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JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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PURSUANT TO

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DIVISION OF INVESTIGATION

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PRELIMINARY REPORT—DEPLETION—OIL AND GAS REVENUE ACT OF 1926

Printed for the use of the Members of the Committee

NOTE.—These reports have been submitted to the Chairman and ordered printed by him, but have not yet been approved by the full Committee

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JOINT COMMITTE ON INTERNAL REVENUE TAXATION

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PRELIMINARY REPORT—DEPLETION—OIL AND GAS REVENUE ACT OF 1926

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, September 20, 1926.

To the Members of the Joint Committee on Internal-Revenue Taxation:

Attached herewith you will find a copy of a report entitled "Preliminary report on effect of section 204 (c) (2), revenue act of 1926, depletion of oil and gas wells."

This report has been prepared by our division of investigation, and while the statistics upon which certain conclusions are based are not entirely complete, nevertheless I am of the opinion that the report contains matter worthy of your consideration.

It is probable that the examination of this report will suggest certain questions which you would like answered, or certain lines of investigation you would like pursued. Your suggestions will be appreciated.

Very truly yours,

WM. R. GREEN,
Chairman Joint Committee on Internal Revenue Taxation.

SEPTEMBER 6, 1926.

Hon. WILLIAM R. GREEN,
Chairman Joint Committee on Internal Revenue Taxation,
Council Bluffs, Iowa.

MY DEAR CHAIRMAN: There is submitted herewith a preliminary report indicating the effect of the change provided for in the revenue act of 1926 in regard to depletion on oil and gas wells, with special reference to the 27½ per cent of gross income allowed for depletion in lieu of discovery depletion. The results of the study of the facts immediately available lead to the tentative conclusions discussed later in this report, and summarized in the following synopsis:

SYNOPSIS

OIL AND GAS DEPLETION

A. *General effect of 1926 act.*

(1) Eliminates discovery depletion and the necessity for valuations as of date of discovery or 30 days thereafter.

(2) Retains the necessity for March 1, 1913, valuations.

(3) Retains the maximum limit for depletion at 50 per cent of the net income from the property.

(4) Retains the minimum limit for depletion on the basis of cost, or March 1, 1913, value of the property.

(5) Allows an arbitrary 27½ per cent of the gross income from the property as depletion, if within the limits described in (3) and (4) above.

B. *Different effects shown by typical cases, 1926 act.*

(1) On oil and gas properties discovered prior to March 1, 1913, the depletion allowable can not be less than, but may be greater than, the depletion allowed by the revenue act of 1924.

(2) On proven oil and gas properties acquired after March 1, 1913, but not entitled to a discovery valuation as defined by the 1924 revenue act, the depletion can not be less than, but may be more than, the depletion allowed by the revenue act of 1924.

(3) On oil and gas properties acquired after March 1, 1913, and entitled to a discovery valuation under the revenue act of 1924, the depletion may be less or more than that allowed by the revenue act of 1924.

(4) Oil properties discovered when the price of oil was high, and which consequently received a high valuation (by the bureau's method of appraisal), will in general receive less depletion; and properties discovered when the price of oil was low, will generally receive more depletion than under the 1924 revenue act.

(5) The effect of the revenue act of 1926 on corporations in the oil industry will not vary greatly from the effect of the act on individuals.

C. *Results indicated by a study of the statistics in regard to 188 representative oil and gas corporations.*

General statistics on a representative group of oil and gas companies indicate the following probable effect of the revenue act of 1926:

(1) The percentage of depletion to gross income from production of 117 oil-producing companies in 1924 was 28.4 per cent. The same companies in 1925 show a percentage of depletion to gross income of 24.1 per cent, or a decrease of 4.3 per cent in the ratio of depletion to gross income.

(2) The percentage of depletion to gross income from production of 24 lessor oil companies in 1924 was 44.7 per cent. The same companies in 1925 show a percentage of depletion to gross income of 25.2 per cent, or a decrease of 19.5 per cent in the ratio of depletion to gross income.

(3) The percentage of depletion to gross income from production of 28 gas-producing companies in 1924 was 15.1 per cent. The same companies in 1925 show a percentage of depletion to gross income of 16.9 per cent, an increase of 1.8 per cent in the ratio of depletion to gross income.

(4) The percentage of depletion to total gross income from all sources of 11 refining and producing oil companies in 1924 was 8.9 per cent. The same companies in 1925 show a percentage of depletion to total gross income of 7 per cent, a decrease in the ratio of depletion to total gross income of 1.9 per cent.

(5) The percentage of depletion to total gross income from all sources of eight refining and producing oil companies, showing a net loss in 1924, amounted to 41 per cent in 1924. The same com-

panies in 1925 show a percentage of depletion to total gross income of 30.7 per cent, a decrease in the ratio of depletion to total gross income of 10.3 per cent.

D. *Tentative conclusions.*

(1) The revenue act of 1926 will allow as great or greater oil depletion than was allowed by the revenue act of 1924 to all those taxpayers (whether lessor or lessee) holding property as classified below:

(*a*) Property on which oil was discovered prior to March 1, 1913.

(*b*) Property acquired after March 1, 1913, but which was proven or discovered at the time of acquisition.

(2) The revenue act of 1926 will probably slightly reduce the depletion allowed to lessees and operators of oil property entitled to discovery value under the revenue act of 1924.

(3) Taking into account all lessees and operators of oil property, it seems probable that they will receive about the same depletion under the revenue act of 1926 that they would have received if the revenue act of 1924 had remained in force, when the average posted price of oil in the United States is $1.65 per barrel.

(4) The revenue act of 1926 will greatly reduce the depletion allowed to lessors.

(5) Oil companies which have received a very high depletion unit in the high-tax years, and consequently excessive depletion, but whose reserves were underestimated, will be very greatly benefited by the 1926 act.

(6) Producers of gas will probably receive greater depletion under the 1926 act than under the 1924 act at normal prices of this product.

(7) As a matter of equity there are some advantages and some disadvantages to the flat rate of 27½ per cent of gross income allowed for depletion in the revenue act of 1926.

TENTATIVE NATURE OF THE REPORT.

As previously stated, this report is preliminary. The reason for this is that the required number of statistics are not yet available for the year 1925. While there have been compiled statistics for some 520 representative corporations in the oil and gas industry for 1924, the data for only 188 of these companies is as yet available for 1925.

It is particularly desirable to secure the data for the same companies in 1925 as in 1924. This method automatically eliminates many inconsistencies which would occur through the comparison of a certain list of companies for 1924 with another list of different companies for 1925.

There is still another reason for making this report preliminary rather than final, which is that, in the case of the very large oil companies, the returns themselves must be analyzed. The gross income of these large oil companies arises from transporting, refining, and marketing oil as well as from producing. For the purposes of our study, the gross income from production alone must be determined. The statistics of the bureau do not segregate this income, and recourse must be had to the returns. The bureau has been requested to furnish the returns for 38 large oil companies. It will take some little time before these returns may be secured without inconvenience to the bureau.

