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INCOME TAX TREATMENT OF EXPLORATION EXPENDITURES IN THE CASE OF MINING

JULY 19, 1966.—Ordered to be printed

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 4665]

The Committee on Finance, to which was referred the bill (H.R. 4665), to amend the Internal Revenue Code of 1954 with respect to the tax treatment of exploration expenditures in the case of mining, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

The bill as passed by the House removes both the $100,000 per year and the $400,000 overall ceiling on the deductions which may be taken for exploration expenditures where the exploration occurred within the United States (including the Outer Continental Shelf). On the other hand, under the House bill exploration expenditures deducted after the date of enactment of this bill were to be "recaptured" primarily through decreased depletion deductions if the mine reached the production stage, or by treating an appropriate amount of any gain as ordinary income in the case of most dispositions of the property. With respect to minerals to which it applied, the House bill repealed entirely the deduction for exploration expenditures in the case of exploration abroad. The House bill, as does your committee's bill, did not apply to the deduction of exploration expenditures in the case of oil, gas, or coal explorations.

Your committee made one major modification in the House bill. It has provided that all taxpayers are to be given the right to continue to deduct exploration expenditures subject to the $100,000 and $400,000 ceilings of existing law without any "recapture" rules being applied. This same change also has the effect of restoring the deduction of exploration expenditures for foreign (and oceanographic) explorations, up to the limits of $100,000 a year or $400,000 overall, as provided under present law.

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Under the bill, as amended by your committee, if a taxpayer elects to deduct expenses in excess of the dollar limitations of present law, the recapture provision will apply not only with respect to these excess amounts, but also, similar in effect to this feature of the bill as passed by the House, the recapture provision will apply with respect to amounts deducted which are below the $100,000 and $400,000 limitations of present law (but only those deducted after the date of enactment of this bill).

In addition, your committee has made a technical amendment providing, in general, that where a distribution of mineral property has been made by a partnership to a partner, exploration expenditures made by the partnership with respect to the mineral property are to be recaptured from the distributee partner. Also the amendment makes sure that the exploration expenditures to be recaptured are to be reduced by the gain that was recognized on the distribution, whether the gain is realized by the distributee partner or the remaining partnership.

II. REASONS FOR THE BILL

Under present law, mining exploration expenditures, that is expenditures for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or any mineral, paid or incurred before the beginning of the development stage of the mine, are deductible in computing taxable income but only to the extent they do not exceed two limitations. Under the first limitation, the deduction of these expenditures paid or incurred during a taxable year may not exceed $100,000. Under the second limitation, the total amount deductible by any one taxpayer for all taxable years may not exceed $400,000. Expenditures in excess of these limitations must be capitalized (i.e., included as part of the cost of the property). If a property proves to be nonproductive, any such capitalized expenditures attributable to it can only be recovered upon its sale, exchange, abandonment, or becoming worthless.

For the many taxpayers who have already reached the $400,000 limit in exploration expenditures, the incentive to continue mining explorations is substantially reduced. Not only do they lose the tax advantage of the immediate writeoff of these exploration costs, but also in the case of exploration expenditures which prove unsuccessful they are likely to have to forego the recovery of these costs for an almost indefinite period. The latter result occurs because in the mining industry it is often considered undesirable to sell or abandon mineral properties where the exploration has proved to be unsuccessful because of the possibility that future exploration may disclose mineral deposits or because new techniques may make mining of lower grade deposits profitable. The effect of present law in such a situation is to force taxpayers nevertheless either to dispose of the properties, irrespective of economic considerations, or to postpone the writing off of these costs almost indefinitely.

Your committee agrees with the House that these restrictive effects of present law on exploration expenditures are undesirable. Your committee has accepted, therefore, the provision of the House bill which permits the current deduction of domestic mining exploration expenditures without regard to the $100,000 or $400,000 limitation.

Your committee also recognizes that in the case of mining properties which become productive, there is an added advantage over present

law in being able to write the exploration expenditures off currently. In addition, gains on the sale of mining property, under present law, are generally treated as capital gains. Allowing an immediate deduction (rather than capitalizing exploration expenditures) in such cases gives a taxpayer a deduction against ordinary income for an amount subsequently taxed to him as a capital gain. This problem would be substantially increased by an unlimited exploration expenditure deduction.

For the reasons given above, your committee's action, like the House bill, provides for the recapture of exploration expenditures which had been deducted (either when the property becomes productive or when it is disposed of) but only where the taxpayer has elected to take deductions currently in excess of the $100,000 and $400,000 limitations of existing law. In any event, the recapture provisions will not be applied with respect to past exploration expenditures. Your committee believed that it was desirable to maintain the incentive of existing law for exploration expenditures up to $100,000 a year and up to $400,000 in aggregate without applying the recapture provisions where these totals are not exceeded. This will assure new and small businesses the full advantage of present law. In addition, your committee has retained the right to deduct amounts for exploration abroad up to $100,000 a year and $400,000 in the aggregate per taxpayer. This gives assurance that the current deduction of exploration expenditures incurred abroad may be continued in the same manner as under existing law. In this respect, it should be noted that this provides for the current deduction subject to these limitations not only of exploration expenditures incurred in a foreign country but also those incurred for exploration under the seas.

It has been estimated that for a short transitional period this bill will result in a revenue loss of $3 million a year. However, because the bill provides for the recapture of exploration expenditures where the amounts deducted exceed the $100,000 or $400,000 limitations, it is not believed that there will be any long run revenue reduction under the bill.

III. GENERAL EXPLANATION

The bill adds a new provision to the code (sec. 617) which provides for the deduction of mining exploration expenditures in the taxable year in which they are paid or incurred without regard to the present $100,000 and $400,000 limitations. This provision is applicable only to mineral exploration expenditures in the United States. Under the bill, as amended by your committee, taxpayers may elect to deduct their mining exploration expenditures either under this new provision without dollar limitations or they may continue to deduct exploration expenditures subject to these limitations. If they elect the new provision without limitations, any of these deductions are subject to the recapture rules specified below. On the other hand, however, if they elect to continue the application of the present provision of the code (sec. 615), which provides these limitations, the recapture rules do not apply.

