OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
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December 4, 2012

Re: LR-12-089 (Gross Production Tax) Inquiry as to certain deduction

This letter is in response to your inquiry as to the deductibility of certain marketing costs from the gross value of natural gas produced in Oklahoma that is subject to Gross Production Tax. As specifically stated in your letter "the purpose of the request for Letter Ruling is whether marketing costs would include lease use fuel".

In restating the facts presented in your letter, the lease use fuel in question is natural gas that is being produced from a well and used to power the lease site compressor which is used for marketing purposes only. Additional facts were provided in a telephone conversation between you and I on July 26, 2012, wherein you explained that in the scenario provided in your Letter Ruling request, the volume of natural gas being used as fuel would not be part of the gross volume of gas being reported in the monthly Gross Production Tax report for this lease.

Oklahoma Statutes provide for a deduction of certain costs associated with marketing natural gas as follows:

68 O.S. Section 1001.4

A. Producers of natural gas and casinghead gas who incur marketing costs of the gas produced may deduct such costs from the gross value when computing the gross value subject to the taxes levied pursuant to Sections 1001 and 1101 of Title 68 of the Oklahoma Statutes.

B. Marketing costs are nonproduction costs incurred by the producer to enable the transport of gas from the well to the market, including:

1. Costs for compressing the gas sold;

2. Costs for dehydrating the gas sold;

3. Costs for sweetening the gas sold; and

4. Costs for delivering the gas to the purchaser.

C. Marketing costs do not include:

1. Costs incurred in producing the gas;

2. Costs incurred in normal lease separation of the oil, gas or condensate; or

3. Insurance premiums on the marketing facility.

Oklahoma Administrative Code 710:45-9-103 further defines certain allowable costs to include:

> "Costs of materials, supplies, maintenance, repairs, and fuel associated with the marketing facility".

Based upon the information provided in your letter, it appears that the term "lease use fuel" is being confused with the deduction for fuel costs associated with a marketing facility. While both may not be subject to gross production tax, the method in which they are perfected for reporting purposes is different.

The marketing deduction that allows for the costs of fuel associated with the marketing facility to be deducted from the gross value of gas subject to gross production tax would apply to such fuel purchased from another source such as natural gas produced from another lease or electricity purchased to power marketing equipment. These are actual costs that are reported as exempt value under exempt code 9 on the monthly production tax report. There is no volume associated with such fuel.

Lease use production is specific to natural gas that is produced from a lease and actually used in its operation. This would include gas used for represurization to aid in the production of the well and gas that would be used to power compressors. Lease use gas is neither reported as gross volume nor exempt value on the monthly tax report. The Tax Commission will initially require an operator to provide written notification that they are utilizing lease use gas and provide the volume used. Additional verification may be periodically requested thereafter.

Further, Oklahoma statutes specifically state that Oklahoma Gross Production Tax is levied on all oil or gas produced except for production used in the operation of the well. Title 68 of Oklahoma Statutes, Section 1009 (B) and (E) states in part:

B. The gross production tax shall become due on the first day of each calendar month "***on all***" lead, zinc, jack, gold, silver or copper, petroleum oil, tank bottoms, pit oil, and liquid hydrocarbons from which petroleum oil is extracted, natural gas or casinghead gas "***produced in and saved***" during the preceding monthly period, and, if the tax is not paid on or before the twenty-fifth day of the second calendar month following the month of production, the tax shall become delinquent and shall be collected in the manner provided by law for the collection of delinquent gross production taxes. The provisions of this subsection shall apply to payment of gross production taxes irrespective of any other statute relating thereto.

E. 2. Gas when produced and utilized in any manner, "***except when used in the operation of the lease or premises in the production of oil or gas***", or for repressuring, shall

be considered for the purpose of this article, as to the amount utilized, as gas actually produced and saved. (**Emphasis added**).

Therefore, the proper method for reporting gross production tax when lease use gas is utilized is to not include the value of lease use gas as part of the exempt value. The effect of reporting the value of lease use gas as exempt value whenever such gas is not included in the gross volume results in an erroneous inflation of the exempt value and constitutes an invalid deduction.

If you should have any questions or need additional information you may contact me at 405-521-3133.

This response applies only to the circumstances set out in your request of July 2, 2012. Pursuant to Oklahoma Administrative Code 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,

OKLAHOMA TAX COMMISSION

Mark J. Hendrix
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