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Person To Contact:
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Date:
April 20, 2011

LEGEND:

Taxpayer =

Parent =
Sister 1 =
Sister 2 =
Sister 3 =
Subsidiary 1 =
Subsidiary 2 =
Country =

Dear :

This letter responds to your letter dated , requesting a ruling that Sister 1 is not precluded from being treated as an independent producer for purposes of § 613A(c) of the Internal Revenue Code, and is not treated as an integrated oil company for purposes of § 291(b)(1)(A) if a related sister company in Taxpayer's consolidated group engages in retail activities.

Facts

The facts are represented by Taxpayer to be as follows:

Taxpayer uses a calendar taxable year accounting period, and the accrual method of accounting for filing its federal income tax return.

Parent is incorporated in Country, and conducts exploration, production and retail activities wholly within Country. Parent does not sell any of its product directly or indirectly to related retailers within the United States (U.S.). Parent does not and will not purchase any product from Sister 1 for Parent's retail activities in Country.

Taxpayer is the holding company for Parent's U.S. operations, and files a consolidated return for its affiliated group. Sister 1, Sister 2, Sister 3, Subsidiary 1, and Subsidiary 2 all are members of Taxpayer's consolidated group. Sister 1, Sister 2, and Sister 3 are all wholly-owned by Subsidiary 1. Subsidiary 2 is wholly-owned by Sister 1.

Sister 1 is an exploration company that holds various working interests in oil and gas leases, and is engaged in the exploration for and production of natural gas and oil in the U.S. Natural gas produced by Sister 1 is transferred to Subsidiary 2 for industrial and commercial sales and transportation on pipelines pursuant to Federal Energy Regulatory Commission (FERC) regulations.

Sister 2 is a retail company that has entered into contracts for the purchase of natural gas from Subsidiary 2 and third parties. Sister 2 will convert the natural gas to compressed natural gas and/or liquefied natural gas and sell it to a variety of users, including industrial, commercial, and individual customers, through retail outlets. Neither Sister 2 nor Subsidiary 2 knows or controls the final disposition of the natural gas sold by Subsidiary 2 into the open market or the original source of the natural gas acquired by Sister 2 from Subsidiary 2. Sales by Sister 2 to end users are expected to exceed $5 million.

Sister 2 may utilize employees of the consolidated group to perform services on behalf of Sister 2, such as accounting and administrative services provided by employees of Parent, Sister 1, and Sister 3. In addition, employees of Sister 1 may provide servicing and maintenance of retail facilities to Sister 2. Any consolidated group employees or assets used will be reimbursed at arms-length market price. Sister 2 will not pay trademark fees to Sister 1.

Subsidiary 2 is a marketing and transportation company that owns certain reporting and tracking software. Subsidiary 2 holds a blanket marketing certificate to sell natural gas on pipelines pursuant to the FERC. FERC regulations require that the transporter hold title of the product when it enters the pipeline. Subsidiary 2 sells natural gas produced by Sister 1 into the stream of commerce to multiple purchasers at market prices. Neither Sister 1 nor Subsidiary 2 has knowledge of or control over what happens to the natural gas after it is sold.

Subsidiary 2 does not have any exploration or development activities. To accommodate the purchasing of natural gas for Sister 2, Subsidiary 2 will enter into back to back contracts: (1) contracts with unrelated third parties to purchase natural gas off the open market, and (2) contracts to resell the third party natural gas to Sister 2.

Each month, pursuant to the third party contract terms, Subsidiary 2 will be invoiced by the unrelated third party for the amount of natural gas delivered to Sister 2's retail sites. Subsidiary 2 will invoice Sister 2 monthly for the identical amount and volumes.

Taxpayer has made the following representations:

(1) Sister 1 does not own a significant ownership interest in Sister 2;

(2) Sister 1's production is sold to persons unrelated to Sister 1 and unrelated to Sister 2;

(3) Sister 2 does not purchase oil or natural gas from Sister 1's customers or persons related to Sister 1's customers;

(4) There are no arrangements whereby Sister 2 acquires for resale oil or natural gas that Sister 1 produced or made available for purchase by Sister 2;

(5) Neither Sister 1 nor Sister 2 knows or controls the final disposition of the oil or natural gas sold by Sister 1 or the original source of the petroleum products acquired for resale by Sister 2;

(6) The gathering lines, pipelines, and interconnections used by Sister 2 to procure and resell natural gas are connected solely to gas lines owned by unrelated third parties. Accordingly, Sister 1 has no specific knowledge that Sister 1's oil or natural gas is or will be commingled with other producers' oil or natural gas that is or may be acquired for resale by Sister 2.

Law and Analysis

Section 291(b)(1)(A) provides that an integrated oil company is required to reduce the deduction for certain intangible drilling and development costs allowable under § 263(c) by 30 percent, and amortize such costs over a period of 60 months.

Section 291(b)(4) provides that for purposes of § 291(b), the term "integrated oil company" is defined as any producer of crude oil to whom § 613A(c), relating to independent producers, does not apply by reason of § 613A(d)(2) or (d)(4), relating to certain retailers or refineries, respectively.