Election.—A taxpayer may initially elect to come under the provision with the dollar limitations and then subsequently (for example, if he desires to incur exploration expenditures in excess of either of these limitations) may elect to apply the new provision with the recapture rules. In the event the taxpayer elects to apply the provi-

sions without limitations, the recapture provisions are to apply not only with respect to the amounts deducted in excess of the limitations, but also any amounts deducted under the existing provision for expenditures incurred after the date of enactment of this act.

A taxpayer may make an election to deduct exploration expenditures under the new provision without limitations at any time during the period for making a claim for refund for the year involved. This election may be revoked without consent of the Treasury Department at any time before the fourth month beginning after the final regulations on the new provision are published. An election once made is to be applicable to all exploration expenditures (covered by the new sec. 617) of the taxpayer for the year in question and all subsequent years. The bill permits the assessment of a deficiency attributable to an election or revocation within the 2 years after the election or revocation is made.

Recapture provision.—The bill provides for the recapture of exploration expenditure deductions when a mine reaches the producing stage. When this occurs the taxpayer may either (*a*) elect to include in income for that year the deductions chargeable to the mine, or (*b*) forego depletion from the property which includes or comprises the mine until the deductions foregone equal the amounts previously deducted.

The election to include the prior deductions in income must be made for all mines reaching the producing stage in a year with respect to which the taxpayer has deducted exploration expenditures under the new provision. Under this alternative the bases of the properties are increased by the amount recaptured and this may subsequently be recoverable through the depletion allowance. This, in effect, places the taxpayer essentially in the position he would have been in, had he initially capitalized the expenditures rather than deducting them currently.

Under the election to forego depletion deductions from a property until this equals the exploration expenditures, the amount of the depletion allowance disallowed is limited to the amount of the "adjusted exploration expenditures" with respect to a mine.

The term "adjusted exploration expenditures" is defined in general as the excess of the exploration expenditures previously allowed as deductions over the reduction in the depletion allowance which occurred because the taxpayer deducted exploration expenditures. This is further reduced for any amounts previously recaptured. A special recapture rule provides for a similar reduction in the depletion allowance where a taxpayer receives a bonus or royalty payment.

The bill also provides for the recapture of exploration expeditures (to the extent not already recaptured as explained above) on the sale or other disposition of a mining property. In the case of a sale, exchange, or involuntary conversion, the adjusted exploration expenditures are recaptured only to the extent of the gain on the sale. (In the case of other forms of disposition, the adjusted exploration expenditures are recaptured only to the extent the fair market value of the property exceeds its cost or other basis.) The amount recaptured on sale or other disposition is to be treated as ordinary income. It also is to be recognized whether or not this would otherwise occur under present law. Dispositions for this purpose include disposals of iron ore which receive capital gain treatment under a special provision of the code (sec. 631(c)).

If only a portion of a mining property (other than an undivided interest) is disposed of, the entire adjusted exploration expenditures are attributed to the portion disposed of, to the extent of the gain (or the excess of fair market value over the basis of the property). This forestalls the avoidance of the recapture provision by selling off the more valuable portion of a property but keeping a portion of it to which the exploration expenditures might in whole or in part be attributed.

However, if an undivided interest in a mining property is disposed of, a proportionate part of the adjusted exploration expenditures is attributed to this interest but again, only to the extent of the gain on the disposition (or the excess of fair market value over the basis).

Despite the rules set forth above where a portion of a mining property is disposed of, the recapture rules are not to apply to the extent the taxpayer establishes to the satisfaction of the Secretary of the Treasury that the expenditures do not relate to the portion disposed of (or to any mine, in the property, which had already reached the producing stage).

Exceptions to recapture rules.—The bill also provides certain exceptions to the recapture rules which are similar in effect to the exceptions to the depreciation recapture provisions under present law applicable in the case of the sale of tangible personal property. The first of these exceptions is for gifts. In this case since the recapture rules do not apply at the time of the gift, the adjusted exploration expenditures go over to the donee. As a result the recapture provisions apply and may result in ordinary income to the donee if he sells the property or takes a depletion deduction. In addition, the bill provides that where a mineral property is given to a charitable organization the amount of the charitable contribution deduction is to be reduced by the amount which would have been treated as ordinary income (under the recapture rules) had the property been sold at its fair market value.

A second exception applies in the case of transfers at death. In this case the adjusted exploration expenditures do not go over to the heir and as a result this recapture is not applied upon the sale of the property by the heir.

A third series of exceptions to the recapture provisions relate to dispositions in transactions which generally are tax free but where the basis of the property in the hands of the transferor is carried over to the transferee. (However, in these transactions, where there is any gain recognized, because the exchange is accompanied by "boot"—i.e., money or its equivalent—then to the extent of this gain, ordinary income may be realized.) To the extent gain is not recognized the "adjusted exploration expenditures" go over to the transferee and may result in ordinary income. The tax-free transactions referred to are those occurring on the complete liquidation of a subsidiary (sec. 332) where the subsidiary's basis goes over to the parent; a transfer of mining property to a corporation controlled by the transferor (sec. 351); a transfer by a corporation which is a party to a reorganization of property in pursuance of a plan of reorganization solely for stock or securities in another corporation also a party to the reorganization (sec. 361); and transfers occurring in reorganizations pursuant to certain receiverships and bankruptcy proceedings (sec. 371 and sec. 374).

Recapture is to occur on the contribution of property to a tax-exempt organization (other than a tax-exempt farm cooperative)

in exchange for stock or securities in the exempt organization. Gain is to be recognized in such a case because a disposition of the property by the exempt organization would not ordinarily be subject to tax.

