

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

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DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

v.

DOCKET NO. M. FUEL 83-108

P & O FALCO, INC.
P.O. Box 108
Shreveport, LA 71161,

Taxpayer.

ORDER

This matter involves a preliminary assessment of oil and gas production and/or privilege tax entered by the Revenue Department against P & O Falco, Inc. (Falco) for the month of February, 1983.

The Department entered the assessment against Falco on November 28, 1983. Falco requested a formal hearing before this office on December 27, 1983. A formal hearing was held on May 14, 1984 in Room 425, Administrative Building, Montgomery, Alabama. Falco was represented by attorney Edward B. McDonough, Jr. The Revenue Department was represented by assistant counsel John Breckenridge.

Based on the exhibits and testimony presented at the hearing, the following findings of fact and conclusion of law are hereby made and entered.

FINDINGS OF FACT

The assessment in issue involves severance tax on condensate and pentate that was severed from the Big Escambia Creek Field in February, 1983. The history of Falco's interest in the Big Escambia Creek Field is as follows:

In 1974, J. E. Fowler Petroleum Products, Inc. (Fowler) began

purchasing condensate and pentate in the Big Escambia Creek Field.

Subsequent to 1974, but prior to 1978, Fowler became Falco. From 1974 forward, Fowler, and later Falco, continually purchased condensate and pentate from the Big Escambia Creek Field.

In November, 1978, Marion Corporation (Marion) began to enter into purchase contracts with various working interest owners in the Big Escambia Creek Field who had previously sold to Falco. Marion ultimately contracted with 31 working interest owners, said contracts becoming effective on July 1, 1980 or upon start-up of Marion's Theodore refining facility, whichever came first. Marion's Theodore refining facility began operations in September, 1980. Consequently, during February, 1983, both Falco and Marion had purchase contracts with working interest owners in the Big Escambia Creek Field.

In February, 1979, Falco and Marion entered into an agreement whereby Falco would resell to Marion all Big Escambia Creek condensate that Falco was purchasing as of October, 1978 and continued to purchase as of the effective date of the agreement.

The effective date of the agreement was the start-up date of Marion's Theodore refinery, September, 1980. The agreement also stipulated that Marion would pay Falco \$.10 per barrel for each barrel of Big Escambia Creek condensate transferred pursuant to the agreement. In return, Falco would handle the disbursement of all funds relating to the condensate delivered pursuant to the

agreement, including payment of the severance tax. Marion would remit to Falco a check for its total liabilities for the preceding month. Falco would then disburse the funds to the proper recipient. Concerning payment of the oil and gas severance tax, from the effective date of the Marion/Falco agreement until February, 1983, Falco filed monthly reports and paid to the Revenue Department the severance tax due on all condensate and pentate that was delivered by Exxon, the Big Escambia Creek Field production operator, to Marion's Theodore refinery. As stated, Marion would remit to Falco its portion of the severance tax liability prior to Falco paying the tax to the Revenue Department. Falco reported and paid the tax, regardless of whether it or Marion had first purchase rights with the working interest owners.

In March, 1983, an involuntary petition for bankruptcy was filed against Marion in Houston, Texas. Also in March, 1983, Marion failed to remit to Falco its portion of the severance tax due for the month of February. Subsequently, Falco failed to file or pay the February severance tax due on the Big Escambia Creek condensate and pentate delivered by Exxon to Marion's Theodore refinery.

The Revenue Department, through agent Dwight Pridgen, audited Falco and determined that Falco was liable for the severance tax on all condensate and pentate delivered to Marion at its Theodore refinery in February, 1983. The Revenue Department's preliminary

determination that Falco is liable for the entire severance tax is based on two positions. First, the Department argues that because Falco had for an extended period reported and paid the entire tax, it is now estopped from asserting that it is liable for only part of the tax. Second, the Department contends that Falco was the first purchaser of all the condensate and pentate in question, and is thus liable for the entire tax. According to the Department, Falco alleged, in an action filed by Falco against Marion in Federal Bankruptcy Court, that it was selling the subject condensate and pentate to Marion. The Department argues that such an allegation confirms that Falco was the first purchaser of the pentate and condensate and that Falco cannot now take a position in conflict with its assertion in the Federal Bankruptcy action.

Falco's position is that it owes tax on only that portion of the production in question on which it had direct purchase contracts with the working interest owners.

CONCLUSIONS OF LAW

Code of Alabama 1975, '40-20-2 levies an annual privilege tax on every person engaged in the business of producing oil and gas in Alabama. Code of Alabama 1975, '40-20-3 sets out that although the tax is levied on the producer, the tax shall be paid by the person in charge of production operations, in this case Exxon. The statute also provides that if the person in charge of production operations does not pay the tax, the Department can collect from

the purchaser.

The facts show that the Revenue Department has administered the production privilege tax by allowing the first purchaser of the oil and gas to report and pay the tax. While the statute is somewhat unclear, it does provide that the first purchaser may account for the tax, in lieu of the production operator. However, if the tax is not paid, the Department may go against either party for collection.

In the present case, the Department has assessed Falco as first purchaser of the entire production of condensate and pentate from the Big Escambia Creek Field. Falco admits partial liability but argues that it is not liable for the tax on that part of the production that Marion purchased directly from the working interest owners. Thus, the determinative issue is whether Falco was the first purchaser of all the condensate and pentate in issue, so as to be liable for the tax.

Prior to 1978, Falco had purchase contracts on all the production in question. Beginning in 1978, Marion entered into purchase contracts with thirty-one separate working interest owners that had previously sold to Falco. As a result, both parties had purchase rights to part of the Big Escambia Creek Field production.

In 1979, Falco agreed to resell to Marion all condensate that Falco continued to purchase from the Big Escambia Creek Field. Exxon, as production coordinator, would ship the entire production

to Marion's Theodore refinery. Thereafter, Falco, pursuant to its agreement with Marion, would report and pay the severance tax on the entire amount, including that portion on which Marion was first purchaser.

The fact relevant to the issue at hand is that both Falco and Marion had first purchase rights to different portions of the Big Escambia Creek production. In view of the fact that the tax is on the first purchaser, this office finds that Falco is liable for the tax in issue on only that portion of the condensate and pentate on which it had first purchase rights pursuant to contracts with the working interest owners. Falco should not be taxed on that portion of the production which Marion purchased directly from the working interest owners.

In accordance with the above findings and conclusion, Falco is hereby ordered to determine the amount of pentate and condensate on which it had first purchaser rights with the working interest owners. The computations, with appropriate verifying documentation, shall be forwarded to this office for entry of a final assessment.

Done this 3rd day of July, 1984.

BILL THOMPSON

Chief Administrative Law Judge

