the income beneficiaries and the trustee on the basis of the trust income (in excess of the income set aside for the reserve) allocable to each. For example:

(i) If under the trust instrument of local law the income of a trust computed without regard to depletion is to be distributed to a named beneficiary, the beneficiary is entitled to the deduction to the exclusion of the trustee.

(ii) If under the trust instrument or local law the income of a trust is to be distributed to a named beneficiary, but the trustee is directed to maintain a reserve for depletion in any amount, the deduction is allowed to the trustee (except to the extent that income set aside for the reserve is less than the allowable deduction). The same result would follow if the trustee sets aside income for a depletion reserve pursuant to discretionary authority to do so in the governing instrument.

No effect shall be given to any allocation of the depletion deduction which gives any beneficiary or the trustee a share of such deduction greater than his pro rata share of the trust income, irrespective of any provisions in the trust instrument, except as otherwise provided in this paragraph when the trust instrument or local law requires or permits the trustee to maintain a reserve for depletion.

(5) *Mineral or timber property held by estate.* In the case of a mineral property or timber property held by an estate the deduction for depletion under section 611 shall be apportioned between the estate and the heirs, legatees, and

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devises on the basis of income of the estate from such property which is allocable to each.

(d) *Definitions.* As used in this part, and the regulations thereunder, the term:

(1) *Property* means—(i) in the case of minerals, each separate economic interest owned in each mineral deposit in each separate tract or parcel of land or an aggregation or combination of such mineral interests permitted under section 614 (b), (c), (d), or (e); and (ii) in the case of timber, an economic interest in standing timber in each tract or block representing a separate timber account (see paragraph (d) of § 1.611-3). For rules with respect to waste or residue of prior mining, see paragraph (c) of § 1.614-1. When, in the regulations under this part, either the word *mineral* or *timber* precedes the word *property*, such adjectives are used only to classify the type of *property* involved. For further explanation of the term *property*, see section 614 and the regulations thereunder.

(2) *Fair market value* of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase.

(3) *Mineral enterprise* is the mineral deposit or deposits and improvements, if any, used in mining or in the production of oil and gas, and only so much of the surface of the land as is necessary for purposes of mineral extraction. The value of the mineral enterprise is the combined value of its component parts.

(4) *Mineral deposit* refers to minerals in place. When a mineral enterprise is acquired as a unit, the cost of any interest in the mineral deposit or deposits is that proportion of the total cost of the mineral enterprise which the value of the interest in the deposit or deposits bears to the value of the entire enterprise at the time of its acquisition.

(5) *Minerals* includes ores of the metals, coal, oil, gas, and all other natural metallic and nonmetallic deposits, except minerals derived from sea water, the air, or from similar inexhaustible sources. It includes but is not limited to all of the minerals and other natural deposits subject to depletion based upon a percentage of gross income from

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the property under section 613 and the regulations thereunder.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6841, 30 FR 9305, July 27, 1965; T.D. 7261, 38 FR 5467, Mar. 1, 1973]

§ 1.611-2 Rules applicable to mines, oil and gas wells, and other natural deposits.

(a) *Computation of cost depletion of mines, oil and gas wells, and other natural deposits.* (1) The basis upon which cost depletion is to be allowed in respect of any mineral property is the basis provided for in section 612 and the regulations thereunder. After the amount of such basis applicable to the mineral property has been determined for the taxable year, the cost depletion for that year shall be computed by dividing such amount by the number of units of mineral remaining as of the taxable year (see subparagraph (3) of this paragraph), and by multiplying the depletion unit, so determined, by the number of units of mineral sold within the taxable year (see subparagraph (2) of this paragraph). In the selection of a unit of mineral for depletion, preference shall be given to the principal or customary unit or units paid for in the products sold, such as tons of ore, barrels of oil, or thousands of cubic feet of natural gas.

(2) As used in this paragraph, the phrase *number of units sold within the taxable year*:

(i) In the case of a taxpayer reporting income on the cash receipts and disbursements method, includes units for which payments were received within the taxable year although produced or sold prior to the taxable year, and excludes units sold but not paid for in the taxable year, and

(ii) In the case of a taxpayer reporting income on the accrual method, shall be determined from the taxpayer's inventories kept in physical quantities and in a manner consistent with his method of inventory accounting under section 471 or 472.

The phrase does not include units with respect to which depletion deductions were allowed or allowable prior to the taxable year.

(3) *The number of units of mineral remaining as of the taxable year* is the number of units of mineral remaining