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In Re:

LEGEND:

Corporation	=
Parent	=
Area	=
<u>a</u>	=
<u>b</u>	=
X	=
Y	=
<u>c</u>	=
Process	=
<u>d</u>	=
<u>e</u>	=
<u>f</u>	=
<u>g</u>	=
<u>h</u>	=
<u>i</u>	=
<u>j</u>	=
<u>k</u>	=
<u>l</u>	=

Dear :

This letter is in response to your letter dated February 2, 2004, and subsequent correspondence on behalf of Corporation, requesting rulings under the Internal Revenue Code.

The represented facts are as follows. Corporation is an accrual method taxpayer utilizing a calendar taxable year. Corporation is the parent of several subsidiaries which file on Corporation's consolidated tax return. Corporation has elected under § 263(c) to deduct its intangible drilling and development costs. Corporation is a wholly owned subsidiary of Parent.

Corporation represents that neither Corporation, nor Parent, nor any subsidiary or affiliated company refines crude oil in either the United States or any other country. Further, neither Corporation, nor Parent, nor any subsidiary or affiliated company is engaged in the retail sale of oil, natural gas, or any product derived therefrom.

The proposed transaction relates to the extraction of hydrocarbons from a lease located in Area. Area is located outside the United States. Currently, hydrocarbons are recovered from the Y formation of Area using open pit mining. The mined hydrocarbon horizon is located between a and b meters below the surface. It has a density that ranges from d to e API, with a viscosity ranging over f centipoises, and is immobile. Once mined, the hydrocarbon is transported to a separator, where it is crushed and the application of heat and water extracts the hydrocarbon from the sand. The hydrocarbon is then subject to fractionation to recover lighter hydrocarbons. The remaining volume is sent to a coker.

Parent intends to implement a new project to recover hydrocarbons from its X lease in Area. The project will target a horizon in the Y formation located approximately c meters below the surface. Corporation represents that the hydrocarbon to be recovered from the X lease is immobile under reservoir conditions, and that no primary production from X has been attempted. At X, the density of the hydrocarbon targeted by the project is g to h API, with a viscosity of i to j centipoises under reservoir conditions of k degrees Fahrenheit and l psi. Because the horizon to be targeted by the new project is located too far below the surface for open pit mining, Parent will utilize Process.

After recovery, the hydrocarbon is blended with a diluent to enable it to move through a pipeline. The blend will be sold at market price to a joint venture consisting of Corporation and a U.S. refiner. The joint venture will transport the blend to an upgrader owned by the joint venture within the United States. The blend will be subjected to fractionation to recover lighter hydrocarbons. The residual volume will be sent to a coker, where additional light hydrocarbons will be recovered. The recovered hydrocarbons will be refined in the joint venture's refinery to produce commercially saleable products.

You request the following rulings:

1. The hydrocarbon recovered from the Y formation through open pit mining is oil from tar sands, and not crude oil, for purposes of § 613A and § 291(b).

2. The hydrocarbon recovered from the X lease, through use of Process is oil from tar sands, and not crude oil, for purposes of § 613A and § 291(b).

3. Refining tar sand oil is not the refining of crude oil under § 613A(d)(4)

4. The volume of tar sand oil processed in an upgrader or refinery is disregarded under the 50,000 barrel per day crude oil exclusion under § 613A(d)(4).

5. The refining of tar sand oil by Corporation's proposed joint venture is not relevant to the determination of whether Corporation is an integrated oil company under § 291(b).

Section 263(c) provides a deduction for intangible drilling and development costs (IDC) relating to oil and gas wells. Section 291(b)(1) provides that the deduction under § 263(c) for IDC will be reduced by 30 percent in the case of an integrated oil company. Section 291(b)(2) provides that amounts not allowed as a deduction under § 291(b)(1) will be amortized over the 60-month period beginning with the month the costs are paid or incurred.

Section 291(b)(4) defines an integrated oil company, for purposes of § 291(b), as a producer of crude oil who is unable to take advantage of the exemption from the limitation on percentage depletion provided under § 613A(c) for independent producers and royalty owners, due to the application of § 613A(d)(2) or § 613A(d)(4). Section 613A(d)(2) provides that § 613A(c) does not apply in the case of a retailer of oil and gas. Section 613A(d)(4) states that if a taxpayer or a related person engages in the refining of crude oil, § 613A(c) will not apply to such taxpayer if on any day during the taxable year the refinery runs of the taxpayer and such person exceed 50,000 barrels.

