



September 15, 2010
Pennsylvania Sales and Use Tax
No. SUT-10-003
Applicability of the Mining Exemption to Fracturing Services

ISSUES

1. Is the equipment used by the Taxpayer in performing cementing, fracturing and acidizing services (collectively "fracturing") tax-exempt under the Pennsylvania mining exemption?
2. Are materials (gases, sand, cement, etc.) used by the Taxpayer in fracturing services subject to tax?
3. Are the Taxpayer's fracturing services and sale of property subject to tax?
4. Does equipment brought into Pennsylvania for use here qualify for the isolated sale exemption?
5. Are vehicles and trailers registered under the International Registration Plan ("IRP") subject to tax?

CONCLUSIONS

1. Yes, equipment predominantly used directly in performance of fracturing services is exempt from tax under the mining exemption.
2. No, materials (gases, sand, cement, etc.) predominantly used directly in fracturing services are exempt from tax under the mining exemption.
3. No, Taxpayer's fracturing services are not subject to tax as these services are directly used in mining. Additionally, the Taxpayer's sale of tangible personal property predominantly used directly in mining are not subject to tax.
4. Yes, equipment to be brought in for use in Pennsylvania qualifies for the isolated sale exemption as long as the sales are infrequent and nonrecurring.
5. Vehicles and trailers registered under the International Registration Plan ("IRP") are subject to tax to the extent that they are required to be registered under 75 Pa. C.S. §§ 101-9909 (the "Vehicle Code").

FACTS

Taxpayer, an out-of-state business entity, plans to provide fracturing services to mining operators in Pennsylvania in the Marcellus Shale formation. Taxpayer currently does not conduct any business in the Commonwealth but will establish an office in the state when contracts with Pennsylvania clients are finalized. Although Taxpayer also provides other services such as pressure pumping and drilling, services to be offered by Taxpayer in the Commonwealth are currently limited to fracturing services as described below:

Cementing

Cementing involves pumping cement slurry (a blended mixture of dry powder cement, water and various additives) to bond casing or piping to the wall of the bore hole. Taxpayer adjusts the amount and composition of the additives, developed by Taxpayer, from job to job. The cement slurry is blended at Taxpayer's bulk plants or at the well site. Cementing is performed by operators provided by Taxpayers using specialized pumping and related equipment.

Fracturing

Fracturing is a well stimulation process used to improve the natural flow of oil or gas. Fracturing begins with the use of a fluid, a mixture of water and chemicals, to crack the rock formation. Then, proppants



such as sand and ceramic materials are injected into the cracks to create open channels through which the gas flows. Once the proppants are in place, the fluid is drained from the well.

Acidizing

Acidizing involves the injection of acid below rock fractures to create flow channels within the rock formation. The acid is specially blended based on a well's bottom temperature, depth, fluid characteristics, and nature of formation. Every acid blend also contains additives such as corrosion inhibitors, surfactants, iron control chelation/reducing agents, mutual solvents, and anti-sludging agents.

Once fracturing is completed, the used chemicals and water will be pumped out of the well bore to be treated and disposed of by the miner using a third party disposal vendor. Taxpayer is not involved in the water/chemicals treatment and disposal process.

In addition to billing for fracturing services, customers are invoiced separately for (1) equipment set up time, (2) equipment standby time, (3) operator time, (4) additional pumping time, and (5) additional chemicals and materials. "Set up time" is time spent on equipment configuration prior to the performance of fracturing services. "Standby time" is the time during which the equipment is on site but not in use. Pumping charges (including a blending charge) are charges for equipment use during fracturing. Charges for additional pumping time and additional chemicals and materials are incurred when actual onsite time or actual usage exceeds that which was originally planned.

Finally, Taxpayer anticipates that equipment purchased outside of the Commonwealth will be used in its operations in Pennsylvania. The equipment was purchased from persons Taxpayer described as non-vendors or vendors who are not vendors of the type of equipment sold.

DISCUSSION

1. Is the equipment used by the Taxpayer in performing fracturing services tax-exempt under the Pennsylvania mining exemption?

The applicability of the mining exemption turns on whether the taxable item is predominantly used directly in mining. 72 P.S. § 7201(k)(8); 61 Pa. Code § 32.35(a). The factors upon which we rely to determine whether a property is directly used are:

(1) physical proximity, (2) temporal proximity, and (3) the existence of an active causal relationship between the use of the property and the mined product. 61 Pa. Code § 32.35(a)(1).

It is important to note that 61 Pa. Code § 32.35(a)(1)(iii) specifically states, in considering the existence of an active causal relationship, "[t]he fact that particular property may be considered essential to the conduct of the business of mining because its use is required either by law or practical necessity does not, of itself, mean that the property is used directly in mining operations." Additionally, the law limits the mining exemption to "[m]achinery, equipment, parts and foundations therefore, and supplies which are used in the actual mining production, to transport or convey the product or production personnel [other than vehicles required to be registered under the Vehicle Code], or to handle or store the product during the production." 72 P.S. § 7201(k)(8); 61 Pa. Code § 32.35(a)(2)(i). Moreover, repair parts that are installed and become an integral part of the direct-use property are also exempt. *Id.*

On the other hand, property such as those that are used, prior to the actual mining operation, to transport personnel or to collect, convey or transport other property, and storage facilities or devices used to store the property prior to actual mining operation are subject to tax. 61 Pa. Code § 32.35(a)(3)(iii)(G). Furthermore, property used in non-mining activities is subject to tax even if



it is used during the mining operation. 61 Pa. Code § 32.35(a)(3)(iii)(H).

Finally, vehicles required to be registered under 75 Pa. C.S. §§ 101-9909 (the "Vehicle Code") and supplies and repair parts for the same are taxable. 72 P.S. § 7201(k)(8); Pa. Code 61 § 32.35(a). Also, no exemption is to be given to maintenance facilities. Id.

Taxpayer, a third party performing mining activities for miners, is entitled to claim the mining exemption for items that are directly used in mining. *Commonwealth v. R.G. Johnson Co.*, 433 A.2d 465 (Pa. 1981). As such, the taxability of the equipment used in the Taxpayer's activities is as follows:

Acid pumper (<i>equipment used to pump specially blended acid</i>)	Exempt
Acid transport (<i>a tractor trailer used to move raw or blended acid to well sites</i>)	Taxable
Batch mixer (<i>equipment used at the well site to mix cement slurry</i>)	Exempt
Bulk truck (<i>a truck that transports dry products to the batch mixer</i>)	Taxable
Cargo trailer (<i>a 14- foot enclosed utility trailer that transports testing equipment</i>)	Taxable
Chemical liquid additive unit (<i>a tractor-trailer-mounted unit that transports chemicals to be used at well sites. The unit maintains the temperature of the chemicals in transit</i>)	Taxable
Chemical transfer (<i>a tractor trailer used to transport the chemical liquid additive unit to well sites</i>)	Taxable
Mechanic service truck (<i>self explanatory</i>)	Taxable
Crew bus (<i>self explanatory</i>)	Taxable
Data van (<i>a van used to house remote control equipment</i>)	Taxable
Electronic Van (<i>self explanatory</i>)	Taxable
Frac iron float (<i>a tractor trailer that transports piping to the well site to connect the manifold and well head</i>)	Taxable
Frac pumps (<i>equipment that injects fluid into a formation</i>)	Exempt
Hydration unit (<i>a tractor trailer hydration unit that mixes and retains fluids on the surface for polymers to hydrate</i>)	Taxable
Manifold trailer (<i>equipment that attaches piping lines to the well head to facilitate the pumping operation</i>)	Exempt
Mobile Data Acquisition & Control Center Van (<i>a van equipped with remote control equipment used to control and operate frac pumps, blenders and liquid additive units during fracturing. The equipment makes automatic adjustments to the pumps, blenders, etc. during fracturing but also provides data so that adjustments may be made by an operator of the fracturing equipment. Data collected is used to monitor the depth of drilling, the flow of fluids and chemicals, and the overall effectiveness of the underground operations. Based on the data collected, the van's controls can change the operation of the pumps or the makeup of the liquid additives.</i>)	Equipment- Exempt Van- Taxable
Mobile food trailer (<i>self explanatory</i>)	Taxable
Pick up truck (<i>self explanatory</i>)	Taxable

Pump down acid equipment <i>(a positive placement pump with boost pump for prime up. Positive placement pump is used to expand a cavity. Boost pump is used to increase the system pressure of the operation. The pump down acid equipment is the pumping equipment used to perform the fracturing)</i>	Exempt
Sand conveyor <i>(a trailer-mounted belt used at well site to transport sand from sand storage bins to the blender)</i>	Taxable
Sand storage bins <i>(a mobile trailer storage bin with multiple compartments that delivers sand to the sand belt or directly to the containers for sand)</i>	Taxable
Sand transport <i>(a tractor trailer used to transport sand from the bulk plant to the well site)</i>	Taxable
Twin cement unit <i>(a system located at the well site that mixes cement to be added to the batch mixer)</i>	Exempt

2. Are materials (gases, sand, cement, etc.) used in fracturing services subject to tax?

Gases, sand and cement used by Taxpayer in fracturing services are directly used in mining activities and are thereby exempt.

3. Are the Taxpayer's fracturing services and sale of property subject to tax?

Generally, mining customers are exempt from tax for services or tangible personal property that is predominantly used directly in mining. 61 Pa. Code § 32.35(a). Therefore, Taxpayer should not bill its customers sales tax on the fracturing services or property directly used in fracturing services.

The taxability of the separately stated charges in addition to the fracturing service fees is as follows:

- Set up time—Exempt.
- Standby time—Exempt.
- Additional pumping time (in excess of pumping time originally planned)—Exempt.
- Operator time (operators are supervised by Taxpayer not miners)—Exempt.
- Additional chemicals and materials (in excess of that which was originally planned)—Exempt.

4. Does equipment brought into Pennsylvania for use here qualify for the isolated sale exemption?

The Department's regulation defines an "isolated sale" as the infrequent sale of a nonrecurring nature made by a person not engaged in the business of selling tangible personal property or the infrequent sale of a nonrecurring nature of tangible personal property acquired for use or consumption by the seller and not sold in the regular course of the business of the person. 61 Pa. Code § 32.4(a). Such sales are limited to no more than three times nor more than a total of seven days in any one calendar year. 61 Pa. Code § 32.1. The isolated sales exemption is inapplicable to the sale of motor vehicles, trailers, semi-trailers or other similar tangible personal property required to be registered or licensed under Federal or Pennsylvania laws. 72 P.S. § 7204(1); 61 Pa. Code § 32.4(b)(7). Therefore, the equipment as described falls within the isolated sales exemption if the sales are infrequent and nonrecurring and are made by a non-vendor or a vendor who is not a vendor of the type of equipment sold.



5. Are vehicles and trailers registered under the International Registration Plan (“IRP”) subject to tax?

The mining exemption does not apply to vehicles required to be registered under the Vehicle Code, 72 P.S. § 7201(k)(8). Since the International Registration Plan does not change the vehicle registration requirements required by law but merely streamlines the process of registration, Taxpayer’s vehicles and trailers are subject to tax regardless of registration under the IRP.