

TITLE 3: TAXATION
CHAPTER 18: OIL AND GAS TAXES (SEVERANCE TAX)
PART 6: VALUE MAY BE DETERMINED BY DEPARTMENT - STANDARD

3.18.6.1 ISSUING AGENCY: Taxation and Revenue Department, Joseph M. Montoya Building, 1100 South St. Francis Drive, P.O. Box 630, Santa Fe NM 87504-0630
[11/15/96; 3.18.6.1 NMAC - Rn, 3 NMAC 18.6.1, 12/29/00]

3.18.6.2 SCOPE: This part applies to all persons severing or engaging in the business of severing oil, natural gas, liquid hydrocarbons other than oil and carbon dioxide, to all persons having an interest in the products severed, to all persons operating oil, natural gas or carbon dioxide leases and to all persons affiliated with such persons.
[11/15/96; 3.18.6.2 NMAC - Rn, 3 NMAC 18.6.2, 12/29/00]

3.18.6.3 STATUTORY AUTHORITY: Section 9-11-6.2 NMSA 1978.
[11/15/96; 3.18.6.3 NMAC - Rn, 3 NMAC 18.6.3, 12/29/00]

3.18.6.4 DURATION: Permanent.
[11/15/96; 3.18.6.4 NMAC - Rn, 3 NMAC 18.6.4, 12/29/00]

3.18.6.5 EFFECTIVE DATE: 11/15/96, unless a later date is cited at the end of a section, in which case the later date is the effective date.
[11/15/96; 3.18.6.5 NMAC - Rn & A, 3 NMAC 18.6.5, 12/29/00]

3.18.6.6 OBJECTIVE: The objective of this part is to interpret, exemplify, implement and enforce the provisions of the Oil and Gas Severance Tax Act, the Oil and Gas Conservation Tax Act, the Oil and Gas Emergency School Tax Act and the Oil and Gas Ad Valorem Production Tax Act.
[11/15/96; 3.18.6.6 NMAC - Rn, 3 NMAC 18.6.6, 12/29/00]

3.18.6.7 DEFINITIONS: "Reasonable value" means the value established by the department under Sections 7-29-4.2, 7-30-6, 7-31-6 or 7-32-6 NMSA 1978.
[5/24/91, 11/15/96; 3.18.6.7 NMAC - Rn & A, 3 NMAC 18.6.7, 12/29/00]

3.18.6.8 REASONABLE VALUE WHEN ACTUAL PRICE NOT DETERMINED AT THE PRODUCTION UNIT:

A. Reasonable value shall be determined in accordance with Section 3.18.6.8 NMAC when actual price is established in a transaction among affiliated persons or established at a point other than at the production unit.

(1) Example 1: P sells natural gas to a California utility. Under the contract, P is paid for natural gas delivered to the California border; P is responsible for arranging and paying for the necessary transportation to California. In this situation, value is not established for the product at the production unit.

(2) Example 2: X, the owner of a refinery, posts a price at which X will purchase oil delivered to the refinery. P, a producer, sells X oil from wells located ten miles from the refinery. P pays for transporting the oil to the refinery. In this situation, value is not established for the product at the production unit.

B. Non-affiliated persons. When actual price is established in an arm's-length transaction among non-affiliated persons, reasonable value shall be determined by subtracting, in accordance with Sections 3.18.6.9 and 3.18.6.10 NMAC, from actual price received the value added by transportation from the production unit, processing in a natural gas processing plant or both.

(1) Example: P enters into an arm's-length contract with U, an out-of-state utility, for sale of natural gas at \$2.00 per mcf delivered to U. P then enters arm's-length contracts with X (a gathering system operator), Y (a natural gas processing plant operator) and Z (a mainline pipeline) to transport and process P's gas. X charges 5 cents per mcf to transport P's gas from P's production unit to Y's processing plant. Y charges 20 cents per mcf to process the gas. Z charges 25 cents per mcf to transport P's gas from Y's plant to U. P is not affiliated with U, X, Y or Z. "Actual price" at the production unit, as that term is defined in Paragraph 3.18.1.7E(1) NMAC, then, is \$1.50 per mcf; this is the base upon which tax is to be paid. It shall be reported as \$2 gross, with 30 cents in transportation

deductions and 20 cents in processing deductions.

