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# Rule 4372's Potential Impact on Sales, Use Taxation of Oil and Gas Services



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The Louisiana Department of Revenue promulgated Louisiana Administrative Code 61:I.4372, entitled "Payment of Sales and Use Taxes by Persons Constructing, Altering, or Repairing Immovable Property" (Rule 4372) effective August 20, 2012. Rule 4372 creates a rebuttable presumption that contractors are the consumers of the personal property that they purchase to construct, alter or repair real property and are therefore liable for the Louisiana sales and uses taxes imposed on those purchases. Although there is yet no conclusive guidance from the courts or the Department, this article explains how oil and gas services contractors could potentially structure re-sales of their personal property inputs to rebut this presumption.

## Basic Rules for LA Sales and Use Taxation of Oil and Gas Services

In Louisiana, only those services enumerated in Louisiana Revised Statutes (RS) 47:301(14) are subject to sales tax. Unless specifically designated or defined in the statute as taxable, sales of services are exempt from Louisiana sales tax.

Oil and gas services that constitute repairs to tangible personal property qualify as taxable under RS 47:301(14)(g). RS 47:301(14)(g) defines taxable sales of services to include the furnishing of repairs to tangible personal property. The regulation on repairs to tangible personal property,

Louisiana Administrative Code 61:I.4301.C, entitled "Sales of Services," provides that both repair and routine servicing of all kinds of tangible personal property are included as taxable services.

For example, in Revenue Ruling 10-003 (November 10, 2010), the Department determined that services involving the reworking of existing wells or fracturing should be considered repair services for purposes of RS 47:301(14)(g). However, the Department ruled that although the reworking and fracturing services were repair services, they were not subject to sales tax because the services were to be performed on oil and gas wells, which

are real property, not personal property. The Department explained that services upon real property are not taxable, as real property is not classified as tangible personal property.

Pursuant to RS 47:301(16)(l), oil and gas wells are classified as "other constructions" and therefore treated as real property. RS 47:301(16)(l) provides that for purposes of state and local sales tax in Louisiana, "other constructions" permanently attached to the ground shall be treated as real property, and not as tangible personal property, without regard to the nature of the ownership of the ground on which the other construction is located. Tangible personal property does not include real property or "other constructions" permanently attached to the ground.

In contrast, the cleaning, redoping, sandblasting, waterblasting and internal and external brushing and spraying of oil field drill pipe are subject to Louisiana sales and use tax under RS 47:301(14)(g) because they are services on tangible personal property.

These basic rules get a little murky when considering how they should apply

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to the personal property that an oil and gas services contractor purchases and uses in connection with performing otherwise non-taxable services on real property.

The general rule is that there is no statutory exemption or exclusion from sales tax upon personal property used in construction or repair of real property. The sales or use tax is payable by the contractor, who is held to be the purchaser or user of all materials used in the construction, restoration, maintenance or repair of real property.

However, in contrast to the terms of an ordinary repair or construction contract, what if the repair or construction

contract provides that the contractor will re-sell the personal property inputs to its customer before using them to perform the repair service or before incorporating them into the real property to be constructed? By creating a sale for re-sale, the contractor avoids paying sales tax to its materials vendor or use tax when importing them into the sale, but would be required to collect sales tax from its customer on the re-sale. But what if the contractor's customer is exempt from sales tax on the purchase of such materials? In this way, could the parties avoid sales and use tax entirely?





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Although there is yet no definitive guidance, Rule 4372 seems to leave that door open.

### Purpose of Rule 4372

According to the introductory comments to Rule 4372, the Department promulgated Rule 4372 to combat the situation where it was forced to refund sales taxes to purchasers who argued that their repair or construction contracts did not reflect a re-sale transaction but an ordinary repair or construction contract. Rule 4372 accomplishes this purpose by offering up the general rule that contractors are liable for the sales or use taxes on their purchases as a rebuttable presumption. According to Rule 4372, this general rule may be rebutted with "credible evidence" such as a writing signed by the contractor's customer stating that title and/or possession of itemized articles of tangible personal property were transferred to the customer prior to their being made real property. In the absence of credible evidence such as documentation reflecting the sale transaction, the Department can rely on the presumption to find the contractor liable.

However, it is doubtful a mere writing signed by the contractor's customer will dictate the parties' tax consequences. The introductory notes to Rule 4372 state that "Since this Rule imposes a rebuttable presumption, it does not interfere with the parties' freedom to contract in cases where tangible personal property is *actually* sold to the customer, and not just used in providing a service." [emphasis added] This would seem to indicate that all of the facts and circumstances of the transaction must reflect a true sale, that documentation alone is not enough. Factors the Department may consider when determining whether an actual sale has taken place are the following: Is the personal property merely incidental to the performance of the services? Is it the kind of project where circumstances normally dictate that materials are sold to the customer before being incorporated into the real property? Did the customer actually pay for the materials at the time of delivery or when the services were completed? Is the contract a true contract of sale and not a typical construction contract? Were the materials actually delivered to

the customer's location before being used by the contractor to perform the services?

At a minimum, to rebut the presumption of Rule 4372 that the contractor is liable for sales or use tax on the purchase or importation of materials required to perform oil and gas services in Louisiana, the contractor and customer must enter into a written agreement for the sale of the materials that specifies their price and a separate service agreement that specifies the price of the services. If all the circumstances reflect an actual re-sale, then under Rule 4372, an oil and gas services

contractor may avoid liability for sales or use tax on the purchase or importation of its personal property inputs. ●

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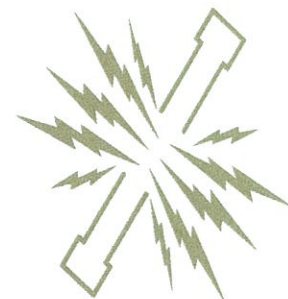
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