It has been possible, however, to match the statistics for 188 oil and gas companies for 1924 and 1925, and it is thought well worth while to make a preliminary report on the facts indicated by this partial list, for three reasons:

(1) The economic principles which must be studied can be discussed.

(2) A classification of the facts, which must be secured to arrive at a final conclusion can be made.

(3) The manner of handling the subject can be outlined, as to make the collection of the complete data more or less a routine matter.

In addition to the above, certain typical cases have been studied and reported on for corporations. Returns for individuals must be studied entirely from typical cases as the statistical department of the bureau does not show depletion allowed individuals.

It must be kept in mind throughout, that the statistics included in this report are not considered sufficiently complete for final conclusions, and that the statements made are therefore tentative and only indicative of what may be expected to be finally proven.

A. GENERAL EFFECT OF 1926 ACT

OIL AND GAS DEPLETION

1. 1926 and 1924 Acts Compared

The revenue act of 1926 provides as follows (sec. 204 (c) (2)):

> In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to the paragraph.

The revenue act of 1924 provided as follows (sec. 204(c)):

> The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that in the case of mines, oil and gas wells, discovered by the taxpayer after February 28, 1913, and not acquired as the result of purchase of a proven tract to lessee, where the fair market value of the property is materially disproportionate to the cost, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter; but such depletion allowance based on discovery value shall not exceed 50 per centum of the net income (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value.

The following definitions of certain words or phrases included in the above must be given in order to discuss the subject intelligently:

"From the property" is interpreted to mean from each individual tract or lease. In other words, the net or gross income must be computed not for all the properties of the taxpayer lumped together, but from each individual leasehold.

"Gross income from the property" may be defined, therefore, for oil and gas properties, as the gross receipts from the sale of oil and gas as it is delivered from the property less the royalties paid in cash, if any. As it is not customary for operators to report oil royalties as a part of their receipts ordinarily, gross income will coincide with gross receipts. In the case of lessor interests, the royalty will represent the gross income from the property. In the case of taxpayers who are operators, refiners, transporters, etc., the gross income from the property must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease.

"Net income from the property (computed without allowance for depletion)" may be defined as the gross income from the property as interpreted above, less the operating expenses, wages, repairs, taxes (except income taxes), losses not compensated by insurance, depreciation, and other legal deductions which can be specifically allocated to the individual tract or lease, and also less a reasonable amount of overhead, general and traveling expenses, etc., as may be properly prorated to this individual tract or lease.

First, what is the direct effect of the revenue act of 1926 as it relates to the depletion allowable on oil and gas wells?

(*a*) It provides that the depletion on each individual tract or lease shall be 27½ per cent of the gross income from such tract or lease except—

(1) That in no case shall the allowable depletion be greater than 50 per cent of the net income from the specific property; and

(2) That in no case shall the allowable depletion be less than it would be if computed on the cost or March 1, 1913, value of that specific property.

Second, what was the effect of the revenue act of 1924 as it related to the depletion allowable on oil and gas wells?

(*a*) It provided, in the case of oil or gas wells discovered by the taxpayer, that the depletion on each discovery tract or lease should be computed on the basis of its fair market value as of date of discovery or 30 days thereafter, except—

(1) That in no case should the allowable depletion be greater than 50 per cent of the net income from the specific property; and

(2) That in no case should the allowable depletion be less than it would be if computed on the cost or the March 1, 1913, value of that specific property.

(*b*) It provided in the case of oil or gas wells, acquired as the result of purchase of a proven tract or lease, that the depletion should be based on the cost or March 1, 1913, value.

2. Results of Change Made in 1926 Act

The above comparison of the 1926 and 1924 revenue acts makes the following results self-evident as to the general effect of the 1926 act:

(*a*) It eliminates discovery depletion and the necessity for valuations as of date of discovery.

Note.—This result is beneficial to the bureau in that it reduces the valuation work. It is beneficial to the taxpayer in that he is relieved from supplying voluminous data on oil properties.

(*b*) It retains the necessity for March 1, 1913, valuations.

NOTE.—This is not a serious matter as the great majority of such valuations have now been made.

(*c*) It retains the maximum limit for depletion at 50 per cent of the net income from the property.

(*d*) It retains the minimum limit for depletion on the basis of the cost or March 1, 1913, value of the property.

NOTE.—The same data must be kept for each property in regard to net income cost, and March 1, 1913, value under both the 1924 and 1925 acts; therefore there is no change in the administration of the features (*c*) and (*d*) described above.

(*e*) It allows an arbitrary 27½ per cent of the gross income from the property as depletion, if within the limits described in (*c*) and (*d*) above.

NOTE.—As the gross income from each property is necessary in determining net income, there is no extra work of computing this provision.

On the whole, we may conclude, as far as the administration of the law is concerned, that the 1926 act requires less work and is simpler. As to the equity and effect on taxes of the provision, that will be discussed later.

An inspection of a considerable number of returns shows that even now the law is sufficiently difficult. A surprising number of errors have been noted in the 1925 returns, showing the inability of many taxpayers to understand the present act.

B. DIFFERENT EFFECTS SHOWN BY TYPICAL CASES

1926 ACT

Before analyzing the different effects of the depletion provision of the revenue act of 1926, a typical case is presented in order to show clearly how this provision is applied in a concrete case.

The figures are taken from an actual 1925 return, the name of the company only being withheld, as it will serve no useful purpose to reveal the identity of the corporation.

The figures follow in Table 1 on the next page.

The operation and interpretation of the revenue act of 1926 as affecting oil properties is well shown by the figures just given in Table I, and a clear understanding of same is essential to a proper consideration of the subject of oil depletion.

The next step will be to prove certain definite propositions relating to the effect of the oil-depletion provision, and to illustrate same by typical cases.

(1) On oil and gas properties discovered prior to March 1, 1913, the depletion allowable under the revenue act of 1926 can not be less than, but may be greater than, the depletion allowed by the revenue act of 1924.

The revenue act of 1924 limited the depletion on properties discovered prior to March 1, 1913, to the basis of a cost or March 1, 1913, value.

On the other hand, the revenue act of 1926, while still allowing the same basis, also allows a deduction of 27½ per cent of gross income for depletion if same is greater than the depletion on cost or March 1, 1913, value.

