

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-123120-02/CC:PSI:B6

Director: Field Operations,

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Years Involved:

Date of Conference:

LEGEND:

Taxpayer:

ISSUES:

1. Whether a fully integrated oil and gas producer (integrated producer) who owns and operates offshore drilling platforms should classify such platforms under MACRS Asset Guideline Class 13.0, Offshore Drilling, or Asset Guideline Class 13.2, Exploration for and Production of Petroleum and Natural Gas Deposits, of Rev. Proc. 87-56, 1987-2 C.B. 674, for depreciation purposes?

2. If the answer to issue #1 is Asset Guideline Class 13.0 with respect to an offshore drilling platform, whether the Asset Guideline Class changes to 13.2 if and when the drilling platform is converted to one used primarily for the production of oil and gas?

CONCLUSIONS:

An integrated producer who owns an offshore drilling platform must classify that platform in Asset Class 13.2 for depreciation purposes. Because we reach this conclusion, we do not address Issue 2.

FACTS:

Taxpayer and its subsidiaries form a large worldwide integrated petroleum and chemical enterprise that explores for, develops, and produces oil and natural gas for refining into petroleum products and chemicals marketed to various customers and end users. Taxpayer and its subsidiaries are engaged in exploration for crude oil and natural gas in onshore and offshore areas of the U.S., Canada and various countries outside of North America. Its United States offshore efforts are conducted primarily in the Gulf of Mexico in both shallow and deep water.

As an integrated oil production company, Taxpayer is engaged in the exploration, offshore and onshore production, refining, transporting and marketing of petroleum products. Taxpayer requested a change of accounting method under Rev. Proc. 96-31 by submitting a Form 3115, dated December 26, 1997. In substance, this request for change in accounting method was to allow Taxpayer to depreciate specific assets using MACRS Asset Class 13.0, "Offshore Drilling," rather than the MACRS Asset Class 13.2, "Exploration for and Production of Petroleum and Natural Gas Deposits," that it had previously used for depreciating these assets.

LAW AND ANALYSIS:

Section 167(a) of the Internal Revenue Code provides a depreciation allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business or held for the production of income. The depreciation deduction provided by section 167(a) for tangible property placed in service after 1986 generally is determined under section 168. This section prescribes two methods of accounting for determining depreciation allowances. One method is the general depreciation system in section 168(a) and the other method is the alternative depreciation system in section 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention.

For purposes of either section 168(a) or section 168(g), the applicable depreciation method and recovery period are determined by reference to class life or by statute. The term "class life" is defined in section 168(i)(1) as meaning the class life (if any) that would be applicable with respect to any property as of January 1, 1986, under section 167(m) (determined without regard to section 167(m)(4) and as if the taxpayer had made an election under section 167(m)) as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990. Former section 167(m) provided that in the case of a taxpayer who elected the asset depreciation range system of depreciation, the depreciation allowance would be computed based on the class life prescribed by the Secretary that reasonably reflected the anticipated useful life of that class of property to the industry or other group.

Section 1.167(a)-11(b)(4)(iii)(b) of the Income Tax Regulations provides rules for classifying property under former section 167(m). Property is included in the asset guideline class for the activity in which the property is primarily used.

The class lives of property subject to depreciation under section 168 are set forth in Rev. Proc. 87-56. This revenue procedure divides assets into two broad categories: (1) Asset Classes 00.11 through 00.4 that consist of specific depreciable assets used in all business activities; and (2) Asset Classes 01.1 through 80.0 that consist of depreciable assets used in specific business activities. An asset that falls within both an asset category (that is, Asset Classes 00.11 through 00.4) and an activity category (that is, Asset Classes 01.1 through 80.0) is classified in the asset category. See *Norwest Corp. & Subs. v. Commissioner*, 111 T.C. 105, 156-64 (1998). The business activity Asset Classes described below are set forth in Rev. Proc. 87-56.

