

§ 1.43-1

§ 1.43-1 The enhanced oil recovery credit—general rules.

- (a) Claiming the credit.
 - (1) In general.
 - (2) Examples.
- (b) Amount of the credit.
- (c) Phase-out of the credit as crude oil prices increase.
 - (1) In general.
 - (2) Inflation adjustment.
 - (3) Examples.
- (d) Reduction of associated deductions.
 - (1) In general.
 - (2) Certain deductions by an integrated oil company.
- (e) Basis adjustment.
- (f) Passthrough entity basis adjustment.
 - (1) Partners' interests in a partnership.
 - (2) Shareholders' stock in an S corporation.
- (g) Examples.

§ 1.43-2 Qualified enhanced oil recovery project.

- (a) Qualified enhanced oil recovery project.
- (b) More than insignificant increase.
- (c) First injection of liquids, gases, or other matter.
 - (1) In general.
 - (2) Example.
- (d) Significant expansion exception.
 - (1) In general.
 - (2) Substantially unaffected reservoir volume.
 - (3) Terminated projects.
 - (4) Change in tertiary recovery method.
 - (5) Examples.
- (e) Qualified tertiary recovery methods.
 - (1) In general.
 - (2) Tertiary recovery methods that qualify.
 - (3) Recovery methods that do not qualify.
 - (4) Examples.

§ 1.43-3 Certification.

- (a) Petroleum engineer's certification of a project.
 - (1) In general.
 - (2) Timing of certification.
 - (3) Content of certification.
- (b) Operator's continued certification of a project.
 - (1) In general.
 - (2) Timing of certification.
 - (3) Content of certification.
- (c) Notice of project termination.
 - (1) In general.
 - (2) Timing of notice.
 - (3) Content of notice.
- (d) Failure to submit certification.
- (e) Effective date.

§ 1.43-4 Qualified enhanced oil recovery costs.

- (a) Qualifying costs.
 - (1) In general.
 - (2) Costs paid or incurred for an asset which is used to implement more than

26 CFR Ch. I (4-1-04 Edition)

- one qualified enhanced oil recovery project or for other activities.
- (b) Costs defined.
 - (1) Qualified tertiary injectant expenses.
 - (2) Intangible drilling and development costs.
 - (3) Tangible property costs.
 - (4) Examples.
- (c) Primary purpose.
 - (1) In general.
 - (2) Tertiary injectant costs.
 - (3) Intangible drilling and development costs.
 - (4) Tangible property costs.
 - (5) Offshore drilling platforms.
 - (6) Examples.
- (d) Costs paid or incurred prior to first injection.
 - (1) In general.
 - (2) First injection after filing of return for taxable year costs are allowable.
 - (3) First injection more than 36 months after close of taxable year costs are paid or incurred.
 - (4) Injections in volumes less than the volumes specified in the project plan.
 - (5) Examples.
- (e) Other rules.
 - (1) Anti-abuse rule.
 - (2) Costs paid or incurred to acquire a project.
 - (3) Examples.

§ 1.43-5 At-risk limitation.

§ 1.43-6 Election out of section 43.

- (a) Election to have the credit not apply.
 - (1) In general.
 - (2) Time for making the election.
 - (3) Manner of making the election.
- (b) Election by partnerships and S corporations.

§ 1.43-7 Effective date of regulations.

[T.D. 8448, 57 FR 54923, Nov. 23, 1992]

§ 1.43-1 The enhanced oil recovery credit—general rules.

(a) *Claiming the credit*—(1) *In general.* The enhanced oil recovery credit (the "credit") is a component of the section 38 general business credit. A taxpayer that owns an operating mineral interest (as defined in § 1.614-2(b)) in a property may claim the credit for qualified enhanced oil recovery costs (as described in § 1.43-4) paid or incurred by the taxpayer in connection with a qualified enhanced oil recovery project (as described in § 1.43-2) undertaken with respect to the property. A taxpayer that does not own an operating mineral interest in a property may not claim the credit. To the extent a credit

included in the current year business credit under section 38(b) is unused under section 38, the credit is carried back or forward under the section 39 business credit carryback and carryforward rules.

