



NOTICE OF PROPOSED  
RULEMAKING  
CAUSE NO. RM 94000012  
PAGE NO. 2

The attached Appendix "A" is the appearance list for the cause. The Commission derived that list from the written comments and the appearance lists from the technical conference and public hearing.

The Commission has fulfilled the statutory requirements for adoption of the proposed rules shown on the attached Appendix "B" ,and said rules should be adopted as permanent rules.

III. **BACKGROUND:**

This rulemaking establishes the procedure for qualifying production for a tax credit under Section 1 of 1994 Okla. Sess. Laws Chapter 311, commonly known as Senate Bill No. 841. The legislation amended provisions of 68 O.S. Section 1001, concerning the gross production tax on oil and gas. The amendments established production incentives in the form of tax credits. The credits apply to production from three categories of wells: wells with production enhancement projects; certain formerly inactive wells, and new wells drilled to a depth of 15,000 feet or more. Section 1(k) of the Act requires a person seeking a credit to apply for qualification at this Agency and the Oklahoma Tax Commission, and it directed both agencies to conduct joint rulemaking. The attached appendix "B" contains the rules numbered as proposed for codification by this Agency.

Under that numbering scheme, 165:10-21-21 through 165:10--21-23 address qualification of a well with a production enhancement project. Section 1(g) of the Act established a credit applicable to any incremental production attributable to the working interest owners in a well, where such incremental production results from a production enhancement project. 165:10-21-22 adopts the statutory definition of the term "production enhancement project" as found in Section 1(g)(2) of the Act. Under that definition, the term "production enhancement project" refers to a workover, recompletion or fracturing of a well.

The tax exemption period for a well with production enhancement project lasts for twenty-eight months from the date of completion of the project. The exemption takes effect on July 1, 1994, and applies to wells with production enhancement projects with project beginning dates before July 1, 1997.

Turning to reactivated wells, 165:10-21-35 through 165:10-21-37 address qualification of formerly inactive wells. Section 1(f) of the Act established a credit applicable to an inactive well for which production is re-established. 165:10-21-36 adopts the definition of "inactive well" found at Section 1(f)(2) of the Act; it states that the term "inactive well" means any well which has not produced oil, gas or oil and gas for a period of not less than two years as evidenced by the appropriate forms on file with the Corporation Commission reflecting the well's status. The definition clearly covers wells which are abandoned or temporarily abandoned. It does not apply to a shut-in gas well inasmuch as such a well is considered to be a producing well. In any event, the exemption takes effect on July 1, 1994, and it

**NOTICE OF PROPOSED  
RULEMAKING  
CAUSE NO. RM 940000012  
PAGE NO. 3**

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.

NOTICE OF PROPOSED  
RULEMAKING  
CAUSE NO. RM 940000012  
PAGE NO. 4

If a well receives a tax credit for enhanced oil recovery under Section 1(d) of the Act, Section 1(l) act prohibits the well from claiming an additional credit under Section 1(e)-(h) of the Act, and it requires the operator to elect between credits.

Returning to the subject of deep wells, Section 1(h)(3) requires a well claiming a deep well exemption to periodically file a certificate with this Agency stating that an amount equal to the credit received during the previous 12 months was reinvested in Oklahoma. 165:10-21-49 implements that requirement. The adopted rule requires the well operator to file OCC Form 1534A annually. The form asks the well operator to make the certification as to the operator's share of credits received on production from the well. The Agency recognizes that a well operator cannot vouch for reinvestment of funds not under his control after distribution of proceeds to working and royalty interests.

In passing, it is also noted that the credit program is subject to suspension based on changes in commodity prices. Section 1(i) of the Act provides that the credits for production in a calendar year shall not be available where the statewide weighted average prices during the calendar year exceed twenty dollars per barrel for oil and two dollars and fifty cents per MMBTU for natural gas.

**IV. DISCUSSION OF RULES AND COMMENTS:**

The major comments in the Senate Bill No. 841 rulemaking are summarized as follows:

1. Tax credit versus tax refund. A number of persons asked for a tax refund as opposed to a tax credit. The Oklahoma Tax Commission interpreted the Act as establishing a tax credit, based on taxes paid on production from a well, and applied against future production from that well. The Oklahoma Tax Commission based its interpretation on the absence of the term "tax refund" in the Act and repeated use of the word "credit" in Section 1(f),(g),(h)&(j) of the Act.

2. Workover versus routine maintenance. In regard to the definition of "workover" in 165:10-21-22, several comments asked the Oklahoma Corporation Commission and the Oklahoma Tax Commission to distinguish between adding equipment under a qualifying workover and a routine replacement of equipment which is not eligible for the credit. Per the comments, the Agencies amended the definition of workover to reflect that "like-for-like" replacement of downhole equipment is not eligible for the credit.

