

Intangible Drilling Costs (IDCs) vs. Geological and Geophysical Costs (G&G)

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Intangible Drilling & Development Costs

- Require an economic interest in oil and gas property
- IRC 263(c): 100% deductible
- IRC 291(b): 70% deductible; 30% amortized over 60 months for integrated oil companies (§§ 613A(d)(2), 613A(d)(4))
- IRC 263(i): Foreign IDCs: election to either capitalize to oil and gas property or amortize over 10 years
- Treas. Reg. § 1.612-4(a)(2): clearing of ground, draining, road making, surveying, and geological works as are necessary in preparation for the drilling of wells

Intangible Drilling & Development Costs (cont.)

- *Louisiana Land & Exploration Co. v. Commissioner*, 7 T.C. 507 (1946)
 - Recognized point at which acquisition costs end and well development expenses [IDCs] begin as occurring after drilling has been at least tentatively decided upon
- *Standard Oil Co. (Indiana) v. Commissioner*, 68 T.C. 325 (1977)
 - Recognized dividing line between exploratory work and development activities as point at which preparation for drilling commences
- *Sun Co., Inc. & Subs v. Commissioner*, 74 T.C. 1481 (1980)
- *Gates Rubber Co. v. Commissioner*, 74 T.C. 1456 (1980)
 - Stated the dividing line between exploratory work and development is point at which preparations for drilling begin

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Geological and Geophysical Costs

Law Prior to Enactment of IRC 167(h):

- *Thompson v. Commissioner*, 9 B.T.A. 1342 (1928)
 - Geological surveys and opinions described as geological expenses and capitalized to cost of acquiring real property for which performed
- *C.M. Nusbaum v. Commissioner*, 10 B.T.A. 664 (1928)
 - Amounts paid to geologist to investigate the presence of oil on a certain tract and to recommend acquisition determined to be capital expenditures

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Geological and Geophysical Costs (cont.)

- *Louisiana Land & Exploration Co. v. Commissioner*, 7 T.C. 507 (1946)
 - Seismic survey was not connected with or confined to area that had been tentatively singled out for drilling
 - Survey was first step in over-all development of tracts with benefit of expenditure expected for the entire useful life of the asset being developed
 - Cost of survey must be capitalized because it resulted in the acquisition or retention of a capital asset

Geological and Geophysical Costs (cont.)

- Revenue Ruling 77-188, 1977-1 C.B. 76
 - Discusses allocation of G&G expenditure among areas of interest located and identified from expenditure
 - If no property is acquired or retained within or adjacent to area of interest, entire G&G expenditure allocable to area of interest is § 165 loss for taxable year in which that particular project area is abandoned
 - G&G expenditure allocable as a capital cost to property acquired or retained

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