S/V Drilling Partners, Snyder Armclar Gas Company, Tax Matters Partner v. Commissioner of Internal Revenue, 114 T. C. 83 (2000)

A taxpayer producing natural gas from sources qualifying under multiple categories under IRC § 29 is entitled to a credit for the total barrels of oil equivalent (BOE) sold, without double-counting the same gas.

Summary

S/V Drilling Partners sold natural gas in 1993 and 1994, classified as coming from both a tight formation and Devonian shale, qualifying for credits under IRC § 29. The Tax Court held that S/V was entitled to a credit for the total BOE sold (32,410 BOE) without double-counting, at a rate of $3 per BOE for gas from a tight formation not Devonian shale and $3 indexed per BOE for gas from both sources. The decision clarified that the credit calculation does not allow for double credits based on multiple classifications of the same gas, impacting how similar dual-source gas production cases should be assessed.

Facts

In 1992, S/V Drilling Partners drilled wells in Pennsylvania, which were classified by the Pennsylvania Department of Environmental Resources and the Federal Energy Regulatory Commission as producing gas from both Devonian shale and a tight formation. In 1993 and 1994, S/V sold 32,410 barrels of oil equivalent (BOE) of natural gas to public utilities, with 15,483 BOE from a tight formation not Devonian shale, and 16,927 BOE from both a tight formation and Devonian shale. S/V claimed a credit under IRC § 29 on its tax returns, seeking to apply double credits for the gas produced from both sources.

Procedural History

The Commissioner issued notices of final partnership administrative adjustment in 1998, adjusting S/V's partnership returns for 1993 and 1994. S/V petitioned the Tax Court to redetermine these adjustments. The Tax Court held that S/V was entitled to a credit for the total BOE sold without double-counting, and the decision was reviewed by the court with Judges Foley and Vasquez dissenting.

Issue(s)

1. Whether S/V is entitled to a credit under IRC § 29 for the total BOE of natural gas sold, including gas classified under multiple categories, without double-counting the same gas?
2. Whether the credit rate for gas produced from both a tight formation and Devonian shale should be indexed under IRC § 29(b)(2)?

Holding

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1. Yes, because IRC § 29 allows a credit based on the total BOE of qualified fuels sold, without permitting double credits for the same gas, even if it qualifies under multiple categories.
2. Yes, because the Commissioner was considered to have conceded that the credit should be indexed for gas from both a tight formation and Devonian shale, as per IRC § 29(b)(2).

Court's Reasoning

The Tax Court interpreted IRC § 29 to mean that the credit is based on the BOE of qualified fuels sold, not on the energy content of the gas produced. The court rejected S/V's argument for double credits, citing legislative history and the statute's language that the credit is fixed at $3 per BOE. The court also noted that the statute does not explicitly prohibit or allow double credits, but judicial preference leans against them unless clearly stated. Regarding the indexing, the court considered the Commissioner to have conceded the issue by not arguing against indexing for gas from both sources, despite the statute's specific non-indexing provision for tight formation gas. The dissenting opinions argued for a literal interpretation of the statute, allowing double credits and opposing indexing for dual-source gas.

Practical Implications

This decision clarifies the calculation of IRC § 29 credits for natural gas from multiple qualifying sources, ensuring that the total BOE sold is credited without double-counting. It impacts how taxpayers should calculate credits for dual-source gas production, reinforcing that the credit is not doubled for gas qualifying under multiple categories. Legal practitioners must carefully assess gas classifications to determine the applicable credit rate, considering whether indexing applies. The ruling may influence business decisions in the energy sector, particularly in regions with dual-source gas reserves, and serves as a precedent for future cases involving similar tax credit calculations under IRC § 29.

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