Louisiana Law Review

Volume 22 | Number 3
April 1962

Federal Income Taxation - Oil and Gas - Determination of Holder of Economic Interest in Sharing Arrangement Transaction

George M. Snellings Jr.

in a legal document words not intended to have legal effect. It is submitted that the instant decision was sound in that it honored the donor's intention insofar as it was reflected in the act of donation.[22] The difficulty with the decision is that it allows a donor to dictate the use to be made of property in perpetuity. If such a result is to be avoided, the proper solution would appear to be legislative rather than judicial. One solution would be to extend R.S. 9:2321, which provides that the title to property donated to religious entities is perfected by the passage of thirty years' continuous and uninterrupted possession and use for the purposes intended by the donation,[23] to cover a donation such as that involved in the instant case.

John Schwab II

FEDERAL INCOME TAXATION — OIL AND GAS — DETERMINATION OF HOLDER OF ECONOMIC INTEREST IN SHARING ARRANGEMENT TRANSACTION

Petitioners' decedent owned, with others, mineral interests under unitized oil and gas leases covering Texas property. He and his group, collectively the Weinert group, transferred an undivided one-half interest in certain mineral leases and a production payment payable out of the proceeds accruing to the retained one-half working interest to two corporations, the Lehman group. Pursuant to this agreement, the Lehman group obligated itself to "loan and advance" to the Weinert group up to a certain amount to pay the share of production and recycling plant costs

22. Justice Hamlin, in his dissenting opinion, took the position that the failure of the donor to challenge the title of the City or School Board between the time the school was closed in 1926 and his death in 1952 was evidence that the donation was unconditional. Orleans Parish School Board v. Manson, 132 So. 2d 885, 890 (La. 1961).

23. LA. R.S. 9:2321 (1950) reads in full: "There is hereby quieted and perfected title to real estate donated to church and religious representatives, associations, corporations or their successors or religious assigns where over thirty years continuous and uninterrupted possession and use for the purposes intended by the donation has been had and elapsed since the execution of the donation and the real estate is presently being possessed and used for the purposes intended in the donation." *Id.* 9:2322 provides: "In all such cases the donees or their successors, assigns, or representatives may effectively use, mortgage, hypothecate, encumber, alienate, or dispose of the property donated or any part thereof without regard thereafter to the conditions or charges imposed in the donation, and declaring the same to have been fully complied with to all intents and purposes by said lapse of time, possession, and use in compliance with said conditions or charges, and declaring the public policy served thereby as against restricting property from commerce."

attributable to the Weinert group. The Weinert group's retained one-half working interest was assigned to a trustee to secure repayment of sums advanced by the Lehman group. The sums advanced and interest thereon, as well as the production payment, which also had been assigned to the trustee, were payable by the trustee to the Lehman group solely from the net profits derived from extraction and sale of minerals and from the operation of the recycling plant.[1] Upon reimbursement of the advances and pay-out of the production payment, the working interest placed in trust was to be reassigned to the Weinert group. The Commissioner of Internal Revenue determined an income tax deficiency in the joint returns of petitioners' decedent and his wife for two tax periods during which the trust was in existence on the theory that the Weinert group continued to possess the economic interest in the one-half mineral interest assigned to the trustee. The essence of the Commissioner's position was that the advances by the Lehman group were merely loans to the Weinert group, the revenues used by the trustee to discharge the advances thus constituted ordinary income to the Weinert group. The petitioners challenged the Commissioner's determination in the Tax Court, and a majority of that tribunal upheld the Commissioner's position on the basis that a loan was clearly indicated.[2] On a petition for review to the United States Court of Appeals, Fifth Circuit, *held*, reversed and remanded.[3] The trans-

1. "As we read the agreement, Weinert incurred no personal liability to repay Lehman for the advances." *In re* Weinert's Estate, 294 F.2d 750, 754 (5th Cir. 1961). It appears that this finding eviscerates the loan theory, for personal liability to repay is the core of the conventional loan transaction.