3. Is installation of a compressor a part of a qualifying workover? A few commentators asked if installing a compressor on a marginal well would qualify as a production enhancement project under Section 1(g) of the Act. In response, the statutory definition of a workover refers to a "downhole operation", and so,

NOTICE OF PROPOSED  
RULEMAKING  
CAUSE NO. RM 940000012  
PAGE NO. 5

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

NOTICE OF PROPOSED  
RULEMAKING  
CAUSE NO. RM 940000012  
PAGE NO. 6

construction require an interpretation which gives full effect to paragraphs (f),(g) and (j). Consequently, physical events under paragraphs (f) and (g)of the Act start the exemption period, while paragraph (j) refers to the first taxes paid on which to base the credit against future production.

8. Documentation for inactive wells for which production is reestablished. Section 1(f)(2) defines the term "inactive well" for purposes of the tax credit for reestablishing production at an inactive well. The paragraph defines an inactive well based on "appropriate forms on file with Corporation Commission reflecting the well status." At the public hearing, questions arose as to what would qualify a well for the tax credit. In response, several options for records are possible: a temporary abandonment permit (OCC Form 1003A); most recent production reports; and the drilling permit (OCC Form 1000) and completion report (OCC Form 1002A) for a dryhole. Also, depending on what was done to restore production, the applicant may file under the production enhancement project exemption and demonstrate zero base production to achieve the same amount of tax credit.

In regard to wells without forms or permits, this Agency recognizes that some operators with inactive wells may be violating Corporation Commission rules, especially those rules requiring plugging or temporary abandonment permits for wells taken out of service. At the public hearing, some of the comments expressed concern over punishment for those violations. In response, this Agency believes that non-compliance with those rules is an issue separate from eligibility from the tax credit, and it will address such non-compliance by separate action in the manner prescribed by those rules.

9. Measured depth for deep wells. Section 1(h)(1) of the Act established a tax credit for a well "drilled to a depth of 15,000 feet or greater." Per the comments, agency staff changed its proposed version of 165:10-21-45 to reflect measured depth in keeping with industry practice.

10. Exemption period for deep wells. Section 1(h)(1)&(2) limit the deep well credit to 28 months or until the exemption or credit equals the cost of drilling and completing the well. At the public hearing, questions arose as to what is the event cutting off what is otherwise a 28 month exemption period; is it the size of the exemption or credit, or are the terms "exemption" and "credit" synonymous? In response, the Oklahoma Tax Commission contends that the exemption is the value of the production on which the credit is based, and that as a result, the exemption will be the limiting factor before the credit.

**NOTICE OF PROPOSED  
RULEMAKING  
CAUSE NO. RM 940000012  
PAGE NO. 7**

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.

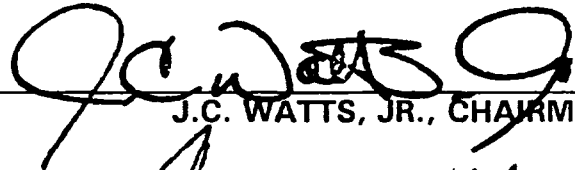
12. Allocation of production on a multi-lease: Several commentators asked how the Corporation Commission would address a tax exemption for a well on a multi-well lease, with a common tank battery. In response, the applicant will be responsible for providing a reasonable basis for allocation of production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

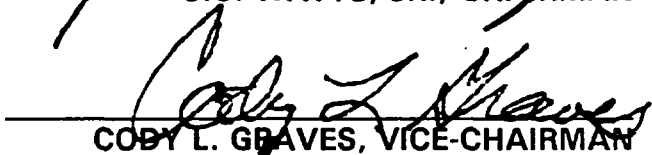
V. FOR FURTHER INFORMATION: For further information, contact, Ben Jackson, Deputy General Counsel, 400 Jim Thorpe Building, Oklahoma City, Oklahoma, 73152-2000, telephone: (405)-521-2255.

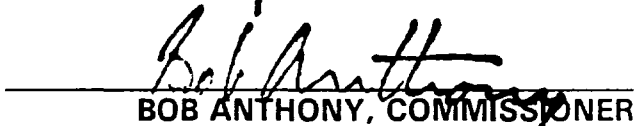
NOTICE OF PROPOSED  
RULEMAKING  
CAUSE NO. RM 94000012  
PAGE NO. 8

VI. ADOPTION OF PERMANENT RULES: The rules shown on the attached appendix "B" are hereby adopted as rules of the Commission, subject to legislative and gubernatorial approval under 75 O.S. Section 250, et seq., and IT IS SO ORDERED.