TABLE 1.—*"A" Oil Co. depletion allowable, 1925*

Lease	Gross income	Net income	Depletion: Limitation, 27½ per cent gross income	Depletion: 1926 revenue act, 50 per cent net income	Depletion on cost	Depletion allowable
Kansas:						
Lease No. 1	$71, 258. 03	$49, 013. 69	$19, 595. 96	$24, 506. 84	$7, 542. 30	$19, 595. 96
Lease No. 2	31, 810. 03	20, 904. 18	8, 747. 76	10, 452. 09		8, 747. 76
Lease No. 3	73, 950. 35	49, 442. 33	20, 336. 35	24, 721. 17	1. 65	20, 336. 35
Lease No. 4	84, 726. 14	59, 868. 29	23, 299. 69	29, 934. 14	170. 34	23, 299. 69
Lease No. 5	10, 691. 66	3, 155. 57	2, 940. 21	1, 577. 79	3, 715. 86	3, 715. 86
Lease No. 6	19, 147. 89	10, 739. 47	5, 265. 67	5, 369. 73	2, 967. 82	5, 265. 67
Lease No. 7	2, 854. 18	1, 520. 71	784. 90	760. 36		760. 37
Texas:						
Lease No. 1	10, 196. 06	6, 061. 24	2, 803. 92	3, 030. 62	373. 11	2, 803. 92
Lease No. 2	5, 189. 78	399. 05	1, 427. 19	199. 52		199. 52
Lease No. 3	4, 107. 80	[1] 491. 98	1, 129. 65			
Lease No. 4	5, 146. 31	1, 026. 70	1, 415. 24	513. 35	75. 60	513. 35
California:						
Lease No. 1	31, 352. 20	5, 698. 13	8, 621. 85	2, 849. 06	499. 10	2, 849. 06
Lease No. 2	77, 785. 06	36, 428. 73	21, 390. 89	18, 214. 36	13, 109. 18	18, 214. 36
Total	428, 215. 49	243, 766. 11	117, 759. 28	122, 129. 03	28, 454. 96	106, 301. 87

[1] Loss.

REMARKS

The following points are of interest:

(1) Out of the 13 leases shown, the 27½ per cent of gross income limitation applies in six cases.

(2) Out of the 13 leases shown, the 50 per cent of net income limitation applies in five cases.

(3) Out of the 13 leases shown, the depletion on cost is used in one case.

(4) Out of the 13 leases shown, there is no depletion, as there is no net income and no cost in one case.

(5) In this case the depletion on the 13 leases computed at 27½ per cent of the gross income is only 3½ per cent less than it would be if computed at 50 per cent of the net income.

(6) It should be noted that, on the California leases where the price of oil is lower than in the other fields, the 27½ per cent of gross income is considerably in excess of the 50 per cent of net income from these properties and therefore does not reduce the depletion over that allowable in the 1924 act.

(7) Depletion on cost must be computed in each case, therefore, an estimation of the total reserves on oil properties must still be computed even though a complete valuation is not called for.

NOTE.—The above is an actual case, name of company being deleted.

It must follow then that on such properties the depletion allowable under the 1926 act will always be as great or greater than it would have been if the 1924 act had remained in force.

While this is true in all such cases, nevertheless we will give an actual typical case as follows, deleting only the name of the company. (See Table 2, below.)

TABLE 2.—*"B" Oil Co. of California, depletion on oil property discovered prior to March 1, 1913*

Depletion, 1925 act:	
Gross income	$873, 486
Depletion allowed on 27½ per cent basis	$240, 187
Depletion which would have been allowed under 1924 act:	
Gross production, 1925, equals barrels	525, 118
Depletion unit, based on Mar. 1, 1913, value, equals	$0. 303797
Depletion	$159, 529

Total increase in depletion by 1925 act equals, $80,658.
Total increase in per cent equals 50.6 per cent.

NOTE.—The above actual case shows that a very considerable increase in depletion can be allowed on properties acquired before March 1, 1913, under the 1926 act over what would be allowed under the 1924 act. If the 27½ per cent of gross income was less than the depletion on March 1, 1913, value, then the March 1 depletion could be used, and hence the depletion allowed would never be less under the 1926 act than it was under the 1924 act.

(2) On proven oil and gas properties acquired after March 1, 1913, but not entitled to a discovery valuation as defined by the revenue act of 1924, the depletion allowable under the revenue act of 1926 can not be less than but may be greater than the depletion allowed by the revenue act of 1924.

In the case of oil and gas properties described above the 1924 act limited the depletion to the basis of cost.

On the other hand, the 1926 act, while maintaining the same basis as a minimum, also allows a 27½ per cent of gross income as depletion if same is greater than the depletion based on cost.

It must follow, then, that in all such cases the depletion allowed by the 1926 act must be as great or greater than that allowed by the 1924 act.

While the above is true in all cases of this kind, nevertheless an actual typical case will be given as follows, the name of the company only being deleted (see Table 3, below):

TABLE 3.—*"C" Oil Co.—depletion, 1925*

Depletion on oil property acquired after Mar. 1, 1913, not entitled to discovery:	
Date of acquisition	1920
Gross income	$1, 625, 860
27½ per cent of gross income	$447, 111
Depletion on cost	1, 659, 628
Depletion allowable:	
Depletion allowable 1926 act equals	1, 659, 628
Depletion allowable 1924 act equals	1, 659, 628

NOTE.—The above actual case shows that the depletion allowable under the 1926 act can not be less than that allowed under the 1924 act in cases of this kind.

The example cited under Table 2 is applicable to cases of this kind if the date of acquisition was after March 1, instead of before. The example in Table 2 showed that the depletion might be more under the 1926 act than under the 1924 act.

In the case cited in this table it might be noted that where oil property has been taken in on reorganization at a very high value, the 1926 act does not reduce the depletion. In this case depletion on cost is greater than the gross income from the property.

(3) On oil and gas properties discovered after March 1, 1913, and entitled to a discovery valuation under the revenue act of 1924, the depletion allowed by the revenue act of 1926 may be less or more than that allowed by the revenue act of 1924.

Where oil has been discovered when the price of oil was high, a high-discovery value results. Depletion on such a value under the 1924 act was often as great or greater than the 50 per cent of net income provided as a maximum limit. It is evident that the depletion allowable under the discovery clause or under the 50 per cent of net income limit may be greater than what would now be allowable under the 27½ per cent of gross income limitation.

To illustrate this, the following actual typical case with the name of taxpayer omitted, is submitted:

TABLE 4.—*"D" Oil Co., 1925 depletion*

Income, 1925:	
Gross income from property	$4, 010, 703. 00
Operating expenses, taxes, overhead, etc	596, 573. 00
Net income from property	3, 414, 130. 00

Depletion:	
Maximum limit, 50 per cent of net income	$1, 707, 065. 00
Minimum limit, depletion on cost	62, 548. 00
27½ per cent of gross income	1, 102, 943. 00
Depletion on discovery value	1, 796, 346. 00
Depletion unit per barrel (discovery)	. 787
Price of oil on discovery	1. 54
Depletion allowed, 1926 act:	
The depletion allowed under the 1926 act is then 27½ per cent of the gross income, equals	1, 102, 943. 00
Depletion which would have been allowable under 1924 act:	
The depletion allowable under the 1924 act is then 50 per cent of net income, equals	1, 707, 065. 00

REMARKS

The above figures bring out the following points of interest:

1. The depletion allowable under the revenue act of 1926 is less by 35 per cent than the depletion allowable under the provisions of the revenue act of 1924.

