Opinion No. 34-778

June 16, 1934

BY: E. K. NEUMANN, Attorney General

TO: Mr. E. R. Wright, Attorney at Law, Santa Fe, New Mexico.

*{*137}* Your letter of June 8th, 1934, to which was attached an explanatory telegram, seeks information regarding the applicability of the School Emergency Tax Act to the following operations:

An Oil Company produces natural gas which it delivers to the Phillips Petroleum Company, which, in turn, extracts therefrom "casinghead gas." After such natural gas is processed, the residue is returned in part to the oil company and part is retained by the Phillips company. Such part retained and returned, is sold in certain quantities and in other quantities is used by the companies to repressure oil sands, fire boilers and is furnished to employees, without charge, for consumption by such employees.

Under Paragraph A of Section 201 of the Act, we find that any person, etc., producing natural gas shall pay a tax at the rate of two per cent of the gross receipts of such business.

We further find, in said section, *{*138}* where those taxable under paragraph A, and who refine, smelt, reduce, compound, manufacture or otherwise prepare for sale or use any minerals, etc., in mills or plants in this state and are taxable under paragraph B of Section 201 of the Act, such producers need not pay the tax levied by paragraph A, as producers of such natural resource products, where the value of such products is accounted for and tax thereon paid by such producers under said paragraph B.

We further find in said section, that where the producers of natural resource products, whose operations are taxable under Sec. 201 (a), sell such products to others engaged in the business of refining, smelting, reducing, compounding, manufacturing or otherwise preparing for sale or use such products in mills or plants in this state and taxable under Sec. 201 (b), such producers need not pay the tax upon the gross receipts of such sales, as a producer, but must report same to the commission.

One other provision pertinent to the matter under consideration is the following, a part of Section 201 (a):

"Any person engaging or continuing in any business taxable under any other paragraph of this section, or any other section of this act, who produces minerals, timber or other natural resource products, the production of which is taxable under this paragraph (A), and who uses or consumes same in his business, or that the gross receipts of such business does not include the value of such natural resource products so used or consumed, shall be deemed to be engaged in the business of mining and producing

minerals, timber or other natural resource products for sale, profit or commercial use, and shall be required to make returns on account of the production of such minerals, timber or natural resource products, so used or consumed, and to pay the tax imposed by this paragraph (A) for the privilege of engaging in the business of producing such natural resource products, and such tax shall be measured by the value of the products thus produced determined under uniform and equitable rules for ascertaining such value, to be prescribed by the Tax Commission."

We can easily determine, under the Act, that the oil company in question would be liable for a tax at the rate of two per cent upon the gross receipts of sales of natural gas produced, if such gas was sold or disposed of by it as produced, unless such product was refined or processed into a manufactured article or sold to a manufacturer, to use an all inclusive term, who manufactures such product in this state and who is taxable under Sec. 201 (b).

If the operation in question is one of sale of natural gas to the Phillips Company, the oil company would not be liable for any tax upon such sale, provided the Phillips Company processed same in this state, in which event the Phillips Company would be taxed as a manufacturer, etc., under Sec. 201 (b) upon the finished product. If then the residue gas were retained by the Phillips Company, its disposition would be taxable, either as a wholesale or a retail sale, as the case might be. The "casinghead gas" disposed of by the Phillips Company would then also be taxed as the Act provides in cases where manufacturers dispose of their goods.

I think the transaction should be considered as an outright sale to the Phillips Company, even though the oil company, as its compensation, receives a part of the proceeds of the sale of both the "casinghead gas" and residue gas. All residue gas not sold by the Phillips Company is returned to the oil company. It is no different than a transaction whereby the oil company would receive money for the gas instead of other things of value, such things of value being a part of the finished goods produced from the commodity sold.

The residue gas returned to the oil company cannot, as I view it, be considered as a part of the compensation paid it, and, consequently, its disposal thereof must be taxed. The tax, of course, is measured according to the kind of transaction in disposing of such gas. If sold it shall always pay the two per cent, as provided *{*139}* in Sec. 201 (a), if consumed by the oil company, it shall bear the tax upon the value as set forth in Section 201 (a), in the part thereof hereinabove quoted.