

810-3-15-.06. Depletion.

(1) There shall be allowed as a deduction in computing taxable income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion.

(a) Depletion allowance for standing timber shall be computed solely on the adjusted basis of the property.

(b) Depletion allowance for oil and gas may be computed on either the cost depletion method or on a percentage of gross income from the property, see Reg. 810-3-16-.01.

(c) Depletion allowance for other exhaustible natural resources shall be computed on the cost depletion method.

(d) The basis for depletion shall be determined in accordance with §§40-18-16 and 40-18-6, Code of Alabama 1975.

(2) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest consists of a capital investment in timber or mineral in place together with recovery of the investment through production.

(a) The allowance for depletion should be equitably apportioned between the lessor and lessee. Each should compute cost depletion from his own adjusted basis; each should compute percentage depletion from his own income from the property. One may use percentage depletion while the other may use cost.

(3) Computation of depletion on basis of cost (mines, oil and gas properties).
When the adjusted basis applicable to the mineral deposit has been determined under §40-18-16 cost depletion for the taxable year is computed by:

(a) Dividing the adjusted basis of the property by the number of recoverable units to arrive at the rate per unit.

(b) Multiply the rate per unit by the number of units sold in the taxable year if the taxpayer is on the accrual method, or the number of units for which payment is received if the taxpayer is on the cash method.

$$\text{Cost depletion} = \frac{\text{adjusted basis}}{\text{recoverable units}} \quad \times \quad \text{Units sold or paid for in taxable year}$$

(5) Computation of depletion on basis of percentage of gross income (oil and gas wells). For a description of the calculation of percentage depletion, see Reg. 810-3-16-.01.

(6) Computation of depletion on basis of discovery value (mines, oil and gas properties). With respect to any property for which discovery value is the taxpayer's basis for depletion, the depletion for any taxable year shall be computed by:

(a) Determining the number of units available to be removed and the unmined value of each unit by a professional geological survey.

(b) As each unit is sold depletion is allowable at the above predetermined unmined value.

(c) When the above total predetermined units have been allowed as depletion, no further depletion is allowed on any excess units removed and/or sold.

(7) Determination of fair market value. If the fair market value of the property at a specified date is to be determined for the purpose of ascertaining the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Department, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be established assuming a transfer between a willing seller and a willing buyer existed as of that particular date. The Department will give due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties or rentals, valuation for local taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in a probate court, and, in the absence of better evidence, disinterested appraisals by approved methods.

(8) Depreciation of improvements. A reasonable provision for depreciation shall be allowed with respect to tangible properties, other than land and inventory properties, which are not subject to depletion, as in the case of mines, oil and gas wells, and other natural deposits and timber. It shall be optional with the taxpayer whether the cost or other basis of the plant and equipment plus allowable capital additions and minus salvage value shall be recovered,

(a) by reasonable charges for depreciation (see Reg. 810-3-15-.05) at a rate determined by the physical or economic life of such plant or equipment, or

(b) at a rate established by the exhaustion of the wasting asset, or

(c) according to the particular conditions of the case, by a method satisfactory to the Department.

Authors: Ann F. Winborne, CPA, Jerilyn P. Christian
Authority: §40-18-15, Code of Alabama 1975
History: Effective September 30, 1982.
Amended July 27, 1988.
Amended September 18, 1996, effective October 23, 1996.