

application is approved by the Commissioner, there is a material change in any of the facts relied upon in such application, a new application must be submitted by the taxpayer.

(i) *Extraction from waste or residue. Extraction of ores or minerals from the ground* means not only the extraction of ores or minerals from a deposit, but also the extraction by mine owners or operators of ores or minerals from waste or residue of their prior mining. It is immaterial whether the waste or residue results from the process of extraction from the ground or from application of mining processes as defined in paragraph (f) of this section. However, extraction of ores or minerals from waste or residue which results from processes which are not allowable as mining processes is not treated as mining. *Extraction of ores or minerals from the ground* does not include extraction of ores or minerals by the purchaser of waste or residue or the purchaser of the rights to extract ores or minerals from waste or residue. The term *purchaser* does not apply to any person who acquires a mineral property, including waste or residue, in a tax-free exchange, such as a corporate reorganization, from a person who was entitled to a depletion allowance upon ores or minerals produced from such waste or residue, or from a person who would have been entitled to such depletion allowance had section 613(c)(3) been in effect at the time of the transfer. The term *purchaser* also does not apply to a lessee who has renewed a mineral lease if the lessee was entitled to a depletion allowance (or would have been so entitled had section 613(c)(3) been in effect at the time of the renewal) upon ores or minerals produced from waste or residue before renewal of the lease. It is not necessary, for purposes of the preceding sentence, that the mineral lease contain an option for renewal. The term *purchaser* does include a person who acquires waste or residue in a taxable transaction, even though such waste or residue is acquired merely as an incidental part of the entire mineral enterprise. For special rules with respect to certain corporate acquisitions referred to in section 381(a), see section 381(c)(18) and the regulations thereunder.

(j) *Definition of controlled group.* When used in this section:

(1) The term *controlled* includes any kind of control, direct or indirect, whether or not legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

(2) The term *group* means the organizations, trades, or businesses owned or controlled by the same interests.

[T.D. 7170, 37 FR 5374, Mar. 15, 1972]

§ 1.613-5 Taxable income from the property.

(a) *General rule.* The term *taxable income from the property (computed without allowance for depletion)*, as used in section 613 and this part, means *gross income from the property* as defined in section 613(c) and §§ 1.613-3 and 1.613-4, less all allowable deductions (excluding any deduction for depletion) which are attributable to mining processes, including mining transportation, with respect to which depletion is claimed. These deductible items include operating expenses, certain selling expenses, administrative and financial overhead, depreciation, taxes deductible under section 162 or 164, losses sustained, intangible drilling and development costs, exploration and development expenditures, etc. See paragraph (c) of this section for special rules relating to discounts and to certain of these deductible items. Expenditures which may be attributable both to the mineral property upon which depletion is claimed and to other activities shall be properly apportioned to the mineral property and to such other activities. Furthermore, where a taxpayer has more than one mineral property, deductions which are not directly attributable to a specific mineral property shall be properly apportioned among the several properties. In determining the taxpayer's taxable income from the property, the amount of any particular item to be taken into account shall be determined in accordance with the principles set forth in paragraph (d)(2) and (3) of § 1.613-4.

(b) *Special rule; decrease in mining expenses resulting from gain recognized*

under section 1245(a)(1). (1) If during any taxable year beginning after December 31, 1962, the taxpayer disposes of an item of section 1245 property (as defined in section 1245(a)(3)) which has been used in connection with a mineral property, then for the purpose of computing the taxable income from such mineral property for such taxable year, the allowable deductions taken into account with respect to expenses of mining (that is, expenses attributable to a mineral property other than an oil and gas property) shall be decreased by an amount equal to the portion of any gain recognized under section 1245(a)(1) (relating to treatment of gain from dispositions of certain depreciable property as ordinary income) which is properly allocable to such mineral property in respect of which the taxable income is being computed. The portion of such gain which is properly allocable to such mineral property shall bear the same ratio to the total of such gain as:

(i) The portion of the *adjustments reflected in the adjusted basis* (as such term is defined in paragraph (a)(2) of § 1.1245-2, relating to definition of recomputed basis) of such section 1245 property, which were allowable as deductions from the *gross income from the property* (as defined in section 613 (c) and § 1.613-3) in computing the taxable income from such mineral property, bears to

(ii) The total of the *adjustments reflected in the adjusted basis* of such section 1245 property.

(2) For the purposes of this paragraph, the adjustments reflected in the adjusted basis of the section 1245 property disposed of shall be deemed to have been taken into account in computing the taxable income from the mineral property for any taxable year notwithstanding that for the taxable year the allowance for depletion was determined without reference to percentage depletion under section 613.

