



Arkansas Natural Gas Severance Marketing Costs

The following lists present various costs by category as "Allowable" or "Disallowed" as marketing costs. While listing many items, this list may not be all inclusive. Marketing cost must be necessary and essential to marketing the gas. Marketing costs may not reduce the taxable value of gas to less than zero. Marketing costs may not be carried forward from one month to another.

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|---|-----------|------------|---|
| WELLHEAD AND DOWNHOLE EQUIPMENT/OPERATIONS | | | These items all relate to either the drilling of the well or well servicing activities. None are deductible as marketing costs. |
| Acidizing | | X | |
| Casing | | X | |
| Cementing | | X | |
| Drill Pipe | | X | |
| Fishing/fishing tools | | X | |
| Fracturing | | X | |
| Hot oiling/hot oil treatment | | X | |
| Injecting bariod | | X | |
| Logging | | X | |
| Packers/setting packers | | X | |
| Paraffin removal | | X | |
| Perforating | | X | |
| Swabbing | | X | |
| Tubing | | X | |
| Well Service | | X | |
| Wire line service | | X | |

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|--|-----------|------------|---|
| Production Equipment/Operations | | | These items are all involved with the production of oil and gas, not marketing the gas. Therefore, none are allowable as marketing costs. |
| Christmas tree | | X | |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|---|---|---|--|
| Compressors: wellhead/suction/vacuum | | X | This type of compressor sits on top of the well bore and is used to suction out the oil and gas. |
| Corrosion inhibiting chemicals | * | X | *Most of these chemicals are used downhole and are not allowable. If the chemical is used in a pipeline that is part of the marketing function, that portion may be allowed. |
| Downhole separation | | X | |
| Electricity to run pumping unit | | X | |
| Lease use gas to run pumping unit | | X | Gas used to run a pumping unit is taxable as lease use gas, and there is not a corresponding marketing deduction for this gas value since the pumping units are used to produce oil and gas. |
| Pumping unit | | X | |
| Replacement valves/parts for Christmas tree | | X | |
| Rods/pulling rods | | X | |
| Submersible pumps | | X | |
| Tanks | | X | |
| Tank and Vessel cleaning | | X | |
| Automatic Shut-Down Devices (ASDs) | | X | These devices will automatically shut-down the operations of all lease equipment in the event there is a problem with the wellhead or within the lease operations. |

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|--|-----------|------------|---|
| EQUIPMENT AFTER THE WELLHEAD | | | |
| Air compressors used to start lease equipment | | X | Not allowable unless used to start equipment that otherwise qualifies as marketing equipment. |
| Break out of heater and removal; set new heater and start hook-up. | | X | Not allowable unless this refers to a qualifying line heater. |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|---|----|---|---|
| Cathodic protection | X | X | These are rods used to prevent corrosion of pipes and vessels. They are allowable if used on the marketing gathering lines or if used on any allowed marketing equipment but not allowed if used downhole. |
| Chrome/stainless piping for handling gas with H2S content. | X* | | *Depends on if the piping qualifies as allowable, based on location of the piping and its function. The "chrome/stainless steel" element is irrelevant. |
| Clean contacts on coffering | X | | See "coffering for compressor" |
| Coffing for compressor building | X | | Coffing is used like a crane to lift and move the compressor. |
| Compressor installation charges | X | | If the compressor is owned and used in manner related to gas marketing, the installation costs may be included in depreciable base. |
| Compressor/parts and service for compressors - gas lift systems | | X | |
| Compressors/parts and service for compressors - to return gas to leases | | X | |
| Compressors/parts and service for compressors - to get gas up to required sales pressure. Compressors owned rather than rented. | X* | | *If compressors perform a dual purpose, the costs can be allocated between allowable and not allowable marketing costs. Must be depreciated over useful life. (Cannot take a rental value for owned equipment.) |
| Compressors - rented sales compressors | X | | Deducted as a monthly expense. |
| Compressors - at central facility (compressor stations) | X | | Same as above for all compressors. |
| Compressor - transmission line | | X | Not allowable unless it occurs before the sale has been made. |
| Compression charge on settlement statement | X* | | *Allowable if not already deducted from the reported price. |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|---|----|---|---|
| Compression fuel for gas lift compressors | | X | |
| Concrete slab for compressor | X | | If compressor is owned, cost of the slab may be included in depreciable base. |
| Concrete pad around compressor to collect oil and drainage, to reduce environmental clean-up in the future. | | X | |
| Cost reimbursement from gas purchaser for compression | | X | Should be included in gross taxable value, and actual marketing costs deducted by the producer. |
| Dehydrators | X | | Takes the water content out of the gas stream. |
| Demulsification chemicals | | X | Used to break down oil emulsions, usually in a heater treater. |
| Fence around compressor | | X | |
| Filters | X* | | *Allowable if used on a piece of equipment that qualifies as a marketing cost deduction. |
| Fin Fans | X | | Used to cool the gas after it has been compressed. |
| Flow lines from separator to purchaser's transmission line | X | | |
| Glycol for use in dehydrators | X | | See "dehydrators" |
| Heater Treater | | X | Used to treat oil, not gas. |
| Hydrogen sulfide (H2S) scavengers | X | | |
| Hydrogen sulfide monitoring | | X | |
| Insurance on compressor | | X | |
| LACT Units | | X | These measure crude oil being sold. |
| Lease chiller | X | | |
| Lease separators | | X | |
| Line heaters | X* | | *Allowable if the heater is located after the separator. Not allowable if the heater is located before the first separator. |
| LTX Unit | X | | |
| Methanol for gas line | X | | Used in preventing freeze-ups. |
| Condensate storage tanks | X | | |
| Painting sales compressor building | | X | |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|--|---|----|---|
| Painting dehydrator | X | | |
| Painting separators | | X | |
| Paint storage tanks to prevent rusting | | X | |
| Pig socks used around oil storage tanks & compressor | | X | Used to clean oil spills. |
| Pigs and pigging equipment | * | X | *Allowable if used on gathering lines prior to the sales point. However, most pigs are used on gas transmission lines after the lease sale, in which case they are not allowed as a marketing cost. |
| Pipeline between wellhead and separator | | X | |
| Pipeline between wellhead and central separation facility | | X | |
| Pipeline between wellhead and sales line if there is no lease separation and no separation prior to sale (gas is sold full well stream). | X | | |
| Pipeline between wellhead and plant if there is no lease separation and gas is going full well stream to the plant for processing | X | | |
| Pipeline after first separator | X | | Between separator and sales line. |
| Removal of contaminated soil, back-fill new dirt | | X | |
| Repair handrails on vessels at tank battery | | X | |
| Repair water leg on heater treater | | X | |
| Security alarm on compressor | | X | Not necessary and essential. |
| Separators at central facility | | X* | *Allowed if first separation has already occurred. |
| Shed/cover over sales compressor | | X | |
| Skid mounting of sales compressor | X | | Skid mounting of gas lift compressor not allowable. |
| Stack packs/production units | | X | Basically separators that contain a heat source. There may also be lease use gas consumed on these. |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|--|---|---|---|
| Sweetening chemicals and H2S Sweetening Scavengers | X | | Used to remove hydrogen sulfide from gas. Not allowed if used downhole. |
| Vapor recovery units | | X | Recovering additional vapors is a production function, not marketing. |
| Drip Stations and the costs of hauling products from drip stations | | X | Pipeline drip is generally considered to be condensate, so the costs of handling it are not deductible. |
| Culverts to protect the pipelines | | X | Not necessary and essential to market the gas. |

