Internal Revenue Service

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Person to Contact:

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July 6, 1999

LEGEND:

Taxpayer =

State 1 =

State 2 =

a =

b =

c =

A =

d =

B =

e =

C =

D =

E =

F =

f =

g =

h =

i =

j =

k =

l =

m =

n =

Dear Sir:

This letter responds to your request, dated , and your supplemental request, dated April 28, 1999, for rulings under §§ 29(c) and 7805(b) of the Internal Revenue Code.

The information submitted and the representations made are summarized as follows: Taxpayer acquired and will acquire, for production and possible sale, leases that cover lands in State 1 and State 2 on which are located approximately a wells. The wells were drilled through coal seams between December 31, 1979, and January 1, 1993, to a depth below the coal seams. The formations into which the wells originally were completed were depleted subsequent to January 1, 1993.

Taxpayer initiated a program to recomplete the wells and produce gas from the coal seams in b. On c, Taxpayer made application to A for a determination that the natural gas produced from d recompleted wells is occluded natural gas from coal seams, as that term was defined in § 107(c) of the Natural Gas Policy Act of 1978 (NGPA). Taxpayer subsequently filed requests for and received well-category determinations from A and B for over e wells. In its order approving Taxpayer's request for well-category determinations, B also approved a procedure whereby future applicants may obtain well-category determinations. Some of the wells included in the project are located on C. Taxpayer has met twice with officials from D, which is the jurisdictional agency responsible for making well-category determinations on lands in E. D has indicated that it will process well-category determinations. In addition, F has

agreed to assist Taxpayer in reinstituting the procedures previously used by D in making well-category determination.

As of f, Taxpayer had re-entered the well bores of g wells and recompleted them in the coal seams. Between now and h, Taxpayer anticipates recompleting between i and j additional wells.

Taxpayer represents that the economics of the project are based on the recompletion and qualification of the full project compromising approximately a wells. The total anticipated cost of the project is k. In order to convert the field to the production of gas from recompleted wells, it was necessary to construct an infrastructure of gas gathering lines and water disposal facilities to service the entire project. As of l, Taxpayer had expended approximately m, most of which was expended to develop the infrastructure. Now that the infrastructure is substantially in place, Taxpayer anticipates a period of accelerated recompletions.

Taxpayer requests a ruling that gas from wells, determined by jurisdictional agencies in State 1 and State 2 to be producing occluded natural gas from coal seams, constitutes "qualified fuel" under § 29(c). Taxpayer represents that if it does not receive a favorable ruling, the project may not be completed and Taxpayer will suffer approximately n in losses. In the event Taxpayer does not receive a ruling that gas produced from the project constitutes qualified fuel under § 29(c), Taxpayer requests relief under § 7805(b) for the full project of approximately a wells. Because Taxpayer acquired the wells for possible sale, Taxpayer requests that the relief, if granted, apply to Taxpayer, its assignees, and successors in interest.

Section 29(a) provides a credit for the taxable year for qualified fuel sold by the taxpayer to an unrelated person during the taxable year, the production of which is attributable to the taxpayer.

Section 29(c)(1)(B)(i) defines the term "qualified fuels" to include gas produced from geopressured brine, Devonian shale, coal seams, or a tight formation.

Section 29(c)(2)(A) provides that, except as provided in § 29(c)(2)(B), the determination of whether any gas is produced from geopressured brine, Devonian shale, coal seams, or a tight formation shall be made in accordance with § 503 of NGPA.

Section 29(f)(1)(A) provides that the credit is available with respect to qualified fuels that are produced from a well drilled after December 31, 1979, and before January 1, 1993.

Section 503 of the NGPA (repealed by the Wellhead Decontrol Act of 1989, effective January 1, 1993) set forth a procedure by which well-category determinations made by jurisdictional agencies were reviewed by the Federal Energy Regulatory

Commission (FERC) for purposes of incentive pricing. In FERC Orders 539 (issued April 9, 1992) and 539-C (issued July 12, 1993), FERC announced that it would review determinations only for recompletions that were commenced before December 31, 1992.