Section 611 generally provides for a depletion deduction in the case of mines, oil and gas wells, other natural deposits, and timber. Section 1.611-1(a) of the Income Tax Regulations provides that in the case of exhaustible natural resources, other than timber, the allowance for depletion is computed upon either the adjusted depletion basis of the property (see § 612, relating to cost depletion) or upon a percentage of gross

income from the property (see § 613 relating to percentage depletion), whichever results in the greater allowance for depletion for any taxable year.

Section 613A(a) provides that except as otherwise provided in § 613A, the allowance for depletion under § 611 with respect to any oil and gas well is computed without regard to § 613.

Under § 613A(c), "independent producers and royalty owners" are allowed a deduction for percentage depletion with respect to limited quantities (depletable quantities) of domestic crude oil or natural gas production. However, § 613A(c) does not apply to any taxpayer that is a "retailer" or "refiner" as defined in § 613A(d)(2) and (d)(4), respectively.

Section 613A(d)(2) provides that a retailer is any taxpayer who (subject to a $5 million de minimis sale rule) directly, or through a related person, sells oil or natural gas (excluding bulk sales of such items to commercial or industrial users), or any product derived from oil or natural gas (excluding bulk sales of aviation fuels to the Department of Defense)—

(A) through any retail outlet operated by the taxpayer or a related person, or

(B) to any person—

(i) obligated under an agreement or contract with the taxpayer or a related person to use a trademark, trade name, or service mark or name owned by such taxpayer or a related person, in marketing or distributing oil or natural gas or any product derived from oil or natural gas, or

(ii) given authority, pursuant to an agreement or contract with the taxpayer or a related person, to occupy any retail outlet owned, leased, or in any way controlled by the taxpayer or a related person.

Section 613A(d)(3) provides that for purpose of § 613A(d), a person is a related person with respect to the taxpayer for purposes of § 613A(d) if a significant ownership interest in either the taxpayer or such person is held by the other, or if a third person has significant ownership interests in both taxpayer and such person. Section 613A(d)(3) provides that the term "significant ownership interest" means, with respect to any corporation, 5 percent or more in value of the outstanding stock of such corporation.

Section 613A(c)(8)(A) provides that for purposes of § 613A(c), persons who are members of the same controlled group of corporations are treated as one taxpayer. This provision, however, does not apply to the provisions within § 613A(d).

Section 1.613A-7(r)(2)(ii) provides that a taxpayer may be deemed to be a "retailer" by virtue of selling oil or natural gas or products derived therefrom through a related person in certain cases in which the taxpayer may benefit by reason of the taxpayer's direct or indirect ownership interest in the related person.

Section 1.613A-7(r)(3) provides that the term "any product derived from oil or natural gas" means products that are recovered from petroleum refineries or extracted from natural gas in field facilities or natural gas processing plants. The term retail outlet means "any place where sales of oil or natural gas (excluding bulk sales of such items to commercial or industrial users), or a product of oil or natural gas (excluding bulk sales of aviation fuels to the Department of Defense), accounting for more than 5 percent of the gross receipts from all sales made at such place during the taxpayer's taxable year, are systematically made for any purpose other than for resale."

In Rev. Rul. 85-12, 1985-1 C.B. 181, a wholly-owned subsidiary of a holding corporation produced oil and gas that it sold at or near the wellhead to unrelated parties. Another wholly-owned subsidiary of the same holding corporation was a retailer of petroleum or petroleum products it purchased from unrelated parties, selling more than $5,000,000 annually to end users. The holding corporation filed a consolidated return with its subsidiaries. The revenue ruling concludes that the producer subsidiary had no direct or indirect ownership interest in the retailer subsidiary, and, thus, did not benefit from the retail sales. Although the two subsidiaries were related persons for purposes of § 613A(d), none of the producer subsidiary's production was, in form or substance, sold through the retailing subsidiary. Thus, the producer subsidiary was not precluded from taking the percentage depletion deduction as provided in § 613A(c) or from being treated as an independent producer for purposes of the former windfall profit tax.

Rev. Rul. 92-72, 1992-2 C.B. 118, describes a situation under which a taxpayer is not considered to be selling oil or natural gas through a related retailer and therefore is not considered a retailer itself for purposes of § 613A(d)(2). In the revenue ruling:

(1) the taxpayer does not own a significant ownership interest in the retailer;

(2) the taxpayer sells its production to persons unrelated to the taxpayer and unrelated to the retailer;

(3) the retailer does not purchase oil or natural gas from the taxpayer's customers or persons related to the taxpayer's customers;

(4) there are no arrangements whereby the retailer acquires for resale oil or natural gas that the taxpayer produced or made available for purchase by the retailer; and

(5) neither the taxpayer nor the retailer knows or controls the final disposition of the oil or natural gas sold by the taxpayer or the original source of the petroleum products acquired for resale by the retailer.

Based on the information submitted and the representations made, we conclude that Sister 1 is not precluded from being treated as an independent producer for purposes of § 613A(c), and is not treated as an integrated oil company for purposes of § 291(b)(1)(A).

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. Specifically, we express or imply no opinion whether the transactions in this case otherwise meet the requirements of § 613A.

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

Sincerely,

Brenda M. Stewart
Senior Counsel, Branch 6
(Passthroughs & Special Industries)
Office of Associate Chief Counsel