

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-103882-99]

RIN 1545-AX06

Depletion; treatment of delay rental

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed amendments conforming regulations relating to delay rental to the requirements of section 263A relating to capitalization and inclusion in inventory of costs of certain expenses. Changes to the applicable law were made by the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988. The proposed regulations provide the public with guidance concerning the application of section 263A to delay rental.

DATES: Written comments must be received by May 8, 2000.

Outlines of topics to be discussed at the public hearing scheduled for May 26, 2000, at 10 a.m. must be received by May 5, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-103882-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-103882-99), Courier's Desk, Internal Revenue Service, 1111

Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/regslst.html](http://www.irs.ustreas.gov/prod/tax_regs/regslst.html).

The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulation, Brenda M. Stewart, (202) 622-3120; concerning submissions and the hearing, LaNita Van Dyke, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 612 to conform them to the requirements of section 263A. Section 263A was enacted by the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085), and amended by the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647 (102 Stat. 3342).

### **Explanation of Provisions**

Under the terms of a lease of mineral property, the lessee acquires, for a stated term, the right and obligation to obtain production of minerals from the property. A lease may provide that for each year that the lessee fails to make efforts to obtain production, the lessee must pay a "delay rental" to the lessor.

Section 1.612-3(c)(1) of the final regulations defines a

delay rental as an amount paid for the privilege of deferring development of the property and which could have been avoided by abandonment of the lease, or by commencement of development operations, or by obtaining production. Section 1.612-3(c)(2) of the final regulations provides that since a delay rental is in the nature of rent, it is ordinary income to the payee and not subject to depletion. The payor may at his election deduct the delay rental as an expense, or charge it to depletable capital account under section 266.

Section 263A was enacted subsequent to the issuance of §1.612-3(c) of the final regulations. The uniform capitalization rules of section 263A generally require the capitalization of all direct costs and certain indirect costs properly allocable to property produced by the taxpayer. Capitalization may be required even though production (development) has not yet begun. §1.263A-2(a)(3)(ii). In some situations, a delay rental may be required to be capitalized under section 263A. Accordingly, the proposed regulation clarifies that subsequent to the enactment of section 263A, the payor of a delay rental may elect to expense currently the delay rental or charge it to depletable capital account under section 266 to the extent that the delay rental is not required to be capitalized under section 263A and the regulations thereunder.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in

Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments that are submitted timely (a signed original and eight copies) to the IRS. The IRS and Treasury request comments on the clarity of the proposed regulations and they may be made easier to understand. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for May 26, 2000, at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments (a signed original and eight (8)

copies) by May 8, 2000. The outline of topics to be discussed at the hearing must be received by May 5, 2000.

A period of 10 minutes will be allotted for each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### **Drafting Information**

The principal author of this proposed regulation is Brenda M. Stewart of the Office of Assistant Chief Counsel (Passthroughs and Special Industries), Internal Revenue Service. However, other personnel from the IRS and Treasury Department participated in its development.

#### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

#### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

##### **PART 1--INCOME TAX**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. In §1.612-3, the second sentence of paragraph (c)(2) is removed and two sentences are added in its place to read as follows:

§1.612-3 Depletion; treatment of bonus and advanced royalty.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \* To the extent the delay rental is not required to be capitalized under section 263A and the regulations thereunder, the payor may at his election deduct such amount or under section 266 and the regulations thereunder, charge it to depletable capital account. The second sentence of this paragraph (c)(2) applies to delay rentals paid with respect to leasing transactions entered into on or after the date these regulations are published as final regulations in the **Federal Register**.

\* \* \* \* \*

Robert E. Wenzel

Deputy Commissioner of Internal Revenue