(3) If the amount of gain described in subparagraph (1) of this paragraph allocable to a mineral property for a taxable year exceeds the allowable deductions otherwise taken into account in computing the taxable income from the mineral property for the taxable year, the excess may not be taken into account in computing the taxable in-

come from the mineral property for any other taxable year.

(4) To the extent that the adjustments reflected in the adjusted basis of the section 1245 property are allocable to mineral property which the taxpayer no longer owns in the taxable year in which he disposes of the section 1245 property, the gain recognized under section 1245(a)(1) does not result in any tax benefit to the taxpayer under this paragraph since he has no taxable income from the mineral property for such year. However, if a taxpayer has, in the taxable year in which he disposes of an item of section 1245 property, only a portion of the original mineral property to which gain described in subparagraph (1) of this paragraph with respect to the section 1245 property is properly allocable, the entire amount of that gain shall nevertheless be taken into account in computing the taxable income of the remaining portion of the mineral property. Furthermore, the fact that a mineral property to which section 1245 gain is properly allocable is (in the taxable year in which the taxpayer disposes of an item of section 1245 property) no longer in existence merely because the mineral property has been made a part of an aggregation or has been deaggregated will not result in the loss of tax benefits under this section. Accordingly,

(i) If a taxpayer has made an aggregation of mineral properties (see section 614 and the regulations thereunder), the amount of any gain described in subparagraph (1) of this paragraph which is properly allocable to the aggregation shall include the portion of any gain which would be properly allocable to the mineral properties which existed separately prior to the aggregation and of which the aggregation is or was composed, if the prior mineral properties had not been aggregated; and

(ii) If a taxpayer has deaggregated a mineral property, the amount of any gain described in subparagraph (1) of this paragraph which is properly allocable to each of the resulting mineral properties shall include a part of the portion of any gain which would be properly allocable to the prior aggregation if the aggregation had not been

deaggregated, the part properly allocable to each of the resulting properties being determined by allocating the gain between the resulting properties in the same manner as basis is allocated between them for tax purposes (see paragraph (a)(2) of § 1.614-6 and example 5 of subparagraph (7) of this paragraph).

(5) In any case in which it is necessary to determine the portion of any gain recognized under section 1245(a)(1) which is properly allocable to the mineral property in respect of which the taxable income is being computed, the taxpayer shall have available permanent records of all the facts necessary to determine with reasonable accuracy the amount of such portion. In the absence of such records, none of the gain recognized under section 1245(a)(1) shall be allocable to such mineral property.

(6) As used in this paragraph, the term *mineral property* has the meaning assigned to it by section 614 and § 1.614-1.

(7) The provisions of this paragraph may be illustrated by the following examples:

Example 1. A, who uses the calendar year as his taxable year, operated and treated as separate properties mines Nos. 1 and 2. On January 1, 1963, A acquired a truck which was section 1245 property. During 1963 and 1964 the truck was used 25 percent of the time at mine No. 1 and 75 percent of the time at mine No. 2. For each such year the depreciation adjustments allowed in respect of the truck were \$800 (the amount allowable). In computing the taxable income from mines Nos. 1 and 2 for each such year, \$200 (25 percent of \$800) of the depreciation adjustments was allocated by A to mine No. 1 and \$600 (75 percent of \$800) to mine No. 2. Thus, for the 2 years, the total of the depreciation adjustments on the truck was \$1,600, of which \$400 was allocated to mine No. 1 and \$1,200 to mine No. 2. On January 1, 1965, A recognized upon sale of the truck a gain of \$500 to which section 1245(a)(1) applied. During 1965, A did not recognize any other gain to which section 1245(a)(1) applied. In computing taxable income from the mines for 1965, the expenses otherwise required to be taken into account are reduced by \$125 (that is \$400/\$1,600 of \$500) for mine No. 1 and by \$375 (that is \$1,200/\$1,600 of \$500) for mine No. 2.

Example 2. The situation is the same as in example 1, except that the truck in question is used 25 percent of the time at mine No. 1, and 75 percent of the time in a nonmining business owned by A. Accordingly, in com-

puting taxable income from A's mines for 1965, the expenses for mine No. 1 otherwise required to be taken into account are reduced by \$125 (that is \$400/\$1,600 of \$500), but no reduction is made in the expenses for mine No. 2, since the truck in question was not used in connection with that mineral property.

