

DEPLETION ALLOWANCE FOR OIL SHALE

I. The Question

Under the existing federal income tax laws, the extractive mineral industries are permitted, in determining their federal income taxes, to deduct from gross income an amount which is designed to compensate them for the depletion of the mineral reserve. This deduction, familiarly known as the depletion allowance, is calculated by (1) applying a percentage which is provided for in the Internal Revenue Code to (2) the sales price of the mineral product. To illustrate with perhaps the most familiar example: In the case of crude petroleum recovered from underground reservoirs by means of wells, the depletion percentage is 27.5%, and the amount to which the percentage is applied is the sales price of the crude oil at the well-head. The Internal Revenue Service has ruled on both aspects of the depletion allowance computation for the oil shale industry (in other words, on both the percentage rate and the depletion base figure).

The ruling that the percentage rates is 15%.—In a published ruling in 1957 (Rev. Rul. 57-529), the Internal Revenue Service took the position that oil shale was in the category, "all other minerals," contained in Section 613(b)(6) of the Code, and that consequently the applicable percentage depletion rate was 15%. In other words, the Service ruled that the oil shale industry was not to be entitled to the 27.5% rate allowed to the rest of the petroleum industry.

The ruling that the depletion base figure does not include the retorting process.—In 1961, the Internal Revenue Service took the position, in an unpublished ruling, that the retorting of oil shale was not a "treatment process considered as mining." Under this ruling, the costs attributable to the retorting necessary to produce crude oil would be excluded from the depletion base, and the oil shale industry would be forced to compute depletion on the value or market price of the crushed oil shale rock rather than of the crude oil product. Since there is no market for mined, crushed oil shale rock, the unpublished ruling obviously contemplates that a theoretical sales price or value should be assigned to the mined and crushed rock by extrapolation from the sales price of the crude oil.

This appendix will discuss only the situation created by the ruling that percentage depletion should be calculated on the value of mined and crushed rock, rather than of oil. Although it is discriminatory for a lower percentage depletion rate to be applied to shale crude oil than is applied to crude oil from conventional sources, it is a far greater discrimination to bar depletion based on the real product—the oil—and to confine it to the unmarketable rock. The statutory background will be reviewed to indicate the reasons why the Service's position is an incorrect interpretation of the purpose of the Congress, and one which, because it is wrong and discriminatory, should be promptly corrected by appropriate legislative or administrative action.

II. Conclusions

In TOSCO's view, the position taken by the Service in its unpublished ruling is an incorrect interpretation of existing law, since it is plain from the text and history of the relevant provision of the Code (enacted as an amendment to Section 613 in 1960) that the Congress did not intend, and made provision to avoid, such gross discrimination against one group of producers as contrasted with competing producers of the same mineral product from other sources. The Service's position is unlikely to be corrected by it, and could be revised either by revision of existing Treasury Regulations by the Commissioner of Internal Revenue, or by corrective legislative action.

Corrective, clarifying legislation was introduced in the second session of the 88th Congress, by Congressman Aspinall of Colorado, Chairman of the Interior Committee. He introduced a bill (H.R. 10869) whose sole purpose is to make it clear that the point-of-application of the percentage rate is to be the shale oil produced from the retort.

III. Discussion

Under the applicable statutory provision (Section 613 of the Code), the allowance for depletion is a specified percentage, multiplied by the "gross income from the property" (with certain exclusions and limitations not pertinent for this discussion). The term "gross income from the property" is defined to mean "the gross income from mining". "Mining" is defined, in detail, to include "the treatment processes considered as mining."