10-0119
TAX TYPE: SEVERANCE TAX
TAX YEAR: 1-1-08 – 12-31-08
DATE SIGNED: 1-6-2011
COMMISSIONERS: B. JOHNSON, M. JOHNSON, M. CRAGUN
DISSENT: COMMISSIONER D. DIXON

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**ORDER GRANTING AUDITING DIVISION'S MOTION FOR SUMMARY JUDGMENT AND DENYING PETITIONER'S CROSS-MOTION FOR SUMMARY JUDGMENT** Appeal No. 10-0119 Account No. ##### Tax Type: Severance Tax Audit Period: 01/01/08 – 12/31/08 Judge: Chapman

Presiding:
D'Arcy Dixon Pignanelli, Commissioner
Kerry R. Chapman, Administrative Law Judge

Appearances:
For Petitioner: REPRESENTATIVE FOR TAXPAYER, Attorney
For Respondent: RESPONDENT, Attorney

STATEMENT OF THE CASE

On July 22, 2010, Auditing Division ("Division") submitted a Motion for Summary Judgment and a Memorandum in Support of its Motion for Summary Judgment. In its Motion for Summary Judgment, the Division asks the Commission to find that a natural gas well does not qualify for the six-month exemption from severance tax allowed under UCA §59-5-102(5)(c) (2008) where drilling, or "spudding," of the well began in 1983. Section 59-5-102(5)(c) provides a six-month exemption for "the first six months of production for development wells started after January 1, 1990." The Division specifically asks the Commission to find that the word "started" in Section 59-5-102(5)(c) refers to the date on which drilling begins on a well.

On August 3, 2010, TAXPAYER ("TAXPAYER" or "taxpayer") submitted Petitioner's Cross-Motion for Summary Judgment and a Memorandum in Opposition to Respondent's Motion for

Summary Judgment and in Support of its Cross-Motion for Summary Judgment. In its Cross-Motion for Summary Judgment, the taxpayer asks the Commission to find that a natural gas well qualifies for the six-month exemption from severance tax allowed under Section 59-5-102(5)(c) where "taxable production" (i.e., production that is subject to severance taxation unless an exemption otherwise applies) did not begin until 2008. Specifically, the taxpayer asks the Commission find that the word "started" in Section 59-5-102(5)(c) refers to the date on which taxable production begins.

On August 16, 2010, the Division submitted its Memorandum in Opposition to Petitioner's Cross-Motion for Summary Judgment. A hearing was held on August 17, 2010, at which time both parties had an opportunity to present oral arguments on their respective motions.

STATEMENT OF UNDISPUTED FACTS

1. On December 17, 2009, the Division issued a Statutory Notice to the taxpayer for the period January 1, 2008 through December 31, 2008, in which it imposed additional severance tax in the amount of $$$$$ and interest (calculated through January 16, 2010) in the amount of $$$$$, for a total assessment of $$$$$.

2. Part of the Division's assessment concerned the taxpayer's claim of the six-month exemption provided in Section 59-5-102(5) for one of its natural gas wells identified as entity number ##### (the "Well"). The Division determined that the Well did not qualify for the exemption that the taxpayer had claimed and assessed severance tax accordingly.

3. The "spud date" of the Well (i.e., the date when the drill bit pierced the earth) is DATE.

4. The Well was "completed" and capable of producing natural gas on DATE. The completion process included "testing" the Well, part of which involved a "flow test" where natural gas was allowed to flow to measure production. A flow test was conducted on the Well on or about DATE.

5. The Well was shut-in on DATE, and remained shut-in for many years until the taxpayer purchased it. The Well is in a remote location. In YEAR, the taxpayer constructed a natural gas gathering system pipeline to the Well at a cost of over $$$$$.

6. On January 7, 2008, the taxpayer began to produce natural gas from the Well that is subject to the severance tax unless an exemption applies.

7. Effective January 1, 1984, the Legislature enacted UCA §59-5-67(6) (1984), which provided an exemption from the occupation tax (a precursor to the severance tax). Subsection 59-5-67(6) provided, as follows: "An exemption from the payment of occupation tax imposed by this article is allowed for a period of six months following the first day of production. Such exemption shall apply only to wells started after the January 1, 1984 effective date of this act."

