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TAXATION—INCOME: TAX COMPUTATION WHERE TAXPAYER REFUNDS REVENUES PREVIOUSLY REPORTED UNDER CLAIM OF RIGHT DOCTRINE. —*United States v. Skelly Oil Company*, 394 U.S. 678 (1969).

In the years 1952 through 1957 the Skelly Oil Company received $505,536.54 from two customers due to a raise in the minimum price for natural gas by the Oklahoma Corporation Commission. In 1958 the Company was required to refund this money due to a vacation of the increased rates by an order of the United States Supreme Court. The Company had included the amounts received in gross income for income tax purposes during the years of receipt in conformance with the claim of right doctrine, whereby amounts received by a taxpayer who claims an unrestricted right to them must be reported as income in the year received.[1] The entire amounts had qualified for the 27½% oil depletion deduction authorized by section 613,[2] which had been taken in prior years. In 1958, when it was determined that the receipts had to be returned to the two customers, Skelly Oil Company deducted from gross income the full amount refunded on its 1958 income tax return, stipulating that it was using the deduction available under I.R.C. section 1341(a)(4).[3] The commissioner determined that the proper amount of the deduction in 1958 should have been $366,513.99, the amount refunded less the amounts previously deducted as percentage depletion, instead of the full $505,536.54. The commissioner was upheld by the District Court, but the Tenth Circuit reversed. The Supreme Court granted certiorari. *Held*: Where the taxpayer has overcharged its customers and has taken depletion deductions on the overcharges, then any deduction for a subsequent refund of the overcharges

1. The claim of right doctrine originated in the decision of North American Oil Consolidated v. Burnet, 286 U.S. 417 (1932). For detailed discussions and analyses of the nature and application of the concept, see generally Lister, *The Use and Abuse of Pragmatism: The Judicial Doctrine of Claim of Right*, 21 TAX L. REV. 263 (1966); Corlew, *The Tax Benefit Rule, Claim of Right Restorations, and Annual Accounting: A Cure for the Inconsistencies*, 21 VAND. L. REV. 995 (1968) [hereinafter cited as Corlew].

2. INT. REV. CODE of 1954, § 613.

3. INT. REV. CODE of 1954, § 1341(a)(4), states that if an item was included in gross income for a prior taxable year because it appeared that the taxpayer had an unrestricted right to it, and a refund of the item is later necessary, the tax for the taxable year of refund will be "the tax for the taxable year computed with such deduction."

must be reduced by the amount of the depletion previously taken. *United States v. Skelly Oil Company*, 394 U.S. 678 (1969).[4]

Two aspects of the *Skelly Oil* decision raise important questions. First, it can be argued that the company was not claiming a double deduction, and that the effect of the Court's holding may be to place the taxpayer in a worse position on balance rather than merely in a position in which incomes and deductions are equalized, as the Court intended. Second, the possible application of the *Skelly Oil* holding to analogous situations is unclear and may be wider than the Court anticipated.[5] This note will thus focus in turn on each of these two points.

Skelly Oil Company asserted that section 1341(a)(4)[6] permitted the deduction of the entire amount repaid to customers,[7] since that section was intended to codify prior law which had always permitted the full amount refunded to be deducted.[8] The Commissioner, however, contended that this interpretation would effectively grant Skelly Oil Company two deductions, one for the allowance originally claimed, and another when the full amount refunded is claimed.[9]

4. The District Court opinion appears at 255 F. Supp. 228 (N.D. Okla. 1966). This decision has been noted in 16 OIL & GAS TAX Q. 12 (1967); 3 TAXATION FOR ACCOUNTANTS 302 (1968). The initial Court of Appeals decision, and the decisions on rehearing, are reported at 392 F.2d 128 (10th Cir. 1968). The decisions have been noted in 16 OIL & GAS TAX Q. 165 (1967); 43 TUL. L. REV. 425 (1969); 47 TEXAS L. REV. 489 (1969); 2 U. OF TOLEDO L. REV. 479 (1969); 41 TEXAS CERTIFIED PUBLIC ACCOUNTANT 58 (1968).