The recapture rules do not apply to property contributed to a partnership in exchange for an interest in the partnership nor to certain distributions by a partnership in partial or complete liquidation of an interest. In the case of a distribution of a mineral property by a partnership to a partner, the recapture rules are applied at the time of the distribution in those cases where (and to the extent) gain is recognized. Your committee has added an amendment to the House bill which provides that where gain is recognized on such a distribution (as the result of the treatment of mineral property as an unrealized receivable to the extent of the adjusted exploration expenditures), the amount of the exploration expenditures which is to be recaptured subsequently is reduced by the amount of the gain attributable to the expenditures which was recognized on the distribution. This applies whether the mining property with respect to which the gain is realized is distributed or whether the distributee partner realizes gain with respect to mineral property remaining in the partnership. Where the property goes over to the partner without recognition of gain, the recapture rules in the case of mineral properties distributed are not to apply at that time. However, provision is made for their application at any subsequent time when the partner (or former partner) disposes of the mineral property or when a depletion deduction would be allowable. Thus, in these and other transactions involving partners and partnerships the bill in general, follows the rules provided by existing law (secs. 1245 and 1250) with respect to depreciable property.

Special rules.—The term "mining property" for purposes of the election to deduct exploration expenditures is defined by the bill to mean any interest or aggregation of interests which constitutes a "property" for purposes of computing the depletion allowance.

The bill also makes technical amendments to certain corporate provisions of existing law (secs. 301, 312, 341, and 453) to coordinate these provisions with the new recapture provisions.

Retention of existing provision with limitations.—Your committee's bill deletes the provision of the House bill which would have limited the deduction under current law with respect to mining exploration expenditures to those incurred with respect to exploration for coal. By so doing, your committee's bill retains as one alternative present law with respect to all minerals, including the existing $100,000 and $400,000 limitations on the amount of expenditures deductible. The effect of this amendment is to permit the deduction of exploration expenditures up to the dollar limitations of existing law without requiring the recapture of amounts so deducted. In addition this amendment permits the deduction, up to the dollar limitations, of expenditures incurred with respect to exploration abroad. Your committee's bill correlates this provision with the new provision added by the bill where exploration expenditures initially are deducted under the present law provision with the limitations and then subsequently an election is made under the new provision without the limitations. Under this correlating provision, if a taxpayer elects to deduct amounts in excess of the dollar limitations for any taxable year, all exploration expenditures for that year and for subsequent years must be deducted under the new provision (sec. 617). In

addition, if a taxpayer receives a mineral property from an individual or a corporation which has elected to deduct exploration expenditures under the new provision for any period prior to such transfer and the transfer was one of which, generally, gain was not recognized, the taxpayer may deduct exploration expenditures for the year of the transfer and for all future years only under the new provision.

In addition, your committee's amendment provides that if a taxpayer elects to deduct exploration expenditures under the new provision all such expenditures paid or incurred after the day of enactment of this bill which have been deducted under the old provision are to be treated, in effect, as having been deducted under the new provision, thereby becoming subject to the recapture provision. This includes expenditures of any individual or corporation who transferred a mineral property to the taxpayer, generally, in a tax-free transfer, but only with respect to expenditures attributed to the property transferred. Your committee's amendment also provides for the extension of the time for the assessment of a deficiency which results from the disallowance of a deduction under the old provision, or the application of the recapture rules, as a consequence of the taxpayer's election to deduct exploration expenditures under the new provision. This extension is for the 2-year period beginning after the day on which the election was made. A deficiency which results from the acquisition of a mineral property in a tax-free transfer may be assessed within the 2-year period beginning after the day on which the election under the new provision is made by the transferor.

Effective date.—The amendments made by the bill are to apply to taxable years ending after the date of its enactment but only in respect of expenditures paid or incurred after such date.

IV. TECHNICAL EXPLANATION OF COMMITTEE AMENDMENTS

SECTION 1. ADDITIONAL EXPLORATION EXPENDITURES IN THE CASE OF DOMESTIC MINING

The first section of the bill adds a new section 617 to part I of subchapter I of chapter 1 of the 1954 code (relating to natural resources) and makes several technical changes necessitated by the addition of the new section to the code. In general, section 617 provides for income tax deductions without limitation for exploration expenditures for domestic minerals (other than coal, oil, and gas) paid or incurred before the beginning of the development stage of the mine, and it provides for the recapture of amounts deducted under section 617 when a mine reaches the producing stage or when a mining property is disposed of.

Your committee has amended the first section of the bill by adding to section 617 a new subsection (g), which contains special rules relating to partnership property, and by making minor clerical changes. The changes made by your committee with respect to partnership property are described below.

For the technical explanation of the first section of the bill (other than the amendments made by your committee), see pages 6 through 13 of the report of the Committee on Ways and Means on the bill.

Special rules relating to partnership property

As passed by the House, section 617(d)(3) provided, inter alia, that section 1245(b)(6) (relating to exceptions and limitations with respect to gain from disposition of certain depreciable property in the case of property distributed by a partnership to a partner) would apply in respect of section 617(d) (relating to gain from disposition of certain mining property) in the same manner and with the same effect as if references in section 1245(b) to section 1245, or to any provision of section 1245, were references to section 617(d) or the corresponding provisions of section 617(d), and as if references to section 1245 property were references to mining property. Subsection (g), which has been added to section 617 by your committee, provides more detailed rules relating to partnership property than were provided by the incorporation by reference of section 1245(b)(6).