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|--|-----------|------------|--|
| OTHER LEASE RELATED ITEMS | | | |
| Ad valorem taxes | X* | | *Allowable on the value of marketing equipment only. If there is no breakdown between marketing equipment vs other equipment, taxes are not allowable. |
| Building or trailer rental | | X | |
| Cattle guards around lease equipment or on lease roads | | X | |
| Clean out dumpsters, trash barrels at lease facility | | X | |
| Cleaning agents | X* | | *Deductibility depends on purpose for which they are being used. Costs are allowable if used on allowable marketing equipment. |
| Construction/installation of lease road | | X | |
| Cost to acquire pipeline right of way | | X | |
| Fence around the lease facility | | X | |
| Fire ant treatment around lease, including compressor | | X | |
| Fire extinguishers | | X | |
| Heat sensing devices on leases | | X | |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|--|----|---|---|
| Hydrostatic testing | X* | | *Usually refers to testing pressure and amount of water in pipelines. Deductibility depends on which pipelines are being tested. Testing after separation is allowable. |
| Miscellaneous parts, valves, fittings, plugs, duct tape, lubricants, tools, etc. | X* | | *Deductibility depends on purpose for which they are being used. Costs are allowable if used on allowable marketing equipment. |
| Motor freight & hauling | X* | | *Deductibility depends on purpose of freight and hauling. Costs are allowable if for allowable marketing equipment. |
| Mowing, weeding around lease equipment | | X | |
| Mowing, weeding pipeline right of way | | X | |
| Repairing fire wall | | X | |
| Repair and maintenance on lease roads | | X | |
| Salt water disposal expenses, including wells and hauling | | X | Water is produced as part of the production operations. Disposing of that water is also a production related expense not related to marketing gas. |