5. The issues considered in this note are not affected by any of the provisions of the Tax Reform Act of 1969, Pub. L. No. 91-172 (Dec. 30, 1969), although § 501 of that Act reduced the depletion percentage for oil and gas producers under INT. REV. CODE of 1954, § 613, from 27½% to 22%.

6. INT. REV. CODE of 1954, § 1341(a)(4).

7. Brief for Respondent at 5, 6, United States v. Skelly Oil Co., 394 U.S. 678 (1969).

8. The claim of right doctrine is closely related to the concept of the annual accounting period for income tax purposes. It is because each taxable year is a separate accounting period, and prior tax returns cannot be reopened after the statute of limitations has run, that the amounts refunded had to be deducted in the year of refunding, rather than retroactively in the years when the amounts were received. *See* Corlew, *supra* note 1.

Because the combination of the annual accounting concept and the claim of right doctrine had produced several situations which Congress felt to be quite harsh when amounts previously reported as income were refunded, in 1954 Congress created an alternative procedure, which is generally more favorable to the taxpayer, for handling items refunded. INT. REV. CODE of 1954, § 1341(a)(5). Skelly Oil Company, however, did not choose this alternative, but instead elected to take the deduction in the year of refund, which is the original procedure still available under the Code. *See* United States v. Skelly Oil Co., 394 U.S. 678, 682 (1969).

9. Brief for Petitioner at 22, United States v. Skelly Oil Co., 394 U.S. 678 (1969).

The Supreme Court, speaking through Mr. Justice Marshall, accepted the Commissioner's position that the Internal Revenue Code should not be so interpreted as to allow a double deduction unless Congress clearly so intended.[10] The Court concluded that Skelly Oil Company was claiming a double deduction, and, since it was unable to find any intent on the part of Congress to allow a double deduction,[11] rendered a decision against Skelly Oil Company.[12]

It can be argued, however, that no double deduction for the same amount was claimed in this case. One possible approach, which was discussed by Justice Stewart in his dissenting opinion, is that in this situation the Internal Revenue Code allows two distinct deductions to be claimed.[13] Another possible argument is that the amount taken as percentage depletion had reduced the basis of the capital asset,[14]

10. United States v. Skelly Oil Co., 394 U.S. 678, 684 (1969). *See also* Charles Ilfeld Co. v. Hernandez, 292 U.S. 62 (1934).

11. The suggestion was advanced by Skelly Oil that the very act of providing alternative methods of treating the refunded amount, and of requiring use of the alternative which produced the lower tax, indicated a Congressional intent to benefit the taxpayer in this situation. The Court apparently did not find this proposition persuasive, possibly because the benefit claimed was not the benefit bestowed. Brief for Respondent at 9, 10, United States v. Skelly Oil Co., 394 U.S. 678 (1969).

12. The Court's decision was also supported by major policy considerations. The following passage from Petitioner's Brief for Certiorari at 16, 17, United States v. Skelly Oil Co., 394 U.S. 678 (1969), indicates the magnitude of the problem which was under consideration.

> As a consequence of the broad sweep of federal, state and local regulation of the sales price of natural gas, producers often collect and report for income tax purposes amounts later refunded to customers. The Federal Power Commission has advised the Commissioner of Internal Revenue, for example, that customer refunds approaching $95,000,000 are likely to result from two Commission rulings recently approved by this Court . . . . In other cases, the Federal Power Commission ordered nearly $90,000,000 in refunds in the three year period ending June 30, 1966. Potential refunds of comparable magnitude are at issue in cases still pending before the Commission. And additional large numbers of customer refunds are likely to result—as did the ones in this case—from the actions of state or local authorities (footnotes omitted).