2. Discovery depletion is even slightly higher than the 50 per cent of net income limitation.

3. Depletion allowed by the 1926 act is still greater by 1,663 per cent than it would be if a cost basis only was allowed.

Having shown in Table 4 that the depletion allowed by the 1926 revenue act may be, in case of certain properties, less than what would be allowed under the 1924 act, it will next be shown that in the case of similar properties the depletion may be greater under the 1926 act.

TABLE 5.—*"E" Oil Co., 1925 depletion*

Income 1925:	
Gross income from property	$103, 931. 00
Operating expenses, taxes, overhead, etc	47, 368. 00
Net income from property	56, 563. 00
Depletion:	
Maximum limit 50 per cent net income equals	28, 282. 00
Minimum limit, depletion on cost equals	3, 253. 00
27½ per cent of gross income equals	28, 581. 00
Depletion on discovery value equals	16, 719. 00
Depletion Unit per barrel (discovery) equals	. 185
Price of oil on discovery (per barrel) equals	. 40
Depletion allowed under 1926 act:	
The depletion allowable under the 1926 act is then 50 per cent of the net income which is very nearly the same as the 27½ per cent limitation, equals	28, 282. 00
Depletion which would have been allowed under the 1924 act:	
The depletion which would have been allowable under the 1924 act is then the discovery depletion	16, 719. 00

REMARKS

The above figures bring out the following points of interest:

(1) The depletion under the 27½ per cent clause in the 1926 act is 69 per cent more than would have been allowed under the 1924 act.

(2) The 27½ per cent limit practically coincides with the 50 per cent limit on net income.

(3) The depletion allowed by the 1926 act is greater by 769 per cent than it would be if a cost basis only were allowed.

SPECIAL NOTE.—Tables 4 and 5 compared show clearly that in the case of discovery valuations as allowed under the 1924 act, the depletion allowable under the 1926 act may be either less or greater than would have been permitted under the former act.

(4) Oil properties discovered when the price of oil was high, and which consequently received a high valuation (by the bureau's method of appraisal) will in general receive less depletion under the 1926 act, and oil properties discovered when the price of oil was low will generally receive more depletion under the 1926 act.

The figures given in the actual typical cases already shown in Tables 4 and 5 illustrate the above point.

In the case cited in Table 4, the price of oil on discovery was $1.54 per barrel and the depletion was decreased 35 per cent by the 1926 act.

On the other hand in the case shown in Table 5, the price of oil on discovery was only 40 cents per barrel and the depletion was increased 69 per cent by the 1926 act.

A knowledge of the analytic appraisal method, used by the bureau very largely in making discovery valuations, enables one to predict with certainty that the proposition shown in particular cases above will follow as the general rule.

The analytic appraisal method is based on the present value of future earnings. The bureau uses the posted price of oil as of date of discovery applied to future estimated production in order to get at these future profits. It is obvious, then, that when the price of oil is low, small profits and low values will be shown and that, very often, under normal conditions the 27½ per cent of gross income will exceed the depletion which would have been allowable under the 1924 and prior acts.

On the other hand, when the price of oil was high on date of discovery, under normal conditions the 27½ per cent of the gross income will often be less than the depletion computed under the 1924 and prior acts.

(5) The effect of the revenue act of 1926 on corporations in the oil industry will not vary greatly from the effect of the act on individuals.

As the wording of the revenue act of 1926 is the same as to the determination of depletion for both individuals and corporations, it must be self-evident that the effect of the act will be practically the same on the net income of the two classes, the only difference being in the tax, one class being taxed at normal and surtax rates and the other class being taxed at a flat rate.

For purposes of illustration we will give in Table 6 on the following page two depletion examples, showing the depletion allowed a lessor individual and the depletion allowed a lessor corporation.

TABLE 6.—*Depletion allowed individual and corporations*

1. Taxpayer: Mr. X, lessor of oil property.

	1924	1925
Gross income	$249, 496	$238, 438
Depletion	[1] $111, 056	[2] $65, 570
Per cent depletion to gross income	44. 5	27. 5

[1] On discovery. [2] 27½ per cent.

Reduction in per cent depletion to gross income to lessor individual by 1926 act equals 17 per cent.

2. Taxpayer: F Oil Co., lessor of oil property.

	1924	1925
Gross income	$134, 953	$133, 687
Depletion	$58, 561	$39, 636
Per cent depletion to gross income	43. 4	29. 6

Reduction in per cent depletion to gross income to lessor corporation by 1926 act equals 13.8 per cent.

NOTE.—The two actual cases above show the same general effect of the act on both individual and corporation.

C. GENERAL STATISTICS

Table 7 on the following page represents a summary of oil and gas statistics as compiled to date. Inasmuch as this is a partial compilation and does not include the largest oil and gas companies in the country, the results indicated thereby must be considered tentative.

In regard to the large oil companies, proper statistics can only be secured concerning same by an analysis of the returns themselves. The returns of the 38 largest companies have been requested from the bureau, as previously stated.

It might also properly be noted in connection with the statistics presented that the companies included in the compilation are representative companies. Corporations having a variety of interests in addition to oil have been omitted unless the income from oil could be segregated from the other income.

The table follows:

TABLE 7.—*Summary of oil and gas statistics (partial compilation)*

Number of companies examined	Classification	For year 1924: Gross income from production	Depreciation	Depletion	Total net income as reported	Total tax	Per cent depreciation to gross income	Per cent depletion to gross income	Per cent depreciation to net income	Per cent depletion to net income	Per cent tax to gross income
	SCHEDULE A.—*Oil-producing companies*										
63	Companies reporting gross incomes less than $100,000 in 1925	$2,962,107	$374,369	$768,907	$725,393	$68,425	12.6	26.0	51.6	106.0	2.3
54	Companies reporting gross incomes of over $100,000 in 1925	25,032,227	3,714,708	7,175,214	5,255,627	609,955	14.8	28.6	70.7	136.5	2.4
117	Total	27,994,334	4,089,077	7,944,121	5,981,020	678,380	14.6	28.4	68.4	132.9	2.4
	SCHEDULE B.—*Lessors of oil property*										
24	Companies reporting gross incomes of $5,000 to $500,000 for 1925	2,339,847		1,046,207	770,108	92,569		44.7		135.8	3.9
	SCHEDULE C.—*Gas-producing companies*										
16	Companies reporting gross incomes less than $100,000 in 1925	552,766	56,934	65,263	196,826	20,673	10.3	11.8	28.9	33.1	3.7
12	Companies reporting gross incomes of $100,000 and over in 1925	9,004,807	730,207	1,377,623	2,337,490	291,435	8.1	15.3	31.2	58.9	3.2
28	Total	9,557,573	787,141	1,442,886	2,534,316	312,108	8.2	15.1	31.1	56.9	3.3
	SCHEDULE D.—*Producers and refiners of oil*										
11		[1] 220,417,654	28,415,154	19,542,922	51,435,629	6,429,204	12.9	8.9	55.2	38.0	2.9
	SCHEDULE E.—*Producers and refiners*										
8	Showing net loss in 1924	71,355,889	9,514,338	29,226,698	[2] 5,824,026		13.3	41.0			

[1] Total gross income.