In Situation 1 of Rev. Rul. 93-54, 1993-2 C.B. 3, X, the owner of an oil and gas property drilled a well after December 31, 1979, and before January 1, 1993. X completed the well in an oil reservoir, and began producing crude oil. Information obtained during the drilling and completion of the well indicated that it had penetrated a coal seam deposit above the oil reservoir. In 1994, when the oil reservoir had been depleted, X plugged the oil zone and recompleted the well to produce gas from the coal seam. Rev. Rul. 93-54 holds that if a well that is drilled after December 31, 1979, and before January 1, 1993, is recompleted after January 1, 1993, to produce fuel that is qualified fuel, the fuel qualifies for the § 29 credit.

In True Oil Company v. Commissioner, 170 F.3d 1294 (10th Cir. 1999), *aff'g* Nielson-True Partnership v. Commissioner, 109 T.C. 112 (1997), the taxpayer began drilling two wells in 1983. The wells were completed in April 1984. Both wells produced gas from a formation that FERC had determined was a tight formation. The taxpayer prepared a well determination application for one of the wells and submitted the application to the appropriate jurisdictional agency. The determination was not reversed by FERC. No well determination application was prepared or submitted for the other well. The taxpayer claimed the § 29 credit for gas produced from both wells. The portion of the credit attributable to the well for which there was no well-category determination was disallowed because no determination had ever been made by the jurisdictional agency or by FERC that the well was producing gas from a tight formation. The court held that a producer must obtain a formal well-category determination before it can claim the § 29 credit.

Section 29 Ruling:

In True Oil Company v. Commissioner, which was decided subsequent to the submission of Taxpayer's ruling request, the Tenth Circuit held that a producer must obtain a formal well-category determination, including review by FERC, before it can claim the § 29 credit. The court indicated that this requirement applies to fuel produced from wells recompleted after January 1, 1993. Consistent with the court's holding in True Oil Company v. Commissioner, Taxpayer's request for a ruling that gas from wells determined by jurisdictional agencies in State 1 and State 2 to be producing occluded natural gas from coal seams constitutes "qualified fuel" under § 29(c) is denied.

Section 7805(b) Ruling:

Although Rev. Rul. 93-54 does not address the issue of well-category determinations under § 503(b) of the NGPA, it may be interpreted as implying that a

producer is not required to obtain a formal well-category determination before it can claim the § 29 credit because a well-category determination could not have been obtained under the facts described in Situation 1. In the present case, Taxpayer made a substantial financial commitment to the project and began the process of obtaining well-category determinations from the appropriate jurisdictional agencies prior to the Tax Court's decision in Nielson True. Also, Taxpayer attempted to comply with the requirements of § 29(c) and § 503 of the NGPA. Taxpayer failed to comply fully because FERC had ceased its oversight of well-category determinations at the time the wells were recompleted.

Taxpayer, its assignees, and successors in interest are granted relief under § 7805(b) for those wells in the project comprising approximately a wells for which Taxpayer has obtained, or will obtain, well-category determinations from the appropriate jurisdictional agencies. Accordingly, the absence of review by FERC will not preclude Taxpayer, its assignees, and successors in interest from claiming the § 29 credit for gas produced from those wells in the project comprising approximately a wells for which Taxpayer has obtained or will obtain well-category determinations from the appropriate jurisdictional agency. The relief granted herein applies with respect to sales of gas produced from the subject wells beginning on the date of recompletion and, pursuant to § 29(f)(2), extending to December 31, 2002.

The rulings contained in this letter are based upon the information submitted and representations made by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. The materials submitted in support of Taxpayer's request for rulings, as well as the determinations made or to be made by the jurisdictional agencies, are subject to verification on examination.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction under the cited provisions or any other provision of the Code. Specifically, we express or imply no opinion whether Taxpayer, it assignees, or successors in interest may claim the § 29 credit for any recompleted wells that are not included in the project of approximately a wells.

Except to the extent expressly provided, this ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Taxpayer.

Sincerely,

Joseph H. Makurath

Joseph H. Makurath
Senior Technician Reviewer, Branch 7
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)