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SALES & USE TAX and TAX INCENTIVES
QUARTERLY NEWSLETTER
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WELCOME

Welcome to the Autumn 2021 edition of our sales and use tax newsletter. This edition focuses on two complex areas of sales tax: taxation of the oil & gas industry and the vendor's responsibilities in determining and documentation of exempt sales.

FOCUS ON THE OIL & GAS INDUSTRY

Sales tax law applicable to oil and gas producers is very complex. Compounding this situation, many oil and gas operators are short-staffed and are heavily focused on rapid development of oil and gas fields. These factors combine to create frequent significant overpayments and underpayments of tax. Some of the major issues in nearby states are shown below:

TEXAS:

- Some services are taxable, most notably repairs of both real and personal property
- Multiple exemptions for services are available including drilling, completing, recompleting, and "stimulating" wells – including new and existing wells
- New construction work is not taxable, but repairs are taxable. Materials on separately stated billings are always taxable.
- By default, services are not taxed: many services such as hauling water, delivery of items, demolition and plugging and abandoning wells are not taxable
- Rentals are generally taxable
- Certain equipment and chemicals used to treat or separate raw crude and gas to make them marketable is exempted – including oil and gas leases as well as gas treatment facilities
- Utilities used to produce or transport oil and gas are not taxable

- Recently, the Comptroller has generated controversy by denying exemption for oil soluble chemicals, gas treatment chemicals, and flowback services - all of which were considered to be non-taxable for decades

OKLAHOMA:

- No exemptions are provided for equipment used in oil and gas well production except for gas treatment plants
- Services are generally not taxed
- Sales of interest in oil and gas leases are taxable to the extent they are allocated to tangible personal property – both surface and downhole
- Sellers of business should be aware of this trap - assessments are often triggered when the OTC reviews income tax returns that contain a Federal Form 4797
- As of 2021, new legislation provides relief from tax on transfers of property between related entities – including between a parent and wholly owned subsidiaries and between those wholly owned subsidiaries

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
- exempts oil soluble chemicals or chemicals used to treat oil or gas
- exempts gas or electricity used to operate wells

LOUISIANA:

- does not tax services to "immovable" (real) property - vendors sometimes wrongly tax services performed on the well itself

For more information on Oil & Gas savings opportunities, read the article we published at: https://www.saltapllc.com/sales-tax-refunds-and-savings-when-cash-is-king/

SELLER BEWARE (OF NOT COLLECTING SALES TAX)!

- **Multi-state sales**
  Because of the "sales tax tsunami" the United States (U.S.) Supreme Court released in its 2018 *Wayfair v. South Dakota* decision, sellers who sell remotely into states in

which they have no physical presence may potentially be subject to sales tax in those states based on "economic nexus." The threshold for economic nexus is based on sales over a one-year period in all states that impose sales tax. However, the similarity ends here. States vary in the following factors:

- *Nexus trigger sales value*
  In all but a few states, the threshold is $100,000. However, in other states, the threshold is more – up to $500,000 in California, New York, and Texas.
- *Nexus trigger sales transaction count*
  In some states, the number of sales is irrelevant as far as nexus, as it should be. Unfortunately, in about half of the states, an "or" test applies, with nexus created either by 200 or more annual transactions or by value of sales.
- *Sales counted in the measure*
  States vary regarding which sales transactions must be included in the value to be considered for their threshold. Some include all sales of goods and services; others allow exclusion of non-taxable services or exempt sales of goods—either for resale or of all exempt sales.
- *Definition of the one-year period*
  For most states, the period is measured by calendar year including past complete years or the current calendar year. For others, the measure is by rolling four quarters, or even rolling 12-month periods.
- *Time allowed to begin compliance*
  Some states allow a period to register and begin collecting tax, but the period can be very short—even the very next month beginning after the threshold is triggered. For a few, no grace period at all is provided.
- For more information on state specifics for economic nexus: https://www.avalara.com/us/en/learn/guides/state-by-state-guide-economic-nexus-laws.html

- **Not collecting tax in states where physical presence occurs**
  If a seller has employees working in a state where sales occur, even on a temporary basis—including repairmen, installers, etc.—nexus exists for sales tax. Additionally, delivery in company vehicles, inventory or leased property located in a state creates nexus.
- **Not taxing services or goods correctly**
  Sellers of services may not be aware that some services are taxable in certain states. For example, a window washing vendor in one state was unaware that state's tax on janitorial services extended to window washing. An assessment for tax over a multi-year period would have been devastating. Other common errors include not correctly taxing freight or other charges added to sales (depending on state laws) and collecting incorrect state and/or local taxes.
- **Not having valid exemption certificates**
  The largest source of audit assessment is due to missing or invalid exemption certificates. Without fail, auditors examining sellers who have made exempted sales will request exemption certificates. Sellers may have collected some documentation, but often the certificates have been lost, were invalid or, for Oklahoma purchasers, the certificate is invalid because the buyer's permit expired.
- **Poor billing practices**
  Sales tax is a form-driven tax. Presentation of sales on invoices matter! For example, if

sales made include both non-taxable services and taxable items, separately stating those elements can avoid unnecessary audit assessments or unnecessary collection of tax from customers. When taxable and non-taxable elements are bundled, the taxable items normally taint the entire transaction. This is what we refer to as the "omelet principal"—adding one bad egg ruins the entire omelet. Audits often result from an audit of the seller's customers. In this scenario, auditors may notice invoices that appear to not include correct taxes. Depending on how the invoice looks and what it says, the audit of the customer could lead to an audit of the seller.

In summary, preparation for an audit includes: 1) knowing whether goods or services sold are taxable, 2) establishing where the seller has nexus, and 3) collecting the correct tax or valid exemption certificates on all sales into those states where compliance is required. The complexity of this task may require usage of sales tax software. If significant exposure exists, usage of voluntary disclosure agreements may reduce penalties and the look-back period.

For more information on duties of sellers to avoid sales tax exposure, read the article we published at: https://www.saltapllc.com/sales-and-use-tax-101-a-basic-level-overview-for-accountants/ and watch for the article in the November OSCPA *Focus* magazine.

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