It is interesting to note that Weinert was still liable for his ratable portion of expenses under the unitization agreement. *Id.* at 761. The court observed this factor but did not really consider its implications. Perhaps the point is so minor that it should not affect the result on balance, but it does seem to reveal an intention that the Weinert group would retain its interest in the leases, the assignment to the trustee serving merely as a form of security. However, it seems that the court in maintaining its position could have countered this argument by reasoning that collateral undertakings, although perhaps of evidentiary value, should not be allowed to govern the construction of the transaction primarily in focus. It is a proper observation that parties may ordinarily contract any number of different agreements with any amount of overlap or inconsistency among them, each standing or falling by its own terms.

2. Estate of H. H. Weinert, 31 T.C. 918 (1959). Three judges concurred in result but were unable to conclude that a loan situation had been presented. They would have predicated a finding in favor of the Commissioner on the basis that the carrying party, the Lehman group, did not possess the economic interest in the minerals in place which produced the income in question, because the activities of the recycling plant could also be looked to for a return of the sums advanced for development. For further discussion of this aspect of the problem, see note 3 *infra*.

3. The case was remanded to apportion the return on Lehman's investment in a manner which would separate the income attributable to production activity

from that derived from the fractionation process. That is, the court found the income from the separation and absorption processes to constitute income from mineral production, but it was unable to ascribe to the fractionation process the same characterization for tax purposes. In this, the court followed Scofield v. LaGloria Oil and Gas Co., 268 F.2d 699 (5th Cir. 1959), in which the plant owner-taxpayer had agreed to purchase gas to be produced and was otherwise a "stranger to the leases" which were there involved. The court, in the *LaGloria* case, found the taxpayer to have no economic interest in the minerals in place for purposes of the depletion allowance, because it relied primarily upon manufacturing and refining phases for return of investment. "In LaGloria the majority and minority of the Court agreed that the processes of separation and absorption are producing activities while fractionation is a refining or manufacturing activity." *In re* Weinert's Estate, 294 F.2d 750, 764 (5th Cir. 1961).

In the landmark case of Anderson v. Helvering, 310 U.S. 404 (1940), the United States Supreme Court held, where the taxpayer could pay the balance owed for the conveyance of real estate and mineral interests to it out of proceeds from production *or from sales of the land,* that the taxpayer had the full economic interest in the minerals in place and therefore was taxable on the proceeds from production which it deposited to the account of the transferor. The taxpayer contended that the transferor had retained the economic interest to the extent of the fraction which the balance due bore to the total consideration, but the Court held *sole dependence* upon *production* for return of capital to be essential to a finding of economic interest. Thus, for all practical purposes, a sale of the entire economic interest was found to have taken place.

The court in the instant case distinguished *LaGloria* on the basis that there the taxpayer was merely a plant owner, whereas in the case before it the Lehman group owned fifty percent of the leasehold and had a lease owner's rights in the other fifty percent for the period of pay-out. Likewise, the court distinguished *Anderson* on the ground that the sale of a fee interest is totally unrelated to mineral development and production, whereas in the *Weinert* case the separation and absorption processes in the recycling plant were found to be production activities. "Here, the plant was not a separate manufacturing plant or business, but an indispensable part of the severance and sale of the gas and liquid hydrocarbons produced from the unitized leases. The operation of the plant was nothing more than the extraction of the liquid hydrocarbons from the gas produced from the unitized leases and the return of such dry gas as was not sold into the geological formation from which it was produced." *In re* Weinert's Estate, 294 F.2d 750, 764 (5th Cir. 1961). However, to be consistent with the determination in *LaGloria* that fractionation is not a production operation, the court remanded to have any of the profits which came from fractionation activity pared off from the income from production. Apparently the court remanded for the split of income according to source in order that the depletion allowance be based solely upon income from production. This is a curiosity, because the income from fractionation would still be that of the Lehman group, and this group was not party to the suit. Of further interest in this connection is the fact that the plant operator could fill the plant processing capacity from sources of supply outside of the unitized property. The court took cognizance of this but closed the issue with a statement that plant income during the taxable periods in fact came only from production from the properties in the unit.

