STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. INC. 89-142
MARSHALL OGLESBY P.O. Box 151 Gilbertown, AL 36908,	§	
Taxpayer.	§	

FINAL ORDER

The Revenue Department assessed income tax against Marshall Oglesby (Taxpayer) for the years 1984 and 1985. The Taxpayer appealed and a hearing was conducted on January 22, 1991. Robert C. Walthall, Esq. appeared for the Taxpayer. Assistant counsel Dan Schmaeling represented the Department. This Final Order is based on the evidence and arguments presented by the, parties.

FINDINGS OF FACT

The relevant facts are undisputed.

The Taxpayer is in the oil and gas business and for the years prior to 1984 capitalized and deducted by depreciation or depletion the intangible drilling costs associated with his business. Intangible drilling costs generally include all expenditures incidental and necessary for the drilling of wells and the production of oil and gas, except those costs incurred for the purchase of tangible property or an interest in such property.

The Taxpayer attempted to currently deduct or expense his intangible drilling costs incurred in the years. 1984 and 1985. The Department disallowed the deductions and instead required the

Taxpayer to capitalize the costs as in prior years. The Taxpayer appealed the resulting preliminary assessments to the Administrative Law Division.

The Department contends that the Taxpayer should be required to capitalize his intangible drilling costs in 1984 and 1985 because he had capitalized such costs in prior years. The Department argues that once an operator elects to capitalize intangible drilling costs, the election cannot be changed, citing Department Reg. 810-3-16-.02 and IRC Reg. 1.612-4.

The Taxpayer contends that the above cited Reg. 810-3-16-.02 allows an operator the option of either expensing or capitalizing intangible drilling costs and that capitalization of such costs in a prior year does not prohibit an election to expense in a later year.

CONCLUSIONS OF LAW

Intangible drilling costs are capital expenditures which as a general rule must be amortized and recovered either through depreciation or depletion. However, for federal purposes the IRS was required by 26 U.S.C.A. §263(c) to promulgate regulations allowing an oil and gas operator the option of either capitalizing or currently deducting such intangible drilling costs. Accordingly, IRC Reg. 1.612-4 was promulgated for that purpose in 1965. Reg. 1-612.4 does not require a formal statement of election. Rather, an operator may elect to currently deduct

intangible drilling costs by claiming them on his return in the first year incurred. If the operator fails to expense the costs in the first year, he is deemed to have elected to recover such expenses through depreciation or depletion. See, Reg. 1.612-4(d). An "election" once made is irrevocable for all subsequent years, except that an operator that has elected to capitalize may in a subsequent year elect to currently expense such costs relating to any non-productive well. Again, the election is at the option of the operator, but once made must be consistently followed. See, Reg. 1.612-4(b)(4).

The Alabama Revenue Code does not contain a provision similar to 26 U.S.C.A. §263 and thus the Department is not required by statute to provide an operator with the option. of expensing intangible drilling costs. Nevertheless, the Department allows the option pursuant to Reg. 810-3-16-.02.

The Alabama regulation is not as detailed as IRC Reg. 1-612-4 and does not specify the mechanics of how an election must be made or if an election once made can be changed. However, subparagraph (3)(a) of the Alabama regulation indicates that an election is necessary because it reads that if "the operator has elected to capitalize intangible drilling and development costs, such costs incurred in drilling a non-productive well may be deducted as a loss at the election of the taxpayer; but such election must be consistently followed". Subparagraph (3)(a) is identical to

subparagraph (b)(4) of Reg. 1-612-4 and provides the one exception by which an election once made can be changed. The exception would be unnecessary and confusing unless the operator was otherwise required to make a binding election to either expense or capitalize.

The obvious intent and purpose of Reg. 810-3-16-.02 is to conform Alabama's treatment of intangible drilling costs with federal treatment of such costs. In such cases where an Alabama statute or regulation is modeled after a federal statute or regulation, the federal law on point should be used as a guideline in construing the less clear Alabama provision. Best v. State, 417 So.2d 197. Accordingly, for Alabama purposes an operator elects to either capitalize or expense intangible drilling costs by the method he chooses to report those costs in the first year incurred, and the election is irrevocable and must be followed in all subsequent years, except as provided in subparagraph (3)(a) an operator may elect to currently expense such costs in a subsequent year relating to a non-productive well.

In this case, the Taxpayer capitalized intangible drilling costs in years prior to 1984 and thus cannot be allowed to currently deduct those costs incurred in 1984 and 1985. The election to capitalize is binding for Alabama purposes to the same extent as for federal purposes.

The above considered, the assessments in issue are correct (as

adjusted by the Department) and should be made final, with interest computed to the date of entry of the final assessments.

Entered on January 31, 1991.

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BILL THOMPSON
Chief Administrative Law Judge