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Louisiana Department of Revenue Attempts to Rewrite Crude Oil Purchase Agreements in an Effort to Collect More Severance Taxes

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The Louisiana Department of Revenue and Louisiana oil producers continue to battle over the imposition of severance tax on oil and condensate produced in Louisiana. Gordon Arata Montgomery Barnett partner Martin Landrieu has posted previously on the Department's attempt to charge hundreds of thousands of dollars in "delinquent taxes" the Department claims is owed under oil purchase agreements; that post can be accessed here. Litigation on this issue is intensifying.

The contract price in a standard oil purchase agreement is commonly structured using several adjustable pricing components followed by a fixed component referred to as a "premium or deduct." The premium or deduct is negotiated by the parties and takes into account various factors specific to the particular field at issue including, among other things, distance of the well from the selling point, quality and quantity of the oil purchased, speculation, risk of loss, marketability and the bargaining power of the parties. The adjustable components are used to calculate what is called the "Base Price," from which the fixed premium or deduct is subtracted. The Department has stated its position that any such deduct should be categorized as an unallowed "transportation deduction," while Louisiana oil producers and their customers take the stance that any such deduct (or premium) is part of the price of the oil as negotiated under the contract.

The Department has initiated audits and has formally assessed dozens of oil companies in Louisiana with a claim that delinquent severance taxes, together with penalties and interest, are owed for oil severed from the ground and water in Louisiana under contracts as described above. That is, the Department is claiming that any deduct component should be categorized as an unallowed transportation deduction and added back into the price for severance tax purposes, resulting in an increase in the price of the oil, even though the parties negotiated the price to be otherwise and the oil producer never received that incremental amount.

In support of its assessments, including interest, penalties, and fees, the Department points to Revenue Information Bulletin No. 08-015, which takes the position that the transportation deduction allowed by 61 LAC Pt I, § 2903(A)(h) is limited to transportation which transports oil *off lease* and excludes the movement of oil on lease, which the Department categorizes as “gathering activities,” and, therefore, not considered “transportation.” The transportation deduction in § 2903 states in its entirety:

> *Transportation Costs*—there shall be deducted from the value determined under the foregoing provisions the charges for trucking, barging, and pipeline fees actually charged the producer. In the event the producer transports the oil and/or condensate by his own facilities, $0.25 per barrel shall be deemed to be a reasonable charge for transportation and may be deducted from the value computed under the foregoing provisions. The producer can deduct either the $0.25 per barrel or actual transportation charges billed by third parties but not both. Should it become apparent the $0.25 per barrel charge is inequitable or unreasonable, the secretary may prospectively re-determine the transportation charge to be allowed when the producer transports the oil and/or condensate in his own facilities.

As the previous post noted, the Department’s recent assaults have the effect of essentially rewriting the contract price two parties agreed upon for the purchase of crude oil in the open marketplace. Louisiana law, however, simply states that you tax the value of the oil and condensate at the time and place of severance. If there is no posted field price, which, there generally is not these days, the value of the oil and condensate at the time and place of severance is determined by the gross receipts received by the producer from the first purchaser, less charges for trucking, barging and pipeline fees (i.e. transportation costs). This method of calculating the value of the oil is aimed at getting to the true value of the oil at the moment it is severed from the earth, that is at the wellhead. It is common sense that if the producer of oil has to expend extra costs to get the oil to the point of sale once it is severed from the earth, that cost will be added to the price the first purchaser pays, but it is not part of the true value of the oil at the time and place of severance. Following the same logic, if the producer and purchaser engaged in an arm’s length transaction agree that a premium or deduct is necessary in order to better reflect the true value of the oil at the time and place of severance, that premium or deduct constitutes part of the value of the oil and should not be unilaterally added back into the price in direct contradiction to the words of the statute and regulation.

Additionally, it is important to note that nowhere in the provision allowing for a transportation deduction is there a distinction between transportation which takes place "on lease" versus "off lease." As Judge Morvant of the 19th JDC recently recognized in *Mantle Oil & Gas, LLC v. La. State Revenue Department*, Case No. 646215, § 2903 simply states that if the producer incurs "charges for trucking, barging, and pipeline fees" in order to get the oil to the point of sale, he may deduct those costs from the price of oil for severance tax purposes. Judge Morvant's decision provides hope that Louisiana courts recognize that the Department's recent attacks on oil and gas producers in Louisiana are in direct contradiction to the law and infringe upon parties' determinations of the market value of oil at the point of severance.

In some instances the Department has taken an alternative approach, claiming that the value of oil for severance tax purposes is the price per barrel published as a "market center price" in one or more published index price bulletins (e.g. NYMEX or ARGUS Petroleum). In other words, the Department has treated a published "market center price" as the statutory equivalent of "posted field price." The Department has stated its position on this issue as follows:

> *The only issue on the schedules is that the contract deductions have been disallowed and added back to the taxable value of the oil. The statute imposing the oil severance tax (47:633(7)(a)) states that the taxable value of oil is the higher of (1) the gross receipts received from the first purchaser, less charges for trucking, barging and pipeline fees, or (2) the posted field price. Based on the Louisiana Administrative Code's definition of posted field price as it relates to the oil severance tax statute, the Department of Revenue has taken the position that the index price bulletins used in contracts are today's equivalent of the posted field price, and therefore the contract deductions are deductions from the posted field price (number 2 in the statute above). Since the statute taxes the higher of gross receipts or the posted field price, we have added the contract deductions back to the taxable price per barrel.*

The Department's position on "posted field price" has been rejected by courts in the past, and does not appear to be supported by the facts this time around either.

In a new twist in a few of the more recent cases, the Department of Revenue has gone so far as to allege fraud and unclean hands on the part of some oil producers and has asserted that they entered into contracts that provide for deductions for certain costs in the determination of the purchase price for the purpose of reducing the severance tax owed.

Please feel free to call Martin Landrieu or Caroline Lafourcade if you have any questions about your severance tax issues.