Example 3. The situation is the same as in example 1, except that the truck in question was used exclusively at mine No. 1 in 1963. On January 1, 1964, the truck was transferred to mine No. 2, and was used exclusively at mine No. 2 during the remaining period prior to its sale. However, A continued to own and operate mine No. 1. For the 2 years 1963 and 1964, the total of the depreciation adjustments on the truck was \$1,600, of which \$800 was allocated to mine No. 1 and \$800 to mine No. 2. In computing taxable income from A's mines for 1965, the expenses for mines Nos. 1 and 2 otherwise required to be taken into account are reduced by \$250 each (that is \$800/\$1,600 of \$500). If A had sold mine No. 1 on January 1, 1964, no reduction in expenses would be allowable as a result of the operation of the truck at mine No. 1, since A would no longer have owned mine No. 1 in the year in which the truck was sold.

Example 4. On January 1, 1963, B, who uses the calendar year as his taxable year and who normally allocates depreciation costs to mines according to the percentage of time which the depreciable asset is used with respect to the mines, acquired a truck which was section 1245 property. During 1963 the truck was used exclusively on mine No. 1, which B operated and treated as a separate property. The depreciation adjustments allowed in respect of the truck for 1963 were \$1,000 (the amount allowable), which amount was allocated to mine No. 1 in computing the taxable income therefrom. On January 1, 1964, B acquired and began operating mine No. 2 and elected under section 614(c) to aggregate and treat as one property mines Nos. 1 and 2. During 1964 B used the truck 60 percent of the time for mine No. 1 and 40 percent of the time for mine No. 2. For 1964 the depreciation adjustments allowed in respect of the truck were \$1,000 (the amount allowable), which amount was allocated to the aggregation of mines Nos. 1 and 2 in computing the taxable income therefrom. On December 31, 1964, B sold mine No. 2. For 1965 the depreciation adjustments allowed in respect of the truck were \$1,000 (the amount allowable), which amount was allocated to mine No. 1 in computing the taxable income therefrom. On January 1, 1966, B recognized gain upon sale of the truck of \$600 to which section 1245(a)(1) applied. In computing the taxable income from mine No. 1 for 1966, the expenses otherwise required to be taken into account are reduced by \$600, since all the depreciation adjustments allowed with respect to the truck, including those allowed with

respect to the use of the truck at mine No. 2 (\$400 for 1964), relate to the same mineral property from which B had taxable income in 1966, the taxable year in which he sold the truck.

Example 5. On January 1, 1962, A, who uses the calendar year as his taxable year, elected under section 614(c) to aggregate and treat as one mineral property his operating mineral interests in mines Nos. 1 and 2. On January 1, 1963, A acquired a truck which was section 1245 property, to be used at both mine No. 1 and mine No. 2. A later elected (with the consent of the Commissioner) to deaggregate mines Nos. 1 and 2, and this deaggregation became effective on January 1, 1964. At the time of deaggregation, half of the tax basis of the aggregated property was allocated to mine No. 1, and the other half to mine No. 2. During each of the years 1963 and 1964, the truck was used 25 percent of the time on mine No. 1 and 75 percent of the time on mine No. 2, and the depreciation adjustments allowed in respect of the truck were \$800 (the amount allowable). On January 1, 1965, A recognized upon sale of the truck a gain of \$500 to which section 1245(a)(1) applied. In computing taxable income from A's mines for 1965, the expenses otherwise required to be taken into account are reduced by \$187.50 (that is half of \$250 for 1963 and \$200/\$800 of \$250 for 1964) for mine No. 1 and by \$312.50 (that is half of \$250 for 1963 and \$600/\$800 of \$250 for 1964) for mine No. 2.

(c) *Treatment of particular items in computing taxable income from the property.* In determining taxable income from the property under the provisions of paragraph (a) of this section:

(1) Trade or cash discounts (or allowances determined to have the same effect as trade or cash discounts) which are actually allowed to the taxpayer in connection with the acquisition of property, supplies, or services shall not be included in the cost of such property, supplies, or services.

(2) Intangible drilling and development costs which are deducted under section 263(c) and § 1.612-4 shall be subtracted from the gross income from the property.

(3) Exploration and development expenditures which are deducted for the taxable year under sections 615, 616, or 617 shall be subtracted from the gross income from the property.

(4)(i) Selling expenses, if any, paid or incurred with respect to a raw mineral product shall be subtracted from gross income from the property. See subdivision (iii) of this subparagraph for the definition of the term *raw mineral prod-*

uct. For example, the selling expenses paid or incurred by a producer of raw mineral products with respect to products such as crude oil, raw gas, coal, iron ore, or crushed dolomite shall be subtracted from gross income from the property.