Asset Class 13.0, Offshore Drilling: Includes assets used in offshore drilling for oil and gas such as floating, self-propelled and other drilling vessels, barges, platforms, and drilling equipment and support vessels such as tenders, barges, towboats and crewboats. Excludes oil and gas production assets. Assets in this class have a recovery period of 5 years for purposes of section 168(a) and 7.5 years for purposes of section 168(g).

Asset Class 13.1, Drilling of Oil and Gas Wells: Includes assets used in the drilling of onshore oil and gas wells and the provision of geophysical and other exploration services; and the provision of such oil and gas field services as chemical treatment, plugging and abandoning of wells and cementing or perforating well casings. Does not include assets used in the performance of any of these activities and services by integrated petroleum and natural gas producers for their own account. Assets in this class have a recovery period of 5 years for purposes of section 168(a) and 6 years for purposes of section 168(g).

Asset Class 13.2, Exploration for and Production of Petroleum and Natural Gas Deposits: Includes assets used by petroleum and natural gas producers for drilling of wells and production of petroleum and natural gas, including gathering pipelines and related storage facilities. Also includes petroleum and natural gas offshore transportation facilities used by producers and others consisting of platforms (other than drilling platforms classified in Class 13.0), compression or pumping equipment, and gathering and transmission lines to the first onshore transshipment facility. The assets used in the first onshore transshipment facility are also included and consist of separation equipment (used for separation of natural gas, liquids, and solids), compression or pumping equipment (other than equipment classified in Class 49.23), and liquid holding or

storage facilities (other than those classified in Class 49.25). Does not include support vessels. Assets in this class have a recovery period of 7 years for purposes of section 168(a) and 14 years for purposes of section 168(g).

In the present case, the initial issue raised is whether the offshore drilling assets of integrated producers fall within the scope of Asset Class 13.0, or within the scope of Asset Class 13.2. This issue arises because, while the language of Class 13.0 can be read in isolation to include all offshore drilling (that is, contract drilling and drilling by producers), Class 13.2 appears to include all drilling assets of producers with no exception for offshore drilling. To resolve this question we must examine the historical evolution of the pertinent asset classes.

History of MACRS Asset Classes 13.0 and 13.1

Rev. Proc. 62-21, 1962-2 C.B. 418, was the first revenue procedure to set forth guideline lives and the use of class lives to determine depreciation deductions. The revenue procedure, which aggregated assets by industry for depreciation purposes, stated that the guideline lives set forth applied to broad classes of assets rather than to individual assets. Part I of the revenue procedure provided guidelines for four separate groups of assets. Group One covered depreciable assets used by all businesses. Group Two covered non-manufacturing activities, excluding transportation, communications, and public utilities. Group Three covered manufacturing. Group Four covered transportation, communications, and public utilities.

Class 2 of Group Two pertained to contract construction, including general building, special trade, heavy construction, and marine contractors. Class 2(a), General Contract Construction, provided a 5-year guideline life and excluded assets used only in marine contract construction. Class 2(b), Marine Contract Construction, provided a 12-year guideline life and included assets used only in marine contract construction.

Class 17 of Group Three of Rev. Proc. 62-21 pertained to petroleum and natural gas. A distinction was drawn between, and different guideline lives were provided for, the drilling equipment of contract drillers and the drilling equipment of producers that performed drilling services for their own account. Class 17(a), Drilling, Geophysical and Field Services, provided a 6-year guideline life and was worded as follows:

Includes the drilling of oil and gas wells on a contract, fee or other basis and the provision of geophysical and other exploration services. Includes oil and gas field services, such as chemically treating, plugging and abandoning wells and cementing or perforating well casings. Excludes integrated petroleum and natural gas producers which perform these services for their own account.

Class 17(b), Exploration, Drilling and Production, provided a 14-year guideline life and was worded as follows:

Includes the exploration, drilling, maintenance and production activities of petroleum and natural gas producers. Includes gathering pipelines and related storage facilities of such producers. Excludes gathering pipelines and related storage facilities of pipeline companies.

