

South Dakota

Department of Revenue

445 East Capitol Avenue

Pierre, South Dakota 57501

Oil & Gas Field Services

March 2011

This Tax Facts is designed to explain how sales and use tax applies to oil and gas field services. If this Tax Facts does not answer your specific question, please call the Department's toll-free Helpline at 1-800-829-9188 between 8:00 AM – 5:00 PM CST, Monday through Friday.

Information found in this document rescinds and replaces all previously written information on this subject. All readers and users of this publication are responsible for keeping informed about changes in tax laws and regulations by reading the department's newsletters, press releases, Tax Facts, and other documents published by the Department of Revenue.

The gross receipts from oil and gas field services rendered on non-commercially and commercially productive wells are subject to sales tax. The 4% state plus applicable municipal sales tax applies to oil and gas field services based on where the service is received. Oil and gas field services are typically received at the location of the well site. The gross receipts include all charges for labor, material, supplies, and miscellaneous items such as mileage or other travel expenses.

Oil and gas field services companies owe sales or use tax on all material, equipment, and supplies they use or consume in providing their services.

Oil and gas field services subject to sales and use tax include:

- Acidizing wells
- Aerial geophysical exploration
- Bailing wells
- Building oil and gas well foundations
- Cementing oil and gas well casings
- Chemically treating wells
- Cleaning lease tanks
- Cleaning wells
- Derrick building, repairing, and dismantling
- Directional drilling of oil and gas wells
- Dismantling of oil well rigs
- Erecting lease tanks
- Erecting tanks
- Excavating slush pits and cellars
- Exploration
- Fishing for tools
- Gas compressing, natural gas at the field
- Gas well rig building, repairing, and dismantling
- Geological exploration
- Geophysical exploration
- Grading oil and gas well foundations

- Hard banding service
- Horizontal drilling
- Hot oil treating of oil field tanks
- Hot shot service
- Hydraulic fracturing wells
- Impounding and storing salt water in collection with petroleum production
- Logging wells
- Mud service, oil field drilling
- Oil sampling service for oil companies
- Oil well logging
- Perforating well casings
- Pipe testing service
- Pit Liners, installation of
- Plugging and abandoning wells
- Pumping of oil and gas wells
- Redrilling oil and gas wells
- Removal of condensate gasoline from field (gathering) lines
- Repairing lease tanks
- Reworking oil and gas wells
- Roustabout service
- Running, cutting, and pulling casings, tubes, and rods
- Seismograph surveys
- Servicing oil and gas wells
- Shooting wells
- Shot-hole drilling service
- Spudding in oil and gas wells
- Surveying wells
- Swabbing wells
- Well drilling: gas, oil and water intake

All other sales of tangible personal property and services are subject to the 4% state plus applicable municipal sales tax. Examples of taxable services are: well operator fees, waste water disposal, utility bills, snow removal, and mowing services.

Construction Services and Realty Improvements

Except for items specifically listed as oil and gas field services, construction services and realty improvements are subject to contractors' excise tax. Construction services and realty improvements subject to contractors' excise tax are not subject to sales or use tax.

The contractors' excise tax application for prime and subcontractors is as follows:

Prime Contractors:

- Owe 2% contractors' excise tax on their gross receipts.
- Owe 4% state, plus applicable municipal use tax on materials furnished by the owner, if the owner does not document sales or use tax was previously paid.
- Includes the value of material furnished by the owner in their gross receipts subject to the contractors' excise tax.
- Owe 4% state and applicable municipal sales or use tax on material they furnish for the contract.
- Must issue prime contractor exemption certificates to subcontractors.
- Cannot deduct amounts paid to subcontractors in determining gross receipts subject to the contractors' excise tax.

Subcontractors:

- Do not owe the 2% contractors' excise tax IF a prime contractors' exemption certificate is received for that project.
- Owe 4% state and applicable municipal sales or use tax on material they furnish for the contract.