Thus, the court in the instant case concluded that some income from another source than production would not alter the assignment of economic interest to the party relying somewhat on production income for return of capital. The court did not attempt to specify what proportions might tip the balance, but in any event this determination is difficult to square with the broad statement of *Anderson* to the apparent effect that there must be *entire* reliance upon production. Moreover, the court decided that the possibility that all income might have come from the recycling plant operation and from processing of minerals derived exclusively from property not included in the unit in question did not affect economic interest since in fact no outside products had been processed in the plant. Again, this is irreconcilable with the Supreme Court's theory in *Anderson* that the *possibility* of income from other sources than production is sufficient to prevent the recipient of income in fact from production from having the economic interest in the minerals in place from which the production income was obtained. "Oklahoma Comaction was either the type of carried interest arrangement in which the carrying party, the Lehman group, held the economic interest in the oil and gas in place which produced the income in question, or it was the exchange of a carved-out production payment for sums pledged to the development of the property. In either case, it was not a loan, and under either construction the petitioners were not subject to taxation on the proceeds paid by the trustee to the Lehman group. The decisive factor is that the substance of the arrangement was a transfer of the economic interest to the Lehman group. It bore the brunt of the development burden and to its benefit inured the bulk of the production income. *In re Weinert's Estate,* 294 F.2d 750 (5th Cir. 1961).

The burden of income taxation on the proceeds resulting from commercial activities in the oil and gas field and the concomitant benefit of deductions, such as depreciation and depletion allowances, fall upon the taxpayer having an *economic interest* in the minerals in place.[4] The purpose of legislative concessions such as percentage depletion and the election to expense or capitalize intangible drilling and development costs was to encourage exploitation of natural resources.[5] Thus, the economic interest requirement insures that only parties risking investment capital to develop mineral resources will receive the deduction benefits. There must be an actual capital investment in the mineral venture and a substantially exclusive reliance upon its suc-

pany is not dependent *entirely* upon the production of oil for the deferred payments; they *may* be derived from sales of the fee title to the land conveyed." Anderson v. Helvering, 310 U.S. 404, 412 (1940) (Emphasis added.) The extent to which the broad rule of *Anderson* has been modified or cut into poses an important problem, and the answers are not suggested here. However, it does seem that the instant case has considerable impact on the development of this facet of oil and gas tax law. To the extent that its determinations on the point represent applicable law, it appears that it substitutes *predominant* reliance upon production for *entire* reliance, which was required in *Anderson.* "[T]he source of return is predominantly production and sale of minerals, which is the situation here." *In re* Weinert's Estate, 294 F.2d 750, 765, n. 26 (1961).

4. Kirby Petroleum Co. v. Commissioner, 326 U.S. 599 (1946); Anderson v. Helvering, 310 U.S. 404 (1940); Palmer v. Bender, 287 U.S. 551 (1933); Murphy Oil Co. v. Burnet, 287 U.S. 299 (1932); Lynch v. Alworth-Stephens Co., 267 U.S. 364 (1925); Commissioner v. Roeser & Pendleton, 118 F.2d 462 (5th Cir. 1941), *cert. denied,* 314 U.S. 635 (1941). See also BREEDING & BURTON, INCOME TAXATION OF OIL AND GAS PRODUCTION 208 (1961); MILLER, OIL AND GAS INCOME TAXATION 15 (2d ed. 1951).

5. For an insight into the policy factors which militate favorably for the allowance of tax benefits to operators and developers in the oil and gas industry, see *Hearings on Revenue Revision Before the House Committee on Ways and Means,* 81st Cong., 2d Sess. (1950).

"The risks and hazards involved in the oil and gas producing business are so great that an adequate incentive must be provided for those willing to risk their funds in the search for oil. Percentage depletion provides the incentive for continuing the search for oil and constitutes part of the reward for success in the cess for a return of the investment.[6] Mere economic advantage is not sufficient to give rise to such an interest.[7]

When one having an economic interest in an oil and gas venture sells or exchanges part or all of the interest, ordinarily the transfer will constitute a taxable event to the transferor.[8] However, an exception to the general rule of taxability has been made, again for the purpose of encouraging development by exempting mineral owners from tax liability, when the consideration for the transfer is to be invested in the development activity. This concession exempts from taxation cash, services, or equipment received by the transferor which are *pledged for development* of the property.[9] Of almost equal significance is the advantageous position of the taxpayer-mineral owner who is able to attract the risk capital needed to reduce the minerals to possession by consenting to a sharing arrangement which transfers the economic interest to the furnisher of development capital until it has paid out an amount sufficient to reimburse the investor for his capital outlay. The effect of such an arrangement is that the transferee, rather than the original owner, is subject to taxation on the income from production attributable to the transferred interest.[10]

Generally speaking, partnerships, "net profits interests," and "carried interest" transactions, in the various forms these as-

---

search." Blaise, *What Every Tax Man Should Know About Percentage Depletion*, 36 TAXES 395, 397 (1958).

