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Sho Sato

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GROUND WATER RIGHTS AND DEPLETION DEDUCTION

SHO SATO*

In the early part of 1963, a federal district court decided that a user of ground water for irrigation, in computing his federal income tax, is entitled to a cost depletion deduction when ground water is being "mined."¹ On June 7, 1965, the Fifth Circuit, in *United States v. Shurbet*, affirmed the decision.² This was evidently a test case, and it has resolved the issue for the irrigators in the Southern High Plains in situations similar to that in *Shurbet*. The case merits careful attention, however. The issue in *Shurbet* is novel, and in view of the overdraft conditions in many groundwater basins today, the impact of the decision should be explored.

The purpose of this discussion is not to reargue the case, but to analyze it to determine its value as precedent. At the outset, it should be made clear that the only issue before the court was whether the taxpayer was entitled to take a cost depletion deduction. There was no question as to percentage depletion; the statute explicitly excludes water from percentage depletion treatment.³

In *Shurbet*, the taxpayer was pumping water primarily for farming use from the groundwater basin in the Southern High Plains in Texas. The findings of the lower court,⁴ which were not disturbed on appeal,⁵ were: (1) the basin was recharged, if at all, only by precipitation on the Southern High Plains because the bed of the

* Professor of Law, University of California, Berkeley. This article has been prepared for the forthcoming publication of *Water Law of the United States* by the Allen Smith Company.

1. *Shurbet v. United States*, 63-2 U.S. Tax Cas. ¶ 9528 (N.D. Tex. 1963), noted in 42 Texas L. Rev. 260 (1963).

2. 347 F.2d 103 (5th Cir. 1965). The Internal Revenue Service has stated that it will follow this decision and "cost depletion will be allowed to taxpayers in the Southern High Plains under acts similar to those" in this case. Rev. Rul. 65-296, 1965 Int. Rev. Bull. No. 50, at 30.

3. Int. Rev. Code of 1954, § 613(b)(6)(A). Section 613(b) specifies the percentage depletion allowable with respect to the enumerated minerals, and in paragraph (6) a percentage depletion of 15% is given to "all other minerals." But the paragraph provides that the phrase "all other minerals" does not include "(A) soil, sod, dirt, turf, water, or mosses; or (B) minerals from sea water, the air, or similar inexhaustible sources." Had the phrase "similar inexhaustible sources" followed "water," one might make the argument that Congress denied a percentage depletion only when the supply was inexhaustible. However, the structure of the exclusions makes clear that "water" of any kind is excluded.

4. *Shurbet v. United States*, 63-2 U.S. Tax Cas. ¶ 9528 (N.D. Tex. 1963).

5. Because the court of appeals accepted the findings of the district court, 347 F.2d at 104-06, the facts are taken from the opinion of the district court.

basin was higher than the surrounding area; (2) although precipitation averaged 20 inches annually, more than 99% was lost by evaporation and transpiration because of the coincidence of the rainfall with the irrigation season, high temperature, and low humidity; (3) the percolation rate of surface water into the basin was extremely slow; (4) the annual recharge averaged between 3/20 to 1/2 inch per year, and (5) the water table had been declining due to an increased number of wells. The court found that the ground water in the basin was being "mined" because the water was being taken from storage and that continual pumping will eventually exhaust the supply or will prevent future extraction when pumping becomes uneconomical.

The cost depletion was computed in the following manner: the cost of the water right was determined by comparing the cost of the land which included the right to ground water purchased by the taxpayer compared with the cost of similar land without such right, the difference being the cost of the water right; the measure of the deduction was a ratio of the current decrease in the water table over the thickness of the zone of saturation at the time of purchase as applied to the cost of the water right.

