Exxon Mobil Corp. v. Commissioner, 114 T. C. 293 (2000)

Estimated dismantlement, removal, and restoration costs can be accrued for tax purposes only when they satisfy the all-events test, requiring a fixed and definite obligation and a reasonably estimable amount.

Summary

Exxon Mobil Corp. sought to accrue estimated dismantlement, removal, and restoration (DRR) costs for the Prudhoe Bay oil field in Alaska for tax years 1979-1982. The Tax Court held that $204 million in fieldwide DRR costs did not meet the all-events test for accrual because the obligations were not fixed and definite. However, $24 million in well-specific DRR costs satisfied the test but could not be accrued as capital costs without IRS permission or as current expenses due to income distortion concerns.

Facts

Exxon Mobil Corp. owned a 22% interest in the Prudhoe Bay Unit (PBU), a partnership operating oil leases in the Prudhoe Bay oil field on Alaska's North Slope. The field was governed by Alaska Competitive Oil and Gas Lease Form No. DL-1 (DL-1 Leases), which did not clearly establish DRR obligations for fieldwide facilities. Exxon estimated future DRR costs of $928 million for the entire field, with its share being $204 million. It also estimated $111. 6 million for well-specific DRR costs, with its share at $24 million. Exxon accrued these costs on its financial statements but not on its tax returns, which accrued DRR costs when the work was performed.

Procedural History

Exxon filed timely claims for refund asserting the accrual of estimated DRR costs. The Tax Court previously allowed accrual of estimated costs for underground mines in Ohio River Collieries Co. v. Commissioner (1981). The IRS disallowed Exxon's claims for accruing estimated DRR costs related to Prudhoe Bay. The case proceeded to the Tax Court, where Exxon argued for accrual of these costs as capital or current expenses.

Issue(s)

1. Whether Exxon's $204 million share of estimated fieldwide DRR costs for the Prudhoe Bay oil field satisfies the all-events test of the accrual method of accounting.
2. Whether Exxon's $24 million share of estimated well-specific DRR costs for the Prudhoe Bay oil field satisfies the all-events test of the accrual method of accounting.
3. Whether Exxon may accrue the $24 million in well-specific DRR costs as capital costs without IRS permission.

4. Whether Exxon may accrue the $24 million in well-specific DRR costs as current business expenses without distorting its income.

Holding

1. No, because the fieldwide DRR obligations were not fixed and definite, and the costs were not reasonably estimable.
2. Yes, because the well-specific DRR obligations were fixed and definite, and the costs were reasonably estimable.
3. No, because such accrual would constitute a change in Exxon's method of accounting for which IRS permission was required and not granted.
4. No, because such accrual would distort Exxon's income.

Court's Reasoning

The court applied the all-events test, which requires that a liability be fixed and definite and that the amount be reasonably estimable. For fieldwide DRR costs, the court found that the DL-1 Leases and Alaska regulations did not establish fixed and definite DRR obligations, and Exxon's estimates were too speculative. For well-specific DRR costs, the court found that the DL-1 Leases and Alaska regulations clearly established Exxon's obligation to plug wells and clean up well sites, and Exxon's estimates were reasonably accurate based on industry practice. However, the court rejected Exxon's attempt to accrue these costs as capital costs without IRS permission, citing a change in accounting method. The court also rejected Exxon's alternative claim to accrue the costs as current expenses, finding that it would distort Exxon's income by disconnecting the expense from the years of oil production and DRR work.

Practical Implications

This decision clarifies that estimated DRR costs can only be accrued for tax purposes when they meet the all-events test. Taxpayers must demonstrate fixed and definite obligations and reasonably estimable costs. The decision distinguishes between fieldwide and well-specific DRR costs, with the latter being more likely to satisfy the test due to clearer regulatory obligations. Taxpayers seeking to change their method of accounting for DRR costs must obtain IRS permission, and current expensing of such costs may be rejected if it distorts income. This case may influence how oil and gas companies approach the accrual of DRR costs in future tax planning and financial reporting, particularly in distinguishing between different types of DRR obligations.