6. Anderson v. Helvering, 310 U.S. 404 (1940); Scofield v. LaGloria Oil and Gas Co., 268 F.2d 699 (5th Cir. 1959); Commissioner v. Roesser & Pendleton, Inc., 118 F.2d 462 (5th Cir. 1941), *cert. denied*, 314 U.S. 635 (1941). See also materials cited in instant case. *In re* Weinert's Estate, 294 F.2d 750, 765, n. 26 (5th Cir. 1961).

7. See Parsons v. Smith, 359 U.S. 215 (1959); Helvering v. O'Donnell, 303 U.S. 370 (1938).

8. Depending upon the duration of his ownership of the interest and the characterization of the type of interest sold as, for example, a reserved production payment, or a carved-out production payment extending over a period less than the life of the working interest, the taxpayer may be required to discharge his tax burden on the basis of the graduated ordinary income tax scale or may be able to avail himself of the normally more favorable capital gains treatment. See Commissioner v. P. G. Lake, Inc., Scofield v. O'Connor, Commissioner v. Fleming, Commissioner v. Wrather, Commissioner v. Weed, consolidated for argument and reported in 356 U.S. 260 (1958). See also Benjamin & Currier, *The Supreme Court and Taxation of Oil, Gas and Production Payments: The Lake Cases*, 19 LOUISIANA LAW REVIEW 579 (1959).

9. See I.T. 4003, 1950-1 Cum. Bull. 10; G.C.M. 22730, 1941-1 Cum. Bull. 214. *Cf.* P-H OIL AND GAS TAXES 1058 (1961).

10. G.C.M. 22730, 1941-1 Cum. Bull. 214. *Cf.* Proposed Treas. Reg. § 1.612-4, 21 Fed. Reg. 8446 (1956). See BREEDING & BURTON, INCOME TAXATION OF OIL AND GAS PRODUCTION 204 (1961); Jackson, *Tax Planning Before Drilling: The Operator's Problem*, 27 TUL. L. REV. 21, 30 (1952); P-H OIL AND GAS TAXES 1152 (1961).

sume, are the types of agreements included under the sharing arrangements heading.[11] Fundamentally, a carried interest arrangement provides that one co-owner of a working interest will advance operational expenses necessary to develop the mineral property on behalf of another co-owner and that these advances will be recovered from such future production as may accrue to the interest of the carried co-owner, or to the entire working interest, or to a production payment carved-out for that purpose.[12] For a time, the position of the Treasury[13] was that the carrying party — the party advancing the costs — had the economic interest in the oil and gas in place which produced the recoupment income. Consequently the carrying party was liable to taxation on that income. This position was also taken by the Tax Court in the cases of *Herndon Drilling Company*[14] and *Manahan Oil Company.*[15] In *Herndon,* the carried party transferred to the carrying party a production payment representing the cost of development figure allocable to his retained working interest. In *Manahan,* the carried party had a reversionary right to the assigned interest if and when the advances for development made by the carrying party had been recovered. In both cases, the carried party divested himself of the interest which produced the income at issue; in neither was the carried party personally liable for the advances made on his behalf. The carrying party in *Manahan* was held to be in a position to deduct all intangibles and capitalize all equipment costs, as that party had the full economic interest in the leasehold for the period of the carry. However, in the *Herndon* situation the carrying party was required

11. See materials cited in note 10 *supra.* Consideration of the problems involved in handling farm-outs, net profits interests, partnerships, and the like is too broad an undertaking to include in this Note. However, comparisons may be useful in forming the carried interest concept. The essential point of difference is that the carried interest arrangement is ordinarily designed to return a fractional economic interest to the assignor-carried party at the termination of the carry, whereas the other arrangements usually involve partial or complete divestment of economic interest with no reversionary possibilities.