The policy arguments for allowing a deduction under these circumstances seem clear. If the water supply is not inexhaustible, the withdrawal of water from such supply depletes the capital to that extent, like the mining of any ore depletes the ore deposit. The income derived from the use of such resource cannot be accurately measured unless a deduction is permitted for a wasting of the capital used in the production of such income. If the rationale behind cost depletion allowances and depreciation deductions is generally sound, there is no reason to deny a deduction for the mining of ground water.⁶

Whether the statute sustains such a policy was the issue in *Shurbet*. Section 611 provides: "In the case of mines, oil and gas wells,

6. The taxpayer sought to amend his complaint to plead the following alternate grounds for refund: (1) depreciation; (2) amortization; (3) business expense, or (4) cost of the goods sold. The district court denied the amendment since the grounds were not mentioned in the claim for refund. Brief for Appellee, pp. 101-09. The Government acknowledged that original capital investment may be recovered by the various methods mentioned by the taxpayer but maintained that the propriety of any such method was not before the court. Brief for Appellant, pp. 17-21. Compare the characterization in *Flona Corp. v. United States*, 218 F. Supp. 354 (S.D. Fla. 1963) (the vacation of judgment in *Flona* is noted in the *Shurbet* case), where deduction for cost of goods sold was permitted for sod originally purchased with the land, and then sold; and a cost depletion was permitted for removal of top soil.

other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion . . . according to the peculiar conditions in each case”⁷

The Government argued principally that water was not a “natural deposit” within the meaning of section 611 because that term referred to minerals which were severed and sold.⁸ According to the Government, the types of minerals which were given the depletion allowance were the same under the cost and percentage depletion provisions.⁹ Because Congress had expressly excluded water from percentage depletion provisions,¹⁰ it necessarily follows that water was not subject to cost depletion allowance either.

The taxpayer, on the other hand, contended: (1) water in the Ogallala Formation was a “natural deposit”;¹¹ (2) cost depletion was independent of percentage depletion,¹² and (3) there is no requirement of sale of the natural deposit in order to obtain a cost depletion deduction.¹³

Both sides engaged in a detailed analysis of legislative history but emerged with opposite conclusions. The taxpayer was able to point to the existing regulation which defines “minerals” to include “all other natural metallic and nonmetallic deposits, except minerals derived from the sea water, the air, or from similar inexhaustible sources.”¹⁴ The regulation continues, “it [the term ‘minerals’] includes but is not limited to all of the minerals and other natural deposits subject to depletion based upon a percentage of gross income from the property under section 613 and the regulations thereunder.” In addition, the taxpayer cited rulings that severance and sale of soil in place, although not given a percentage depletion, was subject to cost depletion.¹⁵

7. Int. Rev. Code of 1954, § 611(a).

8. Brief for Appellant, pp. 22-42.

9. Brief for Appellant, pp. 45-49.

10. *Ibid.*

11. Brief for Appellee, pp. 40-41.

12. Brief for Appellee, pp. 82-99.

13. Brief for Appellee, pp. 42-81.

14. Treas. Reg. § 1.611-1(d)(5) (1960). See Brief for Appellee, pp. 98-99.

15. Rev. Rul. 78, 1953-1 Cum. Bull. 18; Rev. Rul. 55-11, 1955-1 Cum. Bull. 212. See Brief for Appellee, p. 97. These rulings pertained to pre-1954 provisions. But if the Government is correct in its contention that only “minerals” given a percentage depletion qualify for cost depletion under the 1954 Code, severance and sale of soil would no longer be given a cost depletion since soil is expressly excluded from percentage depletion. Int. Rev. Code of 1954, § 613(b)(6)(A). The Government, however, conceded that soil was an exception to the above rule according to administrative interpretation, and that Treas. Reg. § 1.611-1(d)(5) (1960) was drafted to reflect this sole exception. Reply Brief for Appellant, pp. 4-5.

The court disposed of the issue as follows :

In cost depletion, we do not agree with the government that 'natural deposits' have been equated to 'mineral deposits' from which income is derived through severance and sale of the mineral. The language of the cost depletion provisions, sections 611 and 612 of the Internal Revenue Code of 1954, do not convey any such meaning, and it seems to us inconsistent with the purpose and rationale of cost depletion.¹⁶

The court also pointed to the aforementioned regulation and a case¹⁷ dealing with cost depletion for topsoil as refuting the Government's argument based on coextensiveness of cost and percentage depletion.