13. United States v. Skelly Oil Co., 394 U.S. 678, 695-96 (1969). In his dissent, Justice Stewart suggested that Skelly Oil Company had not been attempting to take the same deduction twice but had claimed two entirely separate and distinct deductions, both of which were Congressionally approved. One deduction was for depletion, granted in the INT. REV. CODE of 1954, § 613, to allow recovery of capital investment in oil and gas producing properties. The other deduction was for refunded amounts which had been previously included in gross income, granted in the INT. REV. CODE of 1954, § 1341. The difficulty in this argument is that both deductions, although allowed in separate sections of the INT. REV. CODE of 1954, cover the same amount. An analogous situation might be an amount which was expended for a child's medical care. Although theoretically deductible in some cases as a child care expense and as a medical expense, the Treasury Regulations permit the amount to be deducted only once, as one or the other. Treas. Reg. § 1.214-1(g)(1) (1956).

14. INT. REV. CODE of 1954, § 1016(a).

and that one traditional method of preventing double deductions when capital assets are used would thus be at work in this case.[15] The process works as follows: deductions for depletion are subtracted from the basis of the asset, and if the asset is later sold,[16] the smaller the remaining basis of the asset, the larger the taxable gain.[17]

The preceeding argument was apparently not emphasized, if ever raised.[18] Perhaps emphasis on this argument would have resulted in a different resolution of the dispute, but, since it is possible that the theory behind it would not coincide with the realities of the business world,[19] the Court might well have found that the result which was reached was still necessary in order to prevent an unintended double deduction.

The opinion in *Skelly Oil* seems proper, but it also seems incomplete. The Court leaves open the question as to whether the basis of the depletable asset is to be readjusted upward at the time of the refund.[20] If no readjustment to basis is made at the time of the refund, then any future sale of the depletable asset may result in an inflated taxable gain. In order to achieve the equality which the Court was striving

15. *See* United States v. Ludey, 274 U.S. 295 (1927). It is ironic that although the *Ludey* decision was one of the precedents most heavily relied upon by the Commissioner in the *Skelly Oil* arguments, the argument suggested in the text was apparently not emphasized by *Skelly Oil. See* McLane, *Supreme Court Raises More Questions Than It Answers in Skelly Oil Decision*, 31 J. TAXATION 66 (1969).

16. A practical weakness appears at this point. In employing percentage depletion, an oil or gas producer can take deduction far in excess of his original cost for the producing assets. Commissioner v. Elliott Petroleum Corp., 82 F.2d 193 (9th Cir. 1936); Louisiana Iron & Supply Co., Inc., v. Commissioner, 44 B.T.A. 1244 (1941). There is no certainty, therefore, that any recoupment at all will occur at the point of final disposition of the asset. In fact, it is unlikely that management will fail to utilize its favorable tax position through depletion of the producing properties far beyond cost. A profitable sale would probably call for a price beyond the value of the properties to a purchaser. The normal technique for preventing double deductions might very well prove ineffective in this factual situation.

17. There is a possible objection to the argument that reductions in basis will operate to eliminate any double deduction, since the sale of the asset might result in taxation at capital gains rates. This inequity, however, is inherent in the treatment which the Court has prescribed for handling depletion deductions. In United States v. Ludey 274 U.S. 295, at 303 (1927), the Court stated that " . . . the deduction is to be regarded as a return of capital."

18. *See* note 15, *supra*.

19. *See* note 16, *supra*.

20. While it is arguable that the Court did not comment on the question of basis readjustment because it assumed that a readjustment would be automatic, it is hazardous to place any great emphasis on the Court's silence. It is doubtful that the Court was completely cognizant of the basis problem and, in any event, the resolution of the question of basis readjustment would have been unnecessary to the decision of the immediate case before the Court, since only the amount of the 1958 deduction under INT. REV. CODE of 1954, § 1341(a)(4) was in dispute.

for when it balked at allowing a "double deduction" and to satisfy the apparent congressional intent in making the alternative depletion formula available,[21] it would appear that the taxpayer must be allowed to readjust his basis upward. Neither the Internal Revenue Code of 1954 nor the Treasury Regulations expressly allow such an upward adjustment to basis,[22] however, and it might not be permitted.