8. In 1990, the Legislature passed House Bill No. 110 ("HB 110"), in which it provided an exemption from severance tax. Effective January 1, 1990, Section §59-5-102(2) (1990) provided, as follows in pertinent part:

> (2) No tax is imposed upon:
> . . . .
> (c) the first six months of production for wells started after January 1, 1984, but before January 1, 1990;
> (d) the first 12 months of production for wildcat wells started after January 1, 1990; or
> (e) the first six months of production for development wells started after January 1, 1990.

9. The audio record of the House Floor Debate for HB 110 is found at http://le.utah.gov. Utah HB 110, Gen. Sess. (Feb. 20, 1990). This record indicates that Representative Adams sponsored the bill in response to severe economic conditions affecting the oil and gas producing areas of Utah in 1990. He mentioned that the cost to drill a well in Utah was more than double the cost to drill a well in nearby states. He stated that the bill provisions, which include the "holiday" exemptions provided in Subsection 59-5-102(2) (1990), were intended to attract companies to produce more oil (and gas) in Utah.

10. In the enrolled copy of HB 110, the Legislature provided that the holiday exemptions of Subsection 59-5-102(2) applied to production for wells "**started** after January 1, 1990" (emphasis added). The same language was found in drafts of the bills dated January 12, 1990, December 27, 1989, December 18, 1989, and November 24, 1989. The taxpayer, however, provided an undated draft of the bill in which the word "spudded" appeared instead of the word "started." In this draft, the holiday exemption applied to production for wells "**spudded** after January 1, 1990" (emphasis added).

11. In 2004, the Legislature deleted Subsection 59-5-102(2)(c) (1990), which had provided an exemption from severance tax on "the first six months of production for wells started after January 1, 1984, but before January 1, 1990[.]"

APPLICABLE LAW

1. Under rule 56(c) of the Utah Rules of Civil Procedure, a summary judgment shall be rendered "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Facts and inferences to be drawn by the Commission in the summary judgment proceeding must be viewed in the light most favorable to the party opposing the summary judgment. *See Broadwater v. Old Republic Sur.*, 854 P.2d 527 (Utah 1993).

2. Section 59-5-101(2008)[1] provides severance tax definitions, as follows in pertinent part:

> (5) "Development well" means all oil and gas producing well other than a wildcat well.
> . . . .
> (27) "Well or wells" means any extractive means from which oil or gas is produced or extracted, location within an oil or gas field, and operated by one person.
> (28) "Wildcat well" means an oil and gas producing well which is drilled and completed in a pool, as defined under Section 40-6-2, in which a well has not been previously completed as a well capable of producing in commercial quantities.

[1] The 2008 version of Section 59-5-102 is the law that applies to this case. Previous versions of this law appear in the Statement of Undisputed Facts section of this decision only to assist, if needed, in interpreting the 2008 law.

3. Section 59-5-102(5) provides for certain exemptions from severance tax, as follows in pertinent part:

> (5) A tax is not imposed upon:
> . . . .
> (b) the first 12 months of production for wildcat wells started after January 1, 1990; or
> (c) the first six months of production for development wells started after January 1, 1990.

DISCUSSION

Is there any genuine issue as to a material fact that would preclude the Commission from answering the legal issue before it, specifically how to interpret the word "started" in Section 59-5-102(5)(c) (2008). The taxpayer indicated in its brief and at the hearing that it is seeking a six-month exemption for the Well at issue. Subsection 59-5-102(5)(c) provides a six-month severance tax exemption for "development wells." However, taxpayer's Exhibit 4 suggests that the Well at issue may be a "wildcat well." Subsection 59-5-102(5)(b) provides a twelve-month severance tax exemption for "wildcat wells." The phrase "started by January 1, 1990" is found in both Subsections 102(5)(b) and 102(5)(c). As a result, the Commission's interpretation of the word "started" will have the same effect for both exemptions and will have the same impact on the Well at issue, regardless of whether it is a development well or a wildcat well. Accordingly, there is no genuine issue as to a material fact that would preclude the Commission from deciding the legal issue.