The method of computing the depletion allowance adopted by the court is not without analogy. Generally, cost depletion is computed by the ratio of the appropriate units of the minerals extracted during the year to the total units extractable at the beginning of the year.¹⁸ Where the units are difficult to measure, such as in certain extraction of natural gas, the regulation provides that the cost depletion may be determined on the basis of the decrease in rock pressure.¹⁹ In the light of this authority it would appear that the decline in the water table is a reasonable method of computation.

In appraising the effect of *Shurbet*, however, one should remember the concluding words of the opinion: "[O]ur decision is limited to the allowance of cost depletion for ground water extracted from the Ogallala water reservoir of the Southern High Plains, 'according to the peculiar conditions in each case,' sec. 611 of the 1954 Internal Revenue Code."²⁰

In view of this cautionary statement, one should note that the district court found that the decline in the water table in the taxpayer's wells had been caused by the amount of withdrawal by the taxpayer.²¹

It is conceivable, however, that with the increasing number of wells in the basin the total extraction will increase and the decline

16. 347 F.2d at 108.

17. *Fiona Corp. v. United States*, 218 F. Supp. 354 (S.D. Fla. 1963).

18. Treas. Reg. § 1.611-2(a)(1) (1960).

19. Treas. Reg. § 1.611-2(a)(4) (1960).

20. 347 F.2d at 109.

21. Findings 5.18(e) and 7.2(e), 63-2 U.S. Tax Cas. ¶ 9528. This computation was evidently made by matching the extraction by the taxpayer against the yield from the amount of decline in the zone of saturation.

in the groundwater table under the taxpayer's land will be accelerated by others. In Texas the absolute ownership doctrine has been adopted with respect to percolating ground water and under that doctrine the owner of land overlying a groundwater basin may extract as much as he needs without regard to injury to other overlying owners.²² Allocation based on equitable or correlative share is not recognized under this doctrine; the overlying owner has no assurance regarding any given quantity of water in the future. Even the irrigable acreage overlying the basin will not serve as a practical guide for future maximum annual extraction since water can be exported from the basin for beneficial uses, including municipal uses.²³

If the decline in the water table in the taxpayer's wells is attributable in part to extraction by others, how is the cost depletion to be computed?²⁴ One possible method is to determine the average annual irrigation requirement of the taxpayer for the future and estimate the useful life of the basin to the taxpayer. The product of these two figures will indicate the total number of acre-feet of water which the taxpayer expects to extract. Thus, the unit cost can be determined by dividing the cost basis by the total acre-feet expected to be pumped by the taxpayer. The cost depletion is the product of the unit cost multiplied by the current consumption.²⁵ The disadvantage to this computation, although it attempts to reflect the individual's situation, is that the estimates are rough at best.

Another method calls for a constant readjustment of the unit cost

22. *City of Corpus Christi v. City of Pleasanton*, 154 Tex. 289, 276 S.W.2d 798 (1955); *Houston & T.C. Ry. v. East*, 98 Tex. 146, 81 S.W. 279 (1904). The reasonable use theory similarly permits extraction without regard to adverse consequences to other overlying owners, except that, unlike the absolute ownership doctrine, the water must be used on the land overlying the basin. *Bristor v. Cheatham*, 75 Ariz. 227, 255 P.2d 173 (1953).

23. *City of Corpus Christi v. City of Pleasanton*, *supra* note 22.

24. The Government may take the position in the future that a taxpayer should be allowed a depletion allowance only for the depletion caused by the taxpayer. See Reply Brief of Appellant, pp. 22-23. In fact, the Government may assume a more stringent attitude in refusing a depletion allowance to the extent that water applied by the taxpayer is not consumed by the plant and is therefore not used to produce income. Reply Brief of Appellant, p. 14. The latter position seems unreasonable since evaporation and runoff "waste" appears economically inevitable in field irrigation. Would evapo-transpiration also be denied depletion allowance? To the extent that water was used for personal purposes, depletion allowance should be denied. This issue was raised by the Government, Reply Brief for Appellant, p. 14, but the court ignored it.

