



## *BP America: the Legislative and Practical Aftermath*

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As most in the industry are now aware, on April 25, 2016, the Colorado Supreme Court decided *BP Am. Prod. Co. v. Colo. Dep't of Revenue*, available [here](#), in which it held that the cost of capital invested in transportation, manufacturing, and processing activities are deductible in valuing oil and gas resources for tax purposes under Colorado Revised Statute § 39-29-102(3)(a). Thus, the cost of capital is a deductible cost because it qualifies as “any transportation, manufacturing, and processing costs borne by the taxpayer.” This Opinion made clear that the Colorado Department of Revenue’s determination, since 2003, that the cost of capital may not be deducted as a transportation or manufacturing cost from revenue under this severance tax statute was in error.

### Catching up on the Supreme Court Case

BP America Production Company (“BP America”) sought to deduct, for tax years 2003 and 2004, certain costs of capital for construction of transportation and processing facilities built by its predecessor in interest. The Mineral Audit Section of the Department of Revenue denied the deduction, and BP America paid the Department of Revenue the disputed amount under protest. Pursuant to that protest, a hearing was held in which the Department of Revenue issued its final determination that cost of capital is not a deductible cost under the severance tax statute. BP America challenged the hearing officer’s final determination in Denver District Court. The district court found for BP America and ordered the Department of Revenue to refund to BP America the stipulated amount of cost of capital, which it had paid under protest. The Department of Revenue appealed, and the court of appeals reversed, finding that the cost of capital was not deductible. The Supreme Court, however, sided with the district court, and found that the plain language of the statute allowed a deduction from severance tax payments for cost of capital.

### Subsequent Legislation

Since this decision, Colorado lawmakers introduced two pieces of related legislation: House Bill 16-1468 and Senate Bill 16-218. HB 16-1468, introduced on May 9th, sought to legislatively reverse the Colorado Supreme Court’s decision in *BP* by amending the definition of “Gross income” under C.R.S. § 39-29-102 to specifically exclude cost of capital. HB16-1468 did not make it out of the House prior to the end of the legislative session on May 11, 2016.

SB 16-218, which was supported by the industry, established the necessary reserve fund to provide the ability for the Department of Revenue to make the required severance tax refunds. This bill authorizes the diversion of an estimated \$115.1 million in income tax revenue from the general fund to a reserve fund to pay all severance tax refunds pursuant to the Supreme Court's holding that the cost of capital is an allowable deduction from revenue. SB 16-218 was signed by Governor Hickenlooper on June 10, 2016.

### Going Forward

Because BP America and the Department of Revenue stipulated to the amount of the cost of capital deduction (\$629,186 and \$669,202, plus interest for tax years 2003 and 2004, respectively) neither the district court decision nor the Supreme Court decision provide specific instructions to operators in the calculation of cost of capital deductions. However, the Supreme Court's definitions and its references to the Property Tax Administrator's guidelines should assist operators in working with their tax professionals and attorneys to accurately capture these deductions.

For further information regarding cost of capital deductions after *BP Am. Prod. Co. v. Colo. Dep't of Revenue*, please contact [Malinda Morain](#) or [Karen Spaulding](#).