

JURISDICTION: OKLAHOMA TAX COMMISSION - DECISION
CITE: 99-03-25-012 / NOT PRECEDENTIAL
ID: CR9500012
DATE: 03-25-99
DISPOSITION: SUSTAINED
TAX TYPE: SALES
APPEAL: NO APPEAL TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Upon review of the file and records, including the record of the hearing, the Stipulation of Facts, the exhibits received into evidence, and the briefs of the parties, the undersigned finds:

A. The parties stipulate to the following:

1. CLAIMANT is a Texas corporation authorized to do business in Oklahoma.
2. The Oklahoma Tax Commission ("Commission") is an agency of the State of Oklahoma created pursuant to Section 102, Title 68 of the Oklahoma Statutes (Supp. 1989).
3. CLAIMANT is engaged in the exploration for and development of oil and gas properties. In the course of its business, CLAIMANT purchases producing oil and gas leases and the equipment associated therewith.
4. On November 23, 1993, CLAIMANT purchased certain producing gas leases both within and without the State of Oklahoma, including the equipment located thereon from COMPANY "A" Petroleum Company for an aggregate purchase price of \$157,363,636 pursuant to a Purchase and Sale Agreement dated as of June 7, 1998, (COMPANY "A" Agreement"), between CLAIMANT, COMPANY "A", and COMPANY "A" Acquisition Company.
5. The parties arrived at the purchase price by reference to the net income attributable to the leases. The portion allocated to the Oklahoma leases was \$20,638,402.
6. By invoice dated November 23, 1993, COMPANY "A" invoiced CLAIMANT for sales tax on the transaction in the amount of \$209,428.00.
7. On or about December 13, 1993, COMPANY "A" filed with the Oklahoma Tax Commission a sales tax return covering its sale to CLAIMANT pursuant to the COMPANY "A" Agreement.

8. COMPANY "A" remitted the sum of \$209,428.00 as calculated by the return.
9. On or about December 28, 1993, CLAIMANT paid COMPANY "A" \$209,428.00 by CLAIMANT check for \$209,428.00.
10. To determine the taxable portion of the sale, COMPANY "A" multiplied the value allocated to each Oklahoma lease times 21%.
11. During June, 1993, CLAIMANT made a physical inventory of the equipment associated with each well on each Oklahoma lease.
12. After the sales tax return was filed, MR. "X", an employee of CLAIMANT, then assigned a value to the equipment which had been identified earlier. MR. "X" made the determination of the value of each piece of equipment as of the time of sale based upon his experience in purchasing and selling equipment of the same kind as the equipment purchased by CLAIMANT from COMPANY "A".
13. CLAIMANT did not obtain an appraisal of the value of the equipment from an unrelated third party.
14. Based upon the determination made by MR. "X", CLAIMANT recalculated the sales tax due pursuant to the purchase made under the COMPANY "A" Agreement.
15. CLAIMANT then filed a claim for refund based upon the difference of the sales tax due as originally reported and the tax due as described above.
16. The claim for refund was denied by the Oklahoma Tax Commission.
17. The denial of the refund was protested by CLAIMANT on September 11, 1995.

B. Additional Findings:

1. The equipment located at each of the 316 Oklahoma leases was determined by and through Spill Prevention Compliance Sheets prepared by Claimant's field operators. Only capital equipment is inventoried on these sheets.
2. According to MR. "X", he routinely values equipment utilizing the same methodology after each acquisition. He testified that he values equipment conservatively and errs, if any, by placing a higher value on such equipment.

3. OTC AUDITOR, testified that he recommended the denial of the refund because there was equipment listed on the Compliance Sheets which were not assigned a value by Claimant, there were adjustments to the equipment appearing on the Compliance Sheets which were not explained and the total value of the equipment reported on the reviewed Compliance Sheets approximated the 21% reported by COMPANY "A". OTC AUDITOR admitted that the equipment omitted by Claimant were small items which would not have a great value associated with them. The type of equipment omitted were flow lines, fittings, a Toshiba motor and a separator.

4. MR."X" testified that value is never assigned to this type of equipment when it is exchanged or transferred.

5. MR. "Y", Owner and President of ANONYMOUS Production Equipment, testified that the value assigned to the equipment by Claimant represents the approximate value of such equipment at the time of the sale. MR. "Y" buys, sells and reconditions similar oil and gas production equipment. He further testified that the values shown are the highest value for this type of equipment whether the equipment was in extraordinary condition.

6. TAX MANAGER for Claimant, testified that the purchase price of the leases was arrived at by the Present Value Reserve Reports which is a product of the Net Revenue Stream discounted by 10%. He stated that the equipment did not come into consideration in arriving at the purchase price. He further stated that COMPANY "A" utilized "Present Value Reserve" X 21% to report sales tax on the equipment and that the amount reported did not represent the fair market value of the equipment at the time of the purchase. He further testified that he had never heard of the 21% rule prior to this situation and that the 21% rule results in an exaggerated value since most of the properties are oil rather than gas properties.

7. MR."X" testified that a percentage cannot be applied to a well to determine the value of the equipment because the value of a well is based on reserves not equipment and reserves vary. OTC AUDITOR agreed that by applying the 21% Rule to two different leases with the same equipment, but different values based on net reserves could result in disparate treatment of taxpayers.

8. OTC AUDIT SUPERVISOR, testified that the 21% Rule is used where there is not adequate other documentation to support a different value, including an allocation of the purchase price to tangible personal property in the sale and purchase agreement, an independent third party appraisal or information from the vendor indicating how the transaction was booked. He stated that the 21% Rule is normally used by vendors in cases where the value of the tangible personal property is above 21% of the purchase price. He further stated that there are no Tax Commission rules or regulations requiring an appraisal or adopting the 21% Rule.

