

Internal Revenue Service, Treasury

§ 1.617-4

(1) A disposition which is in part a sale or exchange and in part a gift, or

(2) A disposition which is described in section 617(d) through the incorporation by reference of the provisions of section 1245(b)(3) (relating to certain tax free transactions).

(iii) *Property acquired from a decedent.*

If mining property is acquired in a transfer at death to which section 617(d) applies through incorporation by reference of the provisions of section 1245(b)(2), the amount of the adjusted exploration expenditures with respect to the mining property in the hands of the transferee immediately after the transfer shall include the amount, if any, of the exploration expenditures deducted by the transferee before the decedent's death, to the extent that the basis of the mining property (determined under section 1014(a)) is required to be reduced under the second sentence of section 1014(b)(9) (relating to adjustments to basis where the property is acquired from a decedent prior to his death).

(6) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example 1. A owns the working interest in a large tract of land located in the United States. A's interest in the entire tract of land constitutes one property for purposes of section 614. In the northwest corner of this tract is an operating mine, X, producing an ore of beryllium, which is entitled to a percentage depletion rate of 22 percent under section 613(b)(2)(B). During 1971, A conducts an exploration program in the southeast corner of this same tract of land, and he incurs \$400,000 of expenditures to which section 617(a)(1) applies in connection with this exploration program. A elects to deduct this amount as expenses under section 617(a). During 1971, A's *gross income from the property* computed under section 613 was \$1 million, with respect to the property encompassing mine X and the area in which exploration was conducted. A's *taxable income from the property* computed under section 613, before adjustment to reflect the deductions taken with respect to the property during the year under section 617, was \$400,000. The cost depletion deduction allowable and deducted with respect to the property during 1971 was \$50,000. The amount of adjusted exploration expenditures chargeable to the exploratory mine (hereinafter referred to as mine Y) at the close of 1971 is \$250,000, computed as follows:

Expenditures allowed as deductions under sec. 617(a)	\$400,000
Gross income from the property	\$1,000,000
22 percent thereof	220,000
Taxable income from the property, before adjustment to reflect deductions allowed under sec. 617 during year	400,000
50 percent thereof—tentative deduction	200,000
Taxable income from the property after adjustment to reflect deductions allowed under sec. 617 during year (\$400,000 minus \$400,000)	0
Cost depletion allowed for year	50,000
Amount by which allowance for depletion under sec. 611 was reduced on account of deductions under sec. 617 (\$200,000 minus \$50,000)	150,000
Adjusted exploration expenditures at end of 1971	250,000

Example 2. Assume the same facts as in example 1. Assume further that mine Y, with respect to which exploration expenditures were deducted in 1971, enters the producing stage in 1972, and that no deductions were taken under section 617 with respect to that mine after 1971. A does not make an election under section 617(b)(1)(A) during 1972. Assume that the depletion deduction which would be allowable for 1972 with respect to the property (which includes both mines) but for the application of section 617(b)(1)(B) is \$100,000. Pursuant to section 617(b)(1)(B), this depletion deduction is disallowed. Therefore, the amount of adjusted exploration expenditures with respect to mine Y at the end of 1972 is \$150,000 (\$250,000 less \$100,000).

[T.D. 7192, 37 FR 12945, June 30, 1972]

§ 1.617-4 Treatment of gain from disposition of certain mining property.

(a) *In general.* (1) In general, section 617(d)(1) provides, that, upon a disposition of mining property, the lower of (i) the *adjusted exploration expenditures* (as defined in section 617(f)(1) and paragraph (d) of § 1.617-3) with respect to the property, or (ii) the amount, if any, by which the amount realized on the sale, exchange, or involuntary conversion (or the fair market value of the property on any other disposition, exceeds the adjusted basis of the property, shall be treated as gain from the sale of exchange of property which is neither a capital asset nor property described in section 1231 (that is, shall be

recognized as ordinary income). However, any amount recognized under the preceding sentence shall not be included by the taxpayer in his *gross income from the property* for purposes of section 613. Generally, the ordinary income treatment applies even though in the absence of section 617(d) no gain would be recognized under any other provision of the Code. For example, if a corporation distributes mining property as a dividend, gain may be recognized as ordinary income to the corporation even though, in the absence of section 617, section 311(a) would preclude any recognition of gain to the corporation. For an exception to the recognition of gain with respect to dispositions which involve mineral production payments, see section 636 and the regulations thereunder. For the definition of the term *mining property*, see section 617(f)(2) and paragraph (c)(3), of § 1.617-3. For exceptions and limitations to the application of section 617(d)(1), see section 617(d)(3) and paragraph (c) of this section.

