

**ALABAMA DEPARTMENT OF REVENUE  
ADMINISTRATIVE CODE**

**CHAPTER 810-3-16  
BASIS FOR DEPRECIATION AND DEPLETION**

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**810-3-16-.01      Basis For Depreciation And Depletion.**

(1) The basis upon which depreciation and depletion shall be computed is the adjusted basis for determining gain on the sale or disposition of the property (including any taxes required to be capitalized in connection with the acquisition of a capital asset), as determined under § 40-18-6, except that at the option of the taxpayer:

(a) In the case of mines, or oil and gas wells, depletion may be computed based on discovery value, if the conditions of Code § 40-18-16(b)(2) are met. (see Reg. 810-3-15-.06(6)).

(b) In the case of oil and gas wells only, for taxable years beginning on or after January 1, 1953, a taxpayer may deduct for depletion an amount equal to 27 1/2% of the gross income from the property during the taxable year, computed on the same basis and subject to the same limitations as provided in the Federal Income Tax Act in effect on September 17, 1953, the effective date of Act No. 719-1953 General Acts of Alabama. These limitations on the amount of percentage depletion which may be deducted are:

1. the amount may not be more than fifty percent of the net income from the property before the deduction for depletion, and

2. the amount may not be less than the depletion computed under the cost method.

(2) An election once exercised to claim depletion on the discovery basis or on the percentage basis is irrevocable, and the depletion allowance in respect to each property will for all succeeding tax years be computed in accordance with the election so made. The election to use percentage depletion may be made only with respect to oil and gas wells.

(3) Depreciation and depletion must be charged off on the taxpayer's books, or suitable subsidiary records must be kept to show the basis of the depletable property together with capital additions and all other adjustments. After depreciation or depletion to the extent of 100 percent of the cost or other income tax basis of the depreciable or depletable assets has been allowed, no further deduction will be permitted, except with respect to depletion when the percentage method is used. Land is not subject to a deduction for depreciation.

**Author:** George E. Mingledorff, III.

**Statutory Authority:** Code of Ala. 1975, § 40-18-16.

**History:** Adopted September 30, 1982. Amended February 8, 1989; filed March 20, 1989.

**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.

**Author:**

**Statutory Authority:** Code of Ala. 1975, § 40-18-57.

**History:**