25. To the extent that there is return, water measurement by withdrawal would not be accurate. Thus, consumption measures the exhaustion.

to the taxpayer to the extent that others have caused a decline in the water table. Perhaps this method is theoretically consistent with the cost depletion, but the unit cost will increase to the extent that decline in the water table is accelerated by others.

A measurement dependent upon the water table offers several different methods of determining unit cost. The unit cost may be determined by dividing the cost of the water right by the zone of saturation at the time of purchase. This unit cost may be multiplied by the decline in the water table caused by the taxpayer. This method of computation will not permit the taxpayer to recover through cost depletion the cost attributable to the water right initially purchased, and the unrecovered basis would have to be accounted for at the time of sale or exchange of property.²⁶ Moreover, this method also involves the difficulty of determining how much of the decline is due to the taxpayer's withdrawal and how much to that of others.

Finally, the amount of cost depletion might be computed by taking the same unit cost and multiplying that figure by the annual decline in the water table by whomever caused. There is much to be said for this method because of the ease of administration, but it does raise the fundamental issue regarding the nature of the property bought and the purpose of the depletion deduction. Has the taxpayer purchased a water right measured by the zone of saturation? Or has he purchased a water right measured by his needs and the productive period of the basin? Legally, the taxpayer has a right measured by the former under the absolute ownership because he is free to withdraw as much as he needs even to the extent of exhausting the area of saturation underlying the land of others. But practically, a taxpayer will pay a price measured in part by his actual need and the period of productivity of the basin. If his water right is measured by the zone of saturation, should the taxpayer be permitted a depletion or a loss deduction when the decline under his land is caused by others?²⁷ These questions are not merely matters of

26. It is arguable, of course, that the cost basis applies only to anticipated total withdrawal.

27. Depletion deduction has been described as follows:

The depletion effected by production is likened to the depreciation of machinery or the using up of raw materials in manufacturing. . . . The deduction is therefore permitted as an act of grace and is intended as compensation for the capital assets consumed in the production of income through the severance of the minerals.

Anderson v. Helvering, 310 U.S. 404, 408 (1940).

It should be noted that actual use of property is not necessary for a depreciation

academic interest, for the timing and the amount of deduction might depend upon their resolution.

Another problem arising from *Shurbet* is the significance to be attached to the determination of the court that the taxpayer, under Texas law, "owns the soil and the percolating water which is part of the soil."²⁸ Does the applicability of the *Shurbet* case depend upon whether a particular state determines the overlying owner to "own" the percolating ground water or defines his right to be usufructuary?²⁹ An examination of the Government's contention in this regard should place the court's observation in the proper perspective. The Government argued that the taxpayer had not established that he had an "ownership or investment interest in a specific mineral deposit."³⁰ In other words, the Government was making the argu-

deduction. A depreciable property which has been devoted to a trade or business, although not actually used, is subject to a depreciation allowance. Compare *P. Dougherty Co. v. Commissioner*, 159 F.2d 269 (4th Cir. 1946); *cert. denied*, 331 U.S. 838 (1947); *Kittredge v. Commissioner*, 88 F.2d 632 (2d Cir. 1937), *with Nulex, Inc.*, 30 T.C. 769 (1958). The analogy, however, is imperfect since the decline in the water table is caused by activities of others. It would seem that the taxpayer should be able to take a loss under § 165, Int. Rev. Code of 1954, even if the taxpayer has not withdrawn any water and yet there is a decline. Compare Treas. Reg. § 1.165-6(d) (2) (1960). A case such as *Louisiana Land & Exploration Co. v. Commissioner*, 161 F.2d 842 (5th Cir. 1947), which denied to a purchaser of the fee a loss deduction for worthlessness of a mineral interest, is distinguishable because the condition of the land was not altered in any manner and the taxpayer was merely frustrated in his expectations. More troublesome is a case such as *Pugh v. Commissioner*, 49 F.2d 76 (5th Cir.), *cert. denied*, 284 U.S. 642 (1931), where loss was denied for injury to agricultural capacity of land through impregnation of oil and salt water. But if the right to water is a separable item of property, as must be assumed, then the loss of units of water subject to the right is like the destruction of trees for which a loss deduction is allowed. I.T. 3921, 1948-2 Cum. Bull. 32.

