JURISDICTION:	**OKLAHOMA TAX COMMISSION - DECISION**
CITE:	**87-11-25-11 / 88-01-21-03 / NON-PRECEDENTIAL**
ID:	**P-85-297**
DATE:	**NOVEMBER 25, 1987 / JANUARY 21, 1988**
DISPOSITION:	**SUSTAINED IN PART / DENIED IN PART**
TAX TYPE:	**GROSS PRODUCTION / PETROLEUM EXCISE**
APPEAL:	**AFFIRMED / OK S.CT. 70,121**
	DECISION NOT PUBLISHED

ORDER NO. 87-11-25-11

This matter comes on before the Oklahoma Tax Commission upon the Protest of OIL COMPANY to the proposed assessment of gross production and petroleum excise taxes, penalties and interest, and unknown source liability. The Commission, having held an En Banc Hearing in this matter on the 19th day of June, 1987, pursuant to notice as required by law, having reviewed the evidence, facts and legal authorities presented herein, and being fully advised in the premises, finds:

1. OIL COMPANY, taxpayer, is a purchaser of crude oil produced in Oklahoma. During the relevant audit period, taxpayer purchased oil from various lease locations and transported approximately one half of the purchased oil by truck to storage tanks connected to pipelines where the oil was sold. During the audit period, taxpayer reported and paid gross production and petroleum excise taxes based upon the volume of oil measured by taxpayer at the lease; that is, upon the value paid to producers based upon the lease measurement.

2. The Gross Production Division of the Oklahoma Tax Commission conducted an audit of taxpayer's books and records covering the period from January, 1983 through June, 1985. Commission auditors examined taxpayer's gross production tax reports, its oil sales invoices, its records showing purchases by destination (station), and its inventory records. As part of its oil audit procedure, the Commission auditors performed an inventory audit to determine whether the taxpayer reported the gross volume of oil purchased during the applicable tax reporting period. The inventory audit is performed by starting with the number of barrels contained in the taxpayer's physical inventory at the beginning of the month, adding the number of barrels purchased during the month, subtracting the number of barrels sold and comparing the result to the barrels in physical inventory at the end of the month. Each of the various pipeline stations to which taxpayer transported its oil was treated separately for purposes of determining whether there had been a gain in inventory. The lease measurements were compared to the sale meter measurements taken at the pipeline stations for each month during the audit period. The difference between the two measurements was added to the difference between the beginning and ending physical inventories. If the result was a gain for any month, gross production and petroleum excise taxes, penalty and interest was assessed along with the royalty interest on oil from an unknown source authorized by 68 O.S. 1981 §1003. Losses were carried forward from month to month within each station to account for late run tickets, but a net loss at one station was not netted against a net gain at another station. The audit disallowed losses totaling 440.54 barrels of oil. The audit found a gain of 26,461.75 barrels of oil. The value assigned to this gain

for calculating the tax and unknown source liability was based upon taxpayer's average price during the month when the gain occurred.

3. On September 25, 1985, the Gross Production Division issued a proposed assessment based upon a gain in taxpayer's inventory for the period from January, 1983 through June, 1985 of 26,461.75 barrels of oil with a taxable value of $745,446.93. The Commission assessed gross production tax in the amount of $52,180.52 with penalty of $5,218.02 and interest as of September 30, 1985, of $12,513.86 and petroleum excise tax in the amount of $633.66, penalty of $63.46, interest of $123.13, and royalty interest on oil from an unknown source of $93,181.07.

4. On November 12, 1985, taxpayer timely filed its protest to the September 25, 1985 assessment, after having been granted a thirty (30) day extension. Taxpayer objected to the imposition of additional gross production and petroleum excise taxes and asserted that as a matter of law it had paid all taxes due on the crude oil it purchased during the audit period. Taxpayer argued that the tax is imposed upon the gross value received by the producer and both the producer and purchaser agreed to be bound by the measurements taken at the lease for purposes of determining the gross value to be received by the producer. In support of its position, taxpayer relied upon Commission regulation X-1(a) which defines "gross value of production" as "the gross proceeds realized from ,the first sale of such production . . ."and Stanolind Crude Oil Purchasing Co. v. Cornish, 16 F.Supp. 464 (W.D. Okl. 1935). Taxpayer also objected to the imposition of the royalty interest in oil from an unknown source assessed under 68 O.S. 1981 §1003. Taxpayer asserted that no inventory gains occurred and that it had paid all royalties due on the oil it purchased.