Property distributed to partner

Paragraph (1) of section 617(g) provides that, if a partnership distributes to a partner a property or mine with respect to all or a part of his interest in the partnership, the adjusted exploration expenditures with respect to the distributed property or mine immediately after the distribution will be an amount equal to (1) the adjusted exploration expenditures with respect to the property or mine immediately before the distribution, reduced by (2) the amount of gain realized by the partnership (as constituted after the distribution) to which section 751(b) (relating to unrealized receivables and inventory items) applied on the distribution of the property or mine. Section (1)(c) of the bill (as passed by the House and approved by your committee without change) amends section 751(c) (relating to definition of "unrealized receivables") to provide that the term "unrealized receivables" includes mining property (defined in section 617(f)(2)), to the extent that the partnership would have realized ordinary income under section 617(d)(1) had it sold the distributed mining property at the time of the distribution at its fair market value. Section 751(b) provides that, in the case of a distribution to a partner of more than his proportionate share of unrealized receivables or substantially appreciated inventory items, the partnership is deemed to have sold to the distributee partner an interest in such property to the extent of the excess over his proportionate share therein. The partnership will realize gain in the amount of the difference between the basis of such receivables or inventory items properly allocable to this excess and the value of the distributee's interest in the other assets of the partnership relinquished in exchange for such unrealized receivables or inventory items. Under section 751(a), this gain is treated as ordinary income. If the amount of the adjusted exploration expenditures with respect to the distributed mining property immediately before the distribution exceeds the amount of gain realized by the partnership to which section 751(b) applied on the distribution of the mining property, the excess will be subject to recapture in the hands of the distributee under section 617 (b), (c), or (d).

Property retained by partnership

Paragraph (2) of section 617(g) applies to the situation where a partnership owning mining property distributes other property to a partner in consideration for his relinquishing all or part of his interest in the mining property. In such a case, the distributee partner will

realize ordinary income under section 751(b) to the extent of the difference between his adjusted basis for the mining property relinquished in the exchange and the fair market value of other property received by him in exchange for his interest in the mining property which he has relinquished. Section 617(g)(2) provides that the adjusted exploration expenditures with respect to the property or mine are to be reduced by the amount of gain to which section 751(b) applied realized by the distributee partner with respect to the distribution on account of the property or mine retained by the partnership. If the distributee partner realizes income on the distribution to which section 751(b) applies on account of both mining property and other unrealized receivables (such as sec. 1245 property) retained by the partnership, the adjusted exploration expenditures with respect to the mining property is to be reduced by only so much of the income to which section 751 applies realized by the partner as is properly attributable to the mining property.

SECTION 2. EXPLORATION EXPENDITURES

As passed by the House, section 2 of the bill amended section 615 of the code to restrict the application of section 615 after the effective date of the enactment of H.R. 4665 to coal. Thus, in the case of minerals other than coal, exploration expenditures after the date of enactment would have been deductible only under section 617.

Your committee has amended section 2 of the bill so that exploration expenditures in connection with minerals now within the scope of section 615 may, at the election of the taxpayer, continue to be deducted under section 615, subject to the existing $100,000 annual and $400,000 overall limitations set forth in subsections (a) and (c), respectively. However, your committee has also added to section 615 a new subsection (e), providing for a correlation between sections 615 and 617 in certain cases.

The first paragraph of section 2 of the bill, as amended by your committee, amends section 615(a) to provide that the deduction for exploration expenditures under section 615 is to be allowed at the election of the taxpayer, and that this election is to be made in such manner and at such time as the Secretary of the Treasury or his delegate may prescribe by regulations. If the election is made, expenditures previously deducted under section 615 will be taken into account in determining when the $100,000 annual and $400,000 overall limitations are reached.

Ineligibility to make election under section 615

Section 615(e)(1) sets forth certain situations in which the making of an election under section 617(a) will prevent a taxpayer from taking deductions under section 615(a), even though his deductions under section 615(a) have not exceeded the $100,000 and $400,000 limitations. Under section 615(e)(1), a taxpayer who elects to deduct exploration expenditures under section 617(a) may not deduct exploration expenditures under section 615(a) for the taxable year for which his election under section 617(a) is made or for any subsequent taxable year. Moreover, if a taxpayer elects to deduct exploration expenditures under section 617(a), any election he has previously made to deduct exploration expenditures under section 615(a) for the

taxable year for which the election under section 617(a) is made, or for any subsequent taxable year, is to have no effect. Such a situation could arise because under section 617(a)(2)(B) an election under section 617(a) for a taxable year may be made at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by chapter 1 for the taxable year. For example, assume that A, in the manner prescribed by regulations promulgated by the Secretary of the Treasury or his delegate, elects to deduct exploration expenditures under section 615 in computing his taxable income for 1967 and 1968. Before the expiration of the period prescribed for making a claim for credit or refund of income tax for 1967, A elects, in the manner prescribed by regulations promulgated by the Secretary of the Treasury or his delegate, to deduct his 1967 expenditures for exploration under section 617(a). A's previous elections to deduct exploration expenditures under section 615 for 1967 and 1968 will have no effect.

The provisions of section 615(e)(1) must be read in conjunction with the effective date provision of H.R. 4665. Section 3 of the bill, as passed by the House and approved by your committee, provides that the amendments made by the bill will apply to taxable years ending after the date of the enactment of the bill, but only in respect of expenditures paid or incurred after the date of enactment. For example, assume that the bill is enacted on September 1, 1966, A, a calendar year taxpayer, first elects to deduct exploration expenditures under section 615 for 1966, but he subsequently elects to deduct exploration expenditures for 1966 under section 617. A's election under section 617 will be effective with respect to expenditures paid or incurred by him on or after September 2, 1966, but it will have no effect on expenditures paid or incurred by him on or before September 1, 1966.