[2] Net loss.

Number of companies examined	Classification	For year 1925: Gross income from production	Depreciation	Depletion	Total net income as reported	Total tax	Per cent depreciation to gross income	Per cent depletion to gross income	Per cent depreciation to net income	Per cent depletion to net income	Per cent tax to gross income	Per cent increase (+) or decrease (−) in ratio of depreciation to gross income (1924 to 1925)	Per cent increase (+) or decrease (−) in ratio of depletion to gross income (1924 to 1925)
	SCHEDULE A.—*Oil-producing companies*												
63	Companies reporting gross incomes less than $100,000 in 1925	$2,822,927	$378,008	$589,682	$838,238	$89,549	13.4	20.9	45.1	70.4	3.2	+0.8	−5.1
54	Companies reporting gross incomes of over $100,000 in 1925	42,174,111	3,721,193	10,266,037	13,022,232	1,668,740	8.8	24.4	28.6	78.8	4.0	−6.0	−4.2
117	Total	44,997,038	4,099,201	10,855,719	13,860,470	1,758,289	9.1	24.1	29.6	78.3	3.9	−5.5	−4.3
	SCHEDULE B.—*Lessors of oil property*												
24	Companies reporting gross incomes of $5,000 to $500,000 for 1925	3,000,527	----------	754,909	1,482,164	189,231	----------	25.2	----------	50.9	6.3	----------	−19.5
	Schedule C.—Gas-producing companies												
16	Companies reporting gross incomes less than $100,000 in 1925	561,034	64,011	113,763	150,318	15,432	11.4	20.3	42.6	75.7	2.8	+1.1	+8.5
12	Companies reporting gross incomes of $100,000 and over in 1925	10,549,588	935,631	1,763,016	2,367,248	307,193	8.9	16.7	39.5	74.5	2.9	+ .8	+1.4
28	Total	11,110,622	999,642	1,876,779	2,517,566	322,625	9.0	16.9	39.7	74.5	2.9	+ .8	+1.8
	SCHEDULE D.—*Producers and refiners of oil*												
11		[1] 281,448,044	28,222,279	19,581,101	97,758,294	12,708,578	10.0	7.0	28.9	20.0	4.5	−2.9	−1.9
	SCHEDULE E.—*Producers and refiners*												
8	Showing net loss in 1924	95,840,865	10,458,907	29,393,692	[2] 9,842,340	595,137	10.9	30.7	106.3	298.6	.6	−2.4	−10.3

[1] Total gross income.

[2] Net income for year.

EXPLANATION OF STATISTICS

Schedule A.—Under this heading, in Table 7, is the summary of the figures concerning 117 representative oil-producing companies.

While the 117 companies have been divided into two classes, one with gross incomes less than $100,000 and the other with incomes over $100,000, the difference shown is slight and not worthy of special comment. It does furnish a certain check as to the probable reliability of the figures.

It will be noted that the gross income of the oil companies listed was over 50 per cent greater in 1925 than in 1924. One reason for this increase lies in the fact that the average price of oil in the United States increased 15 per cent in 1925 (from $1.43 per barrel in 1924 to $1.65 per barrel in 1925); the rest of the increase is due to increased production.

The allowance for depreciation in 1924 is $4,089,077 while in 1925 it is $4,099,201. In other words the depreciation shows little change in the aggregate. The percentage of depreciation to gross income, however, falls off from 14.6 to 9.1 per cent. This is because depreciation is based on cost or March 1, 1913, value of assets and does not vary with gross income.

The total allowance for depletion in 1925 is considerably above that allowed in 1924 ($7,944,121 in 1924; $10,855,819 in 1925). From this it can be seen that depletion under the 1926 act is not a function of a fixed value as was depreciation, but is now a function of gross income or net income except in those cases where depletion is computed on cost or March 1, 1913, value. On the other hand, under the 1924 act depletion was a function of a fixed cost March 1, 1913, or discovery value, and was only a function of net income in those cases where the 50 per cent of net income limitation applied.

The percentage of depletion to gross income decreases from 28.4 per cent in 1924 to 24.1 per cent in 1925, a total decrease in per cent of 4.3. Attention is called to the fact that even if the 1924 act had remained in effect for 1925, there would probably have been a decrease in the percentage of depletion to gross income. This will be discussed later.

Schedule B.—This schedule comprises the summary for 24 lessor oil companies. The gross income represents royalties received.

It will be noted that the total allowance for depletion is less in 1925 than in 1924 ($1,046,027 in 1924 and $754,909 in 1925), and this in spite of the fact that the gross income in 1925 has increased about 30 per cent.

The percentage of depletion to gross income decreases from 44.7 per cent in 1924 to 25.2 per cent in 1925. The ratio of depletion to gross income in 1925 is therefore reduced 19.5 per cent. This amounts to a very considerable reduction and increases the percentage of tax to gross income from 3.9 per cent in 1924 to 6.3 per cent on 1925.

From an intimate knowledge of the valuation methods employed by the bureau in this class of cases, it can be stated that the above result is typical for lessor interests.

Schedule C.—This schedule is prepared from the statistics on 28 representative gas-producing companies in the same manner as Schedule A for oil companies.

The number of companies is not sufficient for a close prediction of results.

The percentage of depletion to gross income increases from 15.1 per cent in 1924 to 16.9 per cent in 1925. The ratio of depletion to gross income has therefore increased 1.8 per cent. Attention is drawn to the fact that this ratio for the smaller companies has increased 8.5 per cent. We are inclined to believe that this will be more nearly representative of the actual fact. The larger companies have probably reported gross income from sales to the consumer rather than from price of gas as delivered from the property.

At this time we believe we are safe in stating that the depletion allowed gas-producing companies under the 1926 act will exceed that which would have been allowed if the 1924 act had remained in force.

Schedule D.—This schedule is compiled from the statistics of 11 fairly large companies producing oil and gas. The total gross income of these companies amounts to over $220,000,000. It must be borne in mind that this is the gross income from all operations, not the gross income from oil and gas properties only, this information not being available.