On the other hand, when a decline in the water table is the result of extraction by the taxpayer and others, a depletion allowance for the decline, regardless of the cause, can be justified by an analogy to loss in inventory. See Treas. Reg. § 1.165-6(f) (2) (1960).

In fact, for ease of administration it would appear proper to permit depletion allowance rather than a loss under all circumstances. The tax consequence might be the same under either deduction. Although a loss deduction will ordinarily be determined by the difference in the market value before and after the loss but not exceeding the adjusted basis of the property, Treas. Reg. § 1.165-7(a) (2) (1960); *Alcoma Ass'n, Inc. v. United States*, 239 F.2d 365 (5th Cir. 1956), the taxpayer has assigned a unit basis to the percolating ground water so that the deductible loss would be no greater than the cost depletion allowance.

28. 347 F.2d at 106.

29. See 2 Wiel, *Water Rights in the Western United States* 1041 (3d ed. 1911) (characterizing the California correlative rights as usufructuary). The appropriate right and even the reasonable use theory would appear inconsistent with the absolute ownership theory.

30. Brief for Appellant, pp. 49-50. The taxpayer injected the legal concept of ownership in reply to the Government's argument. Brief for Appellee, p. 10.

ment that, because the percolating ground water is moving according to the gradient, different molecules of water are constantly moving to, and away from, the taxpayer's land. It was an argument based on lack of physical identity rather than legal characterization. Therefore, although it was unfortunate to talk about legal ownership under the absolute ownership doctrine, it would seem that cost depletion should be allowable regardless of whether a given state adopts the absolute ownership, reasonable use, correlative rights or appropriation system of defining the right to percolating ground water.

Shurbet also leaves unanswered the issue whether a depletion allowance will be granted where the water basin is subject to substantial annual recharge, but is also subjected to overdraft conditions. Where the state law imposes no restriction on the total amount of withdrawal, it would appear that a depletion allowance should be granted to the extent that storage water is extracted from the basin. The proof will have to show that the decline in the water table is not merely cyclical, but is a permanent condition due to extraction beyond the average safe annual yield.

In some states, a restriction is imposed on the total amount of withdrawal. For example, in California the total amount of the annual withdrawal from a basin which will be permitted without infringement upon any prior right to the ground water is the average safe annual yield.³¹ A person with a superior right can enjoin those with inferior rights from causing an overdraft. Thus, where there is a substantial recharge, the persons with a superior right to the basin water would have an inexhaustible supply. In some other states, an administrative agency has the authority to restrict the extraction from the groundwater basin to prevent an overdraft or its aggravation.³²

If, however, a prior overdraft condition existed, the decline in the water table would be a permanent condition even if a balance between recharge and extraction is restored. When the balance is restored, the supply becomes inexhaustible; but there still might

31. *City of Pasadena v. City of Alhambra*, 33 Cal. 2d 908, 207 P.2d 17 (1949), cert. denied, 339 U.S. 937 (1950).

