TGS-NOPEC Geophysical Co. v. Commissioner, 155 T. C. No. 3 (2020)

The U. S. Tax Court ruled that TGS-NOPEC Geophysical Co. could claim a domestic production activities deduction for processing marine seismic data as an engineering service related to U. S. oil and gas construction. However, the court rejected the company's argument that the data itself qualified as tangible personal property or a sound recording. This decision clarifies the scope of the deduction for engineering services in the context of the oil and gas industry.

Parties

TGS-NOPEC Geophysical Company and Subsidiaries (Petitioner) v. Commissioner of Internal Revenue (Respondent). Petitioner was the appellant at the U. S. Tax Court level, challenging the IRS's disallowance of their claimed deduction.

Facts

TGS-NOPEC Geophysical Co. (TGS) and its subsidiaries are engaged in the acquisition, processing, and licensing of marine seismic data. In 2008, TGS claimed a domestic production activities deduction (DPAD) under I. R. C. § 199, asserting that the gross receipts from leasing processed marine seismic data were domestic production gross receipts (DPGR). TGS maintained that the processed data was qualifying production property (QPP) as tangible personal property or sound recordings, or alternatively, that the processing services constituted engineering services related to U. S. construction activities.

Procedural History

The IRS disallowed TGS's claimed deduction of $1,946,324 for the 2008 tax year, determining a deficiency of $858,392. TGS petitioned the U. S. Tax Court for a redetermination of the deficiency, asserting entitlement to a DPAD of $2,467,091. The court's decision was based on a de novo review of the legal issues.

Issue(s)

Whether TGS's gross receipts from leasing processed marine seismic data qualify as DPGR under I. R. C. § 199(c)(4)(A)(i) as QPP, or under § 199(c)(4)(A)(iii) as gross receipts derived from engineering services performed in the United States with respect to the construction of real property in the United States?

Rule(s) of Law

I. R. C. § 199 allows a deduction for income attributable to domestic production activities. DPGR includes gross receipts from the lease, rental, license, or disposition of QPP manufactured, produced, grown, or extracted in the U. S. (§ 199(c)(4)(A)(i)(I)). QPP includes tangible personal property, computer software, and sound recordings (§ 199(c)(5)). Alternatively, DPGR includes gross receipts from

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engineering services performed in the U. S. related to the construction of real property in the U. S. (§ 199(c)(4)(A)(iii)).

Holding

The Tax Court held that TGS's processed marine seismic data is not QPP within the meaning of § 199(c)(5) because it is neither tangible personal property nor a sound recording. However, the court held that TGS's processing of marine seismic data constitutes engineering services performed in the United States with respect to the construction of real property under § 199(c)(4)(A)(iii). TGS's gross receipts from such services are DPGR to the extent that the services relate to construction activities within the United States.

Reasoning

The court reasoned that the processed seismic data, despite being delivered on tangible media, is inherently intangible and does not meet the statutory definition of tangible personal property or sound recordings. The court applied the "intrinsic value" test from Texas Instruments I, concluding that the data's value is not dependent on the tangible medium. Regarding sound recordings, the court found that the processed data does not result from the fixation of sound as required by § 168(f)(4). However, the court recognized that TGS's processing activities met the definition of engineering services under § 199(c)(4)(A)(iii) and the related regulations, as they required specialized knowledge and were performed in connection with the construction of oil and gas wells. The court rejected respondent's arguments that TGS's services were not provided at the time of construction or were too removed from the construction activity. The court also distinguished between TGS's own clients and services provided to its parent company's clients, limiting the DPGR to the former.

Disposition

The Tax Court granted TGS a DPAD for 2008, subject to the limitations discussed in the opinion, and directed the parties to calculate the exact amount under Rule 155.

Significance/Impact

This case clarifies the scope of the DPAD under I. R. C. § 199, particularly for the oil and gas industry. It establishes that the processing of seismic data can qualify as an engineering service related to U. S. construction activities, but the data itself does not qualify as tangible personal property or a sound recording. The decision has implications for how companies in the industry structure their operations and claim deductions, emphasizing the importance of the location and nature of services provided. Subsequent cases may further refine the boundaries of what constitutes engineering services under § 199(c)(4)(A)(iii).

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