810-3-16-.02. Allowable Capital Additions, Mines and Oil and Gas Wells.

(1) All expenditure in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in the development stage. The mine will be considered to have passed from a development to a producing status when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

(2) Expenditures for plant and equipment and for replacements, not including expenditures for maintenance and for ordinary and necessary repairs, shall ordinarily be charged to capital account recoverable through depreciation. Expenditures for equipment (including its installation and housing) and for replacements thereof, which are necessary to maintain the normal output solely because of the recession of the working faces of the mine, and which

(a) do not increase the value of the mine, or

(b) do not decrease the cost of production of mineral units, or

(c) do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made, shall be deducted as ordinary and necessary business expenses.

(3) Intangible drilling and development cost, such as wages, fuel, repairs, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the operator, be deducted from gross income as an expense or charged to capital account. If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are returnable through depletion insofar as they are not represented by physical property, and if represented by physical property through depreciation. Expenditures for clearing ground, draining, road making, surveying, geological work, excavation, grading, and the drilling, shooting and cleaning of wells are not considered to be represented by physical property; but expenditures incurred in the installation of casing and equipment and in the construction on the property of derricks and other physical structures are represented by physical property.

(a) If the operator has elected to capitalize intangible drilling and development costs, such costs incurred in drilling a nonproductive well may be deducted as a loss at the election of the taxpayer; but such election must be consistently followed.

(b) The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires property ordinarily considered as having a salvage value. The option does not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for storing or treating oil or gas. These are capital items and are returnable through depreciation. Expenditures in connection with the operation of the wells and of other facilities on the property for the production of oil or gas must be charged off as expense.

(Adopted September 30, 1982) §40-18-57