In its original form, Class 17(a) excluded integrated producers; however, Class 17(b) included only 'producers.' To clarify this apparent omission of integrated producers, Supplement I to Rev. Proc. 62-21, 1963-2 C.B. 740, added integrated producers to Class 17(b). Supplement I also provided that Class 2 of Group Two excluded force account construction (construction by own labor force). At this time all contract drilling, both onshore and offshore, was included in Group Three, Class 17(a).

Appendix II to the original Rev. Proc. 62-21 was a compilation of 59 questions and answers to assist taxpayers in applying the provisions of the revenue procedure. Supplement II, found at 1963-2 C.B. 744, was a compilation of additional questions and answers, numbered 60 through 86. Question 79, set forth below, dealt with the following drilling contractor scenario:

Question:

Guideline Class 17(a), Group Three, Part I of the Revenue Procedure, does not apply to integrated petroleum and natural gas producers who perform drilling, geophysical and field services for their own account. How does this rule affect a taxpayer whose major business activity is drilling, or performing geophysical or other exploration services for others, but who performs some drilling or other services for his own account?

Answer:

Where a taxpayer provides drilling, geophysical, or other petroleum field services, both for others and for his own account, the assets used in connection with the providing of these services should be classified according to their primary use as either Class 17(a), Drilling, Geophysical and Field Services – 6 years, or Class 17(b), Exploration, Drilling and Production – 14 years. The primary use may be determined in any reasonable manner.

Subsequently, Rev. Proc. 66-18, 1966-1 C.B. 646, provided that floating or self-

propelled drilling vessels and barges, platforms, and support vessels used in offshore oil or gas exploration would no longer be allocated between Class 17(a) and 17(b) of Group Three, but would hereinafter be included in Class 2(b) of Group Two. It stated that:

[f]loating or self-propelled drilling vessels and barges, platforms, and support vessels, such as those used in the exploration of oil or gas in offshore operations, are classified in Group 2, Class 2(b), Marine Contract Construction, with a guideline class life of 2 years. Included is the vessel itself and all drilling equipment related thereto. Tenders, barges, towboats, crew boats and other vessels used to transport supplies, equipment, and personnel in offshore operations are classified in the same class. For activities of this kind, this classification includes equipment used in both force account and contract construction.

In 1971 the Asset Depreciation Range System of depreciation was established. This depreciation system also was based on broad industry classes of assets. Rev. Proc. 71-25, 1971-2 C.B. 553, was published to set forth the asset guideline classes, asset guideline periods, and asset depreciation ranges referred to in section 1.167(a)-11(b)(4). Rev. Proc. 71-25 continued the distinction drawn between drilling assets of contractors and those of producers, as can be seen from the following excerpts from the revenue procedure's asset guideline class descriptions:

13.0 - Petroleum and natural gas production and related activities:
(heading, no description given)

13.1 - Drilling of oil and gas wells:

Includes assets used in the drilling of oil and gas wells on a contract, fee or other basis and the provision of geophysical and other exploration services; and the provision of such oil and gas field services as chemical treatment, plugging and abandoning of wells and cementing or perforating well casings; but not including assets used in the performance of any of these activities and services by integrated petroleum and natural gas producers for their own account.

13.2 - Exploration for petroleum and natural gas deposits:

Includes assets used for drilling of wells and production of petroleum and natural gas, including gathering pipelines and related storage facilities, when these are related activities undertaken by petroleum and natural gas producers.

- 15.0 - Contract construction:
Includes such assets used by general building, special trade, heavy construction and marine contractors; does not include assets used by companies in performing construction services on their own account.
- 15.1 - Contract construction other than marine
(no further description given)
- 15.2 - Marine contract construction
(no further description given)