(2) *Examples.* The following examples illustrate the principles of this paragraph (a).

Example 1. Credit for operating mineral interest owner. In 1992, A, the owner of an operating mineral interest in a property, begins a qualified enhanced oil recovery project using cyclic steam. B, who owns no interest in the property, purchases and places in service a steam generator. B sells A steam, which A uses as a tertiary injectant described in section 193. Because A owns an operating mineral interest in the property with respect to which the project is undertaken, A may claim a credit for the cost of the steam. Although B owns the steam generator used to produce steam for the project, B may not claim a credit for B's costs because B does not own an operating mineral interest in the property.

Example 2. Credit for operating mineral interest owner. C and D are partners in CD, a partnership that owns an operating mineral interest in a property. In 1992, CD begins a qualified enhanced oil recovery project using cyclic steam. D purchases a steam generator and sells steam to CD. Because CD owns an operating mineral interest in the property with respect to which the project is undertaken, CD may claim a credit for the cost of the steam. Although D owns the steam generator used to produce steam for the project, D may not claim a credit for the costs of the steam generator because D paid these costs in a capacity other than that of an operating mineral interest owner.

(b) *Amount of the credit.* A taxpayer's credit is an amount equal to 15 percent of the taxpayer's qualified enhanced oil recovery costs for the taxable year, reduced by the phase-out amount, if any, determined under paragraph (c) of this section.

(c) *Phase-out of the credit as crude oil prices increase—(1) In general.* The amount of the credit (determined without regard to this paragraph (c)) for any taxable year is reduced by an amount which bears the same ratio to the amount of the credit (determined without regard to this paragraph (c)) as—

(i) The amount by which the reference price determined under section 29(d)(2)(C) for the calendar year immediately preceding the calendar year in

which the taxable year begins exceeds \$28 (as adjusted under paragraph (c)(2) of this section); bears to

(ii) \$6.

(2) *Inflation adjustment—(i) In general.* For any taxable year beginning in a calendar year after 1991, an amount equal to \$28 multiplied by the inflation adjustment factor is substituted for the \$28 amount under paragraph (c)(1)(i) of this section.

(ii) *Inflation adjustment factor.* For purposes of this paragraph (c), the inflation adjustment factor for any calendar year is a fraction, the numerator of which is the GNP implicit price deflator for the preceding calendar year and the denominator of which is the GNP implicit price deflator for 1990. The "GNP implicit price deflator" is the first revision of the implicit price deflator for the gross national product as computed and published by the Secretary of Commerce. As early as practicable, the inflation adjustment factor for each calendar year will be published by the Internal Revenue Service in the Internal Revenue Bulletin.

(3) *Examples.* The following examples illustrate the principles of this paragraph (c).

Example 1. Reference price exceeds \$28. In 1992, E, the owner of an operating mineral interest in a property, incurs \$100 of qualified enhanced oil recovery costs. The reference price for 1991 determined under section 29(d)(2)(C) is \$30 and the inflation adjustment factor for 1992 is 1. E's credit for 1992 determined without regard to the phase-out for crude oil price increases is \$15 ($\$100 \times 15\%$). In determining E's credit, the credit is reduced by \$5 ($\$15 \times (\$30 - (\$28 \times 1))/6$). Accordingly, E's credit for 1992 is \$10 ($\$15 - \5).

Example 2. Inflation adjustment. In 1993, F, the owner of an operating mineral interest in a property, incurs \$100 of qualified enhanced oil recovery costs. The 1992 reference price is \$34, and the 1993 inflation adjustment factor is 1.10. F's credit for 1993 determined without regard to the phase-out for crude oil price increases is \$15 ($\$100 \times 15\%$). In determining F's credit, \$30.80 ($1.10 \times \28) is substituted for \$28, and the credit is reduced by \$8 ($\$15 \times (\$34 - \$30.80)/6$). Accordingly, F's credit for 1993 is \$7 ($\$15 - \8).

(d) *Reduction of associated deductions—(1) In general.* Any deduction allowable under chapter 1 for an expenditure taken into account in computing the amount of the credit determined

under paragraph (b) of this section is reduced by the amount of the credit attributable to the expenditure.