CORPORATION COMMISSION OF OKLAHOMA

  
\_\_\_\_\_  
J.C. WATTS, JR., CHAIRMAN

  
\_\_\_\_\_  
COBY L. GRAVES, VICE-CHAIRMAN

  
\_\_\_\_\_  
BOB ANTHONY, COMMISSIONER

DONE AND PERFORMED THIS 20 DAY OF October, 1994

ATTEST:

  
\_\_\_\_\_  
CHARLOTTE W. FLANAGAN, SECRETARY



Appendix A

Jack M. Shadle, Jr.  
Marginal Well Commission  
100 E. Boyd, Ste. 510A  
Norman, OK 73019

David J. Noser  
Texaco, Inc.  
P.O. Box 5070  
Bellaire, TX 77402-5070

Mary Ann McMichael  
Delhi Gas Pipeline Corp.  
7301 N.W. Expressway  
Oklahoma City, OK 73162

Chuck Dehart  
Williams  
P.O. Box 2400  
Tulsa, OK 74102

Gregory L. Mahaffey  
Mahaffey & Gore, PC  
2 Leadership Sq., Ste. 1100  
Oklahoma City, OK 73102

Urban F. (Obie) O'Brien, III  
Apache Corp.  
2000 Post Oak Blvd.  
Houston, TX 77056

D.E. Thierwechter  
Marathon  
P.O. Box 3128  
Houston, TX 77253

John C. Bridges  
El Paso Natural Gas  
P.O. Box 1492  
El Paso, TX 79978

Brent Sonnier  
Oxy USA, Inc.  
P.O. Box 26100  
Oklahoma City, OK 73126

Charles Helm  
105 N. Hudson, Ste. 1000  
Oklahoma City, OK 73102

Steve Martin  
Oklahoma Tax Commission  
2501 Lincoln Blvd.  
Oklahoma City, OK 73194

Carolyn H. Thomson  
Oklahoma Tax Commission  
2501 Lincoln Blvd.  
Oklahoma City, OK 73194

Richard Hutton  
O.I.P.A.  
2601 N.W. Expressway, Ste. 107W  
Oklahoma City, OK 73112

Bob Vandewater  
Daily Oklahoman  
P.O. Box 25125  
Oklahoma City, OK 73125

Eric R. King  
King & King  
3330 French Park Dr.  
Edmond, OK 73034

Jessica Danker  
Journal Record  
P.O. Box 26370  
Oklahoma City, OK 73126

Eric Koelling  
Sun  
P.O. Box 2039  
Tulsa, OK 74102

J.T. Portwood  
Alpha Environmental  
P.O. Box 20643  
Oklahoma City, OK 73156

Larry A. Aimes  
Meridian Oil, Inc.  
400 Sam Houston Pkwy E, Ste. 1200  
Houston, TX 77060

John R. Reeves  
211 N. Robinson, 15th Fl.  
Oklahoma City, OK 73102

Mari Dugger  
Williams Field Services  
One Williams Ctr., 36th Fl.  
Tulsa, OK 74172

Steve Kelley  
Kelley & Associates  
100 W. 5th, Ste. 911  
Tulsa, OK 74103

Richard Gore  
211 N. Robinson, Ste. 1100  
Oklahoma City, OK 73102

J. Fred Gist  
Hall, Estill, et al  
2900 Liberty Tower  
Oklahoma City, OK 73102

Jeff Kiser  
Oklahoma Tax Commission  
2501 Lincoln Blvd.  
Oklahoma City, OK 73194

Larry Lago  
Oklahoma Business News  
P.O. Box 1177  
Oklahoma City, OK 73101

Michael D. Stack  
701 N.W. 63rd, Ste. 500  
Oklahoma City, OK 73116

## 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]

**165:10-21-23. Qualification procedure**

(a) **Qualification by the Oklahoma Corporation Commission.** The well operator or one of the working interest owners in the well, on behalf of the well operator and the entire working interest, shall apply for qualification of the production enhancement project and incremental 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 of the order 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 in the well, on behalf of the well operator and the entire working interest, 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 production enhanced.

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

(3) A notarized statement listing the production attributable to the well for the period for which a credit is sought and the working interest decimal of total production.

**PART 7. REESTABLISHMENT OF PRODUCTION FROM AN INACTIVE WELL**

**165:10-21-35. General**

Exemption from the levy of gross production tax on the reestablishment of production from an inactive well 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.

**165:10-21-36. Definitions**

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

"**Effective date**" means the date on which the reestablishment of production has occurred.

[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.