BEFORE THE STATE TAX APPEAL BOARD

OF THE STATE OF MONTANA

SOMONT OIL COMPANY, INC., Appellant, v. THE DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, Respondent.	DOCKET NO.: CT-2012-1 ORDER ON CROSS MOTIONS FOR SUMMARY JUDGMENT

Background

The Montana Oil and Natural Gas Production Tax Act, §15-36-301, MCA, *et seq.*, imposes a production tax on oil producers. By statute, oil is taxed on the gross taxable value of production as set out in §15-36-305, MCA. *See* §15-36-303(6), MCA. At issue in this matter is the interpretation of §15-36-305, MCA and whether the Taxpayer is responsible for paying tax on oil within basic sediment that has settled in the bottom of a tank and is later removed and processed. The language is as follows:

> **15-36-305. Determination of gross value of product.** (1) The total gross value of all oil or natural gas produced and sold each quarter must be determined by taking the total number of barrels or cubic feet of oil or natural gas produced and sold each month at the average value at the mouth of the well during the month that the oil or natural gas is produced and sold, as determined by the department. However, in computing the total number of barrels of oil or cubic feet of gas produced and sold, there must be deducted the amount of oil or gas used by the person in connection with the operation of the well from which the oil or gas is produced or for pumping the oil or gas from the well to a tank or pipeline.
>
> (2) For the purposes of determining average value at the mouth of a well, a fee of up to 25 cents a barrel paid to the operator or producer to administer royalty payments, whether or not the fee is payable on a per barrel basis, may not be considered a part of the value of the oil.

The parties have filed cross motions for summary judgment, both

acknowledging that the facts are not at issue, but that the interpretation of the statue is in contention.

We address the various arguments below.

"Plain Reading" of the Relevant Statute

The Department argues that the plain reading of the statute requires that Somont pay production tax on all oil produced and sold. Somont disagrees, claiming that certain oil, reclaimed from the basic sediment removed from the tank, is not subject to the tax.

The Taxpayer, Somont, presents two arguments. First, the Taxpayer argues that the assessment must occur at the mouth of the well. Somont argues that the oil at issue is valueless when it is removed at the mouth of the well, and only has value after processing. Thus, valuation occurs at the mouth of the well, and the sediment is functionally without value for tax purposes. The DOR and the Taxpayer both concur that if the language of a statute is clear and unambiguous on its face, no further interpretation is required. *Omimex Can. Ltd v. State,* 2008 MT, 403 ¶21, 347 Mont 176, 201 P.3d 3. *See also* 1-2-101, MCA.

We disagree that the plain reading of the statute supports the Somont proposition. Statutory construction indicates that the formula for taxation is to determine, first, the amount of oil produced, with an allowed deduction, and then determine the average value of the oil for the month. Multiplying the two figures determines the taxation amount.

If different forms of oil are recovered from the well, some of which require more processing than others, the statute ignores such distinctions in the calculation of the tax owed. It does not impose a rate based on the quality of the oil as it flows from the well or on the cost of making it merchantable. This lack of distinction makes sense when reviewing a severance tax, as the tax is designed to be imposed when the

oil or gas is severed and removed from the land. We conclude that the DOR is correct, and that the calculation of the tax is clear on its face. In this instance, however, the production tax specifically exempts oil or gas used by the person in connection with the operation of the well from which the oil or gas is produced. We now review the deduction language of the statute.

Allowable Deduction

Somont makes an alternate argument that the oil in the basic sediment should be considered oil used in connection with the operation of the well, and thus may be deducted from the amount calculated for tax purposes.

The second sentence of §15-36-305(1), MCA, permits oil used in the operation of the well or for pumping oil from the well to a tank to be deducted from the taxable amount. There is no indication that the oil needs be merchantable or not merchantable to be properly deducted.

There is no controversy that a tank cannot be emptied by removing only merchantable oil from it. The tank contains merchantable oil and also "basic sediment" at the bottom that is not merchantable when removed. The basic sediment builds up, so the operator must, at some point, remove the sediment to allow additional merchantable oil into the tank. *See* DOR Response to Appellant's Motion for Summary Judgment, p. 3. The sediment has no market value but Somont had the burden of disposing of it so the company began processing it. The sediment, and the oil it contains, is clearly handled by Somont only in connection with operation of the well or for pumping the oil or gas from the well to a tank or pipeline.