(2) This version of Subsection 3.18.6.8B NMAC is applicable to production occurring on or after July 15, 1998.

C. Affiliated persons. When actual price is established in a transaction among affiliated persons or among non-affiliated persons in a non-arm's-length transaction, reasonable value shall be determined in accordance with the first applicable benchmark.

D. Benchmark 1: Reasonable value shall be the average actual price received, less applicable processing and transportation adjustments, provided that:

(1) at least fifty percent of sales or purchases from the same field are arm's-length transactions; and

(2) the price received or paid falls within the range of the prices received or paid for comparable products under arm's-length transactions of comparable terms.

E. Benchmark 2: Reasonable value shall be the actual price received, less applicable processing and transportation adjustments, from the first sale occurring between non-affiliated persons in an arm's-length transaction. However, this reasonable value can never be less than the price actually received, less applicable processing and transportation adjustments, in the first transaction with an affiliate.

F. Benchmark 3: If the reasonable value cannot be determined under preceding benchmarks, then the department may permit or require the taxpayer to use any other method which reasonably measures the value of product. This may include values determined under arm's-length contracts between non-affiliates for comparable product in nearby field, prices received in spot sales or other reliable sources of price or market information.

G. In determining comparability of product under Section 3.18.6.8 NMAC, the department will consider the following factors: time of execution, duration, market or markets served, terms, quality, volume and such other factors as may be appropriate.

[5/24/91, 11/15/96; 3.18.6.8 NMAC - Rn & A, 3 NMAC 18.6.8, 12/29/00]

3.18.6.9 TRANSPORTATION ADJUSTMENTS:

A. The adjustments to actual price provided by Section 3.18.6.9 NMAC apply only in cases where actual price is determined at a point other than at the production unit. The adjustment provided by Section 3.18.6.9 NMAC may be referred to as the "transportation adjustment". The transportation adjustment covers costs of transportation from a production unit to the point at which the product is sold. The transportation adjustment includes charges for gathering, mainline transportation and fuel gas and also includes charges or costs associated with compression incurred downstream of the production unit, as that term is defined in Paragraph 3.18.1.7E(1) NMAC. No transportation adjustment may be claimed or allowed unless the transportation with respect to which the adjustment is claimed actually occurs. This version of Subsection 3.18.6.9A NMAC is applicable to transportation occurring on or after July 15, 1998.

B. For the purposes of Section 3.18.6.9 NMAC:

(1) "producer" means the person or persons owning the product or the operator of the well; and

(2) "transportation company" means the pipeline, gathering company or other entity transporting product.

C. Nonmonetary payments. To secure uniform reporting, when payment of transportation charges is made with product rather than money, the value of the product shall be added to the amount reported as proceeds from the sale as well as reported as a transportation deduction. For purposes of determining the transportation deduction, the value of the product paid shall be the contract price without deduction. In all 3 following cases the volume of production to be reported is 12,500 mcf.

(1) Example: Producer A moves natural gas directly into P's pipeline from A's production unit. A contracts to deliver natural gas to an out-of-state utility for \$2.50 per delivered mcf. A inputs 12,500 mcf to the pipeline.

(a) Case 1: P charges A \$.50 per mcf to transport the gas from A's production unit to the utility; P uses P's own gas for fuel. A's transportation adjustment is \$6,250. A's taxable value is \$2.00 per mcf on 12,500 mcf severed and sold. (\$31,250 received from the utility less \$6,250 paid to the pipeline, divided by 12,500 mcf).

(b) Case 2: P charges A 10% of the gas put into the pipeline plus 27.77¢ per mcf of the remaining gas. A's transportation adjustment is \$6,250 (\$3,125 cash plus \$3,125 in value of product). A's taxable value is \$2.00 per mcf on 12,500 mcf severed and sold (although only 11,250 mcf delivered to the utility). (\$28,125 received from the utility plus \$3,125 for value of product transferred to the pipeline less a transportation deduction of \$6,250, divided by 12,500 mcf).