In this schedule the ratio of depletion to gross income is 8.9 per cent in 1924 and 7 per cent in 1925, a decrease of 1.9 per cent.

The number of companies is not sufficient to allow of great weight being attached to these figures. It would appear that they check fairly well (proportionately) with the results shown in Schedule A.

Schedule E.—This schedule is interesting from the point of view of showing how depreciation and depletion allowances (book deductions) wipe out all taxable income in some cases.

The tabulation includes eight oil and gas companies, having a total gross income of $71,355,889.

Note that—

Depreciation equals	$9, 514, 338
Depletion equals	29, 226, 698
Total	38, 741, 036
Net loss equals	5, 824, 026

If there was no allowance for depreciation and depletion the net loss would be changed to a net profit of $32,917,010.

Also note that the gain of $9,842,340, made by these same companies in 1925 will be reduced to a taxable net income of $4,018,314.

D. GENERAL DISCUSSION AND TENTATIVE CONCLUSIONS

The object of the foregoing matter has been to prove certain definite and specific propositions and to present a summary of the statistics bearing on oil and gas depletion, which taken together will allow of a general discussion of this subject on a basis of fact and enable us to draw certain definite or tentative conclusions according to the completeness of the data.

(1) It has been definitely proved under Part B of this report, that in the case of oil or gas properties acquired and discovered prior to March 1, 1913, or in the case of properties acquired after that date but not entitled to a discovery valuation under the 1924

act, the depletion as now allowed by the revenue act of 1926 may be more than, but can not be less than, that allowed by the prior acts.

What is the practical effect of this proposition?

It means that in all the old oil and gas fields, like Pennsylvania, where very few discoveries have been made since 1913, the depletion under the 1926 act will be more than the depletion which would have been allowed under the prior acts. While some of the individual taxpayers in the old fields will be allowed the same depletion, in the great majority of cases they will get the benefit of a greater depletion. In no individual case can they receive less.

It also means that wherever proven oil property has been transferred since March 1, 1913, the depletion on these properties will aggregate more under the 1926 act than under former acts, for in no individual case can they receive less, and in many cases they will receive more.

The above conclusion is definite and not tentative, as are some of the other conclusions that will be drawn, and we believe the proof of same has been sufficiently demonstrated.

(2) In Part B of this report, we have shown that the depletion allowed under the 1926 act to lessee operators formerly entitled to discovery depletion may be more or less than that allowed by the 1924 act. From the partial compilation of statistics given in Table 7, Part C, we must try to determine whether the depletion allowed by the 27.5 per cent provision will be greater or less in the aggregate, than would have been allowed if the 1924 act had remained in force.

In Table 7, Schedule A, is shown the summary of statistics for 117 representative oil-producing companies. It will be noted that the percentage of depletion to gross income in 1925 is 4.3 per cent less than in 1924. This list of companies includes producers whose former depletion allowances were based on cost, March 1, 1913, value, and discovery value.

Now, we shall show, hereafter, that the reduction of 4.3 per cent in the ratio of depletion to gross income under the 1926 act does not necessarily demonstrate that the provisions of the new act caused this reduction, as it is probable that a very similar reduction would have taken place in this percentage even if the revenue act of 1924 had remained in force.

However, since we have proved that under the 1926 act, the aggregate depletion on properties, whose depletion was formerly based on cost or March 1, 1913, value, must now be greater than formerly, it must follow that if it were possible to segregate the discovery depletion from the 117 companies shown in Schedule A, then such depletion on the basis of the 27.5 per cent provision, would be reduced over the former allowance based on discovery value.

For present purposes, we will therefore tentatively conclude that the depletion under the 1926 act on properties formerly entitled to discovery depletion will be somewhat less than under the act of 1924.

(3) The next question to be raised may be stated as follows:

What effect has the 1926 act had, in the aggregate, on the depletion allowed lessee operators as a general class in comparison with what would have been allowed this class of taxpayers if the revenue act of 1924 had remained in force?

In Schedule A, Table 7, we showed that the ratio of depletion to gross income in 1924 was 28.4 per cent, and in 1925, 24.1 per cent. In other words the ratio decreased 4.3 per cent.

If we attributed this decrease entirely to the 1926 act, we would be wrong, for the reason that it is quite evident that the ratio of depletion to gross income would have decreased even if the revenue act of 1924 had remained in force. Why this is so will now be discussed and an attempt will be made to measure the extent of the decrease in the ratio if the 1924 act had not been changed.

Under the revenue act of 1924, depletion was in general a function of a depletion unit based on a fixed value; i. e., cost, March 1, 1913, value, or discovery value, the exception to this being where the 50 per cent of net income limitation applied.

Under the 1924 act, then, in general, an increase or decrease in production will not affect the ratio of depletion to gross income, but a change in price of oil will change the ratio.

We will illustrate this hypothetically as follows:

In 1924, the "M" Oil Co. showed the following factors bearing on depletion:

Total production____barrels__	100, 000
Price per barrel____	$1. 43
Total gross income____	$143, 000. 00
Average depletion unit (on cost, Mar. 1, or discovery value) ____per barrel__	$0. 40
Total depletion, 100,000×$0.40, equals____	$40, 000. 00
Per cent of depletion to gross income equals____per cent__	27. 97

In 1925 for the same oil company we have the following figures:

Production____barrels__	200, 000
Price per barrel____	$1. 65
Total gross income____	$330, 000. 00
Average depletion unit (if 1924 act remained in force)____	$0. 40
Total depletion, 200,000×$0.40, equals____	$80, 000. 00
Per cent of depletion to gross income equals____per cent__	24. 24
Actual reduction in ratio 1924 to 1925 equals____do____	3. 73
Percentage change in ratio equals $\frac{3.73}{27.97}$ equals____do____	13. 33

Now, this reduction in the ratio of depletion to gross income is entirely due to the raise in price of oil and not at all to the difference in production.

Suppose the price per barrel of oil had remained the same in 1925 as in 1924, then, although we have 200,000 barrels production in 1925 against 100,000 barrels in 1924, the ratio of depletion to gross income will be the same in both years, as shown by the following figures:

1924

Production____barrels__	100, 000
Price of oil____	$1. 43
Gross income____	$143, 000. 00
Depletion, 100,000×$0.40 equals____	$40, 000. 00
Ratio depletion to gross income equals____per cent__	27. 97

1925

Production equals____barrels__	200, 000
Price of oil (assumed same as 1924)____	$1. 43
Gross income____	$286, 000. 00
Depletion, 200,000×$0.40 equals____	$80, 000. 00
Ratio depletion to gross income equals____per cent__	27. 97

On the other hand, the ratio of depletion to gross income is inversely proportionate to the change of price. For we have seen that an increase in price from \$1.43 to \$1.65 has made a difference of 13.33 per cent in the ratio of depletion to gross income.