Examples of construction services subject to contractors' excise tax:

Building road to well site
 Dirt moving
 Land clearing
 Land reclamation
 Pipeline construction
 Cattle guard installation
 Electrical work
 Building construction & repair

Repair Services

Repair services are subject to the 4% state plus applicable municipal sales tax. Tax applies to the total price of the service including labor, parts, and miscellaneous charges such as travel expenses. Sales tax applies based on where the repaired item is delivered. Repairs to items at the well site are subject to tax based on the well site. If repaired items are delivered to another location, sales tax applies based on where the repair is delivered.

Repair companies can purchase repair parts for resale.

Repairs to realty improvements, except for services listed as oil and gas field services, are subject to contractors' excise tax. The contractor repairing real property will owe sales or use tax on repair parts they use or consume in providing the repair.

Example

John repairs gas rigs. John itemized charges for labor at an hourly rate, materials used, and travel expenses (mileage). Because gas rig building, repair and dismantling are included in the list of oil and gas field services, John is providing a service subject to sales tax. The 4% state plus applicable municipal sales tax applies to the total charge for the repair service, materials, and travel expenses. The repair parts may be purchased for resale.

Equipment

Equipment purchased for use in South Dakota is subject to the 4% state plus applicable municipal sales or use tax. Credit will be allowed for sales or use tax paid if the equipment is purchased and delivered to the taxpayer in another state.

When used equipment is brought into the state that was originally purchased for use in another state and the equipment is seven years old or less, use tax must be paid on the fair market value of equipment. The age of the equipment is based on the manufacture date if available; if not available, the age is based on the purchase date. The amount of tax on the equipment will be reduced by the amount of sales or use tax previously paid to another state.

Equipment used in a municipality is subject to that municipality's use tax. Credit will be given for municipal sales or use tax previously paid.

Examples of taxable equipment:

Drilling rigs
 Tools
 Unlicensed off road vehicles

Example

Tom operates an out-of-state drilling company. Tom has a contract to perform a drilling service for an oil and gas well operator in South Dakota that started October 1, 2006. Tom brought a drilling rig into South Dakota that was not previously taxed. The drilling rig was manufactured and purchased in 2005. Does Tom owe use tax on the drilling rig to the State of South Dakota? Yes, 4% state use tax is due on the fair market value of the drilling rig because the drilling rig was less than 7 years old at the time it was brought into South Dakota.

Oil Well Operator's Fees

Fees for managing or overseeing the operation of an oil well in South Dakota are subject to 4% state plus applicable municipal sales tax. Sales tax applies where the well is located. The service provider owes sales or use tax on equipment and supplies for their use.

The operator may purchase supplies, services or equipment for the owner that the owner will retain. The operator does not owe sales tax on the charges to the owner for these items provided sales tax or use tax is paid at the time of purchase and the items are billed to the owners at cost (without markup).

Charges for services that are in addition to the overseeing are subject to sales tax. Examples of taxable services are: roustabout services, facility cost allocations, monitoring and regulating services at the site, charges for water systems, and reimbursement for employees.

Example

Pete's Operating has a contract to oversee the operation of Wade's Oil Wells in South Dakota for \$1000 per month. Equipment and supplies of \$5000 were purchased sales tax paid during the month of July. Pete's owes sales tax on the \$1000 fee for overseeing the wells. Because sales tax was paid on the equipment and Wade's Oil Wells owns the equipment, no additional sales tax is due on the \$5000.

Use of Services

Sales tax applies to services where the service is first used or received. The 4% state plus applicable municipal use tax applies if the service is used in South Dakota. When calculating use tax, credit will be allowed for sales or use tax legally due and paid to other states. *Use tax is not due on the purchase of construction services subject to the contractors' excise tax.*

- Oil and gas field services are subject to sales and use tax where the property is located.
- Services such as management services such as overseeing the operation of an oil well is subject to sales and use tax where the property being managed is located.

Examples

1. A Denver based company oversees the operation of oil wells in South Dakota. They authorize and pay for services and purchases of chemicals and parts needed for each well. These expenses are reimbursed by the wells' owners. The Denver company is paid a flat monthly fee for this service. Is this service taxed?

