

**M e m o r a n d u m****495.0722**

To: Fresno – District Principal Auditor

Date: August 21, 1984

From: Principal Tax Auditor

Subject: Tax Application to Co-Owned Gas Plants and Joint Producing Operations

[G] Corporation

SY -- XX-XXXXXX

Your memorandum to Legal, dated February 1, 1984, was forwarded for our review and reply. We also are in receipt of [G] Corporation's "Model Form Operating Agreement," mailed to us on May 25, 1984, by V--- D---. Please excuse the delay in our response to your memo.

You asked for a review of your proposed instructions to [G] Corporation regarding the application of tax to co-owned gas plants and joint producing operations. For your convenience, we have drafted the suggested guidelines, the content of which has been reviewed by the Legal staff.

Our suggested guidelines are generally consistent with yours, but we did find a conflict in your instruction 4e. This section states that products furnished by the operator from its own stocks will be considered as consumed, and reimbursement to the operator by non-operators for their share of the value of the products consumed does not constitute a sale.

This appears in conflict with Mr. Putnam's letter of February 6, 1969, which states, "It appears to use that petroleum products and other consumable materials used in the operation should be treated the same as the equipment referred to in your suggestion number 4." Suggestion four concluded that "...the operator will be considered as having sold a fractional interest therein to each of the other participants and will collect and report sales tax on such sales."

If you have any questions, please let me know.

GAB:jb  
Attachment

cc: Mr. Gary Jugum

TAX APPLICATION TO CO-OWNED GAS PLANTS  
AND JOINT PRODUCING OPERATIONS

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Under the provisions of Section 6005 of the Sales and Use Tax Law, a group or combination acting as a unit is considered to be a "person." Section 6014 defines a seller as a person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of sales tax.

Transfers of equipment and materials to and from joint and contract operations are subject to the California sales and use tax where there is a change in the ownership of such equipment or materials.

Generally, tax applies to the various aspects of co-owned gas plants and joint producing operations as follows:

1. Formation and Liquidation

A. Contributions of tangible personal property by participants for a capital interest are not subject to tax. The tax does apply, however, to the sale of property to the joint operation for cash or other consideration, not representing an interest in the operation. In this case, the participant is regarded as selling to each participant a fractional interest in the property, the selling participant retaining his fractional interest which is excludable from the measure of tax.

B. The distribution of assets of the joint operation upon its dissolution, or distributions in the nature of a liquidating dividend, are generally not subject to tax. However, withdrawals of assets by a member or members of a joint operation prior to 80% completion of the operation are sales of the property transferred, and are not liquidating dividends. Therefore, such withdrawals are subject to tax. The measure of tax is the price of the property transferred, reduced by the receiving participant's fractional interest.

2. Direct Purchases by Operators - New Materials

After formation of the joint operation, neither the material burden nor freight billed to the other participants on purchases tax paid at source by the operator are subject to tax because the operator is acting as agent of the participants.

3. Withdrawals from Operator's Storehouse

Withdrawals from the operator's own stock of goods, for use in joint operations, normally do not constitute contributions of capital. Such withdrawals are considered to be taxable retail sales to the joint operation, and are measured by the interest transferred to the other participants.

A. New Materials

New materials purchased prior to the formation of joint operations are subject to tax on the selling price. However, a credit for tax-paid purchases is available. Sales and Use Tax Regulation 1701, "Tax-Paid Purchases Resold," provides that a retailer who resells tangible personal property before making any use of it, may take a deduction of the purchase price of the property if, with respect to its purchase, he has reimbursed his vendor for the sales tax or has paid the use tax.

In the case of joint operations, such tax-paid purchases made prior to formation, and later resold to the operation, are subject to the provisions of Regulation 1701. The measure of interest retained by the transferor must remain tax-paid. Thus, a credit would be allowable only with regard to tax paid in excess of the interest retained. Regulation 1701 should be consulted for additional guidance.

B. Used Material

Sales of used materials to the joint operation are taxable only to the extent of the interest assignable to the other participants. No tax-paid credit is allowable for materials that were used by the seller prior to the sale to the joint operation.

C. Exchanges

Exchanges are considered to be sales by the joint operation and sales by the operator under A & B above.

4. Disposal of Materials

- A. Where the operator disposes of property belonging to the joint operation, it is considered a sale by each participant of their respective interest. Tax is due on the total selling price. Primary liability will remain with all participants if the operator fails to report the tax.
- B. If the operator transfers the materials to his own storehouse, tax is due based on the percentage of the other participant's ownership.
- C. On the transfer of new or used materials and equipment from a non-operator participant to a joint operation, such non-operator must accrue and pay sales tax applicable to the interest transferred to the other participants and may charge the other participants for sales tax reimbursement according to their interests.

- D. If petroleum products are furnished by the operator from its own stocks, and consumed in the operation, the operator is considered to have sold a fractional interest therein to each of the other participants and must report sales tax on such sales.

With respect to the above general guidelines, the taxability of any given transaction should be examined in light of the actual contractual agreement between the parties involved.

**M e m o r a n d u m****495.0722**

To: Mr. Glenn Bystrom

May 29, 1996

From: Gary Jugum

Subject: Non-Attorney Opinions

I have reviewed Principal Tax Auditor's memorandum of August 23, 1984 to Fresno - District Principal Auditor.

We are in agreement with his conclusion as follows:

**Co-Owned Gas Plants and Producing Properties.** Contributions of property to the joint operation (JO) for a capital interest are not subject to tax, but sales of property by a participant to the JO for conventional consideration are subject to tax except for the fractional interest of the selling participant. The distribution of assets at the dissolution of the JO are generally not subject to tax, but the withdrawal of assets by a member of the JO before 80 percent completion of the operation are sales and subject to tax except for the fractional interest which had been retained by the member.

New materials provided by the operating member from its own inventory are considered to be taxable sales to the JO, except for the fractional interest of the operator. If the materials were held in a tax paid status, the operator may take a tax-paid purchase resold deduction (except for the fractional interest retained). Transfers of used items from the operators inventory are subject to the same treatment as new materials, EXCEPT a tax-paid purchase resold credit is not allowable. The sale of JO property to non-members is a sale of each member's interest and each is liable for the tax if the sale is taxable and if the operator fails to report the tax. If materials are transferred from the JO to the operator or other member of the JO, tax is due on the proportion of the change in ownership. Transfers by members to the JO are sales by the transferor to the extent of the change in ownership and sales tax reimbursement may be charged to the JO. Petroleum products transferred to the JO by the operator or any member of the JO are subject to the same taxability as the operating materials discussed above. 8/23/84