(c) Case 3: P charges A 20% of the input gas as a delivery charge. A's transportation adjustment is \$6,250 (value of product). A's taxable value is \$2.00 per mcf on 12,500 mcf severed and sold (though only 10,000 delivered to the utility). (\$25,000 from the utility plus \$6,250 for value of product transferred to pipeline minus \$6,250 transportation deduction, divided by 12,500 mcf.)

D. Non-affiliated persons. When the producer and the transportation company are not affiliated persons, actual price may be reduced by the actual monetary charges paid in an arm's-length transaction between the transportation company and the producer for transporting product, provided that the charges do not exceed any applicable tariff set or approved by any federal or state agency having jurisdiction.

E. Affiliated persons. When the producer and the transportation company are affiliated persons or when the transporting of product is not an arm's-length transaction, the transportation deduction shall be determined in accordance with the first applicable benchmark.

F. Benchmark 1: If the transportation charge is subject to regulatory approval, it may not exceed the tariff set or approved by any federal or state agency having jurisdiction.

G. Benchmark 2: If at least fifty percent of the product transported by the transportation company during the reporting period is transported for non-affiliated persons in arm's-length transactions, the transportation deduction for transporting products of an affiliate may be determined as a charge not more than the highest charge nor less than the lowest charge made in an arm's-length transaction by that transportation company to non-affiliated persons for transporting similar product.

H. Benchmark 3: If the transportation deduction is not determined under the preceding benchmarks, then it shall not exceed the sum of actual allowable transportation costs during the previous year on a per barrel or mcf basis, as appropriate. Allowable transportation costs are:

(1) operating expenses, which include operations supervision and engineering, operations labor, fuel, utilities, materials and supplies, property taxes, rent and any other directly attributable operating expense of the pipeline or gathering system;

(2) maintenance expenses, which include maintenance of the pipeline or gathering system and associated equipment, maintenance labor and any other directly attributable maintenance expense;

(3) overhead expenses, which include administrative and other overhead expenses directly attributable to the operation or maintenance of the pipeline or gathering system but excluding federal and state taxes (other than property taxes), payments for product, royalties, trucking expenses and any expense which may be included in a processing adjustment;

(4) depreciation expense, which includes depreciation on the pipeline or gathering system and associated equipment determined on the straight-line method based on the class life of the pipeline or gathering system and equipment and an appropriate salvage value for equipment; a successor in business or purchaser of assets shall base depreciation expense for the purposes of Section 3.18.6.9 NMAC upon the depreciation schedules of the previous owner; and

(5) a reasonable rate of return on depreciable capital assets used in the transportation operation.

I. Trucking expenses. An expense of transporting product by truck may not be deducted from actual price both as a "trucking expense" and a "transportation adjustment".

J. This version of Section 3.18.6.9 NMAC is retroactively applicable to products severed on or after July 1, 1995.

[5/24/91, 7/31/95, 11/15/96, 10/31/98; 3.18.6.9 NMAC - Rn & A, 3 NMAC 18.6.9, 12/29/00]

3.18.6.10 PROCESSING ADJUSTMENTS - NATURAL GAS:

A. The adjustments to actual price provided by Section 3.18.6.10 NMAC apply only in cases where actual price is determined at a point other than at the production unit. The adjustment provided by Section 3.18.6.10 NMAC may be referred to as the "processing adjustment".

B. For the purposes of Section 3.18.6.10 NMAC, "producer" means the person or persons owning the natural gas or the operator of the well.

C. Processing costs are only those costs of removing dissolved liquid hydrocarbons and impurities from natural gas in a natural gas processing plant. Charges or costs associated with dehydration, purification, sweetening and the like are "processing costs" for the purpose of Sections 3.18.6.8 through 3.18.6.10 NMAC.

