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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's EIN:

Tax Year(s) Involved:

Conferences Held:

Taxpayer =

District Director =

ISSUE:

For purposes of computing the alternative minimum tax depletion preference under section 57(a)(1) of the Internal Revenue Code, does the adjusted basis of mineral property include those exploration and development costs required to be capitalized and amortized over 10 years under section 56(a)(2).

FACTS:

Taxpayer is engaged in the business of quarrying aggregate, either for use in the manufacturing of concrete and asphalt or for use as basic fill material, and is subject to the jurisdiction of the District Director. Taxpayer uses the percentage depletion method to determine its allowance for depletion. Pursuant to sections 611 and 613, Taxpayer calculates depletion on a property-by-property basis using the lesser of 5 percent of gross income or 50 percent of taxable income from each property. Taxpayer also incurred mining development and exploration costs which, under section 616(a), it deducted for regular tax purposes. In accordance with section 291(b), Taxpayer capitalized 30 percent of the costs deducted for regular tax purposes under section 616(a). For alternative minimum tax purposes, Taxpayer, under section 56(a)(2), was required to capitalize the section 616(a) development and exploration costs and amortize those costs over ten years.

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For regular tax purposes, Taxpayer included in the adjusted basis of the mineral property the development and exploration costs deferred under section 291(b). For alternative minimum tax purposes, Taxpayer included in its mineral property adjusted basis the costs required to be capitalized under section 56(a)(2). In computing the depletion preference item under section 57(a)(1), Taxpayer uses the adjusted basis of the mineral property, which includes those costs required to be capitalized under section 56(a)(2).

LAW & ANALYSIS:

Section 55 of the Code imposes, in addition to the other taxes imposed by subtitle A, an alternative minimum tax (AMT) equal to the excess (if any) of the tentative minimum tax for the taxable year, over the regular tax for the taxable year. Section 55(b)(2) of the Code defines the term alternative minimum taxable income (AMTI) as the taxable income of the taxpayer for the taxable year, determined with the adjustments provided in sections 56 and 58 and increased by the items of tax preference provided in sections 57.

Section 56(a)(2)(A) of the Code provides that, with respect to each mine or other natural deposit (other than an oil, gas, or geothermal well) of the taxpayer, the amount allowable as a deduction under section 616(a) or 617(a) (determined without regard to section 291(b)) in computing the regular tax for costs paid or incurred after December 31, 1986, shall be capitalized and amortized ratably over the ten year period beginning with the taxable year in which the expenditures were made. Under section 56(a)(7), the adjusted basis of any property to which section 56(a)(2) applies is determined in accordance with the treatment provided in section 56(a)(2).

Section 57(a)(1) provides that, for purposes of the AMT, for each section 614 property the excess of the depletion deduction allowable under section 611 over the adjusted basis of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year) is an item of tax preference.

Section 616(a) provides that there shall be allowed as a deduction in computing taxable income all expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit if paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed.

Generally, the AMT is intended to operate as a tax system that is separate and independent from, but parallel to, the regular tax system. This separate and parallel nature of the AMT

is further described in the General Explanation of the Tax Reform Act of 1986:

> Structure of minimum tax as an alternative system.--For most purposes, the tax base for the new alternative minimum tax is determined as though the alternative minimum tax were a separate and independent income tax system. Thus, for example, where a Code provision refers to a "loss" of the taxpayer from an activity, for purposes of the alternative minimum tax the existence of a loss is determined with regard to the items that are includible and deductible for minimum tax, not regular tax, purposes (footnote omitted).
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> In certain instances, the operation of the alternative minimum tax as a separate and independent tax system is set forth expressly in the Code. With respect to the passive loss provisions, for example, section 58 provides expressly that, in applying the limitation for minimum tax purposes, all minimum tax adjustments to income and expense are made and regular tax deductions that are items of tax preference are disregarded.
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> In other instances, however, where no such express statement is made, Congress did not intend to imply that similar adjustments were not necessary. Thus, for example, for minimum tax purposes it was intended that section 1211 (limiting capital losses) be computed using minimum tax basis, that section 263A (requiring the capitalization of certain depreciation deductions to inventory) apply with regard to minimum tax depreciation deductions, and that section 265 (relating to expenses of earning tax-exempt income) apply with regard only to items excludible from alternative minimum taxable income.

Staff of the Joint Committee on Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986 438 (Comm. Print 1987).

Although the Bluebook does not technically rise to the level of legislative history because it is authored by the congressional staff and not by Congress, such explanations are entitled to great respect. Rivera v. Commissioner, 89 T.C. 343, 349 n.7 (1987). This is particularly true when the staff views are consistent with the other evidence of legislative intent that is present. Estate of Hutchinson v. Commissioner, 765 F.2d 665, 670 (7th Cir. 1985). Section 55(b)(2) of the Code, which defines AMTI as taxable income determined with certain specified adjustments and increased by tax preference items, is consistent with the language in the Bluebook and confirms that AMTI is

computed using the same methodology used in computing taxable income.

