United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 173702
Denver, Colorado 80217-3702

IN REPLY REFER TO:
CVD-FCB-ACS

MAR 11 1996

Dear Payor:

The Minerals Management Service (MMS) recently amended its valuation regulations on transportation, processing, and washing allowance deductions used to calculate royalties due on Federal oil and gas, and coal leases (61 Federal Register, 5448, February 12, 1996). The changes, effective March 1, 1996, eliminate allowance forms-filing requirements and associated sanctions for Federal leases only. The amended regulations do not change allowance forms-filing requirements for Indian leases.

In this letter, we describe what changes and what remains the same, The enclosure presents some questions and answers to further clarify the intent of these regulations and help avoid misinterpretation.

What Changes Under the Amended Reglations

- Allowance forms are no longer required for Federal oil, gas, and coal leases. We are adopting a self-implementing approach in which you claim an allowance deduction by reporting it as a separate line entry on the Form MMS-2014, Report of Sales and Royalty Remittance. using the appropriate transaction code.

- Forms-filing. sanctions, allowance payback, and interest for late form filing are eliminated for Federal leases.

- Payors who improperly net royalty value with their allowance deduction when reporting their monthly royalties due may be assessed up to 10 percent of the allowance reported as a netted amount, not to exceed $250 per violation.

What Doesn't Change Under the Amended Regulations

- Regulatory requirements for Indian leases are unaffected by the amended regulations.

- We are retaining the regulatory allowance limits for oil and gas that have been effective since March 1, 1988. You cannot reduce royalty value by more than 50 percent for transportation or $66\frac{2}{3}$ percent for processing without prior MMS approval. Also, you cannot under any circumstances reduce the value, for royalty purposes, to zero for transportation and/or processing under oil and gas leases; or for transportation and/or washing under coal leases.

- You still must make separate line entries when claiming allowance deductions on the Form MMS-2014.

- We are retaining transportation factors for the reporting of royalties due on oil and gas sold under arm's-length contracts. For specific guidance on this issue, please direct your questions to Mr. James P. Morris, Valuation and Standards Division, at (303) 275-7213.

If you need additional information, please call Mr. Tom Brozovich, Chief, Allowance Compliance Section, at (303) 231-3351 for oil and gas leases; or Mr. Herb Wincentsen, Chief, Solid Minerals Valuation Branch, at (303) 275-7210 for coal leases.

Sincerely,

Donald T. Sant

Robert E. Brown
Acting Associate Director
for Royalty Management

Enclosure

Questions and Answers
Relating to Amended Allowance Regulations
Effective March 1, 1996

1. **What allowance forms am I required to submit after March 1, 1996?**

For Indian leases, you must continue to submit the appropriate allowance form(s), which may include any or all of the following:

- Form MMS-4109, Gas Processing Allowance Summary Report
- Form MMS-4110, Oil Transportation Allowance Report
- Form MMS-4292, Coal Washing Allowance Report
- Form MMS-4293, Coal Transportation Allowance Report
- Form MMS-4295, Gas Transportation Allowance Reports

For Federal leases, you are not required to file any allowance forms. This change includes 1996 estimates, 1995 actuals, and revisions to prior periods. However, you must still adjust the Report of Sales and Royalty Remittance, Form MMS-2014, within a reasonable time period to reflect "actual" allowances taken for any sales month. When replacing estimated allowances with actual allowances on the Form MMS-2014, use Adjustment Reason Code 04.

2. **Will transportation factors be retained?**

The amended allowance regulations for oil and gas retain the transportation factor provision for both Federal and Indian leases.

The only situations where MMS allows you to net transportation costs for royalty reporting on the Form MMS-2014 are when:

- the sale is arm's-length and the contract price is determined net of the cost of transportation, or

- an onshore oil posted price bulletin contains a charge for transportation that is deducted from the posted price paid.

Under any other circumstances, such as a less-than-arm's-length sale or an out-of-pocket transportation cost, you must report the transportation separately on the Form MMS-2014 as a transportation allowance using Transaction Code 11. The MMS will approve a different reporting procedure only in unusual situations.

For additional guidance on when you can deduct a transportation factor from royalty value, refer to the MMS Oil and Gas Payor Handbook, Volume III, Pages 5-4 and 6-3.

3. Does this change the "type" of costs that I may deduct or just the reporting requirements?

The regulations change only the allowance reporting requirements for Federal leases. Regulations at 30 CFR 206 have not changed and continue to govern the types of costs you may deduct.

4. How do I report allowances for Federal and Indian products processed through the same facility?

You must maintain records of all costs and your ownership portion of total throughput to satisfy record keeping requirements.

For both Federal and Indian leases, you must report processing allowances on Form MMS-2014 not to exceed $66^2/_3$ percent of royalty value without prior MMS approval. However, you still must submit Form MMS-4109, Gas Processing Allowance Summary Report, showing throughput attributable to Indian leases.

5. Under the March 1996 regulations, can I recoup an allowance previously denied because of a forms-filing violation under the March 1988 regulations for oil and gas or the March 1989 regulations for coal?

No. You cannot use the amended regulations to obtain relief from forms-filing requirements and related assessments prescribed under the March 1988 oil and gas and March 1989 coal regulations. You can recoup an allowance for prior periods only through adjustments mandated by the Department of the Interior as a result of audit, valuation review, or lease administration.

6. What records must I maintain to support an allowance deduction?

You must maintain all records and cost data used to calculate an allowance amount claimed on the Form MMS-2014. Record keeping requirements, as described at 30 CFR 206, 207, and 212, have not changed under these amended regulations.

7. Will my transportation and processing allowances appear on the Model Form MMS-2014?

No. You are responsible for entering those lines on the Form MMS-2014.