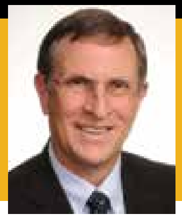
# Sales Tax Refunds and Savings When CASH is King



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In these days of unprecedented hardship for exploration and production companies, everyone is looking for ways to preserve cash. Non-payroll sources of cash, including sales and use tax refunds, can reduce the need to lay off valuable skilled employees who will be sorely needed when the economy recovers. This article is designed to help operators both recognize significant refund opportunities and strategize to minimize these costs prospectively. Articles in previous editions of Accounts have explained that potential for significant tax overpayments exist in states like Kansas, North Dakota, Pennsylvania, Texas, and West Virginia because of complicated tax laws combined with some generous exemptions in those states. When the market was "hot", many companies were sharply focused on drilling and completing as many wells as possible with little thought to issues like sales tax. Because sales tax laws are complex, vendors defensively collect sales tax on invoicing for goods and services, thus creating potential for significant overpayments of tax in many states. In contrast little opportunity to save or recover tax exists in other states like Oklahoma and New Mexico.

Typically, smaller operators do not have the benefit of a tax professional in house, so they either hire a consultant to review their purchases and recover overpaid taxes, sometimes on a repetitive basis, or they simply never recover the tax. We suggest for your consideration a third alternative: using the services of sales tax professionals as an outsourced tax department during ongoing operations.

## RECOVERING OVERPAID TAXES VIA REFUND REVIEWS

In these arrangements, consultants will review purchases for a 3- or 4-year period (depending on the state's statute of limitations law) and are compensated based on a share (typically at rates of 25% to 33%) of the refunds found. Main determinants of significant overpayments are the state in which the property is located and drilling and completion activity. In many states, the services of drilling, completing, recompleting or "stimulating" a well are not taxable while repair type work is taxable. For example:

- Colorado – exempts equipment if the well is located in an Enterprise Zone (covers most of the state); Exemption is limited to $150,000 annually as applicable to used equipment
- Kansas - exempts services associated with the drilling and completion of a well up to the date of completion; exempts drilling mud, fracking materials, and other materials used while drilling wells; exempts equipment used to produce oil and gas, as well as services related to that equipment
- Louisiana – does not tax services to "immovable" (real) property. Often, vendors wrongly tax services performed on the well itself
- New York – exempts machinery and equipment used directly and predominantly in extracting oil and gas
- Pennsylvania – exempts equipment and materials used to complete and operate wells, including tubulars, lifts, tanks, separators, dehydrators, etc.
- Texas – exempts drilling, completing, recompleting, and "stimulating" wells – including new and existing wells. Additionally, certain equipment used to treat or separate raw crude and gas to make them marketable is exempted
- West Virginia - exempts equipment and materials used to complete wells, including tubulars, lifts, tanks, separators, dehydrators, etc. Utilizing the exemption requires holding a direct payment permit or applying for a refund after the invoices are paid including tax charged by the vendor
- Wyoming – exempts services that are completed prior to the setting of production casing, including work to deepen an existing well

In everyday operations of wells, various expenses (LOE) are not taxed in certain states as well. For example:

- Kansas - exempts oil soluble chemicals or chemicals used to treat oil or gas; exempts gas or electricity used to operate wells; exempts repair parts and services for well equipment
- North Dakota – exempts oil soluble chemicals; local taxes are rebatable if they exceed maximums per invoice
- New York – exempts utilities, supplies consumed in operations, and repair parts and services for machinery and equipment used to extract oil and gas
- Pennsylvania – provides a general exemption of goods used to construct or operate wells
- Texas – exempts chemicals used to treat or separate crude and gas to make them marketable, oil soluble chemicals, and electricity and propane to operate wells. Plugging and abandoning wells is exempted. Many roustabout services fall outside the imposition of tax. Local taxes can be reduced utilizing a direct payment permit. NOTE: Recently the Comptroller has been contesting exemption of gas treatment chemicals, but this author believes that this is an incorrect position and that this will be reversed. Additionally, the Comptroller is now taking the position that all field compressors are taxable. This may be challenged as well, but the outcome appears to be uncertain.
- West Virginia – like Pennsylvania, provides a general exemption of goods used to construct or operate wells; however as explained previously, the exemption can only be claimed at the time of purchase if a direct payment is held

## ALTERNATIVE SALES TAX STRATEGIES

Rather than hiring consultants to perform periodic refund reviews, larger operators may choose to try to manage exemptions and tax accruals themselves. However, that is not practical for smaller operators. For those operators, another possible strategy is to hire a firm that specializes in sales taxes pertaining to oil and gas to process payables on an ongoing basis for sales tax management. Such services should include issuance of exemption certificates to eliminate overpayments on a timely basis rather than seeking refunds of tax years later. Additionally, accruals of tax can be made on taxable purchases on which the vendor does not collect tax. Depending on the pricing, effectiveness, and experience level of the service provider, this approach can be less costly than conventional refund reviews and produce potentially greater identification of savings that will occur in real time rather than years later.

In one recent engagement, a small start-up producer based in Texas utilized such an arrangement from the inception of their business though the sale of their assets over a period of about two years. During that time, they drilled and completed three horizontal wells. Savings of about $90,000 per well was achieved.

## SUMMARY

In these lean times for exploration and production operations, every opportunity to save or recover cash can be critical to maintaining liquidity and retaining employees. Recovering and reducing sales taxes incurred in operations is a significant opportunity to do just that.