32. *E.g.*, Nev. Rev. Stat. § 534.110 (1961); Ore. Rev. Stat. § 537.735 (1961); Wyo. Stat. Ann. § 41-129 (1957). In states which recognize appropriative right to ground water, the total amount of extraction might be controlled if the prior appropriator's means of diversion is to be protected. See, *e.g.*, *Current Creek Irrigation Co. v. Andrews*, 9 Utah 2d 324, 344 P.2d 528 (1959). See also *City of Colorado Springs v. Bender*, 148 Colo. 458, 366 P.2d 552 (1961).

exist the adverse consequence of continued increased expenses of pumping from a lower water table. There might also be an additional cost of drilling a deeper well. Should the taxpayer be entitled to a depletion allowance for the lowering of the water table under these circumstances? Conceptually, it is difficult to think in terms of depletion allowance when the supply is inexhaustible. It is arguable that a loss deduction under section 165 of the Internal Revenue Code of 1954 may be taken for a permanent impairment of the water right to the extent that the value of the right has decreased because of future increased pumping costs.³³

While *Shurbet* may hold tax advantages for many taxpayers, there may be disadvantages to others. Because the "mining" of ground water is now determined to be subject to cost depletion, a taxpayer must adjust the basis of the water right for past depletion which was allowable, though not actually taken by the taxpayer.³⁴ In other words, *Shurbet* will operate retroactively to require an adjustment to the basis of the property to the extent that cost depletion should have been taken by the taxpayer in the past. The fact that the taxpayer might have been ignorant of the depletion allowance appears immaterial under section 1016(a)(2).³⁵

Finally, *Shurbet* raises the question whether a taxpayer who incurs "exploration" or "development" expenditures with respect to a groundwater basin with insignificant natural recharge can take advantage of sections 615 and 616.³⁶

Section 615 permits a taxpayer to deduct as ordinary expenses the amounts paid or incurred for the "purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral" before the "beginning of the development stage of the mine or deposit."³⁷ The limitations upon such deduction are \$100,000 in any one taxable year,³⁸ and a maximum of \$400,000 over any number of years.³⁹ The taxpayer also has the election of deferring

33. See note 26 *supra*. The fact that artificial recharge of the basin is possible or is being undertaken would appear immaterial.

34. Int. Rev. Code of 1954, § 1016(a)(2); *cf.*, *Kittredge v. Commissioner* 88 F.2d 632 (2d Cir. 1937).

35. Taxpayers should file a refund claim for the period not barred by the statute of limitations. The period allowed is three years from the time the return was filed or two years from the time the tax was paid, whichever expires later. Int. Rev. Code of 1954, § 6511 (a).

36. Int. Rev. Code of 1954, §§ 615, 616.

37. Int. Rev. Code of 1954, § 615(a).

38. *Ibid.*

39. Int. Rev. Code of 1954, § 615(c)(1).

the expenditures mentioned above and deducting them on a ratable basis of units produced when production is achieved.⁴⁰ If the taxpayer chooses neither to deduct the expenditures nor to treat them as deferred expenses, the expenditures will be capitalized,⁴¹ or a loss deduction will be allowed if the venture proves to be unsuccessful.⁴²

The benefit of the election to deduct the exploration expenditures or to treat them as deferred expenses and deduct them during production inures primarily to a taxpayer who is entitled to take a percentage depletion allowance because the allowance may be taken without regard to the basis of the property.⁴³ If the benefits of this section are available to taxpayers who are restricted to cost depletion, an election to defer the expenditures will have an effect different from capitalizing the expenditures and taking a cost depletion. Thus, for them, the benefit of section 615 is in the election to deduct the expenditures at the time they are paid or incurred.

Section 616 gives the taxpayer the same election with respect to development expenses as with the exploration expenditures. However, section 616 contains no monetary limitation on the amount deductible. But if the taxpayer chooses to defer during the development stage, the amount which can be deferred is restricted to the expenditures in excess of the net receipts during the taxable year from the minerals produced from the deposit for which the expenditures were made.⁴⁴ Development expenditures are those expenditures made after minerals in commercially marketable quantities have been found.⁴⁵

40. Int. Rev. Code of 1954, § 615(b). The deferred expenses are included within the limitations discussed in text accompanying notes 41 & 42 *infra*.