It is noted here that interesting problems may arise in Louisiana if variations of some of the sharing arrangements are subjected to scrutiny in light of indigenous property concepts. Many transactions which would be permissible, or which would have certain fairly well-defined results, in common law systems might be invalid in Louisiana or might produce different results. Since the property laws of each state bear considerably upon the method of federal income tax treatment these differences may become of paramount importance.

12. BREEDING & BURTON, INCOME TAXATION OF OIL AND GAS PRODUCTION 206 (1961); 4 MERTENS, LAW OF FEDERAL INCOME TAXATION § 24.25b (rev. ed. 1960); MILLER, OIL AND GAS INCOME TAXATION 173 (2d ed. 1951); P-H OIL AND GAS TAXES 1152 (1961).

13. G.C.M. 22730, 1941-1 Cum. Bull. 214.

14. Herndon Drilling Co., 6 T.C. 628 (1946).

15. Manahan Oil Co., 8 T.C. 1159 (1947).

to capitalize as basis in the oil payment a fraction of its costs equal to the fraction the retained interest of the carried party bore to the total working interest, on the theory that to that extent the carrying party did not possess the economic interest in the oil and gas in place.

Then the decision of the Tax Court in the *Abercrombie* case[16] cast a cloud of doubt over the tax prospect of carried interest transactions. In that case the carried party assigned a fractional working interest to the carrying party, retaining the portion not assigned. The carried party mortgaged his retained interest to secure repayment of the advances made in his behalf by the carrying party. Although the carried party was not personally liable for the repayment of the advances and was to receive income from his retained interest only after the advances had been recovered by the carrying party, the court reasoned that the advances were merely loans and that the reserved interest from which they were exclusively repayable only served to secure the indebtedness. Hence the carried party was responsible for the taxes due on the repayment income. The Commissioner nonacquiesced in this decision until the Fifth Circuit affirmed the Tax Court's decision on the strength of the retention of legal title by the carried party, equating that to economic interest.[17] On the other side of the *Abercrombie* picture, in 1959 the Fifth Circuit held in *Prater v. Commissioner*[18] that a carried party whom it found not personally liable for advances and whose *retained* interest it found subject to a lien to secure repayment of the advances was entitled to deduct a part of the development costs equal to that part his retained fractional interest bore to the whole working interest. In the cases in which the carried party was held to have the economic interest in the share from which that party might ultimately receive direct revenues, as well as those in which the carrying party was held to have the economic interest in that share, the facts clearly showed that the carried party was not personally liable for the advances and that the carried party would get no share of the profits from the undertaking until the advances had been recovered by the carrying party. Hence it appears that the feature which determined the placement of economic interest was simply the divestment or retention of title to the interest.

16. J. S. Abercrombie Co., 7 T.C. 120 (1946).
17. Commissioner v. J. S. Abercrombie Co., 162 F.2d 338 (5th Cir. 1947).
18. Prater v. Commissioner, 273 F.2d 124 (5th Cir. 1959).

At least two Fifth Circuit cases seem at odds with the *Abercrombie* and *Prater* construction. The 1939 *Ortiz* case[19] involved a situation in which an oil company agreed to turn over a proportion of oil production up to a certain dollar limit to parties who advanced to the company the capital needed by it to obtain leasehold interests. The court held that a conveyance rather than a loan had been effected, because there was no personal liability to repay incurred by the company. The *Abercrombie* decision made no mention of *Ortiz*. Again, in 1960, the Fifth Circuit shunned a non-divestment-of-title approach when confronted with a security arrangement without personal liability on the part of the mineral interest owner in *Wood v. Commissioner*.[20] Furthermore, the loan theory was delivered a telling blow in the recent *P. G. Lake* quintet.[21] In those cases the Supreme Court expressly repudiated the Seventh Circuit *Slagter* case,[22] in which it had been held that the assignor of a carved-out production payment received a loan of the sum exchanged, rather than ordinary income, and that party was thus taxable on the income accruing to the payment.