Section 615(e)(1) also provides that, if any individual or corporation has transferred (within the meaning of section 615(c)(3)) any mineral property to the taxpayer, and the transferor makes or has made an election under section 617(a) which applies to any period before the transfer, the transferee may not elect to deduct exploration expenditures under section 615(a) for the taxable year in which the transfer is made or for any subsequent taxable year. Furthermore, any election previously made by the taxpayer for the taxable year in which the transfer is made or for any taxable year after the transfer is to have no effect. In other words, as to the section under which exploration expenditures may be deducted, the transferee is, for such taxable years, bound by the transferor's election to deduct such expenditures under section 617(a). However, the transferor's election does not preclude the transferee from capitalizing exploration expenditures.

Application of recapture provisions of section 617

Section 615(e)(2) provides that, if a taxpayer makes an election under section 615(a) and subsequently makes an election under section 617(a), the provisions of subsections (a)(2)(C), (b), (c), (d), (e), (f), and (g) of section 617 are, under regulations prescribed by the Secretary of the Treasury or his delegate, to apply to all expenditures which have been paid or incurred by him after the date of the enactment of H.R. 4665 and which have been deducted under section 615(a) or treated as deferred expenses under section 615(b). The effect of this provision is that, if a taxpayer deducts exploration expenditures paid

or incurred after the date of enactment of the bill under section 615 and subsequently deducts exploration expenditures under section 617, the amounts deducted under section 615 must be taken into account in computing adjusted exploration expenditures (defined in section 617(f)(1)) which are subject to recapture under the provisions of subsections (b), (c), and (d) of section 617. In computing adjusted exploration expenditures, amounts deducted under section 615 shall, in accordance with section 617(f)(1)(B), be reduced by, for the taxable year in which a deduction was taken under section 615, the amount (if any) by which the deduction for percentage depletion which would have been allowable under section 613, but for the deduction of such expenditures under section 615, exceeds the amount allowable for the corresponding taxable year for depletion under section 611. For an illustration of the manner in which such an adjustment is to be made, see page 12 of the report of the Committee on Ways and Means.

Section 615(e)(2) also provides that a taxpayer who, having deducted exploration expenditures under section 615, later made an election under section 617(a), must take into account expenditures paid or incurred by any individual or corporation who transferred any mineral property to the taxpayer (determined by applying section 615(c)(3)). However, the only expenses of the transferor which the transferee needs to take into account are those which were paid or incurred with respect to the mineral property transferred. Of course, section 617(e)(2) applies only to amounts allowed as deductions under section 615(a) or treated as deferred expenses under section 615(b). For example, if a taxpayer deducts $100,000 of expenditures paid or incurred by him for 1967 and capitalizes $30,000 of additional exploration expenditures paid or incurred by him in 1967, and elects to deduct exploration expenditures under section 617(a) for 1968, only the $100,000 of expenditures allowed as deductions in 1967, and not the $30,000 capitalized, would be subject to recapture.

If a taxpayer deducts exploration expenditures under section 615 that are not within the scope of section 617(a) (such as exploration expenditures with respect to minerals located neither in the United States nor on the Outer Continental Shelf) and subsequently makes an election under section 617(a), the amounts deducted under section 615 prior to such election will (unless the taxpayer makes an election under section 617(b)(1)(A)) be subject to recapture against the income from the properties with respect to which the deductions under section 615 were allowed.

Because of the provisions of section 615(e)(2), it will be necessary for taxpayers deducting under section 615 exploration expenditures paid or incurred after the date of enactment of H.R. 4665 to maintain records showing the property or mine with respect to which such expenditures were paid or incurred.

Deficiencies

Section 615(e)(3) provides for the tolling of the statute of limitations for the assessment of a deficiency in certain cases. Where the deficiency is attributable to the application of section 615(e)(1) by virtue of a transfer of mineral property, the statutory period for the assessment of a deficiency will not expire until the last day of the 2-year period beginning on the day after the date on which the transferor made the election under section 617(a).

Under section 617(a)(2)(C), where a taxpayer, after making an election under section 615(a) for a taxable year, subsequently makes an election under section 617(a) for the same taxable year or for a prior taxable year, the statutory period for the assessment of a deficiency for the taxable year, to the extent the deficiency is attributable to such election and the application of section 615(e)(1), will not expire before the last day of the 2-year period beginning on the day after the date on which the taxpayer made the election under section 617(a).

Under section 617(a)(2)(C), to the extent a deficiency is attributable to the application of the recapture provisions of section 617 to amounts allowed as deductions under section 615 by virtue of section 615(e)(2), the statutory period for the assessment of any deficiency for any taxable year will not expire before the last day of the 2-year period beginning on the day after the date on which the taxpayer makes the election under section 617(a).

A deficiency to which section 615(e)(3) or section 617(a)(2)(C) applies may be assessed at any time before the expiration of the specified 2-year period notwithstanding any law (such as section 6501) or rule of law which would otherwise prevent such assessment. The provisions of such sections will not limit the assessment of deficiencies during any period of limitations otherwise provided by or pursuant to law but only provide an additional period for the assessment of a deficiency.

Regulations

Section 615(e)(4) provides that the Secretary of the Treasury or his delegate is to prescribe such regulations as may be necessary in order to carry out the provisions of section 615(e), including regulations for the application of section 615 in cases in which an election under section 617(a) has been revoked. Section 617(a)(2)(B) provides that the election provided by section 617(a)(1) may be revoked with the consent of the Secretary of the Treasury or his delegate, before the expiration of the last day of the third month following the month in which the final regulations issued under the authority of section 617(a) are published in the Federal Register, and may thereafter be revoked only with the consent of the Secretary of the Treasury or his delegate. Section 615(e)(4) requires the Secretary of the Treasury or his delegate to prescribe regulations setting forth the manner in which, and the conditions under which, a taxpayer who revokes an election which he has made under section 617(a) may make an election under section 615. The regulatory authority granted the Secretary of the Treasury or his delegate is expected to be used to provide rules for determining to which property amounts deducted under section 615(a) or treated as deferred expenses under section 615(b) may properly be allocated.

V. CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

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(e) SPECIAL RULE FOR CHARITABLE CONTRIBUTIONS OF CERTAIN PROPERTY.—The amount of any charitable contribution taken into account under this section shall be reduced by the amount which would have been treated as gain to which section [1245(a)] *617(d)(1), 1245(a)*, or 1250(a) applies if the property contributed had been sold at its fair market value (determined at the time of such contribution).

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SEC. 301. DISTRIBUTIONS OF PROPERTY.

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(b) AMOUNT DISTRIBUTED.—

(1) GENERAL RULE.—For purposes of this section, the amount of any distribution shall be—

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(B) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, the amount of money received, plus whichever of the following is the lesser:

(i) the fair market value of the other property received; or

(ii) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311, under section 341(f), or under section [1245(a)] *617(d)(1), 1245(a)*, or 1250(a).

* * * * * * *

(d) BASIS.—The basis of property received in a distribution to which subsection (a) applies shall be—

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(2) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, whichever of the following is the lesser:

* * * * * * *

(B) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311, under section 341(f), or under section [1245(a)] *617(d)(1), 1245(a)*, or 1250(a).

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SEC. 312. EFFECT ON EARNINGS AND PROFITS.

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(c) ADJUSTMENTS FOR LIABILITIES, ETC.—In making the adjustments to the earnings and profits of a corporation under subsection (a) or (b), proper adjustment shall be made for—

* * * * * * *

(3) any gain to the corporation recognized under subsection (b) or (c) of section 311, under section 341(f), or under section [1245(a)] *617(d)(1), 1245(a)*, or 1250(a).

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SEC. 341. COLLAPSIBLE CORPORATIONS.

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(e) EXCEPTIONS TO APPLICATION OF SECTION.—

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(12) NONAPPLICATION OF SECTION 1245(a).—For purposes of this subsection the determination of whether gain from the sale or exchange of property would under any provision of this chapter be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b) shall be made without regard to the application of sections [1245(a)] *617(d)(1), 1245(a)*, and 1250(a).

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SEC. 453. INSTALLMENT METHOD.

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(d) GAIN OR LOSS ON DISPOSITION OF INSTALLMENT OBLIGATIONS.—

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(4) EFFECT OF DISTRIBUTION IN CERTAIN LIQUIDATIONS.—

(A) LIQUIDATIONS TO WHICH SECTION 332 APPLIES.—If—

(i) an installment obligation is distributed by one corporation to another corporation in the course of a liquidation, and

(ii) under section 332 (relating to complete liquidations of subsidiaries) no gain or loss with respect to the receipt of such obligation is recognized in the case of the recipient corporation,

then no gain or loss with respect to the distribution of such obligation shall be recognized in the case of the distributing corporation. If the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2) then the preceding sentence shall not apply to the extent that under paragraph (1) gain to the distributing corporation would be considered as gain to which section 341(f) or section [1245(a)] *617(d)(1), 1245(a)*, or 1250(a) applies.

(B) LIQUIDATIONS TO WHICH SECTION 337 APPLIES.—If—

(i) an installment obligation is distributed by a corporation in the course of a liquidation, and

(ii) under section 337 (relating to gain or loss on sales or exchanges in connection with certain liquida-

tions) no gain or loss would have been recognized to the corporation if the corporation had sold or exchanged such installment obligation on the day of such distribution,

then no gain or loss shall be recognized to such corporation by reason of such distribution. The preceding sentence shall not apply to the extent that under paragraph (1) gain to the distributing corporation would be considered as gain to which section 341(f) or section [1245(a)] *617(d)(1), 1245(a),* or 1250(a) applies.

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Subchapter I—Natural Resources

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PART I—DEDUCTIONS

Sec. 611. Allowance of deduction for depletion.
Sec. 612. Basis for cost depletion.
Sec. 613. Percentage depletion.
Sec. 614. Definition of property.
Sec. 615. Exploration expenditures *in the case of coal.*
Sec. 616. Development expenditures.
Sec. 617. Additional exploration expenditures in the case of domestic mining.

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SEC. 615. EXPLORATION EXPENDITURES.

(a) IN GENERAL.—[In] *At the election of the taxpayer, made in such manner and at such time as the Secretary or his delegate may prescribe by regulations, in* the case of expenditures paid or incurred during the taxable year for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral, and paid or incurred before the beginning of the development stage of the mine or deposit, there shall be allowed as a deduction in computing taxable income so much of such expenditures as does not exceed $100,000. This section shall apply only with respect to the amount of such expenditures which, but for this section, would not be allowable as a deduction for the taxable year. This section shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 167, but allowances for depreciation shall be considered, for purposes of this section, as expenditures paid or incurred. In no case shall this section apply with respect to amounts paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of oil or gas.

(b) ELECTION OF TAXPAYER.—If the taxpayer elects, in accordance with regulations prescribed by the Secretary or his delegate, to treat as deferred expenses any portion of the amount deductible for the taxable year under subsection (a), such portion shall not be deductible in the manner provided in subsection (a) but shall be deductible on a ratable basis as the units of produced ores or minerals discovered or explored by reason of such expenditures are sold. An election made under this subsection for any taxable year shall be binding for such year.

(c) LIMITATION.—

(1) IN GENERAL.—This section shall not apply to any amount paid or incurred to the extent that it would, when added to the

amounts which have been deducted under subsection (a) and the amounts which have been treated as deferred expenses under subsection (b), or the corresponding provisions of prior law, exceed $400,000.

(2) AMOUNTS TAKEN INTO ACCOUNT.—For purposes of paragraph (1), there shall be taken into account amounts deducted and amounts treated as deferred expenses by—

(A) the taxpayer, and

(B) any individual or corporation who has transferred to the taxpayer any mineral property.