In *Parson Asphalt Products, Inc. v. Utah State Tax Commission*, 617 P.2d 397 (Utah 1980), the Utah Supreme Court explained that exemptions are narrowly construed and that the person seeking the exemption has the burden to show that they fall within the scope of the exemption. Subsection 102(5)(c) provides a severance tax exemption for "the first six months of production for development wells started after January 1, 1990." The taxpayer asks the Commission to find that "started" refers to the date that taxable production begins at a well. The Division asks the Commission to find that "started" refers to the date that the drilling, or spudding, of the well begins. Critical to the

Commission's interpretation is whether the word "started" modifies the word "production" or the word "wells."

The majority are not convinced that the taxpayer's Well qualifies for the exemption. The majority believe that word "started" modifies the word "wells," the word it immediately follows, and does not modify the word "production." As a result, the majority does not agree with the taxpayer's conclusion that all wells whose production started after January 1, 1990 qualify for exemption. The majority agrees with the Division that the drilling, or spudding, of a well must have begun after January 1, 1990 in order for the well to have been "started after January 1, 1990" and for it to qualify for the exemption.[2]

The majority recognize that one of a number of drafts of HB 110 used the word "spudded" instead of the word "started." However, the majority does not find this fact to show that the Legislature did not intend the word "started" to mean "spudded" for purposes of the exemption. In conclusion, if a well is spudded after January 1, 1990, its production qualifies for a six-month exemption under Section 59-5-102(5)(c) (2008). In this appeal, the Well at issue was spudded in 1983. Accordingly, it does not qualify for a severance tax exemption under Subsection 102(5)(c).

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Kerry R. Chapman
Administrative Law Judge

[2] As an alternative, "started" could also be interpreted to refer to the first operations on the land preliminary to the actual drilling, in which case the word "started" would refer to events prior to the spud date. See *Vickers v. Peaker*, 300 SW.2d 29 (Ark. 1957) (in which the court ruled that a well was started prior to the spud date, referencing numerous pre-drilling events). However, the majority prefer not to interpret "started" to mean a date prior to the date on which a well was spudded.

DECISION AND ORDER

On the basis of the information presented by the parties, the Commission finds that the Section 59-5-102(5)(c) exemption only applies to wells that were spudded after January 1, 1990. Accordingly, the Commission grants the Division's Motion for Summary Judgment and denies the taxpayer's Cross-Motion for Summary Judgment. It is so ordered.

DATED this 6th day of January, 2011.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

Michael J. Cragun
Commissioner

DISSENT

I respectfully dissent from my colleagues.

The applicable law passed in 1990 with Substitute House Bill 110 reads "no tax is imposed on (e) the first six months of production for development wells started after January 1, 1990."

A development well is defined as an oil and gas producing well.

Analyst by the Office of Legislative Fiscal Analyst of Substitute House Bill 110 states, "The purpose of the above changes in the severance tax is to stimulate oil production in the State."[3]

On DATE a minimal amount of natural gas was flared to test the subject well, and then the well was shut-in, as declared on DATE.[4] No more oil or gas was produced from the well following the one day test.

[3] I take administrative notice of this record available to the public on the Utah Legislature website.

[4] Petitioner's exhibit four, which is a federal form filed with the State of Utah, Division of Oil, Gas and Mining.

The subject well was shut-in for 22 years. After the Petitioner acquired the well in May 2006, Petitioner invested $$$$$ to build a pipeline to transport oil and gas from the subject well to market. Once the Petitioner had the pipeline in place, the Petitioner was able to start the well into production, which it did on January 7, 2008.

A shut-in well is of no value to the State of Utah. It provides no jobs. A well in production can help fuel the economy which was also the intent of the bill as understood in listening to the audio of the legislative presentation of Substitute House Bill 110 (1990) on the floor of the House of Representatives by the sponsor Rep. Adams.

We must always look first to the intent of the law.

This is why the controlling word in the law is "production" and "start" modifies "production." The intent of the law was to get wells into production.

I hold the subject well being started into production met the intent of the law. I would have granted the credit for the first six months of production starting January 7, 2008.

D'Arcy Dixon

D'Arcy Dixon Pignanelli
Commissioner

Notice of Appeal Rights: You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §§59-1-601et seq. and 63G-4-401 et seq.

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