

## RECOGNITION AND APPROVAL OF CERTAIN TREASURY REGULATIONS RELATING TO OPTIONAL DEDUCTIONS IN THE CASE OF OIL AND GAS WELLS

JUNE 22, 1945.—Ordered to be printed

Mr. GEORGE, from the Committee on Finance, submitted the following -

### REPORT

[To accompany H. Con. Res. 50]

The Committee on Finance, to whom was referred the concurrent resolution (H. Con. Res. 50) declaring Congress to have recognized and approved the provisions of section 29.23 (m)-16 of Treasury Regulations 111, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the concurrent resolution do pass.

This resolution seeks to reaffirm what the committee believes to have been the intent of Congress as reflected in Treasury regulations giving to the taxpayer the option to either capitalize or charge to expense intangible drilling and development costs in the case of oil or gas wells.

The consideration and adoption of this resolution should not be construed as creating any implication adverse to mines respecting their development costs.

For the information of the Senate the report of the House Committee on Ways and Means on this resolution is attached hereto.

[H. Rept. No. 761, 79th Cong., 1st sess.]

The Committee on Ways and Means, to whom was referred the resolution (H. Con. Res. 50), declaring Congress to have recognized and approved the provisions of section 29.23 (m)-16 of Treasury Regulations 111 and corresponding provisions of prior regulations, granting the option in the case of oil and gas wells to deduct, as an expense, intangible drilling and development costs, having had the same under consideration, report it back unanimously to the House without amendment and recommend that the resolution do pass.

The purpose of the resolution is to remove any doubt as to the validity of Treasury regulations giving to the taxpayer the option to either capitalize or charge to expense intangible drilling and development costs in the case of oil and gas wells. These regulations have been in effect for more than 28 years, and the Congress has continued, in successive revenue acts adopted since that time, the basic statutory provisions from which such regulations are derived. Further-

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more, in section 711 (b) (1) (I) of the Second Revenue Act of 1940, relating to the excess-profits tax, the validity of the regulation was expressly recognized by statute. Section 711 (b) (1) (I) of the Internal Revenue Code specifically provides for an adjustment to the net income of the base-period years where the taxpayers' deduction for intangible drilling and development costs had been abnormal or disproportionate during those years. The Treasury Department in 1942 recognizing that the interpretation of the statute by the regulations had become a part of the statute, recommended in the revenue bill of 1942 that the expensing of development costs be eliminated from the statute for 1942 and subsequent years. Congress was unwilling to adopt this recommendation of the Treasury and expressed its desire to continue the regulation in effect.

The validity of these regulations has been questioned in a recent court action on the theory that the statute providing for deduction of business expenses is ambiguous. However, this position is untenable since the language of the statute is so general in its terms as to render an interpretative regulation appropriate. In practical administration there are admittedly border-line cases between deductible business expenses and nondeductible capital outlays which make such a regulation necessary. Congress has approved the administrative construction adopted in such regulations and has thereby given them the force and effect of law.

The Petroleum Administrator for War has estimated that, for the current year, it would be necessary to drill 27,000 additional wells for oil and gas to sustain the production of petroleum essential for the maintenance of our military and civilian requirements and that petroleum needs would be equally great for the year of 1946.

The uncertainty occasioned by raising doubts as to the validity of these regulations is materially interfering with the exploration for and the production of oil. The Treasury Department and the Bureau of Internal Revenue have announced that they will continue to recognize the regulations under which they now operate unless otherwise directed by Congress.

For these reasons your committee deems it necessary to have Congress reaffirm its position that such regulations are in accordance with and have the full force and effect of law.

The consideration and adoption of this resolution should not be construed as creating any implication adverse to mines respecting their development costs.