(2) In the case of a sale, exchange, or involuntary conversion of mining property, the gain to which section 617(d)(1) applies is the lower of the adjusted exploration expenditures with respect to such property or the excess of the amount realized upon the disposition of the property over the adjusted basis of the property. In the case of a disposition of mining property other than by a manner described in the preceding sentence, the gain to which section 617(d)(1) applies is the lower of the adjusted exploration expenditures with respect to such property or the excess of the fair market value of the property on the date of disposition over the adjusted basis of the property. In the case of a disposal of coal or domestic iron ore subject to a retained economic interest to which section 631(c) applies, the excess of the amount realized over the adjusted basis of the mining property shall be treated as equal to the gain, if any, referred to in section 631(c). For determination of the amount realized upon a disposition of mining property and nonmining property, see paragraph (c)(3)(i) of this section.

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

Example 1. On July 14, 1970, A purchased undeveloped mining property for \$100,000. During 1970, A incurred with respect to the property, \$50,000 of exploration expenditures which he deducts under section 617(a). In 1971, A incurred \$150,000 of exploration expenditures with respect to the property which he deducts on his income tax return. On January 2, 1972, A sells the mining property to B for \$250,000. A's gain on the sale is \$150,000 (\$250,000 amount realized minus \$100,000 basis). Since the excess of the amount realized over the adjusted basis of the mining property is less than the adjusted exploration expenditures with respect to the property (\$200,000), the entire gain is treated as ordinary income under section 617(d)(1).

Example 2. Assume the same facts as in example 1 except that A sells the mining property to B for \$400,000, thereby realizing gain of \$300,000 (\$400,000 minus \$100,000 basis). Since the amount of adjusted exploration expenditures with respect to the mining property (\$200,000) is less than the amount realized upon its disposition (\$300,000), an amount equal to the amount of adjusted exploration expenditures is treated as ordinary income under section 617(d)(1). The remaining \$100,000 is treated by A without regard to section 617(d)(1).

(4) Section 617(d) does not apply to losses. Thus, section 617(d) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of mining property, nor does section 617(d) apply to a disposition of mining property other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of such property is not greater than its adjusted basis.

(b) *Disposition of portion of mining property.* (1) For purposes of section 617(d)(1) and paragraph (a) of this section, except as provided in subparagraph (3) of this paragraph, in the case of the disposition of a portion of a mining property (other than an undivided interest), the entire amount of the adjusted exploration expenditures with respect to such property shall be treated as attributable to such portion to the extent of the amount of the gain to which section 617(d)(1) applies. If the amount of the gain to which section 617(d)(1) applies is less than the amount of the adjusted exploration expenditures with respect to the property, the

balance of the adjusted exploration expenditures shall remain subject to recapture in the hands of the taxpayer under the provisions of section 617 (b), (c), and (d). The disposition of a portion of a mining property (other than an undivided interest) includes the disposition of a geographical portion of a mining property. For example, assume that A owns an 80-acre tract of land with respect to which he has deducted exploration expenditures under section 617(a). If A were to sell the north 40 acres, the entire amount of the adjusted exploration expenditures with respect to the 80-acre tract would be treated as attributable to the 40-acre portion sold (to the extent of the amount of the gain to which section 617(d)(1) applies).

(2) For purposes of section 617(d)(1), except as provided in subparagraph (3) of this paragraph, in the case of the disposition of an undivided interest in a mining property (or portion thereof) a proportionate part of the adjusted exploration expenditures with respect to such property shall be treated as attributable to such undivided interest to the extent of the amount of the gain to which section 617(d)(1) applies. For example, assume that A owns an 80-acre tract of land with respect to which he has deducted exploration expenditures under section 617(a). If A were to sell an undivided 40 percent interest in such tract, 40 percent of the adjusted exploration expenditures with respect to the 80-acre tract would be treated as attributable to the 40 percent of the 80-acre tract disposed of (to the extent of the amount of the gain to which section 617(d)(1) applies).

(3) Section 617(d)(2) and subparagraphs (1) and (2) of this paragraph shall not apply to any expenditure to the extent that such expenditure relates neither to the portion (or interest therein) disposed of nor to any mine, in the property held by the taxpayer before the disposition, which has reached the producing stage. In any case where a taxpayer disposes of a mining property (or interest therein) and treats adjusted exploration expenditures with respect to the mining property as if they relate neither to the portion (or interest therein) disposed of nor to any mine, in the property held by the tax-

payer before the disposition, which has reached the producing stage, the taxpayer shall attach to its return for the taxable year in which the disposition occurred, a statement which includes:

(i) A description of the portion (or interest therein) disposed of;

(ii) A description of the mineral property which included the portion (or interest therein) disposed of;

(iii) An itemization of all expenditures deducted under sections 617 and 615 with respect to such mineral property; and

(iv) A description of the location of all producing mines on such mineral property.