(ii) A reasonable portion of the expenses of selling a refined, manufactured, or fabricated product shall be subtracted from gross income from the property. Such reasonable portion shall be equivalent to the typical selling expenses which are incurred by unintegrated miners or producers in the same mineral industry so as to maintain equality in the tax treatment of unintegrated miners or producers in comparison with integrated miner-manufacturers or producer-manufacturers. If unintegrated miners or producers in the same mineral industry do not typically incur any selling expenses, then no portion of the expenses of selling a refined, manufactured, or fabricated product shall be subtracted from gross income from the property when determining the taxpayer's taxable income from the property.

(iii) For purposes of this subparagraph, a product will be considered to be a raw mineral product if (in the case of oil and gas) it is sold in the immediate vicinity of the well or if (in the case of minerals other than oil and gas) it is sold under the conditions described in paragraph (b)(1) of § 1.613-4. In addition, a product will be considered to be a raw mineral product if only insubstantial value is added to the product by nonmining processes (or, in the case of oil and gas, by conversion or transportation processes). For example, in the case of a producer of crushed granite poultry grit, both bulk and bagged grit will be deemed to be a raw mineral product for purposes of the selling expense rule set forth in this subparagraph.

(iv) The term *selling expenses*, for purposes of this subparagraph, includes sales management salaries, rent of sales offices, sales clerical expenses, salesmen's salaries, sales commissions and bonuses, advertising expenses, sales traveling expenses, and similar expenses, together with an allocable

share of the costs of supporting services, but the term does not include delivery expenses.

(5) Taxes which are taken as a credit rather than as a deduction or which are capitalized shall not be subtracted from the gross income from the property.

(6) Trade association dues paid or incurred by a producer of crude oil or gas or a raw mineral product shall be subtracted from the gross income from the property. See subparagraph (4) (iii) of this paragraph for the definition of the term *raw mineral product*. In addition, a reasonable portion of the trade association dues incurred by a producer of a refined, manufactured, or fabricated product shall also be subtracted from gross income from the property if the activities of the association relate to production, treatment and marketing of the crude oil or gas or raw mineral product. One reasonable method of allocating the trade association dues described in the preceding sentence is an allocation based on the proportion that the direct costs of mining processes and the direct costs of nonmining processes (or in the case of oil and gas, conversion and transportation processes) bear to each other. The foregoing rules shall apply even though one of the principal purposes of an association is to advise, promote, or assist in the production, marketing, or sale of refined, manufactured, or fabricated products. For example, a reasonable portion of the trade association dues paid to an association which promotes the sale of cement, refined petroleum, or copper products shall be subtracted from gross income from the property.

[T.D. 6955, 33 FR 6968, May 9, 1968. Redesignated by T.D. 7170, 37 FR 5374, Mar. 15, 1972, as amended by T.D. 7170, 37 FR 5381, Mar. 15, 1972]

§ 1.613-6 Statement to be attached to return when depletion is claimed on percentage basis.

In addition to the requirements set forth in paragraph (g) of § 1.611-2, a taxpayer who claims the percentage depletion deduction under section 613 for any taxable year shall attach to his return for such year a statement setting forth in complete, summary form, with respect to each property for which such

deduction is allowable, the following information:

(a) All data necessary for the determination of the *gross income from the property*, as defined in §§ 1.613-3 from 1.613-4, including:

(1) Amounts paid as rents or royalties including amounts which the recipient treats under section 631(c).

(2) Proportion and amount of bonus excluded, and

(3) Amounts paid to holders of other interests in the mineral deposit.

(b) All additional data necessary for the determination of the *taxable income from the property (computed without the allowance for depletion)*, as defined in § 1.613-5.

[T.D. 7170, 37 FR 5382, Mar. 15, 1972]

§ 1.613-7 Application of percentage depletion rates provided in section 613(b) to certain taxable years ending in 1954.

(a) *Election of taxpayer.* In the case of any taxable year ending after December 31, 1953, to which the Internal Revenue Code of 1939 is applicable, the taxpayer may elect in accordance with section 613(d) and this section to apply the appropriate percentage depletion rate specified in section 613 in respect of any mineral property (within the meaning of the 1939 Code). In the case of mines, wells, or other natural deposits listed in section 613(b), the election may be made by the taxpayer irrespective of whether his depletion allowance with respect to the property for the taxable year was computed upon the basis of cost, discovery value, or upon a percentage of gross income from the property. Once made, the election shall be irrevocable with respect to the property for which it is exercised. The election may be made for any mineral property of the taxpayer and need not be made for all such properties. *Gross income from the property and net income from the property* shall have the same meaning as those terms are used in 26 CFR (1939) 39.23(m)-1 (Regulations 118).

(b) *Computation of depletion allowance.* The depletion allowance for any taxable year with respect to any property for which the taxpayer makes the election under section 613(d) shall be an amount equal to the sum of: