

Department of Revenue issues guidance on 'mining' exemption to Pennsylvania sales and use tax

Oil and gas developers and their vendors may claim an exemption from Pennsylvania sales and use tax on qualified purchases of certain property and services. Until the past few years, there was little published guidance available to the oil and gas industry on the availability of the so-called "mining exemption" for purchases of property and services used in conventional and unconventional oil and gas extraction.

In response to the demand for guidance on this issue, the Pennsylvania Department of Revenue (DOR) has published several reference materials concerning the application of the mining exemption to oil and gas developers. In September, the DOR published *Sales and Use Tax Information Notice 2014-02*, which provides a detailed examination of the availability of the mining exemption for purchases made at each stage of natural gas development, including exploration, site preparation and pre-production construction, extraction and production, transport, and storage. This article discusses the mining exemption and some of the new guidance contained in the information notice.

The mining exemption

Pennsylvania assesses a 6 percent sales tax on retail sales of tangible personal property and certain services that are made in the Commonwealth and a corollary 6 percent use tax on the use of such property and services, if the vendor does not collect sales tax. 72 P.S. §§ 7202(a) and (b). Exemptions from sales and use taxes exist for the purchase of otherwise taxable goods and services that are used in manufacturing and industrial processes, including mining and resource extraction. 72. P.S. §§ 7201(k)(8) & (o)(4). Purchasers may claim this "mining" exemption if the property or services are predominately used by the purchaser directly in extraction activities, with consideration given to the property's or services' physical and temporary proximity to the extraction operation, and the existence of an active causal relationship between use of the property or service and the extracted product. 61 Pa. Code § 32.35(a)(1).

Who may claim the exemption

The DOR's regulation on the mining exemption states that the exemption is available to "a person engaged in the business of mining." 61 Pa. Code § 32.35(a)(1). The regulation refers to "mining" and "miners" because it was directed at the coal industry. The sales and use tax statute, however, defines "mining" to include exploring or extracting natural resources from the earth. 72. P.S. § 7201(c)(3). In previously released guidance, the DOR confirmed that oil and gas extraction related activities are "mining" activities for purposes of the mining exemption.

Oil and gas developers also rely heavily on third-party contractors to perform critical services at all stages of production, but the mining exemption regulation does not indicate whether vendors that provide services to developers are entitled to claim the exemption. The information notice clarifies this issue by stating that if a developer would be entitled to claim the exemption on its purchase of otherwise taxable property or services, then third-party vendors performing the same development-related activity on behalf of the developer would be entitled to claim the mining exemption on such purchases.

Exploration

The information notice notes that "mining" is defined in the sales and use tax statute to include exploration for natural resources, so otherwise-taxable personal property and services are exempt from sales and use tax when they are predominately used directly in gas exploration-related processes. Examples of property and services used in oil and gas exploration that are covered by the exemption include seismic exploration services, exploratory well drilling services, seismic imaging services and seismic data.

Extraction and production

The DOR's previously published guidance on the mining exemption identified as either exempt or taxable various pieces of equipment used in natural gas extraction and production processes, including equipment related to drilling rigs, fracking units and wastewater impoundments. The information notice contains new guidance on the application of the exemption to purchases of other equipment and services that are used in the production process. The following equipment was identified as

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exempt: gyroscopes and the wireline with which a gyroscope is hoisted and lowered into a wellbore, when the gyroscope data is used by the driller to guide and direct equipment used during drilling production; communication devices used predominately in production activities, such as radios primarily used to coordinate work among production employees of equal rank; equipment used to test and inspect the product up to the last physical change of the gas prior to it being sold to another party; and erosion control materials, such as silt fences, stakes or hay bales, if used to control, abate or prevent air, water or noise pollution generated from production activity. The information notice identified as taxable certain equipment used in production administration and management, including equipment used to record the quantity and quality of work in production or goods in storage, the flow of work, and the results of inspection; equipment used to record the volume and pressure of gas coming from the wellhead; and communication devices used for managerial direction and supervision.

Post-production, transport and storage

Perhaps the most useful new guidance contained in the information notice concerns the availability of the exemption for the purchase of equipment and services that are utilized after gas leaves the wellhead. The DOR's regulation on the mining exemption provides that transportation equipment used to transport extracted product from the extraction point to a preparation site is exempt, but that equipment used to transport product "after the final mining operation" is taxable. 61 Pa. Code §§ 32.35(a)(2)(i)(H) and (3)(iii)(I). The information notice states that the exemption applies to equipment and services used to transport gas from the wellhead to compression and refinery operations up to the last physical change of the gas prior to its being sold to another party. Exempt property includes dehydrators and other equipment used to remove water or vapors or to separate other hydrocarbons from methane; compression and pump equipment used to move gas through gathering lines; and material used in the construction of gathering lines, including pipes and foundation materials used directly under the pipes, such as sand, stone and similar materials. Equipment used to construct gathering lines, including bulldozers and backhoes, is not exempt.

The information notice also addressed the availability of the mining exemption for purchases of equipment and services used in gas storage. The notice, however, notes that since the definition of "mining" in the sales and use tax statute includes the extraction of natural resources from "stockpiles," the withdrawal of natural gas from storage facilities is considered to be an exempt mining activity. Therefore, equipment and services that are purchased for use in withdrawing gas from storage facilities are exempt. Equipment and services used to inject gas into storage facilities, however, are taxable.

If you have any questions about your ability to make a claim to the mining exemption for purchases of equipment and services used in oil and gas development, please contact the author at 412-394-6582 or bmilleville@babstcalland.com.