41. Rev. Rul. 58-358, 1958-2 Cum. Bull. 359.

42. I.T. 4006, 1950-1 Cum. Bull. 48. The loss may not be allowed if the taxpayer either acquires or retains a property based on the data obtained from exploration. *Ibid.* However, I.T. 4006 appears to be dealing with mineral property as such and does not appear to be concerned with the situation where property is retained for independent reasons, as for example, a farmer who retains his farm land for farming purposes despite the failure of the exploration to locate ground water.

43. One of the reasons given for the election under the original act is the necessity for added incentive since the amount of the percentage depletion is not dependent upon the exploration expenditures. S. Rep. No. 781, 82d Cong., 1st Sess. 737 (1951); 1951-2 Cum. Bull. 503.

44. Int. Rev. Code of 1954, § 616(b).

45. Under both §§ 615 and 616, Int. Rev. Code of 1954, the amount expended for depreciable items is not currently deductible. The allowance for depreciation is, however, considered as exploration or development expenditure, as the case may be. Int. Rev. Code of 1954, §§ 615(a), 616(a).

The election to defer the development expense is applicable even during the producing stage except that, during the development stage, the development expenses must be deducted currently and only the excess of the expenses over the net receipts from the minerals produced from such mine can be deferred. Int. Rev. Code of 1954, § 616(b).

The applicability of sections 615 and 616 with respect to ground-water basins is unclear because section 615 refers to "deposit of ore or other mineral" and to "mine or deposit," and section 616 alludes to "mine or other natural deposit" and to "ores or minerals." The court of appeals in *Shurbet* has characterized ground water as a "natural deposit."⁴⁶ The district court has stated that ground water was a "mineral and a natural deposit."⁴⁷ The regulation defines "minerals" to include nonmetallic deposits.⁴⁸ From these bits, an argument favoring the taxpayer can be constructed.⁴⁹

Another issue which must be faced by the taxpayer to take advantage of these sections is whether these sections are available to a taxpayer who does not intend to sell the minerals produced. There is nothing in sections 615(a) or 616(a), which deals with current deduction, that restricts their application to those intending to market the minerals. However, where a taxpayer elects to defer these expenditures under sections 615(b) or 616(b), the deferred expenditures are deductible on a ratable basis as the minerals are "sold." Moreover, the provisions relating to development expenditures are applicable after minerals are found in "commercially marketable quantities." Do these phrases sufficiently color the sections to restrict their applicability to taxpayers engaged in production for sale? It appears that the phrase "commercially marketable quantities" was employed to distinguish between the exploration and the development stage and does not appear to carry any other connotation.⁵⁰ Furthermore, it can be argued that whatever the meaning of "sold," its applicability is restricted to deferred expenditures.

Shurbet has established an important principle. However, it is probably only the first step in the developing tax problems relating to groundwater mining.

Once the producing stage is reached, the expenses incurred to maintain output are deductible as a current expense. *Clear Fork Coal Co. v. Commissioner*, 229 F.2d 638 (6th Cir. 1956). The extraordinary development expenditures during the producing stage are subject to the election under § 616. See S. Rep. No. 781, 82d Cong., 1st Sess. (1951), 1951-2 Cum. Bull. 559. The taxpayer need no longer hazard a guess as to whether the producing stage has been reached in order to obtain a current deduction.

46. 347 F.2d at 108.

47. Finding No. 6.01, 63-2 U.S. Tax Cas. ¶ 9528.

48. Treas. Reg. § 1.611-1(d)(5) (1960).

49. It appears that the primary purpose of §§ 615 and 616, Int. Rev. Code of 1954, was to give added tax advantage to those utilizing percentage depletion, H.R. Rep. No. 586, 82d Cong., 1st Sess. (1951), 1951-1 Cum. Bull. 379; S. Rep. No. 781, 82d Cong., 1st Sess. (1951), 1951-2 Cum. Bull. 489, 503, but there is nothing in these reports to indicate that the benefits of these sections are to be restricted to percentage depletion taxpayers.

50. S. Rep. No. 781, *supra* note 49.