5. During the period beginning January 1, 1983, and ending June 30, 1985, taxpayer purchased approximately 16,995,120 barrels of crude oil within the State of Oklahoma. Approximately 8,322,277 of these barrels were transported by taxpayer to the various pipeline stations where the oil was placed into storage tanks and was measured by meter as it entered the pipeline. Taxpayer was paid for the oil on the basis of the meter measurement. The remainder of the oil was transported by other companies and did not go into taxpayer's inventory. Taxpayer reported and remitted gross production and petroleum excise taxes on the crude oil it purchased in accordance with the method of measurement agreed upon by the taxpayer, as purchaser, and the various owners of the oil, as sellers, by gauging the storage tanks at the well sites using regularly compiled tank tables. Both this method of measurement and measurement by meter are accepted by the oil industry as accurate methods for determining the quantities of oil purchased and sold by the parties. Title to the oil was transferred to taxpayer at the time the oil was picked up at the well sites.

6. The inventory gain of 26,419 barrel represents .3 of 1% of the 8,322,277 barrels purchased and transported by taxpayer during the audit period. The remainder of the barrels purchased by taxpayer were transported by other companies and did not go into taxpayer's inventory; therefore, these barrels were not subject to the inventory audit.

7. The relevant statutes are as follows:

(a) Title 68 O.S. (1981) §1001(b) levies a tax on the production of petroleum or other crude or mineral oil at the rate of seven percent (7%) of the gross value of production of petroleum or other crude or mineral oil based on forty-two (42) U. S. gallons of two hundred thirty-one (231) cubic inches per gallon, computed at a temperature of sixty degrees (60°) Fahrenheit for oil measurements.

(b) Title 68 O.S. (1981) §1011 levies an excise tax of .085 of 1% of the gross value on each and every barrel of petroleum oil produced in the State of Oklahoma which is subject to gross production tax in the State of Oklahoma.

(c) Title 68 O.S. (1981) §1001(f) authorizes the Tax Commission to ascertain and determine whether or not any report required to be filed with it is a true and correct report of the gross products, and of the value thereof, of such person, firm, corporation or association engaged in the production or purchase of oil and natural gas; and further states that if any person, firm, corporation or association has made an untrue or incorrect report of the gross production or value or volume thereof, as hereinbefore required, or shall have failed or refused to make such report, the Tax Commission shall, under the rules and regulations prescribed by it, ascertain the correct amount of either and compute said tax.

(d) Title 68 O.S. (1981) §1003(a) directs the Tax Commission to collect (in addition to the gross production tax) twelve and one-half percent (12½%) of the gross value of all petroleum crude oil or other mineral oil which is reported to the Tax Commission and which report or reports does not disclose the actual source of said petroleum, crude oil or other mineral oil. Section 1003(b) provides that "actual source" shall be the well or wells and particular leasehold from which said petroleum, crude oil or other mineral oil shall have been produced.

(e) Title 68 0.S. (1981) §1005(a) provides that it shall be the duty of every railroad company, pipeline or transportation company to furnish to the Tax Commission, upon forms prescribed by it, any and all information relative to the transportation of crude oil or gas subject to gross production tax, that may be required to properly enforce the provisions of this article; and such reports shall contain, along with other information required, the name of shipper, amount of oil and gas transported, point of receipt of shipment and point of destination; and the Tax Commission may require any such pipeline or transportation company to install suitable measuring devices to enable such company to include in such reports the quantity of oil or gas transported within, into, out of, or across the State of Oklahoma.

(f) Title 68 O.S. (1981) §1005(d) requires every person, firm, association or corporation engaged in the purchasing or storing of crude petroleum oil or other mineral oil subject to gross production tax in the State of Oklahoma to furnish monthly a report to the Tax Commission, upon forms prescribed by it, showing the amount of such oil in storage, giving, along with other information required, the location, identity, character and capacity of the storage receptacle in which such oil is stored.

(g) Title 68 O.S. (1981) §1009(b) specifies that the gross production tax shall become due on the first day of each calendar month on all petroleum oil produced in and saved during the preceding monthly period. Section 1009(d) provides that on oil sold at the time of production, the gross production tax shall be paid by the purchaser of such production, and such purchaser is authorized to deduct in making settlements with the producer and/or royalty owner, the amount of tax so paid. The statute further provides that in the event that oil is not sold at the time of production but is retained by the producer, the tax on such oil shall be paid by the producer for himself including the tax due on royalty oil not sold.

(h) Title 68 O.S. (Supp. 1986) §1013(b)(1) requires every person, firm or corporation engaged in the transportation or hauling of petroleum oil, except where the transportation is by railroad tank car or by pipeline, to secure an annual license and permit before engaging in such activity and to post a surety bond with the Tax Commission.

8. The statutory scheme evidences the legislative intent that the Commission monitor the transportation and transfer of custody of oil beyond the lease locations. By examining the taxpayer's inventory and sale records and comparing these to the lease purchase records and gross production tax reports, the Commission auditors determined that more oil had been sold by taxpayer than had been previously reported as purchased. Although the percentage of gain in this case is small (.3 of 1%), the Commission declines to adopt a "de minimus" standard. Such a standard is outside the scope of the Commission's authority. The Gross Production Tax Code imposes the tax on all oil and gas produced in the State. Production taxes are due on the excess oil, the unreported production, irrespective of the de minimum percentage the excess bears to the total volume purchased.