(c) *Exceptions.* (1)(i) Section 617(d)(3) provides, through incorporation by reference of the provisions of section 1245(b)(1), that no gain shall be recognized under section 617(d) upon a disposition by gift of mining property. For purposes of this subparagraph, the term *gift* means, except to the extent that subdivision (ii) of this subparagraph applies, a transfer of mining property which, in the hands of the transferee, has a basis determined under the provisions of section 1015 (a) or (d) (relating to basis of property acquired by gift). For reduction in amount of the charitable contribution in case of a gift of section 617 property, see section 170(e) and paragraph (c)(3) of § 1.170-1.

(ii) Where a disposition of mining property is in part a sale or exchange and in part a gift, the gain to which section 617(d) applies is the lower of the adjusted exploration expenditures with respect to such property or the excess of the amount realized upon the disposition of the property over the adjusted basis of such property.

(2) Section 617(d)(3) provides, through incorporation by reference of the provisions of section 1245(b)(2), that, except as provided in section 691 (relating to income in respect to a decedent), no gain shall be recognized under section 617(d) upon a transfer at death. For purposes of this paragraph, the term *transfer at death* means a transfer of mining property which property, in the

hands of the transferee, has a basis determined under the provisions of section 1014(a) (relating to basis of property acquired from a decedent) because of the death of the transferor.

(3)(i) Section 617(d) provides, through incorporation by reference of the provisions of section 1245(b)(3), that upon a transfer of property described in subdivision (ii) of this subparagraph, the amount of gain taken into account by the transferor under section 617(d) shall not exceed the amount of gain recognized to the transferor on the transfer (determined without regard to section 617). For purposes of this subdivision, in case of a transfer of mining property and nonmining property in one transaction, the amount realized from the disposition of the mining property shall be deemed to be equal to the amount which bears the same ratio to the total amount realized as the fair market value of the mining property bears to the aggregate fair market value of all of the property transferred. The preceding sentence shall be applied solely for purposes of computing the portion of the total gain (determined without regard to section 617) which shall be recognized as ordinary income under section 617(d). Section 617(d)(3) does not apply to a disposition of mining property to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by chapter 1 of the Code.

(ii) The transfers referred to in subdivision (i) of this subparagraph are transfers of mining property in which the basis of the mining property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of any of the following provisions:

(a) Section 332 (relating to distributions in complete liquidation of an 80-percent-or-more controlled subsidiary corporation). See subdivision (iii) of this subparagraph.

(b) Section 351 (relating to transfer to a corporation controlled by transferor).

(c) Section 361 (relating to exchanges pursuant to certain corporate reorganizations).

(d) Section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings).

(e) Section 374(a) (relating to exchanges pursuant to certain railroad reorganizations).

(f) Section 721 (relating to transfers to a partnership in exchange for a partnership interest).

(g) Section 731 (relating to distributions by a partnership to a partner).

(iii) In the case of a distribution in complete liquidation of an 80-percent-or-more controlled subsidiary to which section 332 applies, the limitation provided in section 617(d)(3), through incorporation by reference of the provisions of section 1245(b)(3), is confined to instances in which the basis of the mining property in the hands of the transferee is determined under section 334(b)(1), by reference to its basis in the hands of the transferor. Thus, for example, the limitation may apply in respect of a liquidating distribution of mining property by an 80-percent-or-more controlled corporation to the parent corporation, but does not apply in respect of a liquidating distribution of mining property to a minority shareholder. Section 617(d)(3) does not apply to a liquidating distribution of property by an 80-percent-or-more controlled subsidiary to its parent if the parent's basis for the property is determined, under section 334(b)(2), by reference to its basis in the stock of the subsidiary.

[T.D. 7192, 37 FR 12947, June 30, 1972]

EXCLUSIONS FROM GROSS INCOME

§ 1.621-1 Payments to encourage exploration, development, and mining for defense purposes.

(a) *General rule.* (1) Under section 621, a taxpayer shall exclude from gross income amounts which are paid to him:

(i) By the United States or by an agency or instrumentality of the United States,

(ii) As a grant, gift, bounty, bonus, premium, incentive, subsidy, loan, or advance,

(iii) For the encouragement of exploration for, or development or mining of, a critical and strategic mineral or metal,

(iv) Pursuant to or in connection with an undertaking by the taxpayer to explore for, or develop or produce, such mineral or metal and to expend or