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**Internal Revenue Service**

Department of the Treasury  
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Telephone Number:

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Date: May 22, 2006

**LEGEND:**

Taxpayer:

Method:  
Method 2:  
Reservoir:  
Field:  
State:  
Year:  
Date 1:  
Date 2:  
Date 3:  
Date 4:  
Quantity:  
Change 1:

Change 2:

Dear \_\_\_\_\_ :

This letter responds to your letter requesting a ruling that, for purposes of section 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 by Taxpayer are summarized as follows. Taxpayer is the owner of an economic interest in oil and gas property producing from the Reservoir of the Field within State.

Since startup in Year and until Date 1, the Field was operated using Method 2. That operation was self-certified as a qualified enhanced oil recovery project by a

petroleum engineer's certification dated Date 2. During this time period Taxpayer injected Quantity of miscible gas in accordance with the certification.

In Date 3, Taxpayer began first injection of enriched gas in connection with a project using the Method. The Method differs from Method 2 in that miscibility is not obtained due to Change 1. The Taxpayer plans to use the Method until the end of the Field's economic life unless Change 2 occurs, which would likely cause the Method to become ineffective. Taxpayer has represented that converting to the Method will result in a negligible decrease in ultimate oil recovery. On Date 4, the oil conservation agency in State approved Change 1 and stated that it is consistent with good engineering practices.

The Method uses a combination of native and non-native enriched gases to facilitate a multiple contact vaporization process, which modifies the fluid properties of the oil causing it to be displaced from the rock. The enriched gas injection also provides energy and a drive mechanism to force the oil to a production well.

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 section 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.

As a condition of issuing this letter, the Service requires Taxpayer to file a petroleum engineer's certification for use of the Method at the Reservoir. Furthermore, the Service also requires that in Taxpayer or any other operator's continued certification of the project, in addition to the requirements of § 1.43-3(b), the operator shall include a statement whether the gases or other fluids injected during the taxable year were capable of displacing oil from the reservoir rock by means of modifying the properties of the fluids in the Reservoir.

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.

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

Sincerely,

***/s/***

Joseph H. Makurath  
Senior Technician Reviewer, Branch 7  
(Passthroughs & Special Industries)