

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
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Date:
April 06, 2006

LEGEND:

Taxpayer:

Method:
Reservoir:
Date:
State:
Year:

- a:
- b:
- c:
- d:
- e:
- f:
- g:
- h:

Dear _____ :

This letter responds to your letter, dated September 12, 2005, requesting a ruling that, for purposes of § 43 of the Internal Revenue Code, the Method, as applied at the Reservoir is a qualified tertiary recovery method that is not described in § 1.43-2(e)(2) of the Income Tax Regulations or in a revenue ruling.

The facts and representations submitted are summarized as follows. Taxpayer is the owner of an operating interest in oil and gas property producing from the Reservoir within State. On Date, Taxpayer began the first injection of gas in connection with a project using the Method. The Method involves the simultaneous permanent removal of water from watered-out portions of the Reservoir and the injection of immiscible natural gas from an extraneous source into the upstructure portion of the Reservoir.

Taxpayer represents that the Method will affect the Reservoir fluid by lowering the gas/liquid contact in the fracture system, thereby disrupting the equilibrium between the fracture and matrix fluids and allowing oil to be captured in downstructure producing wellbores.

The project will use natural gas imported through an existing fuel supply pipeline and purchased at the local market price. The anticipated rate of extraneous gas injection will range between a and b for a period of approximately c years, and then the gas injection rate will be decreased to approximately d over the next several years. Approximately e of extraneous gas is expected to be purchased and injected during the life of the project. Downstructure fluid withdrawals also will be increased by approximately i.

A peak incremental oil rate of approximately f is expected. Taxpayer has submitted a conceptual model that indicates that the incremental gross oil recovery should be approximately h if the project is continued until Year.

Section 43(a) provides a credit in an amount equal to 15 percent of certain costs paid or incurred by a taxpayer in connection with a qualified enhanced oil recovery project.

Section 43(c)(2) defines the term "qualified enhanced oil recovery project" to mean any project that: (1) involves the application (in accordance with sound engineering principles) of one or more qualified tertiary recovery methods (as defined in § 193(b)(3)) that reasonably can be expected to result in a more than insignificant increase in the amount of crude oil that ultimately will be recovered; (2) is located within the United States (within the meaning of § 638(1)); and (3) with respect to which the first injection of liquids, gases, or other matter commences after December 31, 1990.

Section 1.43-2(e)(1) defines the term "qualified tertiary recovery method" to mean any one or combination of the tertiary recovery methods described in § 1.43-2(e)(2) or a method not described in § 1.43-2(e)(2), which has been determined by revenue ruling to be a "qualified tertiary recovery method." A taxpayer may request a private letter ruling that a method not described in § 1.43-2(e)(2) or in a revenue ruling is a qualified tertiary recovery method. Generally methods identified in revenue rulings or private letter rulings will be limited to those methods that involve the displacement of oil from the reservoir rock by modifying the properties of the fluids in the reservoir or by providing the energy and drive mechanism to force the oil to a production well.

Section 1.43-2(e)(3) states that the term qualified tertiary recovery method does not include waterflooding and cyclic gas injection. Cyclic gas injection is the increase or maintenance of pressure by injection of hydrocarbon gas into the reservoir from which it was originally produced.

A method not described in § 1.43-2(e)(2) may be a qualified tertiary recovery method if it involves the displacement of oil from the reservoir rock by modifying the properties of the fluids in the reservoir or provides the energy and drive mechanism to force the oil to a production well. The Method does both.

The Method resembles cyclic gas injection, an excluded method under § 1.43-2(e)(3), in that in both cases hydrocarbon gas is being injected into the reservoir. Cycling, which is introduced early in the life of the field, is a primary method for recovering condensate from a gas condensate reservoir by maintaining the original pressure of the reservoir to prevent retrograde condensation. (See Manual of Oil and Gas Terms, Howard R. Williams and Charles J. Meyers, 1987, Matthew Bender, page 215. See *also* § 1.613A-7(k)). In this case, the reservoir is not a condensate reservoir and the gas is not being injected to prevent retrograde condensation.

Based on the information submitted and the representations made, as well as review by Service experts, we conclude that the Method now being implemented in the Reservoir is a “qualified tertiary recovery method” not described in § 1.43-2(e)(2) or in a revenue ruling. Accordingly, the project using the Method is a qualified enhanced oil recovery project provided that it otherwise meets the requirements of § 43 and the regulations thereunder.

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 project implemented by Taxpayer otherwise meets the requirements of a qualified enhanced oil recovery project under § 43 and the regulations thereunder.

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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/

Brenda M. Stewart
Senior Counsel, Branch 7
(Passthroughs & Special Industries)