

IRC Section 617(b)(1)(A)

Election To Include Pre-Production Mine Exploration Expenditures in Gross Income

Overview

Section 617(a) permits taxpayers to elect to deduct exploration expenditures paid or incurred during the taxable year. When the mine reaches the production stage, the deduction for depletion under section §611 is disallowed until the amount of depletion which would be allowable equals the amount of the exploration expenditures previously deducted.

However, §617(b)(1)(A) permits taxpayers to elect to include in gross income an amount equal to the exploration expenditures with respect to such mines when the mines reach the production stage. This amount is added to the basis of the mine and is recovered through depletion. Generally, this election is made on a mine-by-mine basis. However, the election can also be made with respect to all mines which reach the producing stage during a tax year.

Reg. §1.617-1(a) generally defines exploration expenditures to include the costs of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral for which a deduction for depletion is allowable under §613 (other than oil or gas) paid or incurred by the taxpayer before the beginning of the development stage of the mine or other natural deposit. Reg. §1.617-3(c)(2) provides that a mine is considered to have reached the producing stage when:

- the major portion of the mineral production is obtained from workings other than those opened for the purpose of development; or
- the principal activity of the mine is the production of developed ores or minerals rather than the development of additional ores or minerals for mining.

The recapture is triggered if the mine reaches production at any time during the tax year, notwithstanding that it may not be in the production stage at year-end. If the mine includes more than one property, the depletion is limited until the aggregate depletion disallowance is equal to the adjusted exploration expenditure with respect to such mine. If an election under §614(c)(1) to aggregate more than one mine together for all income tax purposes, the depletion is limited until the aggregate depletion disallowance is equal to the

adjusted exploration expenditures with respect to all aggregated mines. If a mining property contains more than one mine, the recapture provisions only apply to the adjusted exploration expenditures related to the mine or mines that reach the producing stage during the tax year.

An election can be made with respect to all mines in a subsequent tax year even though an election was not made with respect to mines which reached the producing stage in a previous year. However, such an election could not be made with respect to mines that reached the producing stage in a previous year.

As with other §617 elections, the election is made at the **partner or shareholder** level for partnerships and S corporations.

When to File

The election is made clearly indicating on the return that such an election is being made. While this requirement may be met by separately labeling such amount in the return, it is recommended that a statement be attached to the tax return for any taxable year in which any mines have reached the production stage during the taxable year. The election must be made no later than the due date, including extensions, of the taxpayer's income tax return for such year.

Where to File

The election statement is attached to the taxpayer's timely filed income tax return, which is mailed to the designated Internal Revenue Service Center.

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1. Code Section: 617, 611, 703, 1363
2. Topic: Depreciation and Amortization; Natural Resources; Partnerships; S Corporations
3. Return Type: 1040, 1120

Authorities

IRC §617(b)(1)(A); §703(b)(2); §1363(c)(2)(A); Reg. §1.617-3(b)