RAB-90-13

Allowable Marketing Cost Deductions to Severance Tax (Replaced by RAB 92- 9)

STATE OF MICHIGAN

DEPARTMENT OF TREASURY

TREASURY BUILDING

LANSING, MICHIGAN 48922

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REVENUE ADMINISTRATIVE BULLETIN 1990-13

Approved: April 12, 1990

ALLOWABLE MARKETING COST DEDUCTIONS TO SEVERANCE TAX

RAB-90-13. The Michigan Severance Tax Act provides that the value (tax value) of all production of oil and gas shall be computed at wellhead. [MCL 205.303(1)]. If the market is away from the wellhead, there may be marketing costs allowed as deductions from the selling price determined at such time as title to the severed product transfers to the purchaser of the oil or gas.

The purpose of this Bulletin is to identify the marketing costs referenced in Revenue Administrative Bulletin 1989-18, which can be deducted in determining the wellhead value for severance tax. This Bulletin is directed at gas production only, as the marketing costs for Michigan oil and condensate are nil. Further, these marketing costs will apply only when the gas conditioning equipment is owned and operated by the producer. (Refer to Revenue Administrative Bulletin 1989-18 for allowable gas production costs paid to a third party.)

For gas production, the following marketing costs are allowable as deductions from the selling price to arrive at the wellhead value for severance tax purposes:

1. Plant investment, straight-line depreciation for each year of the statutory period in accordance with provisions of the Internal Revenue Code;

2. Operating costs for each year;

3. Return on investment, based on the average prime rate for the year applied against the average of yearly beginning and ending depreciated investment; and

4. Direct overhead (i.e., administrative costs directly allocated to the plant operation).

Note: Normal lease separation is not a marketing cost and the required equipment up to and through lease separation shall not be included in the marketing cost computations.

After the marketing costs are determined, they must be divided by the full capacity production for the plant to arrive at the per thousand cubic feet (MCF) allocation.

The allowable marketing cost deduction for future years would be based upon either the average MCF cost for the past four years or the MCF cost computed for the previous year. At the end of each subsequent year, the actual costs would need to be determined and adjustments would need to be made for any difference between the actual marketing costs and the estimate.