OKLAHOMA TAX COMMISSION

TAX POLICY AND RESEARCH DIVISION
TONY MASTIN, DIRECTOR

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June 14, 2001

Re: Our file number LR 01-72: Income Tax - Recognition of Income and Expense

Dear

This is in response to your inquiry of May 22, 2001 wherein you inquired as to the proper Oklahoma income tax treatment of certain income and expense items. Following is a restatement of the facts outlined in your letter, the questions posed, and our response thereto.

FACTS:

Corporation A is a corporation with its headquarters in Corporation A is a member of a federal consolidated return group, which includes various affiliated companies. During 1999, Corporation A entered into a prepaid crude oil sales contract to deliver a specified quantity of crude oil at a location within Oklahoma. The contract calls for Corporation A to deliver the specified quantities of oil on a monthly basis beginning in 2000 and ending in 2003.

In exchange for the crude oil to be provided, Corporation A received an advance payment from the buyer that Corporation A recognized as taxable income in the consolidated federal return of its parent and affiliates that was filed for their 1999 tax year. During 1999, Corporation A was not doing business in Oklahoma and had no connection (employees, agents, offices, inventories, etc.) with Oklahoma, therefore Corporation A did not have nexus in Oklahoma and did not file an Oklahoma corporation income tax return.

During 2000, Corporation A was involved in a reorganization that included the merger of Corporation A with Corporation B, an affiliated company. Corporation B was conducting business, production of oil and gas, within Oklahoma, and therefore; Corporation A, the survivor of the merger, was now doing business in Oklahoma. As a result of the merger, Corporation A became subject to the Oklahoma corporate income tax as of the date of the merger and will report its Oklahoma taxable income in an Oklahoma consolidated return with other affiliated corporations.

In accordance with the terms of the prepaid crude oil sales contract, during 2000, Corporation A delivered on a monthly basis the specified quantity of the oil to the buyer at the Oklahoma location. At the time of the execution of the contract, Corporation A had intended to use its oil produced in offshore locations in the Gulf of Mexico to satisfy the quantities to be delivered under the contract. However, due to high transportation costs, by the delivery due date, it became more economical to purchase the crude oil to be delivered from unrelated producers in Oklahoma rather than to transport the crude oil produced in the Gulf of Mexico.

The cost of these purchases will be treated as cost of goods sold and deductible for federal income tax purposes in the tax years 2000 through 2003.

QUESTIONS:

1. As explained above, in 1999 Corporation A did not have nexus in Oklahoma and did not file an Oklahoma corporate income tax return that reported the advance payment received for the future deliveries of crude oil. Was this correct for Oklahoma income tax purposes? If this treatment was not correct, please explain.

2. Are the purchases of crude oil made within Oklahoma in 2000 through 2003 and delivered to the buyer in Oklahoma deductible expenses for Oklahoma income tax purposes as they are for federal income tax purposes?

3. If the answer to question 2 is yes, are these deductible expenses allocable to Oklahoma or are they apportionable to Oklahoma?

RESPONSE:

1. Yes. Since corporation A did not have nexus with Oklahoma during tax year 1999, no return was required to be filed.

2. Since the cost of these purchases are deductible for federal income tax purposes to arrive at federal taxable income, they will be deductible for Oklahoma purposes as well since our starting point for calculating Oklahoma taxable income is federal taxable income.

3. These deductible expenses would be apportionable.

This response applies only to the circumstances set out in your request of May 22, 2001. Pursuant to Commission Rule 710:1-3-73(e), this Letter Ruling may be generally relied upon **only** by the entity to whom it is issued, assuming that all pertinent facts have been accurately and completely stated, and that there has been no change in applicable law.

If I can be of further assistance, please feel free to call me at (405) 521-3133.

Sincerely,

FOR THE OKLAHOMA TAX COMMISSION

Michael C. Kaufmann
Tax Policy Analyst