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applies to oil and gas wells which were inactive for two years before July 1, 1994.

Concerning deep wells, 165:10-21-45 through 165:10-21-49 address well qualification, auditing and certificates of reinvestment. Section 1(h) of the Act established a credit for production from a well spudded between July 1, 1994 and June 30, 1997, and drilled to a depth of 15,000 feet or greater. The deep well exemption period extends from the date of first sales until the total amount of the exemption or credit equals the total cost of drilling and completing the well, provided that the exemption period shall not exceed twenty-eight months from the date of first sales.

For all three credits, the tax credit program works in the following way: the well operator or a working interest owner on behalf of the owners in the well applies for qualification at this Agency, which determines whether or not the well meets the technical criteria for a credit. The application is filed on OCC Form 1534, and should be accompanied by supporting documentation, such as copies of invoices and receipts substantiating the claim. It is contemplated that most applications will undergo adjudication by a desk review process without formal hearing. If an application is approved under the desk review process, an order will issue to that effect. However, a formal evidentiary hearing is available, if the application is denied or if processing of the application would take more than 60 days. Upon receipt of the order from desk review or the hearing process, the applicant may then request a credit from the Oklahoma Tax Commission. The request is made by letter accompanied by the items specified in the above-described rules. Those items are needed to process the request for a credit. In that regard, the Oklahoma Tax Commission under Section 1(k)(3)-(4) does not readjudicate the technical issues. If provided with the required documentation, the Oklahoma Tax Commission will issue the credit in the same manner as it would issue a tax refund.

Under Section 1(j) of the Act, credits are applied against future production. For production between July 1, 1994 and June 30, 1995, the credit cannot be claimed until after July 1, 1995. For production between July 1, 1995 and June 30, 1996, the credit cannot be claimed until after July 1, 1996. For production between July 1, 1996 and June 30, 1997, the credit cannot be claimed under after Jul 1, 1997.

During the program, tax credit accrues for gross production taxes paid, and credits will be applied in the following way: the tax liability is calculated as usual; accrued credit for the well will be used to pay off tax liability for that well on dollar-for-dollar basis; however, Section 1(i) of the Act assesses a tax of 1% of gross value on oil and gas notwithstanding the exemptions under Section 1(f)-(h) of the Act. The one percent tax will be paid from proceeds, and the unused credit under Section 1(f)-(h) would be carried forward to apply against future tax liability.

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compressors and other production or transportation related surface equipment, by themselves, would not allow a well to qualify as a production enhancement project.

4. Working interest owner may apply upon operator's default: The rule proposals initially required the well operator to file the application and request the tax credit. The well operator is the customary person responsible for making regulatory filings. In addition, limiting the number of applications will speed processing of the exemption and avoid conflicting filings. However, some commentators expressed concern that a working interest needs to be able to file for the tax credit where the well operator fails or refuses to file. The Agencies agreed with the comment and amended the certification procedure to allow a working interest owner to file in place of the well operator.

5. Alternative Certification Procedure. The well qualification procedure at the Corporation Commission involves a desk review process instead of an evidentiary hearing. The desk review procedure has worked effectively for the tax credit programs for enhanced oil recovery projects and horizontal wells. However, one commentator asked for the ability to go through the hearing process, if the desk review took more than 60 days. The Agencies agreed to that request and amended the qualification procedure to allow the operator to seek *de novo* adjudication by application, notice and hearing, when the application is denied or processing takes more than sixty days.

6. Request to the OTC for the credit. The original rule proposals referred to an application to the Oklahoma Tax Commission for the tax credit. At the request of some of the comments, agency staff changed the term "application" to a "request for a tax credit", which is consistent with customary usage in the law of taxation.

7. Use of sales to establish the exemption period. A number of commentators do not like basing the exemption period on a physical event, and they want to begin the exemption period with the date of first sales. They contend that production is customarily reported using sales, and starting the exemption period on first sales would be consistent with current accounting practices. To support their position, they rely on Section 1(j) of the Act, which directs computation of the credit from the date of first sales. In response, the starting point for the exemption period in the proposed regulations comes from the statute. For production enhancement projects and inactive wells for which production is reestablished, Section 1(f)(1)&(g)(1) start the 28 month exemption period with a physical event: for a reactivated well, the physical event is reestablishment of production; for a production enhancement project, the physical event is the date of completion of the production enhancement project. Principles of statutory

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11. Drilling and completion costs for deep wells. The cost of drilling and completing a deep well also arises in comments on 165:10-21-49 concerning OTC auditing requirements. In regard to that rule, the Oklahoma Tax Commission took the position that the drilling and completion costs potentially reducing the 28 month exemption period are limited to downhole costs and that items such as land related expenses and production equipment at the surface are not covered. The Tax Commission's position is consistent with its treatment of other wells for purposes of the enhanced oil recovery project and horizontal well tax exemptions. However, industry representatives took a different view, explaining that in trade usage, "dryhole costs" and "completed well costs" include the excluded items.