The separate and parallel system was formally adopted by the Internal Revenue Service in §1.55-1(a) of the Income Tax Regulations, which was published in 1994. This regulation provides that except as otherwise provided by statute, regulations, or other published guidance, all Internal Revenue Code provisions that apply in determining the regular taxable income of a taxpayer also apply in determining the AMTI of the taxpayer.

Consistent with the principle that the AMT is a separate and parallel system, mining property has a separate adjusted basis under the regular tax system and the AMT system. Further, the adjusted basis of mining property is affected by whether development costs are currently deducted or capitalized and amortized over a number of years. Developments costs allowed as a deduction under section 616(a) for regular tax purposes must be capitalized and amortized ratably over 10 years for AMT purposes under section 56(a)(2). Under section 56(a)(7), the adjusted basis of the depletable property is determined on the basis of the treatment provided in section 56(a)(2). Accordingly, if, as in the present case, a taxpayer deducts its development costs under section 616(a), the determination of regular tax and AMT adjusted basis will reflect the different regular tax and AMT treatment of those costs.

Although it is clear that mining property has both a regular tax and an AMT adjusted basis, the question to be addressed is which of the two must be used in computing the section 57(a)(1) depletion preference. Section 57(a)(1) provides only that the depletion preference equals the extent to which the section 611 deduction exceeds the "adjusted basis of the property."

As discussed above, the AMT is a separate, parallel tax system. Therefore, the adjusted basis of the mining property for purposes of computing the AMT depletion preference should be the equivalent of the adjusted basis for purposes of determining AMT gain or loss upon a disposition of that property. Gain or loss included in AMTI upon a disposition of mining property is determined in accordance with the AMT adjusted basis, not the regular tax adjusted basis. Accordingly, the AMT adjusted basis is to be used to compute the section 57(a)(1) depletion preference.

The contrary argument to our position is that the regular tax adjusted basis should be used to compute the preference because the depletion preference existed prior to and was unchanged by the separate, parallel AMT system. That is, prior to the inception of the separate, parallel AMT system as enacted by the Tax Reform Act of 1986, the depletion preference was

computed by comparing the difference between the regular tax depletion deduction and the regular tax adjusted basis. The language describing the preference did not change from the language that described the pre-1987 depletion preference. Thus, arguably, it would be improper to now use the AMT adjusted basis in computing the depletion preference. Further, §1.57-1(h)(3), which cross-references section 1016 and the regulations thereunder for purposes of determining the adjusted basis of the property used to compute the depletion preference and was promulgated prior to the inception of the separate, parallel AMT system, arguably lends support to the argument that the regular tax adjusted basis must be used to compute the preference.

However, as noted above, the AMT is not an add-on tax measured exclusively by amounts excluded or deducted under the regular tax system. See §1.55-1(a). Rather, it is a separate, independent tax base where the adjustments provided in sections 56 and 58 are taken into account and any deduction or exclusion from income that is a tax preference item under section 57 is disregarded. Thus, while the language used to describe the depletion preference has not changed, the system under which the preference is computed has changed dramatically.

Prior to 1987, taxpayers had a single, regular tax depletion deduction under section 611. The depletion preference was designed to remove the tax benefit of that section 611 deduction to the extent of any excess depletion (i.e., depletion in excess of basis). Under the AMT system, there is a separate and parallel depletion deduction under section 611 that may be larger or smaller than the regular tax section 611 deduction. Thus, in order for the AMT system to appropriately remove the tax benefit of excess depletion, the depletion preference should equal the extent to which the AMT depletion deduction exceeds AMT adjusted basis. Further, because §1.57-1(h)(3) was promulgated prior to the enactment of the separate and parallel AMT system, that section is not applicable to the extent it requires the regular tax adjusted basis to be used in computing the depletion preference.

CONCLUSION:

In computing the depletion preference under section 57(a)(1), the alternative minimum tax adjusted basis, which includes any costs capitalized under section 56(a)(2), is to be used. Accordingly, any amount deducted for AMT purposes under section 611 that exceeds the AMT adjusted basis of the depletable property is treated as an item of tax preference and is subject to the AMT. Further, for purposes of computing the depletion preference for years subsequent to the year in which the mining development costs are incurred, adjusted basis, including the

portion of the adjusted basis attributable to the development costs, is to be reduced by the amount deducted for AMT purposes under section 611.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this memorandum have not yet been adopted. Therefore, this memorandum will be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in the memorandum. See section 17.04 of Rev. Proc. 99-2, 1999-1 I.R.B. 73. However, a technical advice memorandum involving a continuing transaction generally is not revoked or modified retroactively if the taxpayer can demonstrate that the criteria in section 17.06 of Rev. Proc. 99-2 are satisfied.