(3) APPLICATION OF PARAGRAPH (2)(B).—Paragraph (2)(B) shall apply with respect to all amounts deducted and all amounts treated as deferred expenses which were paid or incurred before the latest such transfer from the individual or corporation to the taxpayer. Paragraph (2)(B) shall apply only if—

(A) the taxpayer acquired any mineral property from the individual or corporation under circumstances which make paragraph (7), (8), (11), (15), (17), (20), or (22) of section 113(a) of the Internal Revenue Code of 1939 apply to such transfer;

(B) the taxpayer would be entitled under section 381(c)(10) to deduct expenses deferred under this section had the distributor or transferor corporation elected to defer such expenses; or

(C) the taxpayer acquired any mineral property from the individual or corporation under circumstances which make section 334(b), 362(a) and (b), 372(a), 373(b)(1), 1051, or 1082 apply to such transfer.

(d) ADJUSTED BASIS OF MINE OR DEPOSIT.—The amount of expenditures which are treated under subsection (b) as deferred expenses shall be taken into account in computing the adjusted basis of the mine or deposit, but such amounts, and the adjustments to basis provided in section 1016 (a)(10) shall be disregarded in determining the adjusted basis of the property for the purpose of computing a deduction for depletion under section 611.

(e) CORRELATION WITH SECTION 617.—

(1) INELIGIBILITY TO MAKE ELECTION UNDER THIS SECTION.—If the taxpayer makes an election under section 617(a), no election may be made by the taxpayer under subsection (a) for the taxable year for which the election under section 617(a) is made or for any subsequent taxable year, and any election previously made by the taxpayer under subsection (a) for any such taxable year shall have no effect. If any individual or corporation who transfers (within the meaning of subsection (c)(3)) any mineral property to the taxpayer makes or has made an election under section 617(a) which applies to any period prior to such transfer, no election may be made by the taxpayer under subsection (a) for the taxable year in which such transfer is made or for any subsequent taxable year, and any election proviously made by the taxpayer under subsection (a) for any such taxable year shall have no effect.

(2) APPLICATION OF RECAPTURE PROVISIONS OF SECTION 617.—In the cose of a taxpayer who has made an election under subsection (a) and who makes an election under section 617(a), the provisions of subsections (a)(2)(C), (b), (c), (d), (e), (f), and (g) of section 617

shall, under regulations prescribed by the Secretary or his delegate, apply to all expenditures paid or incurred by the taxpayer after the date of the enactment of this subsection which have been deducted under subsection (a) or treated as deferred expenses under subsection (b). For purposes of the preceding sentence, there shall be taken into account expenditures paid or incurred by any individual or corporation who has transferred any mineral property to the taxpayer (determined by applying the rules of subsection (c)(3)), but only with respect to mineral property so transferred.

(3) Deficiencies.—

(A) The statutory period for the assessment of any deficiency for any taxable year, to the extent such deficiency is attributable to the application of paragraph (1) by reason of a transfer of mineral property, shall not expire before the last day of the 2-year period beginning on the day after the date on which the election under section 617 (a) is made by the transferor; and such deficiency may be assessed at any time before the expiration of such 2-year period, notwithstanding any other law or rule of law which would otherwise prevent such assessment.

(B) For statutory period for assessment of deficiencies attributable to elections by taxpayers under section 617 (a), see section 617 (a) (2) (C),

(4) Regulations.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this subsection, including regulations for the application of this section in cases in which an election under section 617(a) has been revoked.

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SEC. 617. ADDITIONAL EXPLORATION EXPENDITURES IN THE CASE OF DOMESTIC MINING.

(a) Allowance of Deduction.—

(1) General rule.—At the election of the taxpayer, expenditures paid or incurred during the taxable year for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral in the United States or on the Outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented; 43 U.S.C. 1331), and paid or incurred before the beginning of the development stage of the mine, shall be allowed as a deduction in computing taxable income. This subsection shall apply only with respect to the amount of such expenditures which, but for this subsection, would not be allowable as a deduction for the taxable year. This subsection shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 167, but allowances for depreciation shall be considered, for purposes of this subsection, as expenditures paid or incurred. In no case shall this subsection apply with respect to amounts paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of oil, gas, or coal or of any mineral with respect to which a deduction for percentage depletion is not allowable under section 613.

(2) *ELECTIONS.*—

(A) *METHOD.*—*Any election under this subsection shall be made in such manner as the Secretary or his delegate may by regulations prescribe.*

(B) *TIME AND SCOPE.*—*The election provided by paragraph (1) for the taxable year may be made at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for the taxable year. Such an election for the taxable year shall apply to all expenditures described in paragraph (1) paid or incurred by the taxpayer during the taxable year or during any subsequent taxable year. Such an election may not be revoked after the last day of the third month following the month in which the final regulations issued under the authority of this subsection are published in the Federal Register, unless the Secretary or his delegate consents to such revocation.*

(C) *DEFICIENCIES.*—*The statutory period for the assessment of any deficiency for any taxable year, to the extent such deficiency is attributable to an election or revocation of an election under this subsection, shall not expire before the last day of the 2-year period beginning on the day after the date on which such election or revocation of election is made; such deficiency may be assessed at any time before the expiration of such 2-year period, notwithstanding any law or rule of law which would otherwise prevent such assessment.*

(b) *RECAPTURE ON REACHING PRODUCING STAGE.*—

(1) *RECAPTURE.*—*If, in any taxable year, any mine with respect to which expenditures were deducted pursuant to subsection (a) reaches the producing stage, then—*

(A) *If the taxpayer so elects with respect to all such mines reaching the producing stage during the taxable year, he shall include in gross income for the taxable year an amount equal to the adjusted exploration expenditures with respect to such mines, and the amount so included in income shall be treated for purposes of this subtitle as expenditures which (i) are paid or incurred on the respective dates on which the mines reach the producing stage, and (ii) are property chargeable to capital account.*

