

Sales & Use Tax in the Oil and Gas Industry

Presented By:

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Department of
Taxation

Agenda

- Overview of Oil & Gas Industry
 - Producers
 - Midstream
 - Transmission
 - Service Providers
- Current BTA Case



Overview of Oil & Gas Industry

- **Producers:** Companies engaged in upstream activities of finding, developing, and operating oil and gas wells.
- **Midstream:** Companies engaged in processing, storing, transporting and marketing oil, natural gas and natural gas liquids.
- **Transmission:** Companies engaged in moving oil and gas via interstate and intrastate pipelines.
- **Service Providers:** Companies engaged in providing services to the oil and gas industry.



Kilbarger Constr., Inc. v. Limbach, 37 Ohio St. 3d 234 (1988)

- Engaged in the drilling of oil and gas wells.
 - At issue were bulldozers which:
 - were used to clear a path to the drilling site and clear and level the site;
 - used to build access roads to the site and build culverts;
 - prepare right of ways for flow lines from the drilling site to the storage tanks and to backfill the trenches in which the flow lines were buried.
- Bulldozers used for site preparation were not used directly in mining.
- The use of exploration does not expand the exemption to include site preparation.



Universal Minerals, Inc. v. Limbach, Case #86-E-322, 6/30/1989

- The gravel which provides a level foundation for the well head is not directly used in oil and gas production.
- The meters measure the flow of oil and gas after separation from the oil. The valves regulate the flow of gas after separation and the clock measures the flow of gas after separation. The BTA found that because these items are used to aid transportation of gas and oil after processing has ceased exemption is to be denied.
- The flow lines that carry the gas and oil to the compressor station or heat treatment qualify for exemption.
- Processing ceases at the compressor station or heat treatment facility.
- The pipe which transports the oil and gas from this point to market is taxable.
- Processing occurs in the compressor. Items which are used prior to the compressor are taxable.



Producers

- Exploration and production companies engaged in upstream activities of finding, developing, and operating oil and gas wells.
- Ohio Rev. Code Ann. § 5739.02(B)(42)(a).
 - Tax does not apply to sales where the purpose of the purchaser is to “use or consume the thing transferred directly in producing tangible personal property for sale by mining, including, without limitation, the extraction from the earth of all substances that are classed geologically as minerals, production of crude oil and natural gas...”



Producers

- Production
 - Production begins with the drilling of the well. *Kilbarger Constr., Inc. v. Limbach*, 37 Ohio St. 3d 234 (1988)
- Exploration
 - “Both [production and exploration] activities involve drilling. The distinction is that exploration may or may not result in a producing well, while production results from the finding of a producing well.” *Kilbarger Constr., Inc. v. Limbach*, 37 Ohio St. 3d 234 (1988)
- Tangible personal property and services used in pre and post mining processes are taxable.
 - *Universal Minerals, Inc. v. Limbach*, 86-EE-322 (1989)
 - *Kilbarger Constr., Inc. v. Limbach*, 37 Ohio St. 3d 234 (1988)
- Tangible personal property and services used during the mining process are exempt. Ohio Admin. Code 5703-9-22.

Producers

Test Your Knowledge:



Q: Company I is engaged in the business of oil & gas fracturing. This is accomplished by pumping a special mixture into well holes to fracture the rock strata and open the fissure to allow oil & gas to flow to the well. Is the blender and related equipment portion of the blender truck exempt?

Producers

Test Your Knowledge:

A: No.

