



Revenue Ruling

No. 10-003

November 10, 2010

Sales Tax

Oil and Gas Well Fracturing Services

Purpose

The purpose of this Revenue Ruling is to provide guidance to Department of Revenue employees and taxpayers to clarify the taxability of the services and materials provided by a company in the business of oil and gas well completion and well rework services, including a process call “frac service.”

Statement of Facts

Advice has been requested by an attorney, on behalf of his client “Company A,” to determine their sales and use tax liability on oil and gas well fracturing and the materials used to provide this service.

Company A is in the business of providing well completion and well rework services. Company A is headquartered outside Louisiana. Company A provides pressure pumping services to oil and gas companies, including some companies that operate in Louisiana. Company A’s services are used in completing new oil and gas wells and in reworking existing wells in order to enhance production of oil and gas.

One of Company A's services is a process called hydraulic fracturing (or “frac service”). Hydraulic fracturing is a method of well stimulation in which a thick fluid is pumped into a well under extremely high pressure. When the well is pressurized, the fluid is forced through the formation, creating new fractures through which oil or gas can flow. Although the fluid is recovered when the pressure is released, one of the constituents in the hydraulic fluid, the “proppant,” remains in the formation after the procedure. The proppant Company A uses in its frac service is sand. The shape of the sand does not change during the hydraulic fracturing process and it does not become permanently affixed to the subsurface. The purpose of placing the proppants in the subsurface fractures is to prop them open so that oil will flow through them and into the well bore where the oil will travel to the surface.

Company A separately states the charges for time and materials (proppants) on its invoices to its customers. The separately-stated charge for the proppants generally runs about twenty-five (25) percent of the charge for the well frac service.

Issue

Whether the state of Louisiana imposes sales tax or gross receipts tax on the separately-stated labor charges for performing well fracturing services?

Whether Louisiana imposes a sales tax or gross receipts tax on the separately-stated charge for proppants (i.e., sand) which remain in the formation as part of the frac service?

If the separately-stated charges for proppants to “Company A’s” customers aren’t taxable, is Company A liable for paying tax on its purchase of proppants?

Legal Analysis/Discussion:

Sales of Services and Labor

Well Completing

The taxability of services is governed by La. Revised Statute Ann. 47:301(14), which levies a sales tax on specifically enumerated services.¹ This tax is presently addressed in La R.S. 47:302 C, 47:321 (C), and 47:331(C) which provides in part: "There is hereby levied a tax upon all sales of services, as herein defined, in this state..." Unless specifically designated or defined in the statute as taxable, sales of services are exempt from state sales tax.

Based upon the facts provided, Company A is classified as a contractor.² The services provided by Company A comprise of completing new oil and gas wells and reworking existing wells, including a process called hydraulic fracturing, in order to enhance production of oil and gas. Such services are not among specifically enumerated services defined under La. R.S. 47:301(14), and therefore will not be subject to state sales tax.

¹ La R.S. 47:301 (14) statutorily defines the following services as taxable “sales of services”:

- the furnishing of sleeping rooms, cottages or cabins by hotels;
- the sales of admissions to amusement places, athletic entertainment, and recreational events;
- the furnishing of storage or parking privileges by auto hotels and parking lots;
- the furnishing of printing or overprinting, photostating, or similar services of reproducing written or graphic matter;
- the furnishing of laundry, cleaning, pressing, and dyeing services;
- the furnishing of cold storage space and the service of preparing tangible personal property for cold storage;
- the furnishing of repairs to tangible personal property, such as automobiles, machinery, and equipment;
- the furnishing of telecommunication services for compensation.

² La. R.S. 47:342 (3) As such, the word, "contractor" shall include oil field service contractors, which shall consist of those contractors performing general oil well servicing, maintenance, and construction when conducted as a single company unit. "General oil well servicing" shall include welding, pipe coating, pipe inspection, wireline service, automation, workover, logging, analysis, seismograph, installing and servicing equipment, packing, platform work, perforating, and completion.

Well Rework

La. R.S. 47:301(14)(g) further defines taxable sales of services to include the furnishing of repairs to tangible personal property. The regulation on repairs to tangible personal property, LAC 61:I.4301.C. *Sales of Services*, (i), adds that “both repair and routine servicing of all kinds of tangible personal property are included as taxable services.” However services, repair, or routine work are not taxable upon immovable property, as immovable property is not classified as tangible personal property. Accordingly, La. Rev. Stat. Ann. § 47:301(16)(l) provides that for purposes of state and local sales tax in Louisiana, “other constructions” permanently attached to the ground shall be treated as immovable property, and not as tangible personal property, without regard to the nature of the ownership of the ground on which the other construction is located. Tangible personal property does not include immovable property or “other constructions” permanently attached to the ground. Pursuant to La. R.S. 47:301(16)(l), oil and gas wells are classified as “other constructions” and therefore treated as immovable property.