The Commissioner would seem to have an argument, based on the language of the Internal Revenue Code and the Regulations, that the depletion amounts allowed in the years 1952 through 1957 should serve as deductions from the basis of the oil and gas producing properties, and that the reduction of the deduction allowed for the 1958 refund should have no effect on basis. The amount to be subtracted from basis to calculate gain or loss on disposition is the amount of depletion allowed or allowable in each prior tax year.[23] In determining the amount by which basis is to be reduced in the event of improper depreciation (and, by analogy, depletion) figures in prior years, the Treasury Regulations state that the amount from which a taxpayer received a tax benefit in the year allowed should be the reduction in basis of the asset.[24] Although the net effect of the transactions and the

21. INT. REV. CODE of 1954, § 613(a), which authorizes percentage depletion, states that, "In no case shall the allowance for depletion under § 611 [authorizing cost depletion] be less than it would be without reference to this section." Thus, it appears that Congress did not intend that the use of percentage depletion should result in a worsened position for the taxpayer. Although the Internal Revenue Code is considering a different factual situation, the section still seems to reflect the attitude of the drafters on depletion. If no readjustment to basis were permitted, however, a taxpayer electing percentage depletion could be in a substantially poorer position than one electing cost depletion in the event of the refund of an amount previously reported as income under a claim of right.

For example, if taxpayer A deducted $1,000 per year for ten years as cost depletion, and taxpayer B deducted the same amounts as percentage depletion, and in the eleventh year all receipts from oil and gas production had to be returned to customers, taxpayer A would be allowed a deduction for the full amount of his refund under INT. REV. CODE of 1954, § 1341(a)(4), but taxpayer B would be allowed only the amount of his refund reduced by his previous depletion deductions of $10,000. If no readjustment in the basis of taxpayer B's property were allowed, he would be poorer by $10,000 in deductions through his use of percentage depletion.

22. Treas. Reg. § 1.1016-2(a) (1957) authorizes an adjustment to basis for "any expenditure . . . or other item properly chargeable to capital account," but no more specific guidance appears in either the Regulations or the Internal Revenue Code.

Amendment of the depletion figures of prior years' returns, even those on which the statute of limitations has not elapsed, is apparently not available to the taxpayer in the *Skelly Oil* situation. There is no change possible in the computation of the deduction unless the amount of gross income from the production of oil and gas is changed (INT. REV. CODE of 1954, § 613(a)), and the claim of right doctrine (*supra* note 1) prohibits such a change in gross income.

23. INT. REV. CODE of 1954, § 1016(a)(2); Treas. Reg. 1.1016-3(a)(1) (1957).

24. Treas. Reg. § 1.1016-3(b)(1) (1957).

decision in *Skelly Oil* was to allow no depletion deduction, and although there was none allowable, still a depletion deduction was allowed and taken in the years 1952 through 1957. In each of these years, furthermore, Skelly Oil Company apparently received a tax benefit from the depletion allowed. The Court's treatment of the refund in 1958 eliminates that tax benefit, but there is no provision in the Internal Revenue Code or in the Treasury Regulations for increasing the basis by the amount in controversy. The annual accounting concept is at work here; the amounts were not allowed in 1958![25]

There appears to be no decision or ruling directly in point on this issue. An analogous situation, however, is the subject of a Revenue Ruling.[26] There, stockholders who had received a distribution greater than the cost of their shares and had reported the excesses as capital gains under a claim of right in the year of receipt, were later obliged to restore those amounts to the corporation. The basis of the stock in the hands of the shareholders, to the extent that it had been applied against the amounts received in determining the gains reported in the year of the original distribution, was allowed to be restored under the Revenue Ruling. The rationale behind the Ruling was that the original deductions had been allowed as returns of capital, which are not taxable. The depletion allowance, too, has been characterized as a return of capital,[27] and there appears to be no reason for a difference in treatment between the factual situation resulting in the Revenue Ruling and the *Skelly Oil* situation.