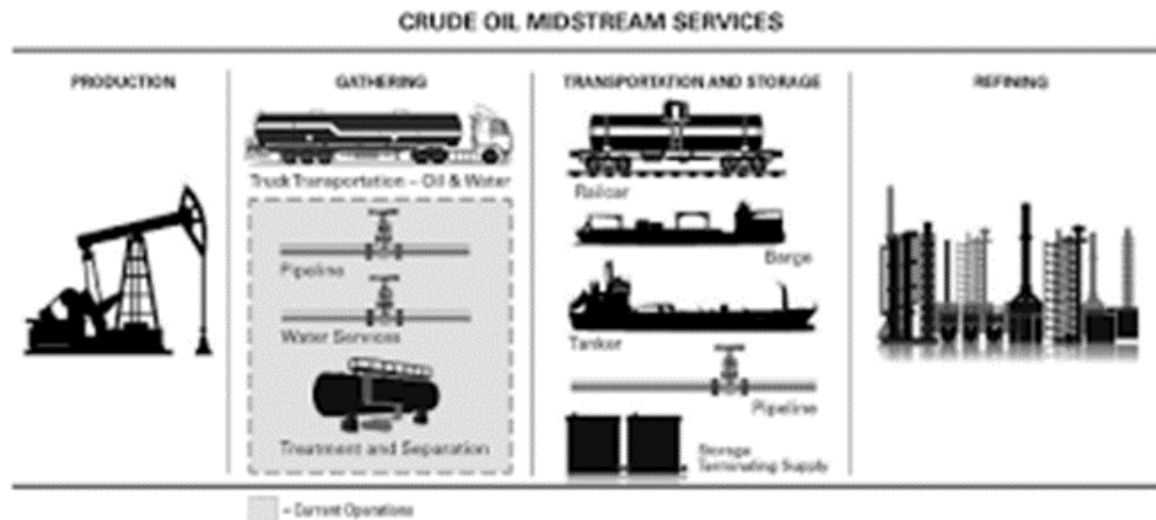
Production begins at the actual drilling of the well. At best the blenders would qualify as adjuncts, however, adjuncts to items used directly in the production of natural gas are not exempted.

Independent Frac Service, Inc. v. Limbach, Case #89-J-863,
6/28/1991



Midstream

- Companies generally engaged in processing, storing, transporting and marketing oil, natural gas and natural gas liquids.
- Ohio Rev. Code Ann. § 5739.02(B)(42)(g).
 - “To use the thing transferred, as described in section 5739.011 of the Revised Code, primarily in a manufacturing operation to produce tangible personal property for sale;”
- *Brico Well Service, Inc v. Lindley*, Case #82-D-588
 - The trucks were found to be primarily transportation vehicles and as such not used directly nor essential to the actual drilling activity.
- *Universal Minerals, Inc. v. Limbach*, 86-EE-322



Midstream

- Ohio Rev. Code Ann. § 5739.011 (B).
 - Ohio Rev. Code Ann. § 5739.02(B)(42)(g), “thing transferred” includes, but is not limited to:
 - Production machinery and equipment that act upon the product or machinery and equipment that treat the materials or parts in preparation for the manufacturing operation.
 - Materials handling equipment.
 - Consumables that interact with the product.
 - Machinery and equipment used to control, physically support, produce power for, or lubricate.
 - Testing equipment.
 - Machinery and equipment used to transport or transmit electricity, coke, gas, water, steam, or similar substances used in the manufacturing operation.

Midstream

Test Your Knowledge:



Q: Company B is in the oil and gas industry. They utilize trucks, liquid holding tanks mounted on the trucks, pumping equipment, hose racks and bumpers. The trucks are used to acquire water at an off site location and to haul such water to the drill site. The trucks also transfer various waste liquids from drill site storage tanks or open pits to the tanks on the trucks and then hauled the waste liquids to a disposal site. One of the trucks also had a high pressure pump that was used 40 to 60% of the time in the “killing of the well.”

Are the items exempt from taxation?

Midstream

Test Your Knowledge:

A: No.

The primary purpose is to facilitate hauling and transporting and the items are therefore taxable. Specially designed trucks used only or primarily in transporting a useless by-product is not used directly nor is it being used in conjunction with providing services in the exploration for *** even though it is necessary to remove such by-product.

Buckeye Water Service Co v. Limbach,
Case #84-D-40



Transmission

- Transmission companies are engaged in moving oil and gas via interstate and intrastate pipelines.
- Ohio Rev. Code Ann. § 5739.02(B)(42)(a).
 - Tax does not apply to sales where the purpose of the purchaser is to “use or consume the thing transferred directly... in the rendition of a public utility service,...”
- Ohio Rev. Code Ann. § 5739.01(P).
 - “Used directly in the rendition of a public utility service” means that property that is to be incorporated into and will become a part of the consumer's production, transmission, transportation, or distribution system and that retains its classification as tangible personal property after such incorporation; fuel or power used in the production, transmission, transportation, or distribution system; and tangible personal property used in the repair and maintenance of the production, transmission, transportation, or distribution system, including only such motor vehicles as are specially designed and equipped for such use. In this definition, “public utility” includes a citizen of the United States holding, and required to hold, a certificate of public convenience and necessity issued under 49 U.S.C. 41102.