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|---|-----------|------------|--|
| LABOR EXPENSES | | | |
| Cellular phone in pumper's truck, radios, CBs, etc. | X* | | *Include in overhead. Allow at 10% rate. |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|--|----|----|---|
| Company labor expenses if there is contract labor on the same lease | | X | Company labor should not be allowed when the company has hired contractors to work on the marketing equipment. The contract labor expenses can be claimed on marketing equipment. If the contractors work only on specific equipment, i.e., the compressor, then an appropriate percentage of company labor can be allowed for time spent working on other marketing equipment. |
| Contract labor | X* | | See "Company labor expenses" |
| Cost to operate district office building, warehouses, shops, garages, etc. | | X | |
| Cost of secretary in district office | | X | Does not work on equipment which is physically handling gas. |
| Field supervisor cost | X* | | *Include in overhead. Allow at 10% rate. |
| Gauger salaries/benefits | | X* | *Deductible only if gauger is doing the work of a pumper on marketing equipment. |
| Hand tools used by pumper/gauger | X* | | *If the employee's duties are such that his or salary is an allowable marketing expense, the tools the employee uses are then includable as an overhead expense at a 10% rate.. |
| "Break out of heater and removal; set new heater and start hook-up" | X* | | *See line heaters. |
| Meals/food expenses for pumper/gauger | | X | |
| Meals/food expenses for other district office personnel | | X | |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|--|----|---|---|
| Pumper salaries/benefits | X* | | *The percentage of salary attributable to pumper's time spent working on marketing equipment is allowable. The percentage of salary attributable to other duties, i.e. production, is not allowable. A standard percentage is often used, i.e., 50% of the salary charged to gas wells and 25% charged to oil wells. Each situation should be evaluated independently to determine appropriate percentages. If the only meter on the lease is an allowable marketing meter, and no other marketing equipment, only 10% of the salary is deductible. |
| Safety clothing/equipment | | X | Required by OSHA or EPA. |
| Supervisors of company and contract labor | X* | | *Allowable at 10% overhead rate. |
| Thawing gas lines | X* | | *Allowable if the lines being thawed are after the initial separation. |
| Transportation expenses for pumpers/gaugers (trucks) | X* | | *Include in overhead at 10% rate, if the transportation expenses are directly related to marketing equipment. |

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|-----------------------|-----------|------------|--|
| METERS | | | |
| Gas analysis expenses | X | | To make sure contract requirements are met. |
| Meters - sales | X | | Meter on which payment is based. If sales meter is owned by producer, the cost of the meter (depreciation plus monthly maintenance expense) is deductible. |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|---|----|---|--|
| Meter - allocation meter | X | | Allowable if more than one well or lease is paid from a single purchaser meter. If the sales meter is owned by the purchaser, the producer is allowed to take the cost of lease allocation meters (since we require lease level reporting). |
| Meters - check | | X | Used to verify sales volumes; usually located next to the purchaser's sales meter. |
| Meter to measure lease use gas | | X | |
| Meter calibration services | X* | | *For sales or allocation meters only. |
| Pens for meters; graphic red pen, graphic green pen, black static pen | X | | Allowable if used in an allowable meter only. |

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|---|-----------|------------|--|
| ELECTRICITY | | | |
| Central separation/compression facility | X* | | *Partially allowable. Allocate electricity costs based on how much is used in each function of the facility. |
| District office building | | X | |
| Electronic gate | | X | |
| Gas lift compressor | | X | |
| Gas sales compressor | X | | |
| Generators | X* | | *Depends upon use. If used for allowable equipment, it is allowable. |
| Lease security light | | X | |
| Maintenance shop | | X | |
| Oil pumps | | X | |
| Pumping unit | | X | |
| Storage building | | X | |

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|---------------------|-----------|------------|----------|
| PLANTS | | | |
| Compressors - inlet | X | | |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|--|----|---|---|
| Compressors - tailgate | X* | | *Compressors handling sales gas before the sales meter are allowable. Compressors handling gas being returned to leases for gas lift, injection or lease use, or transmission, are not allowable. |
| Control room computers | X | | |
| De-methanization expenses | X | | |
| Installing breaker in control room | X | | |
| Janitorial expenses for office building, storage buildings, and control room | | X | |
| Painting of plant piping and other facilities | | X | |
| Propane compressors | X | | Before the sales meter |
| Scrubbers | X | | |
| Water chilling expenses | X | | |
| Trucks for intra-plant transportation | X* | | *Allowed at the 10% overhead rate. |
| Trucks provided for the transportation of plant managers and supervisors | | X | |

| ITEM | ALLOWABLE | DISALLOWED | COMMENTS |
|---|-----------|------------|---|
| MISCELLANEOUS ISSUES | | | |
| Accounting department salaries | | X | Recording revenue from leases and reporting taxes. |
| Carbon dioxide recovery projects | | X* | *These projects are normally used to enhance production of crude oil. Only an allocation of expenses may be allowed as a marketing cost. The cost of removing CO2 from a gas stream that is being sold is allowable. The cost of returning CO2 to leases and injecting back into the formation is not allowed. The allocation should be based on a study of the schematics for each individual situation. |
| Brokerage or Marketing Fees | | X | |
| Tax-Exempt leases and Partially tax-exempt leases | | X* | *Marketing cost may only be taken on taxable gas. |

Arkansas Natural Gas Severance Marketing Costs

| | | | |
|---|--|---|--|
| Insurance premiums on any equipment or facilities | | X | |
| Legal Department salaries and expenses | | X | Legal department prepares contracts for marketing gas. |
| Production Fees | | X | These fees relate to the amount produced. Sometimes there is a fee for delivering less than the amount called for in the contract. |
| Environmental fees and taxes | | X | |