

**M e m o r a n d u m****440.3050**

To: Mr. Glenn Bystrom

Date: October 29, 1985

From: Gary Jugum

Subject: --- --- ---

We have reviewed the material relative to the audits of the two referenced accounts insofar as ex tax purchases of kerosene distillate are concerned. We have also reviewed prior memoranda of this office dated January 30, 1951 (E. H. Stetson), September 25, 1953 (E. H. Stetson), and May 31, 1972 (J. Manarolla).

We are of the opinion that the reference taxpayers may purchase the kerosene distillate in question for resale and that the taxpayers incur no use tax liability resulting from activities which occur in the production process, including injection for well stimulation. The distillate is resold as part of the crude oil product to the extent that the distillate is recovered and is not dissipated as waste in the process. The critical factor is that to meet the viscosity requirements of the purchaser, as provided by the purchase contract, the distillate must be incorporated as a diluent with the heavy crude product. While it is true that the distillate provides a beneficial effect in the well stimulation process, the distillate must be included in the product sold and delivered to meet contract specifications. Thus, in accordance with Regulation 1525 as it presently reads and in accordance with Regulation 1525 as it is proposed to be amended and in accordance with Kaiser Steel Corporation v. State Board of Equalization, 24 Cal.3d 188, the primary purpose for which the distillate is purchased is for resale. Accordingly, the tax does not apply. Note too that this has been our consistent administrative interpretation for the last 34 years.

Herewith the master files and reports of field audit with respect to the referenced accounts.

GJJ:sr

Attach.