(2) *Certain deductions by an integrated oil company.* For purposes of determining the intangible drilling and development costs that an integrated oil company must capitalize under section 291(b), the amount allowable as a deduction under section 263(c) is the deduction allowable after paragraph (d)(1) of this section is applied. See § 1.43-4(b)(2) (extent to which integrated oil company intangible drilling and development costs are qualified enhanced oil recovery costs).

(e) *Basis adjustment.* For purposes of subtitle A, the increase in the basis of property which would (but for this paragraph (e)) result from an expenditure with respect to the property is reduced by the amount of the credit determined under paragraph (b) of this section attributable to the expenditure.

(f) *Passthrough entity basis adjustment—(1) Partners' interests in a partnership.* To the extent a partnership expenditure is not deductible under paragraph (d)(1) of this section or does not increase the basis of property under paragraph (e) of this section, the expenditure is treated as an expenditure described in section 705(a)(2)(B) (concerning decreases to basis of partnership interests). Thus, the adjusted bases of the partners' interests in the partnership are decreased (but not below zero).

(2) *Shareholders' stock in an S corporation.* To the extent an S corporation expenditure is not deductible under paragraph (d)(1) of this section or does not increase the basis of property under paragraph (e) of this section, the expenditure is treated as an expenditure described in section 1367(a)(2)(D) (concerning decreases to basis of S corporation stock). Thus, the bases of the shareholders' S corporation stock are decreased (but not below zero).

(g) *Examples.* The following examples illustrate the principles of paragraphs (d) through (f) of this section.

Example 1. Deductions reduced for credit amount. In 1992, G, the owner of an operating mineral interest in a property, incurs \$100 of intangible drilling and development costs in connection with a qualified enhanced oil re-

covery project undertaken with respect to the property. G elects under section 263(c) to deduct these intangible drilling and development costs. The amount of the credit determined under paragraph (b) of this section attributable to the \$100 of intangible drilling and development costs is \$15 ($\$100 \times 15\%$). Therefore, G's otherwise allowable deduction of \$100 for the intangible drilling and development costs is reduced by \$15. Accordingly, in 1992, G may deduct under section 263(c) only \$85 ($\$100 - \15) for these costs.

Example 2. Integrated oil company deduction reduced. The facts are the same as in *Example 1*, except that G is an integrated oil company. As in *Example 1*, the amount of the credit determined under paragraph (b) of this section attributable to the \$100 of intangible drilling and development costs is \$15, and G's allowable deduction under section 263(c) is \$85. Because G is an integrated oil company, G must capitalize 25.50 ($\$85 \times 30\%$) under section 291(b). Therefore, in 1992, G may deduct under section 263(c) only \$59.50 ($\$85 - \25.50) for these intangible drilling and development costs.

Example 3. Basis of property reduced. In 1992, H, the owner of an operating mineral interest in a property, pays \$100 to purchase tangible property that is an integral part of a qualified enhanced oil recovery project undertaken with respect to the property. The amount of the credit determined under paragraph (b) of this section attributable to the \$100 is \$15 ($\$100 \times 15\%$). Therefore, for purposes of subtitle A, H's basis in the tangible property is \$85 ($\$100 - \15).

Example 4. Basis of interest in passthrough entity reduced. In 1992, I is a 50% partner in IJ, a partnership that owns an operating mineral interest in a property. IJ pays \$200 to purchase tangible property that is an integral part of a qualified enhanced oil recovery project undertaken with respect to the property. The amount of the credit determined under paragraph (b) of this section attributable to the \$200 is \$30 ($\$200 \times 15\%$). Therefore, for purposes of subtitle A, IJ's basis in the tangible property is \$170 ($\$200 - \30). Under paragraph (f) of this section, the amount of the purchase price that does not increase the basis of the property (\$30) is treated as an expenditure described in section 705(a)(2)(B). Therefore, I's basis in the partnership interest is reduced by \$15 (I's allocable share of the section 705(a)(2)(B) expenditure ($\$30 \times 50\%$)).

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