

OKLAHOMA TAX COMMISSION

TAX POLICY AND RESEARCH DIVISION
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June 23, 2003



Re: Our File No. LR-03-108, (Gross Production Tax) Gas Processing Tax Deduction.

Dear [REDACTED]

This letter is in response to your inquiry as to whether the processing of gas where liquids are recovered and sold would be exempt from the levy of Gross Production Tax.

As explained in your letter, the two (2) tertiary recovery units employing the method of nitrogen injection produce wet gas wherein the [REDACTED] installed a liquid extraction facility. The liquid hydrocarbons are separated and sold and the processed gas is reinjected. It is the processing costs incurred in the operation of the liquid extraction for which the [REDACTED] is seeking a tax deduction.

In your letter you relate a scenario wherein if there was a buyer who processed such gas, the buyer would have deducted the costs of operating the liquid extraction facility and paid [REDACTED] a value net of costs on which Gross Production Tax would have been levied.

This in fact is a true statement. However, this is not the result of a tax deduction. A percentage of proceeds contract allows the purchaser/processor to retain a percentage of the liquids as compensation for processing such gas. Gross Production Tax is levied on the gross proceeds realized at the lease from the initial sale of oil and/or gas.

Currently, the only allowable deduction from the levy of Gross Production Tax is applicable to costs effecting the delivery of gas from the well to the point of first sale wherein the costs associated with the gathering, compressing and treating may be deducted. The established guidelines for taking this deduction state that the deduction shall not include any costs incurred in the production of gas, oil or condensate or in the separation therefrom of any product subject to Gross Production Tax.

Therefore, those costs associated with the operation of liquid extraction may not be deducted from the levy of Gross Production Tax.

This response applies only to the circumstances set out in your request of June 6, 2003. 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.

Sincerely,

Mark J. Hendrix
Tax Policy Analyst

cc: Bob Calton
Audit