We note that when interpreting several provisions of a statute (or statutory scheme) the court will adopt a construction, if possible, which gives effect to all. *In re Snyder*, 2006 MT 308, ¶13, 335 Mont. 11, 149 P.3d 26, *Wild v. Fregein Construction*, 2003 MT 115, ¶ 20, 315 Mont. 425, 68 P.3d 855. Further, if a taxing statute is susceptible

to two constructions, doubt should be resolved in the favor of the taxpayer. *Western Energy Co. v. Department of Revenue*, 1999 MT 289, ¶ 10, 297 Mont. 55, 990 P.2d 767 (holding that the taxpayer's construction of the coal production tax did not frustrate the plain language of the statute.)

Somont argues that allowing a deduction for the oil that is trapped in the sediment and must be removed from the tank would be in line with the tax returns previously filed and accepted by the Department after audit. At no time in the past has Somont paid taxes on any oil that has been removed with (or in) the basic sediment. The DOR admits that it has audited Somont in the past and not required a change to their tax returns. Response to Request for Admission 1. The Department has also admitted that, in general, it allows deductions for oil used in connection with oil and gas operations as authorized by §15-36-305(1), MCA. Response to Request for Admission 8.

The DOR states that the key factor for taxing the oil is whether it is sold versus remediated. Response to Request for Admission 9. We note, however, that the statute does not speak to the sale of the oil as the test for deductibility, but merely whether the oil was used in connection with the operation of the well, in this case by pumping the oil into a tank.

Further, there appears to be some difficulty in calculating what the amount of oil might be for tax purposes. To create merchantable oil from the basic sediment, Somont mixes the basic sediment with other recyclable oil and eventually generates merchantable oil, some of which comes from Somont's well.

In this instance, the Taxpayer provides a reasonable explanation, under the above statutory sentence, for its filing of its taxes in this instance, and over a long period of time including past audit periods.[1] Taxing statutes are generally read in favor of a reasonable interpretation of the taxpayer when there are differing methods

of interpretation, and we see no indication of administrative rule or other Department of Revenue clarifications that would have provided the Taxpayer notice that its long-accepted interpretation was incorrect. Somont's second argument regarding a deduction under §15-36-305, MCA, is reasonable, and does not frustrate the statute's plain language. Thus, we find it correct as a matter of law, and deny the Department's implementation of additional taxes in this matter.

We find it troubling that the briefing indicates that the DOR appears to have changed its interpretation of the statutory taxing scheme. DOR admits that Somont has been audited in the past, and Somont's treatment of the reclaimed oil was not challenged. Thus, there appears to be some inconsistency in the taxation methodologies used by the DOR, but no new regulations were promulgated which might give notice to the Taxpayer that the taxing scheme was changing.

[1] See pages 9-10, Somont's Combined Motion for Summary Judgment, especially footnote 2, page 10.

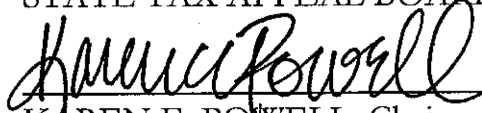
ORDER

Upon review of the facts, exhibits, and the arguments of the parties, the Taxpayer's Motion for Summary Judgment is granted and Department of Revenue's Motion for Summary Judgment is denied. The Department of Revenue's implementation of additional taxes is reversed.

DATED this 5th day of February, 2013.

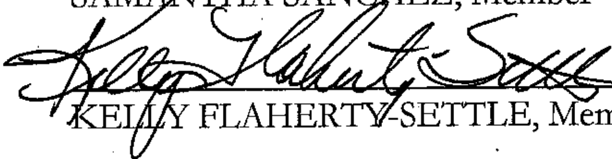
BY ORDER OF THE
STATE TAX APPEAL BOARD

(SEAL)



KAREN E. POWELL, Chairwoman

SAMANTHA SANCHEZ, Member



KELLY FLAHERTY-SETTLE, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-70-111, MCA, and 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 5th day of February, 2013, a true and correct copy of the foregoing has been served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

Brian D. Lee Lee Law Office PC PO Box 790 Shelby, MT 59474	_✓__U.S Mail, Postage Prepaid _____Hand delivered _____E-mail _____Telecopy
Brendan R. Beatty Derek R. Bell Special Assistant Attorneys General Office of Legal Affairs Department of Revenue P.O. Box 7710 Helena, Montana 59604-1712	_____U.S. Mail, Postage Prepaid _____Hand delivered _✓__Interoffice mail _____E-mail _____Telecopy

DONNA EUBANK
Paralegal