OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION

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July 11, 2011

Re: LR-10-076 (Sales Tax Inquiry)

Dear :

I am writing this letter in response to your inquiry regarding sales tax, set forth verbatim are the facts presented along with the responses thereto.

Facts:

Company A (''A") is an oil and gas operating company. Company B ("B") is a horizontal drilling contractor who provides lateral drilling services to "A" on a day work basis (flat rate per day for services provided). The scope of "B"'s services is to provide the equipment and technical personnel necessary to assist a drilling contractor and advise the oil and gas operating company in the drilling of the horizontal section of the wellbore from the point of kick-off from the vertical section to the horizontal section of the wellbore (or curve) to the total depth of the wellbore. All of these services are performed inside the wellbore for the purpose of starting or stimulating production from the new well.

"B" provides all equipment and personnel necessary to perform the services, and the equipment remains "B"'s property. "A" is responsible for repairs resulting from damages, other than ordinary wear and tear, and for either the purchase cost or lease rate of additional equipment (such as diamond drilling bits) that might be required to complete the wellbore path.

"B" supplies "A" with a two page invoice. Page one contains the well identification information, a total invoice charge for both equipment and services, and an invoice description of "Medium Radius Lateral Drilling Services'. Page two contains daily drilling report information, formation information, and descriptions of the equipment that may have been required to perform the described services.

The equipment and personnel services are necessary to provide location and directional information (Measurement While Drilling) so that the technicians know the exact location of the bit and the path it has followed in order to rotate and orient the drill bit in order for it to turn from vertical, build to the desired angle and direction, and then change that angle and direction as desired.

"B" provides the following down hole equipment as part of their services: Angle build motors, angle hold motors, non-magnetic drill collars, nonmagnetic flex collars, float subs, orienting subs, measurement while drilling (MWD) flow subs, MWD downhole tolls, drill string stabilizers, lift subs, crossover subs, float valves, baffle plates, and magnetic single shot survey kits. "B" provides the following surface equipment: computers, software, printers, equipment trailer, and personnel mobile home.

Transportation costs and partial lost-in-hole insurance on motors, tools, and MWD equipment are also provided. "B"'s personnel provide the following services:

Services are performed by one or more experts in horizontal drilling operations (at least one of which is present at the well site during the entire lateral drilling process from kickoff point to total depth of well) and include equipment set-up and rig down, well planning services, horizontal measurement while drilling requiring constant monitoring, multishot survey from kick-off point to surface, equipment inspection services, equipment maintenance and repair services for normal wear and tear (all related to "B's" equipment provided to perform the work), and preparation of related daily logs and completion reports.

Personnel subsistence and transportation costs are also provided.

It should be noted that the lateral drilling services contemplated under the contractual agreement between "A" and "B" could not be rendered or completed in accordance with "P"'s (???) contractual obligations and "A"'s expectations under the agreement without the presence and more importantly the technical expertise of the personnel provided by "B". The equipment provided by "B" under the agreement does not setup, operate, and monitor itself or interpret its own results. The directional drilling and measurement while drilling technicians provide integral highly skilled labor necessary to operate, maintain and complete the services contemplated in the contractual agreement. Clearly, their duties extend beyond the scope of mere supervisory services. Additionally, "A" does not exercise any direct control or supervision over the operator of the drilling equipment in the performance of his expert services under the contract.

Question:

Do the lateral drilling services as described above being provided by Company "B" constitute a taxable or non-taxable service on new wells and /or existing wells? In other words, should Company "A" be charged gross receipts tax by Company "B" for all or a portion of the services/rentals provided?

Also, should Company "B" pay gross receipts tax on its purchases incurred in order to provide the services or rentals to Company "A"? The type of purchases would be for operating supplies, equipment (drill motors, Measurement While Drilling devices, etc.), repairs by outside vendors, repair parts purchased, transportation, etc.

Response:

The furnishing for a charge of equipment with an operator is considered a service which is not subject to sales tax. OAC 710:65-1-11(g). For the subject transactions to be considered a service and not the rental of tangible personal property Company "B" must be in direct control of the equipment i.e., drill motors, Measurement While Drilling devices, etc. If Company "B" relinquishes control of said equipment to Company "A" then the transaction would be a rental.

Based on the facts presented, Company "B" is a service provider considered to be a consumer or user and as such is required to pay state sales or use tax and any applicable local tax on all items of tangible personal property and taxable services used to perform its nontaxable service. Should Company "B" make purchases outside Oklahoma from a vendor that is not required to collect Oklahoma sales or use tax, Company "B" would be required to accrue and remit Oklahoma state and any local use tax on the equipment, parts and materials purchased.

This response applies only to the circumstances discussed in your written request of February 17, 2010. Pursuant to Oklahoma Administrative Code 710:1-3-73(e), this Letter Ruling may be generally relied upon only by the entity to whom it is issued, assuming that all pertinent facts have been accurately and completely stated, and there has been no change in applicable law.

Sincerely,

OKLAHOMA TAX COMMISSION

Marc Morrison
Tax Policy Analyst