D. Nonmonetary payments. To the extent that payment of the processing charge is made with product (other than liquids separated from natural gas) rather than money, reported proceeds shall include the value of the product transferred. The value shall also be reported as a processing deduction. The value of liquids shall not be

reported as either part of proceeds or as a transportation deduction when the entire value of the liquids is transferred to the natural gas plant operator as part of the plant operator's processing fee.

(1) Example 1: The operator of a natural gas processing plant charges \$.05 per mcf of natural gas processed (as measured at the plant inlet) plus two-thirds of the receipts from sale of the separated liquids. G moves 10,000 mcf to the plant for processing; liquids worth \$150 are separated by the processing. G reports the \$150 from sale of the liquids to the proceeds from sale of the residual gas; G's processing adjustment is \$600.

(2) Example 2: The operator of a natural gas processing plant charges 5% of the residual gas from processing plus two-thirds of the receipts from sale of the separated liquids. For this example, liquids worth \$150 are separated from G's gas by the processing; the operator also takes 1,000 mcf of the residual gas as part of the fee. G sells the remaining gas at \$1.50 per mcf. G adds \$1,650 to proceeds from sale of the gas (\$150 from liquids and \$1,500 from residual gas) and deducts \$1,600 (\$100 in liquids and \$1,500 residual gas).

E. Non-affiliated persons. When the producer and the operator or owner of the natural gas plant are not affiliated persons, the producer may reduce actual price by the actual monetary charges paid in an arm's-length transaction between the owner or operator of the natural gas processing plant and the producer for processing natural gas.

F. Affiliated persons. When the producer and the operator or owner of the natural gas processing plant are affiliated persons or when the product is processed in an non-arm's-length transaction among non-affiliated persons, calculation of the processing adjustment shall be in accordance with the first applicable benchmark.

G. Benchmark 1: If at least fifty percent of the natural gas processed is processed for non-affiliated persons in arm's-length transactions, the producer may reduce actual price by the actual monetary charges paid for the processing of the natural gas provided that the charges paid are not more than the highest charge nor less than the lowest charge made in an arm's-length transaction to non-affiliated persons for processing of similar natural gas.

H. Benchmark 2: If less than fifty percent of the natural gas processed during the reporting period is processed for non-affiliated persons in arm's-length transactions, the processing adjustment for processing products of an affiliate shall not exceed allowable processing costs of the natural gas processing plant during the previous calendar year on an mcf basis. Allowable processing costs are:

(1) operating expenses, which include operations supervision and engineering, operations labor, fuel, utilities, materials and supplies, property taxes, rent and any other directly attributable operating expense of the natural gas plant;

(2) maintenance expenses, which include maintenance of the processing plant and its equipment, maintenance labor and any other directly attributable maintenance expense;

(3) overhead expenses, which include administrative and other overhead expenses directly attributable to the operation or maintenance of the processing plant but excluding federal and state taxes (other than property taxes), payments for product, royalties, trucking expenses and any expense which may be included in a transportation adjustment;

(4) depreciation expense, which includes depreciation on the processing plant and its equipment determined on the straight-line method based on the class life of the processing plant and equipment and an appropriate salvage value for equipment. A successor in business or purchaser of assets shall base depreciation expense for the purposes of Section 3.18.6.10 NMAC upon the depreciation schedules of the previous owner; and

(5) a reasonable rate of return on depreciable capital assets used in the processing operation.

I. This version of Section 3.18.6.10 NMAC is retroactively applicable to products severed on or after July 1, 1995.

[5/24/91, 7/31/95, 11/15/96; 3.18.6.10 NMAC - Rn & A, 3 NMAC 18.6.10, 12/29/00]

HISTORY OF 3.18.6 NMAC:

Pre-NMAC History: The material in this part was derived from that previously filed with the State Records Center: TRD Rule OG-91, Regulations Pertaining to the Oil and Gas Tax Acts, filed 5/24/91.

History of Repealed Material: [RESERVED]

NMAC History:

3 NMAC 18.6, Oil and Gas Taxes (Severance Tax) - Value May be Determined by Department - Standard, filed 11/4/96.

3.18.6 NMAC, Oil and Gas Taxes (Severance Tax) - Value May be Determined by Department - Standard, filed 12/13/00.