On the basis of this Revenue Ruling and the inherent equity of allowing some recognition of the total expenditure made by Skelly Oil in 1958, and despite the technical language of the Internal Revenue Code and the Regulations, which admittedly does not expressly authorize the restoration of basis in a factual situation such as arose in

25. Treas. Reg. § 1.1016-3(a)(1)(ii) (1957).
26. Rev. Rul. 456, 1958-2 Cum. Bull. 415.
27. *See* note 17 *supra*. Although Congress apparently intended the percentage depletion deduction to provide an incentive to oil and gas exploration and development, and, although to achieve those ends it created a deduction which bears little relationship to the investment in the properties to be depleted (*see, e.g.*, Commissioner v. Southwest Exploration Co., 350 U.S. 308 (1956)), there is no reason to believe that the Court will back away from its previous characterizations of the percentage depletion deduction. In the *Skelly Oil* decision, the Court described Int. Rev. Code of 1954, § 613, as ". . . the section which allows taxpayers to deduct a fixed percentage of certain receipts to compensate for the depletion of natural resources from which they derive income." United States v. Skelly Oil Co., 394 U.S. 678, 679 (1969).

Skelly Oil, it appears probable that the basis of the oil producing properties should be restored if the issue is raised. Having effectively eliminated any effect of the depletion deductions previously allowed, the Court would probably find no grounds for refusing recapitalization of the amounts so handled.

Unlike the question of the proper treatment of the basis of the assets previously depleted, which it did not discuss, the Court did consider the question of the intended scope of its decision in *Skelly Oil*.[28] Despite this discussion, however, the scope remains somewhat unclear.

It is doubtful that the Court intended a broad application of the holding in *Skelly Oil*, or that such an application would be proper. If the holding was meant to apply to every situation in which the deduction for an item refunded must be adjusted for deductions which had been taken in prior years, but in which the deduction would not have been allowed had the amount refunded been included in gross income in those prior years, then the effect of the case would be to introduce many undesirable complexities into the law. A few examples of the difficulties which would result from such an interpretation should suffice to point out the potential problems.

Charitable contribution deductions authorized by I.R.C. section 170[29] can be carried forward for five years if they are not available as deductions in the year of contribution because they exceed 30% of adjusted gross income in that year. Under a broad interpretation of the *Skelly Oil* holding, one who claimed a charitable contribution deduction up to the maximum percentage of adjusted gross income in a year in which he included in gross income an item which he was later obliged to refund (and where the statute of limitations for amending his prior return has run), would lose the benefit of the deduction in the year of receipt, and would probably also be denied the carry-forward privilege provided by the Code.[30]

28. In fact, the Court devotes an entire page of its decision to the limitation of its holding. United States v. Skelly Oil Co., 394 U.S. 678, 685-86 (1969).

29. Int. Rev. Code of 1954, § 170.

30. Int. Rev. Code of 1954, § 170(b)(5). The carry-forward is only permitted in cases where the charitable contributions for the year of contribution exceed 30% of the adjusted gross income for that year. If the statute of limitations has run, the return for the year of contribution cannot be adjusted, and the contributions would not exceed 30% of the adjusted gross income for *that year*. The fact that Congress specifically prohibited

A taxpayer claiming a standard 10% deduction might well find, after repaying a claim of right item previously reported as income, that the standard deduction which he was effectively allowed, being reduced by 10% of the amount refunded, is less than the itemized deductions available to him in the year of receipt. He could not make any change in his prior return if the statute of limitations had elapsed.[31]

In his dissenting opinion, Justice Stewart indicated that he believed the holding in the case would be broadly construed.[32] It is arguable, however, that the *Skelly Oil* decision will not be as broadly construed as Justice Stewart indicates. Differences in nature between the various deductions which are defined as a percentage of specific tax return income figures such as *gross* or *adjusted gross* income, the language of the Court, and the prior case law all seem to indicate that a much narrower interpretation of the holding was intended and should result. There is no logical necessity for extending the holding of the *Skelly Oil* decision to all deductions which are in some way related to a specific tax return figure. These deductions, with only a few exceptions,[33] are not of the same nature as the percentage depletion allowance.