Rev. Proc. 71-25 was superceded by Rev. Proc. 72-10, 1971-1 C.B. 721, which was published to implement the Class Life Asset Depreciation Range System authorized by former section 167(m). Rev. Proc. 72-10 modified Asset Class 13.1 by adding the word "onshore" to its description. Asset Class 13.2 remained unchanged. Also, a description was added to Asset Class 15.2 providing that the class included floating, self-propelled and other drilling platforms used in offshore drilling for oil and gas. After publication of Rev. Proc. 72-10, Class 15.2 could not have included the activities of an integrated producer because the heading to Class 15 was Contract Construction and that of Class 15.2 was Marine Contract Construction - integrated producers were not in the activity of contract construction. The addition of the word onshore at this time to Class 13.1 distinguished onshore drilling activities of contract drillers from their offshore activities. The addition of the word onshore to Class 13.1 did not imply that the description of drilling activities of integrated producers in Class 13.2 was limited to onshore drilling; if that were the case the word onshore would also have been added to Class 13.2 at that time, but Class 13.2 was unchanged.

Rev. Proc. 77-10, 1977-1 C.B. 548, superceded Rev. Proc. 72-10 and modified the description of assets included in Asset Class 15.2 to be consistent with Rev. Proc. 66-18. The revenue procedure also deleted Class 15.0 and transferred the pertinent part of its description to Class 15.1. Generally, the headings ending in ".0" were deleted in Rev. Proc. 77-10 (although if a class ending in ".0" did not have subparts, no change was made in the numbering). This restructuring required the rewording of some of the class to include the material that had previously been included in the deleted headings. Revised Class 15.2 was described as follows:

- 15.2 Marine Contract Construction:
Includes assets used by general building, special trade, and heavy construction contractors predominantly in marine construction work. Does not include assets used by companies in performing marine construction services for their own account except for floating, self-propelled, and other drilling platforms and support vessels used in offshore drilling for oil and gas which are included whether used for

their own account or others.

Still, this Class 15.2 did not include the activities of an integrated producer because the Class clearly is directed exclusively to those in the business of contract construction. The use of the word companies in the second sentence refers to those in the business of contract construction and continues to be responsive to the issue raised in Rev. Proc. 66-18 of a contractor who could drill for its own account or for another. Recognizing Rev. Proc. 66-18 was explicitly mentioned as a change made by Rev. Proc. 77-10. Nothing in Rev. Proc. 77-10 indicates any intent to move an integrated producer's offshore drilling activities from Class 13.2 to Class 15.2; such a significant change would have been specifically mentioned.

Rev. Proc. 78-5, 1978-1 C.B. 557, revised Asset Class 13.2 of Rev. Proc. 77-10 to include petroleum and natural gas offshore transportation facilities used by petroleum and natural gas producers and others in the offshore pipeline transportation of oil and natural gas. The revenue procedure states that these assets were formerly included in Class 46.0, Pipeline Transportation. Revised Class 13.2 read as follows:

13.2 - Exploration for and Production of Petroleum and Natural Gas
Deposits:

Includes assets used by petroleum and natural gas producers for drilling of wells and production of petroleum and natural gas, including gathering pipelines and related storage facilities. Also includes petroleum and natural gas offshore transportation facilities used by producers and others consisting of platforms (other than drilling platforms classified in Class 15.2), compression and pumping equipment, and gathering and transmission lines to the first onshore transshipment facility. The assets used in the first onshore transshipment facility are also included and consist of separation equipment (used for separation of natural gas, liquids, and solids), compression or pumping equipment (other than equipment classified in Class 49.23), and liquid holding or storage facilities (other than those classified in Class 49.25). Does not include support vessels.

The "others" referred to in the description of Class 13.2 include pipeline companies. In addition, the first parenthetical in the description makes it clear that drilling contractors' drilling platforms continued to be included in Class 15.2. Reading this parenthetical to say that the offshore drilling platforms of integrated producers are excluded from this class requires a conclusion that the offshore drilling platforms of integrated producers are included in Class 15.2. Yet the heading and text to Class 15.2 limits the class to contract construction. Nothing in Rev. Proc. 78-15 indicates an intent to move offshore drilling assets originally encompassed within Class 13.2 of Rev. Proc. 77-10 to Class 15.2.

