

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 369

January 3, 1974

CHARACTERIZATION OF THE TEXAS OIL AND NATURAL GAS PRODUCTION TAXES

Syllabus:

Resident Taxpayers Receiving Royalties Derived from Texas Oil and Natural Gas Sources May Not Deduct the Texas Oil and Natural Gas Production Tax Under Revenue and Taxation Code Section 17204 Because Said Tax is Measured by Income. The Texas Tax for Administration Purposes is Based on Volume Produced and is Deductible.

Advice has been requested whether the production tax imposed under Title 122A of the Revised Civil Statutes of Texas is a tax measured by income thus not deductible under Revenue and Taxation Code Section 17204. It was further requested whether the tax was deductible under Revenue and Taxation Code Section 17202 as an ordinary and necessary business expense.

A review of the applicable Texas statutes unequivocally shows that though the tax is a privilege tax, in that it is upon the occupation of owning, controlling or managing oil and gas wells, said tax is based on the market value of the oil and the natural gas produced, and is thus measured by the gross income derived from said products. This is particularly true with regard to royalty interest owners who, by definition, are without the benefits or burdens of the management and operation of the wells. Article 4.01, Title 122A, Texas Revised Civil Statutes. Accordingly, said Texas taxes on oil and natural gas production are not deductible from royalties reported as gross income pursuant to Revenue and Taxation Code § 17204(c)(2)(b).

The leading case of Burnet v Harmel, 287 U.S. 103 (1932) established that proceeds from oil and gas drilling operations are to be considered gross income, and that the apparent return of capital is a mere incidental matter. Thus oil and natural gas extraction are considered in the same vein as metals mining activities, which principle was recognized in the Appeal of L. N. Jesson, et al., Cal. St. Bd. of Equal., June 24, 1957, CCH 200-731, P-H 58,109: "While economically part of the royalty income of appellant is undoubtedly a return of capital, it is a well established rule that the concept of taxable income includes all proceeds from the sale of ore."

Title 102, Article 6032 of the revised civil statutes of Texas levies a tax of 3/16 of one cent per barrel of crude petroleum produced, in addition to the above mentioned taxes, and directs that this additional tax be used for the administration of the conservation laws of Texas relating to oil and

gas. This additional tax is based on volume produced rather than on the market value or the product. This additional tax is not measured by income. It is a tax paid or accrued in carrying on a trade or business or an activity related to expenses for production of income. Accordingly, it is held that this additional tax is deductible under Revenue and Taxation Code § 17204(a)(4).

The second question regarding Revenue and Taxation Code Section 17202 is governed by the familiar rule of the particular or specific statute governing another of more general application enunciated in Code of Civil Procedure, Section 1859. 5 Mertens, Law of Federal Income Taxation, Section 27.01 holds that where the tax in question is a specific liability of the taxpayer incurred by him then the deduction must be secured under the tax deduction statute and not under the business expense statute or any other statute. The Board of Equalization in a long line of appeals, commencing with the Appeal of Ernest J. and Evelyn Primm, Cal. St. Bd. of Equal., July 23, 1959, CCH 201-324, P-H 58, 159, has consistently applied that the exclusive tax remedy must be secured under the statute specifically designed for it and recourse may not be had to a statute of more general application.

Attention is directed to the recent Appeal of Charles T. and Mary R. Haubiel, Cal. St. Bd. of Equal., January 16, 1973, CCH 204-882, P-H 58,017-D, which overruled the decision in Appeal of Georgica Guettler, Cal. St. Bd. of Equal., April 1, 1963, CCH 200-212, P-H 58,079, and Appeal of Edward and Freda L. Meltzer, Cal. St. Bd. of Equal., April 1, 1953, CCH 200-213, P-H 58,081. Royalty income is gross income in California, Revenue and Taxation Code Section 17071(a)(6). In the situation posited, taxpayers received gross royalty income from which a gross income tax had been extracted. Any other aspects of the Texas taxing scheme which may constitute a tax on capital or a tax on gross receipts will have no effect upon nondeductibility of the tax in accordance with Revenue and Taxation Code Section 17204(c)(2)(B).