While the percentage depletion deduction is a completely arbitrary figure, most other deductions are representative of amounts actually expended, and are simply limited to percentages of gross income, or other tax return figures, or are reduced by such percentages.[34] Further, the percentage depletion deduction does not really hinge upon a "tax

the alteration of the adjusted gross income figure for the year of contribution to reflect future net operating loss carry-backs adds even more weight to the position that the carry-forward would be lost in the case of a future refund of claim of right items, at least if these items were deducted under the provisions of INT. REV. CODE of 1954, § 1341(a)(4). (Congress apparently did foresee and approve a change in the charitable deductions themselves if the deduction were under INT. REV. CODE of 1954, § 1341(a)(5). *See* note 41 *supra.*)

31. *See* Corlew, *supra* note 1.

32. United States v. Skelly Oil Co., 394 U.S. 678, 692 (1969). Justice Stewart believed that the language at 685, where the Court stated that there could be no deduction "for refunding money that was not taxed when received," meant that "whenever a taxpayer seeks to deduct a refund of money received as income in a prior year, the deduction must be reduced by the percentage of gross income in that year which, for whatever reason, was not also taxable income." *See* note 38, *infra.*

33. Possible exceptions include the dividend exclusion deduction and the 10% standard deduction, among others, although the latter is distinguished on a different basis in the text following note 36 *infra.*

34. *See, e.g.*, INT. REV. CODE of 1954, § 213 (medical deductions); INT. REV. CODE of 1954, § 170 (charitable contribution deductions).

return figure" per se; rather, it hinges upon what may be only a portion of that figure, viz., the gross income received through production of oil or gas.[35] While the gross income from oil and gas production might well be the gross income for tax purposes, this would be only coincidental. Congress did not intend to relate the percentage depletion allowance to the tax return gross income figure, but, rather, to relate the depletion deduction to that portion of the tax return gross income which arose directly from the utilization of a specific capital asset.[36] These factual dissimilarities in the nature of the various deductions related to specific tax return income figures, or portions thereof, are arguments against the automatic extension of the *Skelly Oil* holding to all of them.

The Court itself, in an apparent attempt to clarify the extent of its holding, pointed out a further distinction between the depletion deduction and most other "percentage" deductions. In attempting to explain the distinction which it was drawing, the Court commented that the decision was restricted to cases where a certain portion of *gross income* would go untaxed, and noted that deductions such as the standard deduction hinge upon *adjusted gross income.* The Court further said that the decision was aimed only at cases where "the government would always lose." Finally, the Court stated explicitly that it was making no attempt to require the tax savings from deduction to be equal to the tax consequences of the receipts in prior years, and that the approach adopted in the *Skelly Oil* decision would affect only a few cases.[37] The Court apparently felt that the combination of these limitations and explanations spelled out fully the extent of the holding. Some unfortunate language in the majority opinion, however, deprives it of the desired clarity.[38]

The Court apparently intended to reduce deductions under section

35. Int. Rev. Code of 1954, § 613.

36. Treas. Reg. § 1.613-3(a) (1960) specifically restricts "gross income from the property" for oil and gas wells, for Int. Rev. Code of 1954, § 613(c)(1) purposes, to the amount for which the taxpayer sells the oil or gas in the immediate vicinity of the well.

37. United States v. Skelly Oil Co., 394 U.S. 678, 686 (1969). *See* note 28 *supra*.

38. *Id.* at 685. The Court stated: "We cannot believe that Congress intended to give taxpayers a deduction for refunding money that was not taxed when received." This language, however, was apparently not intended as a statement of the general rule of the case, but was, instead, a winding-up of the argument regarding the question of Congressional intent to allow a double deduction in the immediate factual situation under review.

