

Notice sent: Final Interlocutory None
Disp Parties: All
Disp code: CVD/CLS 4018
Redact pgs:
Judge JKD Clerk UAm

DC BK12125 PG802

Filed in The District Court
of Travis County, Texas

CAUSE NO. D-1-GN-09-004284

EM APR 30 2012

At 2:16 P M.
Amalia Rodriguez-Mendoza, Clerk

SOUTHWEST ROYALTIES, INC.,
Plaintiff

v.

SUSAN COMBS, Comptroller of Public Accounts
of the State of Texas and GREG ABBOTT,
Attorney General of the State of Texas,
Defendants

§
§
§
§
§
§
§
§

IN THE DISTRICT COURT OF

TRAVIS COUNTY, TEXAS

353rd JUDICIAL DISTRICT

FINAL JUDGMENT

On April 9, 2012, Plaintiff Southwest Royalties, Inc. and Defendants Susan Combs, Comptroller of Public Accounts of the State of Texas, and Greg Abbott, Attorney General of the State of Texas, appeared by and through their respective counsel and announced ready for trial. The Court conducted a bench trial on April 9 and 10, 2012. Plaintiff brought suit under Texas Tax Chapters 112 and 151 to recover sales and use tax for the period January 1, 1997, through April 30, 2001. The Court finds it has jurisdiction over the parties and the issues. The Court has considered the pleadings, evidence, case law, and arguments of counsel.

Plaintiff contends it is exempt from paying sales and use tax on the disputed items. In seeking the tax exemption, Plaintiff bears the burden of proof to establish that the exemption applies. The Court finds that Plaintiff failed to meet that burden, and the Court renders judgment for Defendants on all counts.

The primary dispute among the parties centers on the construction of the exemption for Property Used in Manufacturing, Tex. Tax Code §151.318(a)(2) and whether the equipment used by Plaintiff to bring petroleum to the ground surface qualifies for the exemption. The statute



provides:

(a) The following items are exempted from the taxes imposed by this chapter if sold, leased, or rented to, or stored, used, or consumed by a manufacturer:

(2) tangible personal property **directly used** or consumed in or **during the actual** manufacturing, **processing**, or fabrication of tangible personal property for ultimate sale **if the use** or consumption of the **property is necessary** or essential to the manufacturing, **processing**, or fabrication operation and **directly makes or causes a chemical or physical change to:**

- (A) **the product** being manufactured, processed, or fabricated for ultimate sale; or
- (B) any intermediate or preliminary product that will become an ingredient or component part of the product being manufactured, processed, or fabricated for ultimate sale. . . .

(Emphasis added). The parties have discussed at length whether the extraction of petroleum from underground is "mining" or "manufacturing." The determination of Plaintiff's claim does not turn on this question. By application of the plain meaning of the statute, Plaintiff has failed to prove the exemption applies.

It is undisputed that a physical change occurs when petroleum is brought to the surface of the ground. The difference in pressure underground and above ground causes gas to come out of the petroleum with the result that Plaintiff recovers oil and gas. In other instances, the temperature difference from below to above ground causes some gas to condense and become liquid. These changes from liquid to gas and gas to liquid are "physical changes" within the meaning of the statute. It is also undisputed that the physical changes are caused by differences in pressure and temperature that result from lifting the petroleum to the surface. Proof that a physical change has occurred, however, is insufficient to establish that the exemption applies because what must be shown is that the **equipment at issue directly causes** the physical change

to the petroleum.¹ A "reasonable definition of 'direct' implies a close link with no intervening causes." *Sabine Mining Co. v. Strayhorn*, 2007 WL 2390686, *11 (Tex. App.—Corpus Christi Aug. 23, 2007) (No. 13-06-330-CV) (mem. op.). The Court specifically finds that the change of pressure and temperature "intervene[] to cause the changes to marketable" oil and gas and that Plaintiff's equipment that brings it to the surface "is merely an indirect cause of the changes."

The State contends that the exemption does not apply on these facts. The Court agrees with the State's construction of the statute. The burden is not on the State to prove that the exemption does not apply; the burden is on Plaintiff to prove that it **does** apply and the extent of the refund that is within that exemption. The Court finds that Plaintiff has not met its burden of proof. The evidence established that the direct cause of the physical change is the change in pressure and/or temperature. The Comptroller's construction of the exemption is reasonable and does not contradict the plain language of the statute, particularly in light of other provisions in the tax code that would be rendered meaningless, i.e. Tex. Tax Code §§ 151.317 and 151.324. The Court follows the reasoning in the memorandum opinions, *Houston Wire & Cable Co. v. Combs*, 2008 WL 678540 (Tex. App.—Austin March 12, 2008) (03-07-00006-CV) (mem. op.); *Sabine Mining Co. v. Strayhorn*, 2007 WL 2390686 (Tex. App.—Corpus Christi Aug. 23, 2007) (No. 13-06-330-CV) (mem. op.).

The Court renders the following judgment:

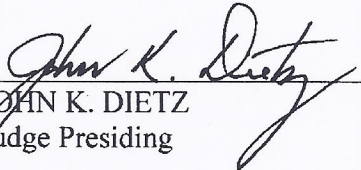
1. Defendants' Plea to the Jurisdiction of April 11, 2012, is DENIED.
2. Plaintiff's claim for a refund under Tex. Tax Code § 151.318 is DENIED.
3. Plaintiff's claim for a refund under Tex. Tax Code § 151.3111 is DENIED.

¹ The Court does not address other factors in the exemption because the causation requirement disposes of the case.

4. Plaintiff to pay costs of court.

All relief requested by the parties and not specifically granted herein is DENIED. This judgment disposes of all parties and claims and is final and appealable.

SIGNED the 30th day of April, 2012.



JOHN K. DIETZ
Judge Presiding