12. Allocation of production on a multi-lease: Several commentators asked how the Corporation Commission would address a tax exemption for a well on a multi-well lease, with a common tank battery. In response, the applicant will be responsible for providing a reasonable basis for allocation of production to the exempt well.

V. FOR FURTHER INFORMATION: For further information, contact, Ben Jackson, Deputy General Counsel, 400 Jim Thorpe Building, Oklahoma City, Oklahoma, 73152-2000, telephone: (405)-521-2255.

Appendix A

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APPENDIX "B"

SUBCHAPTER 21. APPLICATIONS FOR TAX CREDIT

[New]

PART 6. PRODUCTION ENHANCEMENT PROJECTS

165:10-21-21. General

Exemption from the levy of gross production tax on the incremental production attributable to the working interest owners which results from a production enhancement project shall be determined according to the provisions of this Part, which have been jointly adopted by the Oklahoma Corporation Commission and Oklahoma Tax Commission pursuant to 68 O.S. Section 1001K.

165:10-21-22. Definitions

The following words and terms, when used in this Part, shall have the following meaning, unless the context clearly indicates otherwise:

"Base production" means the average monthly amount of production for the twelve-month (12) period immediately prior to July 1, 1994.

"Effective date" means the project beginning date for the production enhancement project.

"Exemption period" means a period of twenty-eight (28) months from the date of completion of the production enhancement project.

"Incremental production" means the amount of crude oil, nature gas or other hydrocarbons which are produced as a result of the production enhancement project in excess of the base production.

"Production enhancement project" means any workover or recompletion or fracturing of a producing well.

"Recompletion" means any downhole operation in an existing oil well or gas well that is conducted to establish production of oil or gas from any geological interval not currently completed or producing.

"Working interest" means the gross value of the production of oil and/or gas, less the royalty interest therein.

"Workover" means any downhole operation in an existing oil or gas well that is designed to sustain, restore or increase the production rate or ultimate recovery in a geologic interval currently completed or producing in said existing oil or gas well. "Workover" includes but is not limited to acidizing, reperforating, fracture treating, sand/paraffin removal, casing repair, squeeze cementing, or setting bridge plugs to isolate water productive zones from oil or gas productive zones, or any combination thereof. "Workover" shall not mean the routine maintenance, repair, or like-for-like replacement of downhole equipment such as rods, pumps, tubing, packers, or other mechanical devices.

[New]

"Exemption period" means a period of twenty-eight (28) months from the date upon which production from an inactive well is reestablished.

"Inactive well" means any well that has not produced oil, gas or oil and gas for a period of not less than two (2) years as evidenced by the appropriate forms on file with the Oklahoma Corporation Commission reflecting the well's status.

165:10-21-37. Qualification procedure

(a) **Qualification by the Oklahoma Corporation Commission.** The well operator or one of the working interest owners, on behalf of the well operator and the other owners of the well, shall apply for qualification of the well and production at the Oklahoma Corporation Commission on OCC Form 1534.

(1) OCC Form 1534 shall be completed in its entirety and, together with supporting documentation, shall be submitted to the Technical Services Department of the Conservation Division of the Oklahoma Corporation Commission for review.

(2) If the Department approves the application, an order of the Oklahoma Corporation Commission shall be issued, and a copy shall be forwarded to the operator.

(3) If the application is denied or refused, or approval is delayed beyond sixty (60) days, the applicant may seek review by application, notice and hearing.

(b) **Request to the Oklahoma Tax Commission for a Tax Credit.** If the Oklahoma Corporation Commission grants the application, the well operator or one of the working interest owners, on behalf of the well operator and the other owners of the well, shall then make its request for a tax credit by letter to the Gross Production Section, Business Tax Division, Oklahoma Tax Commission. Such letter request shall be accompanied by the following:

(1) A Corporation Commission order certifying the well as an inactive well for which production has been reestablished.

(2) A copy of OCC Form 1534 submitted to the Corporation Commission.

(3) A copy of OTC Form 320C that shows the date of the reestablishment of production of oil and/or gas.

(4) A notarized statement listing the production attributable to the well for the period for which the credit is sought.

PART 8. DEEP WELLS

165:10-21-45. General

Exemption from the levy of gross production tax on the production of gas, oil or gas and oil from wells spudded between July 1, 1994 and June 30, 1997, and drilled to a depth of fifteen thousand (15,000) feet or more shall be determined

[New]

165:10-21-48. Audit requirements

The deep well drilling and completion costs claimed shall be subject to verification through audit by the Oklahoma Tax Commission. Costs allowed in computing deep well payout shall include only the costs of drilling and completing the

well and shall not include any cost incurred after the completion date. Neither shall it include lease acquisition costs, tank batteries, meters, pipelines or other external equipment.

165:10-21-49. Certificate of investment to be filed by the operator

All operators claiming the exemption or credits for deep wells shall file OCC Form 1534A certifying that the operator within twelve (12) months from the date of the certificate will invest in the State of Oklahoma an amount equal to the total of any such credits or exemptions received in the previous twelve (12) months. The deadline for filing the first certificate shall be July 31, 1996, and each July 31 thereafter, until conclusion of the program.