9. Regulation 8-68.1001-1 defines gross value of production as the gross proceeds realized from the first sale of such production including the actual cash value and all premiums otherwise given to or reserved for the producer and all interest owners of such production without any deduction for costs whatsoever. In Atlantic Refining Company v. Oklahoma Tax Commission, 360 P.24 826 (Okl. 1961), the court defined "gross value" as the posted field price for oil or gas of like kind, character and quality produced in the same field or area, without deduction of transportation charges to pipelines. Both of these definitions of "gross value" address the issue of whether each barrel of oil produced has been properly valued for purposes of computing the tax, rather than the issue of whether the correct volume has been reported.

10. The Gross Production Section of the Business Tax Division has consistently and uniformly assessed production taxes on gains in crude oil inventories.

11. The loss allowance charged by the pipeline is not relevant to the question of whether gross production taxes are due on the additional oil sold by taxpayer, because the loss charged by the pipeline company is to account for the loss in volume that occurs as oil is transported through the pipeline. The gross production tax is levied on the gross volume of all oil produced in this state; therefore, any losses occurring after the point of production are not relevant for purposes of computing production taxes.

12. The disallowed losses of 440.54 barrels should be offset against the gain of 26,461.75 barrels and the proposed assessment of gross production and petroleum excise taxes reduced accordingly.

13. The royalty interest in oil from an unknown source was assessed under the authority of 68 O.S. 1981 §1003 on the basis that the lease source of the overage oil was unknown. The evidence establishes that all oil entering taxpayer's inventory originated from the leases from which taxpayer purchases oil and that producers and royalty interest owners were paid for the oil on the basis of the lease measurement. Due to the small percentage of gain experienced and the lack of any evidence that the oil in question came from a source other than the leases from which taxpayer purchases, the assessment of the unknown source liability is improper in this case. In Commission Order No. 87-08-18-06, published as a precedential order pursuant to Order No. 87-10-01-03, we observed that Section 1003 imposes upon the Commission the duty to collect, in addition to gross production tax, 12½% of the gross value of petroleum oil reported to the Commission if the report does not disclose the actual source of the petroleum oil and we noted that the Commission has heretofore assessed and collected unknown source liability in the same manner as the gross production tax, but without penalty or interest. Our decision regarding the applicability of Section 1003 in this protest does not encompass factual situations where the percentage of gain is sufficiently significant to bring into question the lease source of the overage oil and to negate the inference that the gain was the result of minor discrepancies in the measurement of the oil.

14. The proposed assessment of additional gross production and petroleum excise taxes, adjusted to eliminate 440.54 barrels from the assessed gain, which represent the formerly disallowed losses, is correct and proper; The Division is directed to compute production taxes on a gain of 26,021.21 barrels, rather than the 26,461.75 barrels as previously assessed; and based upon the facts in this case, the assessment of the royalty interest on oil from an unknown source in the amount of Ninety-three Thousand One Hundred Eighty-one Dollars and Seven Cents ($93,181.07) is erroneous and should be withdrawn.

NOW THEREFORE, IT IS HEREBY ORDERED that the protest of OIL COMPANY is denied as to the assessment of additional gross production and petroleum excise taxes, penalties and interest accruing thereon as adjusted to account for the disallowed losses and that said protest is sustained as to the assessment of the royalty interest on oil from an unknown source.

ORDER NO. 88-01-21-03

This matter comes before the Oklahoma Tax Commission pursuant to regular assignment on the agenda. The Commission, having reviewed the computation therein, and being fully advised in the premises, finds and orders that the revised gross production and petroleum excise tax computation filed by the Gross Production Section of the Business Tax Division herein on the 28th day of December, 1987, marked as Exhibit "A", attached hereto and hereby incorporated by reference, is in compliance with the Commission's direction to the Division in Commission Order No. 87-11-25-11 and said computation is hereby held to be the proper production taxes due in the above referenced protest.

REVISED COMPUTATION

COMES NOW the Gross Production Section of the Business Tax Division in response to the direction of the Oklahoma Tax Commission in its Order No. 87-11-25-11 to compute production taxes on a gain of 26,021.21 barrels of oil, rather than the 26,461.75 barrels previously assessed and submits the following revisions with interest computed to November 13, 1985, the date the gross production and petroleum excise taxes were paid under protest:

Gross Production Tax:	$51,282.80
G P. Interest:	13,616.44
G.P. Penalty:	5,128.25
Petroleum Excise Tax:	622.76
P.E. Interest:	136.52
P.E. Penalty:	62.37
Total:	$70,849.14

The Division requests that the Commission find the above amounts were properly calculated and adopt the revised figures as the proper amount due in accordance with Commission Order No. 87-11-25-11.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.