OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION

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August 24, 2011

RE: LR-11-071 (Sales Tax Inquiry)

Dear

I am writing in response to your request regarding Oklahoma sales tax. Set forth are the facts presented along with the questions posed and the responses thereto.

Facts:

XYZ Corporation ("XYZ") is an Oklahoma-based well servicing company that provides well hydraulic fracturing services ("frac jobs") for oil & gas companies in the state of Oklahoma. Hydraulic fracturing is a well stimulation service in which frac fluids (primarily water) are pumped down casing or a temporary workstring under high pressure to artificially fracture the reservoir rock in order to increase permeability and production.

Proppants (natural sand and ceramics) are suspended in the frac fluid and function as propping agents. The fluid, which contains the proppants, enters the producing formation and parts, or fractures, it. When the pressure is released at the surface, a small portion of the frac fluid returns to the wellbore and the fractures in the formation partially close on the proppants, leaving channels for the oil or gas to flow through to the wellbore. The small portion of the frac fluid is recovered by XYZ when the pressure is released at the surface, but the proppants remain downhole in the formation of the well for an indefinite period of time after the fracturing service is performed. Any recovered frac fluid is then disposed of by XYZ.

XYZ purchase the proppants and frac fluids used in the frac jobs from third –party vendors. When invoicing its customer for the frac job, XYZ separately states the labor and material charges. Please provide clarification on the application of the Oklahoma Sales and Use Tax Code for the following questions:

Questions

1. When providing hydraulic fracturing services, is XYZ considered a contractor as defined by Oklahoma Administrative Code 710:65-19-56?

2. Is XYZ considered the end user and consumer of the materials (proppants and frac fluids) that uses to perform the fracturing services? If not, are the materials used by XYZ to perform fracturing services resold to XYZ's customer; thereby allowing XYZ to purchase the materials tax free as purchases for resale?

3. If XYZ's purchases of proppants and frac fluids are taxable to XYZ when purchased because they are consumed in the service, are the separately stated charges for these materials non-taxable when XYZ invoices the oil & gas company for the frac job?

Response:

The hydraulic fracturing services described above are not one of the enumerated transactions subject to sales tax in Oklahoma pursuant to Section 1354 of Title 68 of the Oklahoma statutes. The separately stated charges billed customers for the proppants and frac fluids are subject to sales tax in Oklahoma.

If your Client acts wholly as a provider of a nontaxable service, it would be the taxable consumer/user of all items of tangible personal property and taxable services used to provide the service. Oklahoma Administrative Code 710:65-19-309. As such, your client would not separately state the proppant and fluid charges and itemize tax but would owe state sales or use tax and any local tax as applicable on the items purchased to provide the hydraulic fracturing service. If your client makes purchases from outside Oklahoma, from a vendor that is not required to collect Oklahoma sales or use tax, it is required to accrue and remit Oklahoma state and any local use tax on the items purchased. OAC 710:65-1-7.

If your client acts as a vendor making sales of tangible personal property–proppants and frac fluids–along with the provision of a nontaxable service, it must collect sales tax on the gross receipts[1] attributable to these sales in Oklahoma and report and remit same to the Oklahoma Tax Commission. Separately stated charges for the hydraulic fracturing services are not subject to sales tax. In addition, vendors can make purchases of tangible personal property exempt from sales tax for resale purposes pursuant to an Oklahoma sales tax permit. 68 O.S. § 1357(3).

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[1] The terms gross receipts, gross proceeds and sales price are synonymous and are defined as "the total amount of consideration . . . for which personal property or services are sold . . . whether received in money or otherwise. . . without any deduction for the following:

1. the seller's cost of the property sold,
2. the cost of materials used, labor or service cost,
3. interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller,
4. charges by the seller for any services necessary to complete the sale, other than delivery and installation charges,
5. delivery charges and installation charges, unless separately state on the invoice, billing or similar document given to the purchaser, and
6. credit for any trade-in . . . ." 68 O.S. § 1352(12)(a).

This response applies only to the circumstances discussed in your written request of May 03, 2011. 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