The instant case presented a factual picture which would fit the framework of none of the prior cases. The Weinert group neither retained title nor divested itself of title in favor of the Lehman group. Rather, the Weinert group transferred title to its retained interest to a trustee "for the purpose of securing repayment" of the advances, with an agreement that the trustee and the Lehman group would reconvey the interest when the advances and the production payment had been recouped. To resolve the issue before it, the court applied two fundamental principles of tax law. "First, substance must take precedence over form. Second, the tax concept of 'economic interest' and not the common law concept of title must control the division of taxable income in the development and operation of oil and gas property."[23] An application of these principles resulted in the determination that in substance the carrying party (or alternatively the production payment purchaser) risked the investment capital and received the income in question. Consequently the economic interest vested in the carrying party regardless of the fact that title was in the trustee.

19. Ortiz Oil Co. v. Commissioner, 102 F.2d 508 (5th Cir. 1939).
20. Wood v. Commissioner, 274 F.2d 268 (5th Cir. 1960).
21. Commissioner v. P. G. Lake, Inc., 356 U.S. 260 (1958).
22. Commissioner v. Slagter, 238 F.2d 901 (7th Cir. 1956).
23. *In re* Weinert's Estate, 294 F.2d 750, 755 (5th Cir. 1961).

Faced with the seeming impossibility of distinguishing *Abercrombie* on substantive grounds, the court in the instant case chose to limit its rule to cases on all fours with its factual situation.[24] Furthermore, the court disparaged the emphasis placed on common law ownership concepts in *Abercrombie*, and was critical of the fact that the decision in *Prater* had the tax effect of allowing the carried party "to deduct expenses he has not paid, for which he is not liable, which his so-called 'creditor' (the carrying party) may never recoup."[25] It seems that cases such as *Abercrombie* and *Prater* embody a construction which is practically the antithesis of the rule that substance prevails over form. In those cases the fact of retained legal title dominated the conclusions reached. The carried parties were not personally liable, and this salient fact irrefutably negates the presence of a conventional loan. Since the carried parties would in no event derive income from the working interests in question until the advances made by the carrying parties had been recovered, it appears that the security transactions effectively shifted the economic interest in mineral production from the carried parties to the carrying parties. In the instant case the transfer to the trustee was intended as a security measure and the provision for reassignment to the Weinert group was to be operative at such time as the advances were recovered, the total effect of the arrangement being no different from that of a reversionary interest on the one hand or that of a retained interest subject to a prior claim for advances on the other. Pursuing these thoughts further, it appears that the Tax Court's decision in *Herndon*, to the extent it required partial capitalization of intangibles on the ground that the carrying party did not receive the entire work-

24. "The difficulty in applying Abercrombie to sharing arrangements generally is that, however correct the decision may have been on the facts before the Court, the statements in the opinion emphasizing the common law concept of ownership tend to weaken the tax concept of economic interest, so important in oil and gas taxation — to the Government as well as to taxpayers. If Abercrombie is interpreted too broadly, it will discourage sharing arrangements created out of the exigencies of the oil and gas business and necessary, in many cases, to development of oil and gas property. We interpret Abercrombie narrowly, as indeed, the Service — prior to the instant case — has consistently interpreted it." *In re* Weinert's Estate, 294 F.2d 750, 756 (5th Cir. 1961). "The Service first filed a non-acquiescence to Abercrombie, 1946-2 Cum. Bull. 6, then later withdrew the non-acquiescence, 1949-1 Cum. Bull. 1. The policy adopted in GCM 22730, 1941-1 Cum. Bull. 214 and GCM 24849, 1946-1 Cum. Bull. 66 embodies the Manahan-Herndon approach. . . . 'Indeed, from all indications, it would not be surprising if the Service were to refuse to apply the Abercrombie principle to an exactly similar factual situation unless the taxpayer's name were also J. S. Abercrombie Co.' Peck, Recent Developments in Oil and Gas Taxation, 10th Ann. Inst. on Oil and Gas Tax (SW. Legal Fdn. 1959) 421." *Id.* at 757, n. 14.