Now, if we take this increase in price, \$0.22, and divide by \$1.65 we also have 13.33 per cent, which proves that an increase in price under the 1924 act would cause a corresponding decrease in the per cent of depletion to gross income.

Now, from our statistics in Table 7, Schedule A, we have shown that the average figures for 117 companies indicate a decrease in the ratio of depletion to gross income of 4.3 per cent (28.4 − 24.1 per cent). As the price of oil increased from \$1.43 in 1924 to \$1.65 in 1925, we would expect a change of $\frac{0.22}{1.65}$ equals 13.33 per cent in the ratio of depletion to gross income if the 1924 act had been retained in effect for 1925, or 28.4 × 13.33 per cent equals 3.8 per cent (decrease).

As the actual decrease appears to be 4.3 per cent, it follows that the effect of the revenue act of 1926 on lessee operators as a whole is to reduce the depletion over what would have been allowable by the former act by one-half of 1 per cent.

But this figure appears to be within the limit of accuracy of our present statistics, so that for the present we will tentatively conclude that the depletion allowable to lessee operators under the 1926 act is about the same as would have been allowed if the revenue act of 1924 had remained in effect, as far as the year 1925 is concerned.

As a corollary to this proposition, we will now show that when the average price of oil in the United States is above \$1.65 per barrel (tentative) the depletion is greater under the provisions of the 1926 act than formerly, and when the average price of oil in the United States is less than \$1.65 per barrel (tentative) then the depletion will be less under the new act.

To give a practical illustration of how the ratio of depletion to gross income varies inversely as the price of oil, the statistics for four companies in the California field, all producing low-grade oil, have been averaged. The results follow:

Year	Average price (California)	Per cent of depletion to gross income
1921	\$1.31	34.72
1922	.92	37.88
1923	.61	41.12
1924	.98	24.38
1925	1.19	23.38

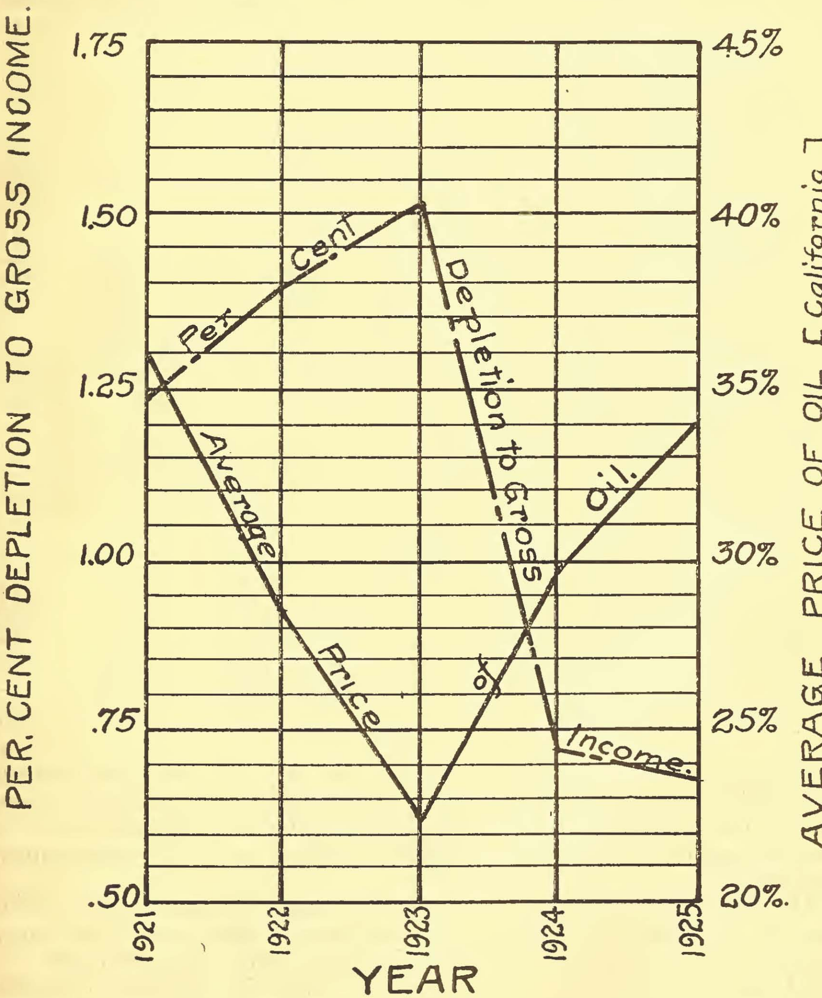
This result is also shown graphically on Chart I on the following page.

The preceding chart is sufficient to show that the depletion does vary according to the principles stated. We have not lost sight of the fact that the law was changed in 1924 and also that the 50 per cent of net income limitation is an element which introduces a certain modification in our mathematical results. It will not be necessary, however, to discuss the corrections which might be applied to take care of the 50 per cent factor in this preliminary report.

Now, it must be evident that if, under the provisions of the 1924 act, the per cent of depletion to gross income is inversely proportionate to the price, this is not so under the 1926 act except to a very limited degree. In every case where depletion is computed on the

CHART-1

PER. CENT DEPLETION TO GROSS INCOME INVERSELY PROPORTIONAL TO AVERAGE PRICE OF CRUDE OIL.



basis of 27.5 per cent of the gross income, the ratio of depletion to gross income will remain the same whatever may be the price of oil.

It will follow, then, that there is a certain average price of oil at which the depletion in the aggregate would be the same under the 1924 act as under the 1926 act.

But we have shown that in 1925 the price of oil was $1.65 per barrel and that the depletion would be about the same under both acts.

It is tentatively concluded, therefore, that when the average price of oil in the United States is less than $1.65 per barrel the depletion to lessee operators will be less under the 1926 act than formerly, and when the average price of oil in the United States is greater than $1.65 per barrel, the depletion to lessee operators under the 1926 act will be greater than formerly.

It also follows from the foregoing that the 1926 act is more beneficial to the low-price oil fields and to the old fields not entitled to discovery value. This is brought out by the compilation shown below, Table 8.