Although the service explained and provided by Company A does not specifically use the term “repair,” reworking existing wells or fracturing should be considered a repair service. *Black’s Law Dictionary* defines repair as follows: “[t]o mend, remedy, restore, renovate. To restore to a sound or good state after decay, injury, dilapidation, or partial destruction.” The First Circuit Court of Appeals in *McNamara v. Stauffer Chemical*, 506 So. 2d. 1252, looked to the definition of “repair” in *Black’s Law Dictionary* ruling “it is our opinion it was well within the purpose and objective of the legislature for the word ‘repair’ to be given a general and liberal meaning, and not to be construed in a highly limited sense, and that such word clearly encompasses the ‘restoration of tangible personal property’ in a process, or service which ‘restores’ the thing (spent sulfuric acid) to the condition in which it originally existed (usable sulfuric acid).”³ Reworking means reconditioning, cleaning out, or otherwise attempting in good faith to establish, increase, or restore production in an existing well by downhole operations. Therefore reworking or fracturing existing wells is a “repair” service, but a “repair” service which restores functionality to an immovable property and is consequently not subject to state sales tax.

Labor services

As previously stated, sales of services are exempt from state sales tax, unless specifically designated or defined in the statute as taxable. Generally, labor or installation charges are not included as taxable services, when the charge is separately billed and accounted for at the time of the installation. However, labor charges included in the sales price will be subject to taxation. La. R. S. 37:301(13).⁴ According to LAC 61:I.4301(C) “*Sales Price*” (a) (iv) all instances where

³ *McNamara v. Stauffer Chemical*, 506 So. 2d. 1252 (La. App. 1st Cir. 1987) addressed the definition of repair, finding the chemical treatment process of regenerating or restoring spent sulfuric acid was found to be a repair service because the process restored the acid to a sound and usable state.

⁴ La. R.S. 37:301 (13) states the sales price shall include the total amount for which tangible personal property is sold, but excludes finance charges, cash discounts allowed and taken, installation charges, and any taxable repair or remodeling charges incurred by the seller to enhance the value of the property to be sold

an expense, such as labor, is required to be separately stated, the effect of combining the charge with another taxable item included in the sales price will subject the entire amount to sales tax. Further, in the case of *Department of Revenue v. Baton Rouge SMSA Limited Partnership d/b/a BellSouth Mobility*, No. 423,577 (19th Judicial District Court Jun. 18, 1998), the court ruled that separately stated installation charges are services explicitly excluded from the definition of sales price under La. Rev. Stat. Ann. § 47:301(13)(a). Based upon the foregoing, Louisiana shall not impose a sales tax on “separately” stated labor charges.

Material/Proppant Used

La. Rev. Stat. Ann. § 47:302(A), § 47:321(A), and § 47:331(A) imposes a tax on the sale at retail, the use, the consumption, the distribution, and the storage for use or consumption in this state, of each item or article of tangible personal property. The sale or use of tangible personal property is generally presumed taxable, unless expressly exempt. There is no statutory exemption or exclusion from sales tax upon materials used in construction or repair of immovable property. The sales or use tax is payable by the contractor, who is held to be the purchaser or user of all materials used in the construction, restoration, maintenance or repair of immovables.

To address the issue of whether materials used by Company A, such as a “proppant” or sand, are subject to tax, it is important to determine whether that material is classified as tangible personal property. La. R. S. 47:301(16)(a) defines tangible personal property as personal property that can be seen, weighed, measured, felt, touched, or is perceptible to the senses. The Louisiana Supreme Court has ruled that “tangible personal property” is equivalent to corporeal movable property as defined in Article 471 of the Louisiana Civil Code. The Louisiana Civil Code describes corporeal movable property as things that physically exist and normally move or can be moved from one place to another. If property is movable and meets the definition of tangible property, it is tangible personal property.

The material or sand proppant used by Company A, props the fractures open to allow the oil to flow freely, restoring proper function to the oil well. The shape of this proppant does not change nor does it make up or become permanently affixed to the well structure. The proppant classifies as a movable and further meets the definition of tangible personal property. A tax shall be imposed upon the sale or use of the material, sand proppant.

Conclusion

Although La. Rev. Stat. Ann. § 47:301(14)(g) defines taxable “sales of services” to include repair and routine servicing transactions, the tax is limited to transactions related to “tangible personal property.” The service and repair performed on a well is not within the scope of “sales of services,” as immovable property is not classified as tangible personal property. For that reason, the services offered by “Company A,” well completion or reworking existing wells, including the process called hydraulic fracturing are considered nontaxable services.

Accordingly, Louisiana will not impose a sales tax on “separately” stated service charges or labor charges. However, service or labor charges combined with taxable materials, such as the proppants purchased and used by “Company A,” will subject the entire bill to taxation.

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A Revenue Ruling is issued under the authority of LAC 61III.101.C. A Revenue Ruling is written to provide guidance to the public and to Department of Revenue employees. It is a written statement issued to apply principles of law to a specific set of facts. A Revenue Ruling does not have the force and effect of law and is not binding on the public. It is a statement of the department's position and is binding on the department until superseded or modified by a subsequent change in statute, regulation, declaratory ruling, or court decision.