

§ 1.632-1

26 CFR Ch. I (4-1-04 Edition)

held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977). The rules contained in paragraph (d) of § 1.631-2 relating to bonuses in the case of contracts for the disposal of timber shall be equally applicable in the case of bonuses received for the grant of a contract of disposal of coal or iron ore under this section.

(d) *Nonapplication of section.* Section 631(c) shall not affect the application of the provisions of subchapter G, chapter 1 of the Code, relating to corporations used to avoid income tax on shareholders. For example, for the purposes of applying section 543 (relating to personal holding companies), the amounts received from a disposal of coal or iron ore subject to section 631(c) shall be considered as mineral royalties. The determination of whether an amount received under a contract to which section 631(c) applies is *personal holding company income* shall be made in accordance with section 543 and the regulations thereunder, without regard to section 631(c) or this section. See also paragraph (e) of § 1.272-1.

(e) *Special rules with regard to iron ore.*

(1) With regard to iron ore, section 631(c) and this section apply only to amounts received or accrued in taxable years beginning after December 31, 1963, attributable to iron ore mined in such taxable years.

(2) Section 631(c) and this section apply only to disposals of iron ore mined in the United States.

(3) For the purposes of section 631(c) and this section, iron ore is any ore which is used as a source of iron, including but not limited to taconite and jaspilite.

(4) Section 631(c) shall not apply to any disposal of iron ore to a person whose relationship to the person disposing of such iron ore would result in the disallowance of losses under section 267 or 707(b).

(5) Section 631(c)(2) results in the denial of section 631(c) treatment in the case of a contract for disposal of iron ore entered into with a person owned or controlled, directly or indirectly, by the same interests which own or control the person disposing of the iron ore, even though section 631(c) treatment would not be denied under the

provisions of section 631(c)(1). For example, section 631(c) treatment is denied in the case of a contract for disposal of iron ore entered into between two *brother and sister* corporations, or a parent corporation and its subsidiary. The presence or absence of control shall be determined by applying the same standards as are applied under section 482 (relating to the allocation of income and deductions between taxpayers).

[T.D. 6841, 30 FR 9307, July 27, 1965, as amended by T.D. 7730, 45 FR 72650, Nov. 3, 1980]

§ 1.632-1 Tax on sale of oil or gas properties.

(a) If the taxpayer, by prospecting and locating claims or by exploring or discovering undeveloped claims, has demonstrated the principal value of oil or gas property, which prior to his efforts had a relatively minor value, the portion of the tax (or, in the case of taxable years beginning before Jan. 1, 1971, the surtax) imposed by section 1 attributable to a sale of such property, or of any interest of the taxpayer therein, shall not exceed 33 percent (or, in the case of taxable year beginning before Jan. 1, 1971, 30 percent) of the selling price of such property or such interest. Shares of stock in a corporation owning oil or gas property do not constitute an interest in such property. To determine the application of section 632 to a particular case, the taxpayer should first compute the tax (or surtax) imposed by section 1 upon his entire taxable income, including the taxable income from any sale of such property or interest therein, without regard to section 632. The proportion of the tax (or surtax) so computed, indicated by the ratio which the taxpayer's taxable income from the sale of the property or interest therein, computed as prescribed in this section, bears to his total taxable income is the portion of the tax attributable to such sale and, if it exceeds 33 percent (or 30 percent) of the selling price of such property or interest, such portion of the tax (or surtax) shall be reduced to that amount.

(b) In determining the portion of the taxable income attributable to the sale of such oil or gas property or interest therein, the taxpayer shall allocate to the gross income derived from such

sale, and to the gross income derived from all other sources, the expenses, losses, and other deductions properly appertaining thereto and shall apply any general expenses, losses, and deductions (which cannot properly be otherwise allocated) ratably to the gross income from all sources. The gross income derived from the sale of such oil or gas property or interest therein, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the taxable income attributable to such sale. The taxpayer shall submit with his return a statement fully explaining the manner in which such expenses, losses, and deductions are allocated or apportioned.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 7117, 36 FR 9421, May 25, 1971]

MINERAL PRODUCTION PAYMENTS

§ 1.636-1 Treatment of production payments as loans.

(a) *In general.* (1)(i) For purposes of subtitle A of the Internal Revenue Code of 1954, a production payment (as defined in paragraph (a) of § 1.636-3) to which this section applies shall be treated as a loan on the mineral property (or properties) burdened thereby and not as an economic interest in mineral in place, except to the extent that § 1.636-2 or paragraph (b) of this section applies. See paragraph (b) of § 1.611-1. A production payment carved out of mineral property which remains in the hands of the person carving out the production payment immediately after the transfer of such production payment shall be treated as a mortgage loan on the mineral property burdened thereby. A production payment created and retained upon the transfer of the mineral property burdened by such production payment shall be treated as a purchase money mortgage loan on the mineral property burdened thereby. Such production payments will be referred to hereinafter in the regulations under section 636 as carved-out production payments and retained production payments, respectively. Moreover, in the case of a transaction involving a production payment treated as a loan pursuant to this section, the produc-

tion payment shall constitute an item of income (not subject to depletion), consideration for a sale or exchange, a contribution to capital, or a gift if in the transaction a debt obligation used in lieu of the production payment would constitute such an item of income, consideration, contribution to capital, or gift, as the case may be. For the definition of the term *transfer* see paragraph (c) of § 1.636-3.

(ii) The payer of a production payment treated as a loan pursuant to this section shall include the proceeds from (or, if paid in kind, the value of) the mineral produced and applied to the satisfaction of the production payment in his gross income and *gross income from the property* (see section 613(a)) for the taxable year so applied. The payee shall include in his gross income (but not *gross income from the property*) amounts received with respect to such production payment to the extent that such amounts would be includible in gross income if such production payment were a loan. The payer and payee shall determine their allowable deductions as if such production payment were a loan. See section 483, relating to interest on certain deferred payments in the case of a production payment created and retained upon the transfer of the mineral property burdened thereby, or in the case of a production payment transferred in exchange for property. See section 1232 in the case of a production payment which is originally transferred by a corporation at a discount and is a capital asset in the hands of the payee. In the case of a carved-out production payment treated as a mortgage loan pursuant to this section, the consideration received for such production payment by the taxpayer who created it is not included in either gross income or *gross income from the property* by such taxpayer.

(2) If a production payment is treated as a loan pursuant to this section, no transfer of such production payment or any property burdened thereby (other than a transfer between the payer and payee of the production payment which, if the production payment were a loan, would extinguish the loan) shall cause it to cease to be so treated. For example, A sells operating mineral interest X to B for \$100,000, subject to a