25. *In re* Weinert's Estate, 294 F.2d 750, 763, n. 21 (5th Cir. 1961).

ing interest during the carry, was ill-considered. In that case the transfer of an oil payment sufficient to cover recoupment of the capital outlay by the carrying party attributable to the share of the carried party in effect conveyed the whole interest in the mineral property. This conclusion seems proper in view of the approved policy of looking to the substance of a transaction rather than to the form by which it is accomplished. The carried party in *Herndon* would get no income from the mineral property until the carrying party had recouped its investment. Thus it seems that the fact the carried party retained title to the fractional interest from which it hoped to derive income after the pay-out of the production payment should not have been governing. The transfer of the oil payment was tantamount to a transfer of the retained interest for the period of the carry.

The instant case clearly indicates the Fifth Circuit's disenchantment with the analysis and construction which it employed in rendering the opinions in *Abercrombie* and *Prater.* Why the court did not seize its opportunity to establish a uniform rule for carried interest arrangements in which the carried party has in substance abandoned the economic interest by overruling the *Abercrombie* and *Prater* cases is, of course, a matter for conjecture only. However, it is suggested that those cases cannot properly be squared with the instant case, the rest of the Fifth Circuit's jurisprudence in the area, or the present position of the Supreme Court.

Although the court's alternative characterizations of the interest before it may leave something to be desired from the standpoint of legal orthodoxy, no substantive difference in results compels a choice. Under the view that the transaction was a carried interest by which the carrying party obtained the economic interest for the period of the carry, that party would pay taxes and be entitled to related deductions and the carried party would not enter the tax scene at all for that period. The same tax consequences would obtain if the contracts were held to have effected the sale of a carved-out production payment, the price for which was pledged to mineral development. The decision in the instant case seems legally correct, because it coordinates income and deductions and puts them both in the lap of the party who is, in fact, the investor looking to the oil and gas in place for a return of his capital. Also the substance-over-form approach is clearly in keeping with the present-day level of tax law development. Inasmuch as this case may represent a return to what appears to be a sounder basis for the examination of carried interest cases, as well as a step in the direction of expressly overturning the *Abercrombie* and *Prater* rule, it is a welcome addition to the growing body of carried interest jurisprudence. Moreover, it furnishes a stepping stone for the eventual adoption of a pattern of analytical consistency and evenhanded tax treatment based upon the placement of economic interest as revealed by the actions of the parties rather than as dictated by technical construction of the instruments employed in setting up a given transaction.

George M. Snellings III

TORTS — INJURED TORTFEASOR CANNOT SUCCEED TO CAUSE OF ACTION AGAINST LIABILITY INSURER

A husband, injured through his wife's negligent driving, sued her liability insurer under the Direct Action Statute for damages for personal injuries. At the trial the insurance company admitted the wife's negligence. After trial, but before judgment was rendered, the husband died from causes unrelated to the accident. His widow, his succession representative, and his major daughter each moved to be substituted as party plaintiff. The trial court's decision that the admission of negligence operated to make the action a heritable property right[1] was rejected by the court of appeal, which concluded that the proper party plaintiff was the surviving widow under Revised Civil Code Article 2315 as amended in 1948.[2] The court of appeal held further that

1. The trial court reasoned that the judicial admission of negligence was an admission of indebtedness. Therefore, the action was converted into a property right even though the amount had not been judicially determined.

The opinion of the court of appeal, reported at 125 So. 2d 12 (La. App. 3d Cir. 1960), rejected the argument that the trial court's decision was supported by Article 2291 of the Louisiana Civil Code, which provides that a judicial confession is full proof against the party making it. The court of appeal pointed out that this article relates merely to the obligation of proof. Since the admission was only of negligence and not of liability or indebtedness, no property right was vested at that point in the proceedings. The Louisiana Supreme Court agreed with this view. See 134 So. 2d 45, 47, 48 (La. 1961).

2. At the time of the accident in the instant case this article read in part as follows: "Every act whatever of man that causes damage to another, obliges him by whose fault it happened to repair it; the right of this action shall survive in case of death in favor of the children, including adopted children and children given in adoption, or spouse of the deceased, or either of them, and in default of these in favor of the surviving father and mother or either of them, and in default