

# **IRC Section 263(c)**

## **Election To Expense Or Capitalize Intangible Drilling And Development Costs**

### **Overview**

Section §263(c) permits "operators" who incur oil, gas, or geothermal well development costs to expense or capitalize intangible drilling and development costs ("IDCs") as defined in Reg. §1.612-4(a). An operator is one who holds a working or operating interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting working or operating rights. IDCs generally include items such as labor, fuel, repairs, hauling and supplies that do not have a salvage value.

The option to charge IDCs to expense may be exercised by claiming IDCs as a deduction on the taxpayer's return for the first taxable year in which the taxpayer pays or incurs such costs; **no formal statement is necessary**. If the taxpayer fails to deduct such costs as expenses in such return, he shall be deemed to have elected to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property.

Deductions otherwise available pursuant to §263(c) are not allowable for costs to which deductions are allowed under either §59(e), which allows such costs to be **electively** capitalized and amortized over ten years, or under §291(b), which requires 30% of IDCs be capitalized and amortized over a 60-month period.

Partnerships (and S corporations) make the election at the entity level.

### **When to File**

The election is made by claiming IDCs as a deduction on the taxpayer's return for the first taxable year in which the taxpayer pays or incurs such costs. Since the IRS guidance is unclear on whether an election can be made on an amended return, the election should 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 is made by deducting the IDCs on the taxpayer's timely filed income tax return, which is mailed to the designated Internal Revenue Service Center.

## **Index**

1. Code Section: 263, 59, 291, 703
2. Topic: Alternative Minimum Tax; Corporations; Deduction Items; Depreciation and Amortization; Natural Resources; Partnerships; S Corporations
3. Return Type: 1040, 1065, 1120, 1120S

## **Authorities**

IRC §263(c); §59(e); §291(b); Reg. §1.263(c)-1; Reg. §1.612-4(a); Reg. §1.612-4(d); Reg. §1.703-1(b)(1)