Effective Date: October 22, 2001

COORDINATED ISSUE
MINING INDUSTRY
RECEDING FACE DEDUCTION
UIL 612.03-03

ISSUE

Do X's expenditures for various conveyor system components, as described in scenarios A through D below, qualify for the receding face deduction as provided by Treas. Reg. Section 1.612-2(a)?

FACTS

X is an underground/surface miner of mineral Y. X utilizes a conveyor system to transport mineral or waste rock from the "working face" out of the mine. The mineral is removed from the mine for processing and sale. In the case of waste rock, the conveyor system removes the rock for disposal. The term "working face" means the face at the end of a mine tunnel heading or at the end of a full-size excavation.

The conveyor system presently utilized by X consists of a 48" mainline belt and belting structure (including idlers and rollers, etc.), which receive material at transfer points from feeder belts that extend to the mining face(s). The system includes belting, belt drive motors, booster drives, belt tensioning devices, transfer stations etc.

Scenario A

X is an underground miner of mineral Y. The mine has a 1500' mainline conveyor used to transport mineral Y to the surface. X adds to this mainline system towards the working face by adding a completely new free-standing 250' conveyor structure, complete with motor, 500' of belting, and a transfer station. Subsequent to making these additions, production at the mine did not increase. The cost of operating the mine remained constant and the mine did not increase in value.

Scenario B

Same as Scenario A, except X extends the mainline conveyor by 250'. X purchases 3,500' of belting, 250' of new conveyor structure that is added to the existing structure, and a new booster drive motor to supplement the main belt drive. The new booster motor accommodates the additional mechanical drive requirements of the 250' extension. As part of the extension project, X replaces the entire mainline belt with the 3,500' belt. The old mainline belt was replaced as part of the extension project because of its deteriorated condition and to improve its reliability.

The 250’ extension was required to reach the current location of the working face to maintain current production.

Scenario C

Same as Scenario A, except X upgrades the entire mainline belt and extension from 48” to 60” belting. This increase in belt capacity allows X to increase its production rate by 20%, resulting in a corresponding 10% reduction in the overall cost per ton to produce the mineral.

Scenario D

X is a surface miner of mineral Y. X has a conveyor system used to transport excavated overburden to its waste rock disposal site. Because of capacity constraints and environmental concerns, X can no longer utilize the current waste rock disposal site. In order to maintain its current production rate from the mine, X constructs a new conveyor system to a newly approved alternative disposal site. During this period, mining has continued, and as the case with all mines, the working face receded as the mineral and overburden were removed. The construction of the new conveyor system was necessitated by the lack of capacity and environmental concerns at the first disposal site, even though the working face was contemporaneously receding.

LAW AND ANALYSIS

As a general rule, the cost of mine improvements and equipment are capitalized and recovered through depreciation over their useful lives. Section 1.612-2(a) of the regulations, however, provides that certain expenditures, although capital in nature, shall be deducted as ordinary and necessary business expenses. The particular expenses (for equipment, its installation and housing) that can be deducted are those that are required to maintain the normal output of the mine and are necessitated solely because of the recession of the working face. The latter requirement means that there must be a direct and exclusive casual relationship between the expenditure and the recession of the working face. Section 1.612-2(a) further provides that the expenses cannot (1) increase the value of the mine; (2) decrease the cost of production of mineral units; nor (3) represent an amount for restoration of the property or making good the exhaustion thereof for which an allowance has been made.

CONCLUSION(s)

Scenario A

The costs of the new 250’ conveyor structure, complete with motor, 500’ of belting, and a transfer station, were incurred solely for the purpose of maintaining the capacity of the mine as the working faces receded. Thus, the expenditures met the threshold requirement that they were made solely because of the recession of the face. Further, the expenditures did not increase production at the mine nor decrease the cost of operation and they did not enhance the value of

the mine. Therefore, the costs associated with the expansion of the conveyor belt system are deductible under section 1.612-2 of the regulations.

Scenario B

The new 250' of conveyor structure, along with its supplemental booster drive motor, was incurred solely because of the recession of the face and the expenditures incurred to add the new conveyor and motor did not increase production at the time, decrease the cost of operation, or enhance the value of the mine. Accordingly, the cost of the additional structure is deductible under section 1.612-2. The cost of the 3500' of belting, however, was incurred, in part, to replace 3000' of worn out belting. Thus, the cost of the 3500' of belting was not incurred solely due to the recession of the working face. Furthermore, the belting expenditure does not meet the test of 1.612-2(a)(3), since it represents an amount expended in restoring property or in making good the exhaustion thereof for which an allowance has been made. Accordingly, this expenditure is not eligible for deduction as a receding face expense.

Scenario C

X is not eligible to deduct any of the expenditures under section 1.612-2. While these expenditures were incurred because of the recession of the working face, they result in a 10% reduction in the overall cost per ton to produce the mineral; hence they fail to satisfy the test of section 1.612-2(a)(2) of the regulations, which requires that the expenditure does not decrease the cost of production of mineral units. These costs must be capitalized as mine equipment.

Scenario D

The cost of the conveyor to the new waste rock disposal site was mandated by capacity constraints at the old site and environmental regulations. Expenditures necessary to maintain production of the mine which are not exclusively related to the movement of the working face are not deductible under section 1.612-2(a) simply because the mining face had receded during the course of mining. Thus, even though the expenditures were required to maintain the normal output of the mine. X is not eligible to deduct any costs under section 1.612-2, since the expenditures were not incurred solely because of the recession of the working face.