Rev. Proc. 77-10 was also modified by Rev. Proc. 80-58, 1980-2 C.B. 854, the stated purpose of which was to delete existing Asset Classes 15.1, Contract Construction other than Marine, and 15.2, Marine Contract Construction, and to establish two new classes for assets used in construction (Class 15.0) and used in offshore oil and gas drilling (Class 13.0). Rev. Proc. 80-58 noted that Class 15.2 included assets used in offshore oil and gas drilling. Thus, the assets used in offshore oil and gas drilling that had been included in former Class 15.2 were moved to new Class 13.0. The new asset classes established by Rev. Proc. 80-58 were described as follows:

13.0 - Offshore Drilling:

Includes assets used in offshore drilling for oil and gas such as floating, self-propelled and other drilling vessels, barges, platforms, and drilling equipment and support vessels such as tenders, barges, towboats and crew boats. Excludes oil and gas production assets.

15.0 - Construction:

Includes assets used in construction by general building, special trade, heavy and marine construction contractors, operative and investment builders, real estate subdividers and developers, and others except railroads.

Nothing indicates that this rewriting was intended to do anything other than to divide the marine contract construction activities into [contract] offshore drilling and [contract] construction. If this change was intended to move offshore drilling of integrated producers to Class 13.0, the change would have been explicitly mentioned.

Rev. Proc. 77-10 was superceded by Rev. Proc. 83-35, 1983-1 C.B. 745. Asset classes 13.0 and 15.0 in Rev. Proc. 83-35 were the same as set forth in Rev. Proc. 80-58. Class 13.2 was the same as set forth in Rev. Proc. 78-5, as modified by Rev. Proc. 80-58. Rev. Proc. 87-56 contains the same descriptions of Asset Classes 13.0, 13.2, and 15.0 that are contained in Rev. Proc. 83-35.

Taxpayer's arguments

Taxpayer argues (1) that the rules of statutory construction apply in interpreting Rev. Proc. 87-56, (2) that the Service acted intentionally and purposely when it specifically excluded integrated petroleum producers from Class 13.1 but chose to exclude only oil and gas production assets from Class 13.0, and (3) that in light of the clarity of the exclusion in Class 13.1, it seems inconceivable that Service intended the language "excludes oil and gas production assets," as used in Class 13.0 to carry the same meaning as does the phrase "does not include assets ... used by integrated petroleum and natural gas producers" in Class 13.1.

Taxpayer further argues that Class 13.0 specifically includes assets used in offshore drilling for oil and gas, dealing exclusively with such assets, while, in contrast Class 13.2 is a general category including assets used by producers for drilling wells and production of petroleum and natural gas as well as gathering pipelines and assets related to the offshore transportation of petroleum and natural gas. In addition, the Taxpayer argues that Service's reading of Class 13.0 to exclude integrated producers renders superfluous the specific exclusion of integrated producers in Class 13.1, which is contrary to statutory construction canon - that a statute must be read to give effect to all of its provisions.

Therefore, Taxpayer argues that after Rev. Proc. 66-18 it became clear that all offshore drilling assets were to be classified under the then Class 2(b), as modified by Rev. Proc. 66-18, irrespective of whether such assets were used for a taxpayer's own account. Taxpayer argues it is significant that Asset Class 13.0, like Asset Class 15.2, expressly includes "floating, self-propelled and other drilling platforms" "used in offshore drilling for oil and gas" and that Class 13.0 does not, by its own terms, limit includable drilling platforms to those of contractors. Taxpayer concludes that the absence of such an express limitation within Class 13.0, coupled with the fact that the replaced class (Class 15.2) included platforms of taxpayers "whether used for their own account or others," leads inescapably to the conclusion that Treasury intended Class 13.0 to encompass platforms of taxpayers "whether used for their own account or others" without limitation. Thus, the taxpayer reasons, beginning in 1966, and continuing to the present, the Service has created and sustained a separate class distinction for offshore drilling assets.