Transmission

Test Your Knowledge:



Q: Company M purchases gas from oil well owners. They do not drill or are engaged in extracting the oil & gas. Company M installs lines from the landowners wellheads and the lines run to their plant. At this plant Company M processes the gas into butane, propane, etc. After removal the lines pipe the gas to the utilities. Company M is not a public utility or a natural gas company. Is Company M engaged directly in the exploration for and production of natural gas for others?

Transmission

Test Your Knowledge:

A: No. The lines were simply used in transporting the natural gas and only indirectly used.

McWood Corp. v. Porterfield, 13 Ohio St. 2d 143, 3/20/1968

The Court agreed with the BTA's ruling from which they quoted *Powhatan Mining Co.* "where the principal use of property claimed to be used directly in a particular activity is in transportation to and from that activity as opposed to in process. Such use is not directly in. The Court also agreed with the BTA's finding and reliance on *Youngstown Building Material & Fuel Co.* and rejected that the natural gas processing facility was a "unitary" or "integrated" facility.



Service Providers



- Service providers are companies engaged in providing services to the oil and gas industry.
- Ohio Rev. Code Ann. § 5739.02(B)(42)(a).
 - “Persons engaged in rendering services in the exploration for, and production of, crude oil and natural gas, for others are deemed engaged directly in the exploration for, and production of, crude oil and natural gas.”

Service Providers

Test Your Knowledge:



Q: Company A prepares the sites for drilling and after drilling is completed restores and reclaims the site.

At issue are a backhoe, Mack tractor truck, Mack dump truck, dump bodies, base radio station, 2 utility bodies, dozer, parts for the dozer, backhoe and trucks and welding equipment.

Are the items exempt?

Service Providers

Test Your Knowledge:

A: No.

While the items may be important to and complimentary of the production of crude oil and natural gas. They are not used during the actual production process.

The service provider is subject to the same limitations under the exemption.

Oil Field Services, Inc. v. Limbach, Case #84-C-55



Service Providers

Test Your Knowledge:



Q: Company S performs hydraulic fracturing services. One of the steps involves pumping a specific mixture into the well in order to fracture the rock formation to release the oil and gas. At this step a fracturing pump is used in conjunction with a high pressure manifold unit to create a compounding effect.

Is the pump and manifold exempt?

Service Providers

Test Your Knowledge:

A: Yes.

The manifold unit and the fracturing pumps are exempt from taxation as directly used in in mining since they function in unison to create a high pressure injection that actually fractures the rock formation and frees oil and gas.



Pollution Control

- Exemption for certified pollution control facilities including air pollution control facilities, noise pollution control facilities, and industrial water pollution facilities. Ohio Rev. Code Ann. §5709.20(E)
- Exemption on tangible personal property incorporated into a pollution control facility, but the facility must be certified. Ohio Rev. Code Ann. §5709.25(A)
- As part of the tax exemption application process, Ohio EPA is required to provide a technical evaluation and review of any property sought for tax exemption status.

Rentals with Operator

- Non-taxable service (may be fixed or indefinite period of time) if the operator is necessary for the property to perform as designed. The operator must do more than maintain, inspect, or set-up the tangible personal property. Ohio Rev. Code Ann. §5739.01(UU)(1)(c)

2015:1465 *Stingray Pressure Pumping LLC VS. Joseph W. Testa*

Hydraulic fracturing operations

Taxpayer argues that contested items qualify for the exemption because they are used directly in the production of crude oil and natural gas.

- Tax Commissioner's Final Determination (FD)
 - Taxable:
 - Monitoring – Control Unit
 - Chemical Additive Unit
 - Frac Van Unit
 - Iron Trailer
 - Iron Truck/Tractor
 - Blender Unit
 - T Belt Unit
 - Acid Unit
 - Gel Unit
 - Sand Silo Unit
 - Exempt:
 - High Pressure Manifold/Missile Unit
 - Pumping Units
 - Twin Cementers
- BTA Decision January 17, 2018
 - Tax Commissioner's FD is affirmed

Questions?

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