Section 1.613A-7(g) defines crude oil, for purposes of § 613A, as a mixture of hydrocarbons which existed in the liquid phase in natural underground reservoirs and which remains liquid at atmospheric pressure after passing through surface separating facilities, hydrocarbons which existed in the gaseous phase in natural underground reservoirs but which are liquid at atmospheric pressure after being recovered from oil well (casinghead) gas in lease separators, and natural gas liquid recovered from gas well effluent in lease separators or field facilities before any conversion process has been applied to such production.

Section 29(c)(1)(A) formerly provided a credit for the sale of oil produced from shale and tar sand. The definition of tar sand that Congress contemplated in enacting § 29 was provided in a ruling issued by the Federal Energy Agency, the precursor of the Department of Energy. Under FEA Ruling 1976-4, tar sands are "[t]he several rock types that contain an extremely viscous hydrocarbon which is not recoverable in its natural state by conventional well production methods including currently used enhanced recovery techniques. The hydrocarbon-bearing rocks are variously known as bitumen-rocks, oil impregnated rocks, oil sands, and rock asphalt." The hydrocarbon recovered from tar sand, when upgraded into tar sand oil, is a synthetic crude oil. Congress considered tar sand oil to be a crude oil substitute, rather than crude oil. *See Shell Petroleum, Inc. v. United States*, 182 F.3d 212, 221 (3rd Cir. 1999); *see also* S. Rep. No. 96-394. Congress also intended that the credit for the production of tar sand oil would encourage the development of new energy technologies, because typically such technologies are needed to produce alternative energy sources. *Id.* at 224. This requires the use of a production method not in use in 1980. *See Shell Petroleum, Inc. v. United States*, 319 F.3d 1334, 1340 (Fed. Cir. 2003).

It is well established that tar sand oil and crude oil are mutually exclusive categories of hydrocarbons. It follows logically that the refining or upgrading of oil from tar sand is not the refining of crude oil. Therefore, for purposes of § 613A(d)(4), the upgrading or refining of tar sand oil is not considered in determining whether a taxpayer's refining exceeds 50,000 barrels of crude oil per day. As a result, a taxpayer's upgrading of tar sand oil has no impact on whether the taxpayer will be considered an integrated oil company under § 291(b)(4) due to the application of § 613A(d)(4).

We now turn to the hydrocarbon which Parent will recover from Y. Corporation represents that the hydrocarbon produced through surface mining is immobile. Open pit mining is not a conventional well production method in use in 1980. We conclude that Corporation has shown that the hydrocarbon Parent recovers through open pit mining from Y and upgrades is tar sand oil within the meaning of FEA Ruling 1976-4.

With respect to Parent's X lease, Corporation represents that the hydrocarbon is immobile under reservoir conditions. The density of the hydrocarbon is g to h API, with a viscosity of i to j centipoises under reservoir conditions. No primary production from the X lease has been attempted. Parent will use Process to recover the hydrocarbon from X. Process is not a conventional well production method in use in 1980, including then-used enhanced recovery techniques. Based on the forgoing, we conclude that Corporation has shown that the hydrocarbon Parent recovers through use of Process from X and upgrades is tar sand oil within the meaning of FEA Ruling 1976-4.

Based solely on the facts submitted and representations made, we conclude:

1. The upgraded hydrocarbon recovered from the Y formation through open pit mining is oil from tar sands, and not crude oil, for purposes of § 613A and § 291(b).

2. The upgraded hydrocarbon recovered from the X lease, through use of Process is oil from tar sands, and not crude oil, for purposes of § 613A and § 291(b).

3. Refining tar sand oil is not the refining of crude oil under § 613A(d)(4)

4. The volume of tar sand oil processed in an upgrader or refinery is disregarded under the 50,000 barrel per day crude oil exclusion under § 613A(d)(4).

5. The refining of tar sand oil by Corporation's proposed joint venture is not relevant to the determination of whether Corporation is an integrated oil company under § 291(b).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Corporation. A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/ Joseph H. Makurath
Senior Technician Reviewer, Branch 7
Office of Associate Chief Counsel
(Passthroughs & Special Industries)