Taxpayer's initial argument is that the language used in Asset Classes 13.0, 13.1 and 13.2 of Rev. Proc. 87-56 clearly provides that all offshore drilling platforms, whether owned by a contract driller or an integrated producer, falls within Asset Class 13.0. Taxpayer argues that the rules of statutory construction, as applied to revenue procedures, reach this determination, citing Estate of Schwartz v. Commissioner, 83 TC 943, 953 (1984), and Dillon Reed & Co. v. U.S., 875 F.2d 293 (Fed. Cir. 1989). In Dillon Reed Co., the court concluded that in cases of statutory construction, the intentions of the draftsman is deduced from a view of every material part of the statute, citing U.S. v. Morton, 467 U.S. 822 (1984).

However, in Norwest Corporation v. Commissioner, 111 TC 105, 163 (1984), in discussing an asset classification question, the court says:

We are not interpreting a statutory provision. Although Congress clearly was concerned with the Commissioner's implementation of the class life system, and the system implements section 167, we are interpreting an administrative creation, and thus, we must determine the administrator's intent. We are persuaded by respondent that Rev. Proc. 62-21 established a pattern that was carried over into subsequent revenue

procedures, including Rev. Proc. 87-56. Notwithstanding the failure to continue a specific priority rule in subsequent revenue procedures, there is sufficient similarity in style and organization between Rev. Proc. 62-21 and its successors that we think that a similar priority rule was intended, and so we find.

Therefore, analysis of language and scope of the asset classes of Rev. Proc. 87-56 must start with the language and organization of the prior, superseded revenue procedures and their stated changes, beginning with the introduction of the class life system. The initial revenue procedure detailing asset classes for depreciation purposes was Rev. Proc. 62-21. This revenue procedure clearly provided distinct asset classes and guideline lives for marine contractors (Class 2(b)), contract drillers (Class 17(a)), and integrated producers (Class 17(b)). However, in Rev. Proc. 66-18, the Service provided a change in position with regard to contract drillers who provide offshore services for others and for their own account. In such a case, floating or self-propelled drilling vessels and barges, platforms, and support vessels used in offshore oil and gas exploration would no longer be allocated between Class 17(a) and Class 17(b), but would hereinafter be included in Class 2(b). Question 79 in Supplement II to Rev. Proc. 62-21 shows the Service was concerned with contract drillers whose assets would be in either Class 17(a) or Class 17(b) depending on the primary use of the assets. In addition, use of the force account language in Rev. Proc. 66-18 was necessary because Supplement I to Rev. Proc. 62-21 specifically excluded force account construction. If the intent of this language was to include offshore drilling activities of integrated producers in a contract construction class, much more specific language would have been used. Thus, the 1966 change was only applicable to contract drillers. Integrated producers' separate treatment under Class 17(b) was unaffected by the change.

The change created by Rev. Proc. 66-18 apparently was not remembered when Rev. Procs. 71-25 and 72-10 were issued because in Rev. Proc. 77-10 the Service announced as substantive change that Asset Class 15.2 (Marine Contract Construction) was modified to be consistent with Rev. Proc. 66-18. Later, as outlined above, Asset Class 13.2 was revised by Rev. Proc. 78-5 to include all offshore pipeline transportation of oil and natural gas whether by [integrated] producers or "others" (and to remove these assets from Class 46 (Pipeline Transportation)). The "others" included pipeline companies. The language "[a]lso includes petroleum and natural gas offshore transportation facilities used by producers and others consisting of platforms (other than drilling platforms classified in Class 15.2)" in Class 13.2 made it clear that drilling contractor's drilling platforms continued to be treated under Class 15.2, but did not move offshore drilling activities of integrated producers out of Class 13.2. At this time the title of Class 15.2 was Marine Contract Construction, therefore this class could not include integrated producers. The language in Class 15.2, "[d]oes not include assets used by companies in performing marine construction services for their own account except for floating, self-propelled, and other drilling platforms and support vessels used

in offshore drilling for oil and gas which are included whether used for their own account or others” refers to assets used by contract drilling companies for their own account not by integrated producers for their own account.

