Severance Tax - Oil and Gas

What deductions are allowed when computing gross income for oil and gas severance tax?

There are three deductions from gross income allowed under Colorado law [§39-29-102(3)(a), C.R.S.] for severance tax purposes:

- transportation,
- processing,
- manufacturing.

Transportation. The transportation deduction is the cost of moving identifiable, measurable oil or gas, including gas that is not in need of initial separation, from the point at which it is first identifiable and measurable to the sales point or other point where the value is established. [§39-29-102(7), C.R.S.] Costs directly attributable to transportation systems that are deductible include:

- The cost of compression downstream of the meter or measurement point,
- The cost of a pipeline that transports oil, gas or natural gas liquids along with compressors used in the transportation process,
- Overhead costs and depreciation directly attributable to the process of transportation, within the boundaries of the transportation system.

Deductible transportation costs begin after the initial separation until the sales point. Total transportation costs on a taxpayer owned transportation system must be allocated to all the production moved through the system and not allocated to only the taxpayer's production.

Processing and Manufacturing. The processing and manufacturing deduction is the cost incurred when natural gas is processed through a gas processing plant where identifiable natural gas liquids are stripped from the natural gas into residue gas and natural gas liquid product or the various individual natural gas liquid products and/or the hydrogen sulfite and sulfite. Only costs incurred prior to sale can be deducted.

Processing and manufacturing costs begin at the inlet of a gas processing plant or refinery and end at the tailgate of that facility. If a facility has multiple uses, only the costs for processing or manufacturing are allowed. Overhead costs and depreciation directly attributable to the activity of processing or manufacturing, within the boundaries of a refinery or gas processing plant, are deductible costs. Total processing and manufacturing costs from a taxpayer owned processing or manufacturing system must be allocated to all the products processed through the system and not be allocated to just taxpayers production.

Nondeductible costs include, but are not limited to:

- Gathering costs, which are defined as the movement of unseparated bulk production to the point of initial separation.

- Economic opportunity costs such as rate of return on investment.

- Other lease costs such as costs of putting oil and gas into marketable condition are not considered transportation, processing or manufacturing costs.