(B) *If subparagraph (A) does not apply with respect to any such mine, then the deduction for depletion under section 611 with respect to the property shall be disallowed until the amount of depletion which would be allowable but for this subparagraph equals the amount of the adjusted exploration expenditures with respect to such mine.*

(2) *ELECTIONS.*—

(A) *METHOD.*—*Any election under this subsection shall be made in such manner as the Secretary or his delegate may by regulations prescribe.*

(B) *TIME AND SCOPE.*—*The election provided by paragraph (1) for any taxable year may be made or changed not later than the time prescribed by law for filing the return (including extensions thereof) for such taxable year.*

(c) *RECAPTURE IN CASE OF BONUS OR ROYALTY.*—*If an election has been made under subsection (a) with respect to expenditures relating to a mining property and the taxpayer receives or accrues a bonus or a royalty*

with respect to such property, then the deduction for depletion under section 611 with respect to the bonus or royalty shall be disallowed until the amount of depletion which would be allowable but for this subsection equals the amount of the adjusted exploration expenditures with respect to the property to which the bonus or royalty relates.

(d) Gain From Dispositions of Certain Mining Property.—

(1) General rule.—Except as otherwise provided in this subsection, if mining property is disposed of the lower of—

(A) the adjusted exploration expenditures with respect to such property, or

(B) the excess of—

(i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value (in the case of any other disposition), over

(ii) the adjusted basis of such property,

shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Disposition of portion of property.—For purposes of paragraph (1)—

(A) 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 paragraph (1) applies.

(B) In the case of the disposition of an undivided interest in a mining property (or a 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 paragraph (1) applies.

This paragraph shall not apply to any expenditure to the extent the taxpayer establishes to the satisfaction of the Secretary or his delegate 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.

(3) Exceptions and limitations.—Paragraphs (1), (2), and (3) of section 1245(b) (relating to exceptions and limitations with respect to gain from disposition of certain depreciable property) shall apply in respect of this subsection in the same manner and with the same effect as if references in section 1245(b) to section 1245 or any provision thereof were references to this subsection or the corresponding provisions of this subsection and as if references to section 1245 property were references to mining property.

(4) Application of subsection.—This subsection shall apply notwithstanding any other provision of this subtitle.

(e) Basis of Property.—

(1) Basis.—The basis of any property shall not be reduced by the amount of any depletion which would be allowable but for the application of this section.

(2) Adjustments.—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (d)(1).

(f) DEFINITIONS.—For purposes of this section—

(1) ADJUSTED EXPLORATION EXPENDITURES.—The term "adjusted exploration expenditures" means, with respect to any property or mine—

(A) the amount of the expenditures allowed for the taxable year and all preceding taxable years as deductions under subsection (a) to the taxpayer or any other person which are properly chargeable to such property or mine and which (but for the election under subsection (a)) would be reflected in the adjusted basis of such property or mine, reduced by

(B) for the taxable year and for each preceding taxable year, the amount (if any) by which (i) the amount which would have been allowable for percentage depletion under section 613 but for the deduction of such expenditures, exceeds (ii) the amount allowable for depletion under section 611,

properly adjusted for any amounts included in gross income under subsection (b) or (c) and for any amounts of gain to which subsection (d) applied.

(2) MINING PROPERTY.—The term "mining property" means any property (within the meaning of section 614 after the application of subsections (c) and (e) thereof) with respect to which any expenditures allowed as a deduction under subsection (a)(1) are properly chargeable.

(3) DISPOSAL OF DOMESTIC IRON ORE WITH A RETAINED ECONOMIC INTEREST.—A transaction which constitutes a disposal of iron ore under section 631(c) shall be treated as a disposition. In such a case, the excess referred to in subsection (d)(1)(B) shall be treated as equal to the gain (if any) referred to in section 631(c).

(g) SPECIAL RULES RELATING TO PARTNERSHIP PROPERTY.—

(1) PROPERTY DISTRIBUTED TO PARTNER.—In the case of any property or mine received by the taxpayer in a distribution with respect to part or all of his interest in a partnership, the adjusted exploration expenditures with respect to such property or mine include the adjusted exploration expenditures (not otherwise included under subsection (f)(1)) with respect to such property or mine immediately prior to such distribution, but the adjusted exploration expenditures with respect to any such property or mine shall be reduced by the amount of gain to which section 751(b) applied realized by the partnership (as constituted after the distribution) on the distribution of such property or mine.

(2) PROPERTY RETAINED BY PARTNERSHIP.—In the case of any property or mine held by a partnership after a distribution to a partner to which section 751(b) applied, the adjusted exploration expenditures with respect to such property or mine shall, under regulations prescribed by the Secretary or his delegate, be reduced by the amount of gain to which section 751(b) applied realized by such partner with respect to such distribution on account of such property or mine.

(h) CROSS REFERENCE.—

For application of subsections (b)-(g) of this section to certain expenditures deducted or treated as deferred expenses under section 615, see section 615 (e).

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SEC. 751. UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

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(c) UNREALIZED RECEIVABLES.—For purposes of this subchapter, the term "unrealized receivables" includes, to the extent not previously includible in income under the method of accounting used by the partnership, any rights (contractual or otherwise) to payment for—

(1) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(2) services rendered, or to be rendered.

For purposes of this section and sections 731, 736, and 741, such term also includes [section 1245 property (as defined in section 1245(a)(3))] *mining property (as defined in section 617(f)(2), section 1245 property (as defined in section 1245(a)(3))*, and section 1250 property (as defined in section 1250(c)), but only to the extent of the amount which would be treated as gain to which section [1245(a)] *617(d)(1), 1245(a)*, or 1250(a) would apply if (at the time of the transaction described in this section or section 731, 736, or 741, as the case may be) such property had been sold by the partnership at its fair market value.

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