With Rev. Proc. 80-58, Asset Class 15.2 (Marine Contract Construction), and Asset Class 15.1 (Contract Construction), were merged into a single asset class - Construction, Class 15.0. A new asset class, Class 13.0, entitled Offshore Drilling was created for certain offshore drilling activities. Up until this change in 1980, Class 13.2 included the offshore drilling activities of petroleum and natural gas producers because these activities could not have been included within Class 15.2 (Marine Contract Construction). Taxpayer argues that the clear and specific language of Class 13.0 includes all offshore drilling activities, not just those of contractors. However, nothing in Rev. Proc. 80-58 indicates that any change was made, or intended to be made, to the assets described in Class 13.2. In fact, the exclusion in Class 13.2 of platforms described in prior Class 15.2 was specifically changed to be an exclusion of assets described in Class 13.0, the new asset class created to receive the assets of offshore drilling contractors that previously were included in prior Class 15.2. Thus, Class 13.0 only includes the offshore drilling assets of contract drillers that were included in prior Class 15.2.¹

If one looks only at the language of Rev. Proc. 87-56 in isolation from the historical development, the proper asset class for offshore drilling assets of integrated producers is unclear. Both Class 13.0 and 13.2 are broadly inclusive of industry activities. However, the use of “onshore” in Class 13.1 limits this class to onshore drilling and the omission of this word in describing the drilling activities included in Class 13.2 (integrated producers) is consistent with Class 13.0 applying only to offshore drilling of contract drillers, Class 13.1 applying to onshore drilling activities of contract drillers, and Class 13.2 applying to both onshore and offshore drilling activities of integrated producers. If the language alone of Class 13.0 unambiguously included all offshore drilling activities, that is, the drilling activities of both contract drillers and integrated producers, the inclusion of the word onshore in Class 13.1 would have been unnecessary. The inclusion of the word onshore in Class 13.1 was necessary to limit Class 13.1 to onshore drilling of wells by contractors and the failure to include this limitation in describing the drilling activities included in class 13.2 strongly implies that Class 13.2 is not limited to onshore wells as Taxpayer argues. In Rev. Proc. 72-10, both the word onshore was added to Class 13.1 and the description of marine contract construction in Class 15.2 was expanded to include offshore drilling. No specific language in the evolution of Class 13.2 has ever indicated that offshore drilling assets

¹We believe that until 1996, all integrated producers treated their offshore drilling assets as included in Asset Class 13.2, which indicates that the view expressed in this memorandum is consistent with the industry’s understanding of Class 13.2 prior to 1996.

of integrated producers are included in any other class. Based on the history of Rev. Proc. 87-56, the offshore drilling platforms of integrated producers always have been in Class 13.2 and its predecessor Group III, Class 17(a).

Review of the evolution of the pertinent asset classes shows that, since the inception of the asset classes, different classes were provided for the drilling assets of contract drillers and producers. The distinction established by Rev. Proc. 62-21 was maintained in subsequent revenue procedures. Further, drilling platforms classified by Rev. Proc. 66-18 and subsequent pronouncements were marine contract construction assets. The description of these drilling assets was moved to asset class 13.0 from asset class 15.2 by Rev. Proc. 80-58. The drilling platforms of production companies cannot be described as contract drilling assets.

The distinction drawn between the drilling assets of contract drillers (5-year recovery period for offshore assets for purposes of section 168(a)) and integrated producers (7-year recovery period for section 168(a)) for depreciation purposes is understandable because of the significant difference in assets. Producer-owned offshore equipment often is dual purpose in nature (used for drilling and production) and fixed in place over the life of the producing property, but the use of contractor-owned drilling equipment is mobile and continually used for drilling in varying environments and at different locations. Further, the asset classes are based on a composite of assets used in an industry. The composite life of all the assets of an integrated producer would be expected to be longer than the composite life of assets of a contract driller because the composition of assets of an integrated producer includes production assets that can be expected to have a longer life when compared to the offshore drilling assets of a contract driller.

CONCLUSIONS

An oil and gas producer who owns an offshore drilling platform should classify that platform in asset class 13.2 for depreciation purposes. Because we reach this conclusion, we do not address Issue 2.

CAVEAT

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.