1341[39] by amounts related to the subject of the deduction which were eliminated from income in the prior year. There seemed to be no intention to eliminate all amounts which might have been taken as deductions and affected, rather than completely determined, by the inclusion in income of the amount refunded. Thus, a charitable contribution deduction should not represent a reduction in the section 1341 deduction[40] if an oil overcharge were later refunded, nor should the medical deduction be increased.

Certainly, had the Court intended to include within the scope of this decision all items which were in any manner contingent upon specific tax return income figures, they would have employed different language in writing the opinion. The proper language for expressing such an intention was available in the government's brief, where the Commissioner asked the Court to find that the Treasury Regulations applicable to section 1341(a)(5) are also applicable to section 1341(a)(4).[41] The Court apparently did not adopt this language, or this line of reasoning.

In addition to explicitly incorporating the previously considered limitations into its opinion, the Court gave no indication that it was altering the previously developed case law, upon which section 1341 (a)(4) was based.[42] The prior case law relating to treatment of refunds of amounts previously included in gross income under a claim of right does not support a broad interpretation of the *Skelly Oil* holding.[43] The cases directly related to the treatment of claim of right

39. INT. REV. CODE of 1954, § 1341.
40. *Id.*
41. Brief for Petitioner at 21, United States v. Skelly Oil Co., 394 U.S. 678 (1969). The Commissioner stated that both the House Ways and Means Committee and the Senate Finance Committee, in discussing the meaning of INT. REV. CODE of 1954, § 1341 (a)(5), noted that " . . . to the extent that adjusted gross income or taxable income may be changed, items such as the medical and charitable deductions which are dependent upon income may also be affected." (H.R. REP. No. 1337, 83rd Cong., 2d Sess. A 294 (1954); S. REP. No. 1622, 83rd Cong., 2d Sess. 452 (1954)). The Commissioner further noted that the Congressional views expressed in the Committee Reports were expressly incorporated in Treas. Reg. § 1.1341-1(d)(4) (1957). The Commissioner urged that, although the situation under review in the *Skelly Oil* dispute was not provided for previously, the principles annunciated above should be extended to the *Skelly Oil* situation.
42. INT. REV. CODE of 1954, § 1341(a)(4).
43. *See* Healy v. Commissioner, 345 U.S. 278 (1953); United States v. Lewis, 340 U.S. 590 (1951). *See also* 14 OIL & GAS TAX Q. 67 (1965).

The government contended that the decisions in O'Meara v. Commissioner, 8 T.C. 622 (1947), and Arrowsmith v. Commissioner, 344 U.S. 6 (1952), provided precedent for the result reached by the Court in the *Skelly Oil* decision. The *O'Meara* decision, however,

items, which were later refunded, consistently allow the entire amount refunded as the deduction. Had the Court intended to overrule the implication from those cases that the established procedure would continue in any situation except the narrow factual pattern under review, they would probably have said so, rather than devoting a page of the opinion to the limitation of the factual pattern to which the *Skelly Oil* holding was intended to apply.[44]

Justice Stewart in his dissenting opinion may have overestimated the impact of this case. The final result will probably be an application of this decision only to cases where the specific amount refunded under section 1341(a)(4)[45] has previously been reduced by a deduction which was a percentage of that specific amount. It is not existence as a percentage of a tax return figure which brings a deduction within the rule of the *Skelly Oil* decision; rather, it is the complete determination of the original deduction by the particular items of gross income being refunded which brings the holding into play.

While the *Skelly Oil* decision leaves numerous tax accounting questions unanswered, the final resolution of these problems along the lines proposed in this note seems both desirable and probable. If the suggested interpretations do follow, it seems that the *Skelly Oil* decision will represent an equitable and practical interpretation of section 1341 (a)(4) of the Internal Revenue Code of 1954.

dealt primarily with a question as to whether one who did not own oil or gas producing properties could avail himself of the percentage depletion allowance, and the *Arrowsmith* decision went only to the point of permitting examination of prior years' returns to determine whether amounts were properly characterized as ordinary income or capital gains.

44. *See* note 28, *supra*.

45. INT. REV. CODE of 1954, § 1341(a)(4).