9. The amount in controversy in this cause is \$76,971.18.

ISSUES AND CONTENTIONS

The issue presented for decision is whether Claimant sustained its burden of proving that the Division erred in denying its claim for refund of the sales tax remitted on the transfer of the equipment associated with the sale of 316 Oklahoma oil and gas leases. This issue turns on the determination of what amount of the purchase price of the properties should be allocated to the equipment.

Claimant contends that the amount of the purchase price to be allocated to the equipment should be based on the fair market value of the equipment at the time of the transfer. It asserts that the amount reported in its claim for refund represents the fair market value of the equipment at the time of the transfer. Claimant further contends that the amount reported by COMPANY "A" for purposes of remitting sales tax on the transfer of the equipment is erroneous since it is based on an arbitrary rule.

The Division contends that the claim for refund should be denied. In support of this contention, the Division argues that some equipment was omitted by Claimant and that the total value of the equipment reviewed on the Compliance Sheets approximated the 21% reported by COMPANY "A". The Division further argues that a valuation performed by the purchaser of property is suspect since the purchaser is the one liable for the sales tax on the transfer.

CONCLUSIONS OF LAW

1. Jurisdiction over the parties and subject matter of this proceeding is vested in the Tax Commission. 68 O.S. 1991, § 207.

2. Sales tax is levied on the gross receipts or gross proceeds of each sale of tangible personal property. 68 O.S. 1991, § 1354(1)(A).

3. "Tangible personal property" is defined to mean "personal property which may be seen, weighed, measured, felt, or touched or which is in any other manner perceptible to the senses." 68 O.S. 1991, § 1352(N). The phrase "tangible personal property" is all inclusive, and is not limited except by specific exemption. ***Magnolia Petroleum Co. v. Oklahoma Tax Commission***, 326 P.2d 821 (Okl. 1958).

4. The terms "gross receipts" or "gross proceeds" are defined in part to mean "the total amount of consideration for the sale of any tangible personal property . . . whether the consideration is in money or otherwise." 68 O.S. 1991, § 1352(F). Where a transaction involves real property and/or intangible personal property, as well as tangible personal property, the gross receipts or gross proceeds paid for the property must be allocated among the various types of property for purposes of determining the amount of sales tax payable as a result of such transaction. *Magnolia*, supra. See, *WEBR, Inc. v. State Tax Commission*, 397 N.Y.S.2d 200, 58 A.D.2d 471 (App.Div. 1997)¹.

5. The Commission may not apply a formula without statutory authority or Commission rule or regulation which does not take into consideration the actual facts of a case. *Fort Howard Paper Company v. Oklahoma Tax Commission*, 792 P.2d 87, 90 (Okl.App. 1989), citing *Oklahoma Tax Commission v. First National Bank & Trust Co.*, 178 Okla. 260, 62 P.2d 1220 (1936). The 21% Rule applied by the vendor to report sales tax on the transfer and relied upon by the Division to deny the claim for refund is neither supported by statutory authority nor by Commission rule or regulation. Further, the 21% Rule does not take into consideration the actual facts of this case. Accordingly, the use of the 21% Rule to report sales tax on the transfer of the equipment and the Division reliance thereon to deny the claim for refund is erroneous.

6. Claimant contends that the appropriate basis for the allocation of the purchase price to the tangible personal property is the fair market value of such property. "Fair market value" is that value or price which a willing purchaser would pay and a willing seller would accept under ordinary circumstances. *Onego Corporation v. United States*, 295 F.2d 461, 463 (10th Cir. 1961). See, *FinaServe, Inc. v. Oklahoma Tax Commission*, 828 P.2d 440 (Okl.App. 1991). In *FinaServe*, the Court held that the Commission's assessment of sales tax on the net book value of equipment transferred as a part of the sale of gasoline stations was erroneous. The Court reasoned:

By itself, the net book value of equipment does not accurately gauge the equipment's worth to the buyer of the realty upon which the seller's equipment was used. Book value is only a statement of market value, determined years before, less depreciation. Book value of equipment reveals nothing about the *present* sale value placed on the equipment by a buyer and seller. A fact finder may not properly ignore the facts of a rising or falling market, or of obsolescence of the equipment. *Id.*, at 442-443. (Emphasis original).

¹In this case the Appellate Division of the Supreme Court of New York considered a transaction involving the sale of both tangible personal property and real property and held that "the Tax Commission had the right, indeed, the obligation, to arrive at a fair sales price of the personal property for sales tax purposes."

7. The Division does not dispute the values assigned to the equipment by the Claimant in this cause. Instead, the Division argues that a valuation performed by the purchaser of property is suspect since the purchaser is the one liable for the sales tax on the transfer and that some equipment was omitted by Claimant. The Division did not audit the valuation performed by Claimant. Where "the amount claimed is not the correct amount which the taxpayer is entitled to claim as a matter of fact, then we know of no reason why it could not be audited and corrected as any other claimed deduction, by proper action of the authorities." *Oklahoma Tax Commission v. First National Bank & Trust Co.*, 178 Okla. 260, 261, 62 P.2d 1220, 1221 (1936). The uncontroverted evidence in this matter shows the value assigned to the equipment by Claimant is correct and proper and that the omitted equipment consisted of the type of equipment which is never assigned a value when it is exchanged or transferred. See, *FinaServe*, *supra*. at 442.

8. Claimant's protest to the denial of the claim for refund of sales tax remitted on the purchase of the equipment transferred as a part of the sale of 316 Oklahoma oil and gas leases should be sustained.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it WAS DETERMINED that the protest to the denial of the claim for refund of CLAIMANT, be sustained.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was **NOT** deemed precedential by the Commission. This means that the legal conclusions are not 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.