TABLE 8.—*Effect of 1926 act on different oil fields*

	Number of companies	Gross income	1924 depletion	Per cent of depletion to gross income	Gross sales	1925 depletion	Per cent of depletion to gross income
Appalachian field	8	$366, 179	$65, 122	17. 78	$396, 815	$67, 537	17. 02
Central States field	7	3, 001, 847	844, 704	28. 14	5, 205, 379	1, 327, 768	25. 51
Mid-continent field	14	3, 329, 274	1, 067, 361	32. 06	5, 645, 906	1, 264, 002	22. 39
Gulf coast field	15	2, 028, 535	724, 416	35. 71	11, 121, 584	3, 002, 321	27. 00
California field	34	6, 203, 664	1, 867, 823	30. 11	6, 673, 638	1, 976, 841	29. 62
Rocky Mountain field	4	224, 735	35, 979	16. 01	565, 138	140, 930	24. 94
Grand total	82	15, 154, 234	4, 605, 405	30. 39	29, 608, 460	7, 779, 399	26. 27

	1925 per cent of depletion to gross income 1926 act	1925 probable per cent depletion to gross income if 1924 act remained in force	1925 increase (+) decrease (−) caused by 1926 act
			Per cent
Appalachian field	17. 02	15. 69	+1. 33
Central States field	25. 51	24. 83	+. 68
Mid-continent field	22. 39	28. 29	−5. 90
Gulf coast field	27. 00	31. 51	−4. 51
California field	29. 62	26. 57	+3. 05
Rocky Mountain field	24. 94	14. 13	+10. 81
Total	26. 27	26. 81	−. 54

While the statistics in Table 8, above, are not complete enough to justify a definite conclusion, they do show that the low-priced fields like California and Rocky Mountains are benefited by the revenue act of 1926, and also the old Appalachian field receives more depletion.

On the other hand, the mid-continent and Gulf coast fields, where prices have been good and a large number of discoveries have been made, show a decided decrease in depletion under the 1926 act.

(4) An examination of Schedule B, Table 7, indicates that the depletion allowed lessors under the revenue act of 1926 will be considerably reduced.

In 1924 the ratio of depletion to gross income was 44.7 per cent, while in 1925 it was 25.2, a decrease of 19.5 per cent.

While we might have expected a decrease in the ratio from 44.7 per cent to 39.5 per cent due to the increase in price, as shown by the principles already demonstrated, there is still a decrease in the ratio of 14.3 points.

Expressing this in terms of the reduction in depletion, the percentage reduction in depletion is 14.3 divided by 39.5 equals 37 per cent.

We may tentatively conclude, therefore, that the depletion allowed lessors has been reduced at least one-third by the revenue act of 1926 at present oil prices.

(5) There is one special class of oil properties which will be greatly benefited by the 1926 act.

This class may be described as consisting of those properties which were discovered when the price of oil was high and were allowed a high depletion unit for high-tax years, but whose reserves were underestimated.

The method of valuation employed by the engineering division of the Income Tax Unit, at least up to 1924, in general was based on the present worth of future expected profits. A low discount factor was used (usually 10 per cent) which would have given high values if a hazard factor had not been applied to the reserves. This hazard factor applied to the oil reserves had the effect of lowering the valuation and in general bringing it to a proper figure. However, this hazard factor in the way it was originally applied did not reduce the depletion unit and allowed very great depletion in the high-tax years.

Now, if the act of 1924 had remained in force after the discovery value had been wiped out by depletion no further depletion would be allowed. The 1926 act, however, allows depletion to continue on these properties.

This matter can not be completely discussed without going into a complete description of the present-worth method of valuation, which we desire to avoid in this preliminary report. However, as the matter is important we will illustrate the main points involved by a simple hypothetical case.

The "X" Oil Co. discovered oil when the price was $2.50 per barrel. The bureau valued the property and were conservative on the reserves, but arrived at the high depletion unit of $1.75 per barrel. Now, the total valuation on the property was $1,000,000 and the discovery depletion on this property to December 31, 1924, had exhausted this value.

Under the 1924 act no further depletion would be allowed and excessive depletion in former years would to a considerable extent be offset by no depletion in subsequent years.

The act of 1926, however, wiped out this valuation limit, and the property still being producing, it will still be entitled to 27.5 per cent depletion on the gross income.

This feature is deserving of further study and statistics, as it is probable the effect of the valuation limit in depletion would have made itself felt in present and future returns in a reduction in depletion, even if the 1924 act had remained in force.

(6) According to our partial statistics in Table 7, Schedule C, it is seen that gas-producing companies receive slightly greater depletion under the revenue act of 1926 than under the revenue act of 1924.

Conferences with engineers of the Bureau of Internal Revenue confirm this fact, and we believe that final figures will show that the 1926 act is even more beneficial to the gas producers than our partial statistics indicate. It will be well, therefore, to let this subject remain open for final discussion until a sufficient number of returns have been examined.

(7) As a matter of equity there are some advantages and some disadvantages to the flat rate of 27.5 per cent of gross income allowed for depletion in the revenue act of 1926.

The advantages can be classified as follows:

1. Reduces valuation work in the bureau.
2. Distributes the depletion more uniformly among the industry without regard to price of oil on discovery.
3. Gives operators in low-priced fields a fair depletion.
4. Gives operators in the old fields a fair depletion.

The disadvantages of this provision can be classified as follows:

1. It is based on no sound economic principle.
2. It does not materially reduce the depletion allowed to the industry as a whole as was expected.
3. It is much more severe on the lessor than on the lessee.
4. It removes the reasonable valuation limit for depletion maintained under all prior acts.

CONFIRMATORY DATA

As this report is being completed a few additional statistics have become available, which are so confirmatory of the statistics in Table 7, that we can not refrain from quoting same, as additional weight can be given the remarks based on the former statistics knowing that they are reasonably confirmed.

The pertinent part of these statistics follow:

Year	Number of companies	Gross income	Depletion	Per cent of depletion to gross income
1924	21	$25, 998, 114	$7, 352, 350	28. 3
1925	21	31, 381, 534	8, 114, 496	25. 8
Decrease in ratio depletion to gross income				2. 5

Reference to Schedule A, Table 7, will show that this decrease checks within 1.8 per cent with the decrease there shown.

Further, we have analyzed the returns of two large oil companies with the following results:

Year	Gross income	Depletion	Per cent of depletion to gross income
1924	$33, 507, 543	$10, 420, 659	31. 1
1925	41, 414, 637	11, 234, 469	27. 1
Decrease in ratio depletion to gross income			4. 0

This checks within 0.3 per cent of the results in Table 7, Schedule A.

The agreement in these separate compilations is as close as could be expected and does not affect the tentative conclusions we have drawn.

CONCLUSION

In concluding this preliminary report we wish to summarize the most important points, tentatively, as follows:

When the average price of oil in the United States is at $1.65 per barrel, as it was during 1925, the effect of the provisions of the revenue act of 1926 are such as to slightly reduce the depletion allowed the oil industry. This reduction, however, falls entirely on the lessors as the depletion allowed the lessees is practically what it would have been under the 1924 act.

As to future years, if the price of oil goes above $1.65 per barrel the depletion will be greater under the 1926 act; if it goes below $1.65, it will be less under the 1926 act.

The distribution of the depletion allowances is very different under the new act than it would have been under the old, the old and low priced fields getting more depletion and the new and high priced fields getting less.

The work of collecting the necessary facts for a final report on the subject is progressing.

Respectfully submitted.

L. H. Parker,
Chief, Division of Investigation

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