The 4% state tax plus applicable municipal tax applies to the operator's fees based on the location of each well. The operator will owe sales tax on his receipts for services, chemicals, parts, and equipment purchased on behalf of the owners if sales tax was not paid at the time of purchase.

If the Denver company does not collect South Dakota sales tax, South Dakota use tax is due on the total charge for the management services. Use tax is due based on the well locations.

2. Sam checks a well site on a regular basis and reports problems to the appropriate people. This fee is subject to sales tax based on the well site.

If sales tax is not collected, the purchaser will owe South Dakota use tax on the full charge because the service is used for the well site in South Dakota.

3. Ted provides hot shot services. Ted's bill includes charges for labor at an hourly rate and charges for propane and oil. The propane is used to heat the oil to shoot down the well. 4% state and applicable municipal sales tax applies to the entire invoice. In addition, Ted must pay 4% sales or use tax on the propane, oil, and any other items consumed in providing this service.

If sales tax is not collected, the purchaser will owe use tax on the full charge from the service provider.

Taxable products and services

Drilling services used in exploring for petroleum and natural gas are subject to the 4% state plus applicable municipal sales tax. Sales tax is due on drilling charges, pipe charges, standby charges, drill up or drill down charges, plus reimbursable expenses such as fuel and mileage.

Waste disposal is subject to the 4% state plus applicable municipal sales tax. This includes collecting water or other fluids from the well or tanks and hauling it away for disposal. Sales tax applies based on where the waste is picked up. If picked up in South Dakota and hauled to another state, South Dakota sales tax applies. The entire fee is subject to tax including the charge for pumping, mileage from the trucks' base to SD well, mileage from well to disposal site, and other charges for disposal at the site.

Water for use at oil wells is subject to the 4% state plus applicable municipal sales tax. This includes the charges for water plus any delivery charges including mileage and pumping charges. The water supplier may purchase the water for resale by issuing an exemption certificate to the seller.

Diesel fuel, heating oil, and propane used for drilling, heating buildings, and heating oil or equipment is subject to the 4% state plus applicable municipal sales or use tax. If the seller delivers the fuel to the oil well, use tax is due if South Dakota sales tax have not been charged.

Delivery Charges are the charges by the retailer for preparation and delivery to a location designated by the purchaser of tangible personal property or services sold by that retailer. Delivery charges include transportation, shipping, postage, handling, crating, and packing. Delivery and handling charges are subject to the same state and municipal sales tax rate as the merchandise when delivered to a customer in South Dakota. If the product is not taxable, the delivery and handling charges are not taxable. If a retailer hires a transportation company and bills the customer for the transportation service, the retailer must include the transportation charges in their taxable receipts.

Gravel sales, including transportation charges, are subject to the 4% state plus applicable municipal sales tax.

Bucket Trucks leased without an operator are subject to the 4% state plus applicable municipal sales tax if leased for 28 days or less are subject to sales tax. Bucket trucks leased without an operator for more than 28 consecutive days are exempt from sales tax. If an operator is provided to operate the equipment being furnished, the contract is for a service and does not meet the definition of a lease. The type of service provided in this contract determines the tax application. Construction services as defined in Division C of the 1987 Standard Industrial Classification manual are subject to contractors' excise tax. All other services are subject to sales tax, unless they are specifically exempt.

Exempt Products and Services

Trucking charges are exempt from sales or use taxes. This includes loading and unloading charges when billed with the transportation. Loading and unloading charges that are not part of the trucking company's services are subject to sales or use taxes.

If hired to erect or dismantle and transport equipment, this service is subject to sales tax. Charges to erect or dismantle equipment are not transportation charges.

Use tax

The state and many cities impose a use tax that applies when the seller didn't charge sales tax. The difference between the sales tax and the use tax is who is responsible for its payment. Where the sales tax is the responsibility of the seller, the use tax is the responsibility of the purchaser. If the person selling material doesn't charge sales tax, for whatever reason, the purchaser is responsible for paying the use tax.

Use tax is paid in the tax reporting period the purchaser is invoiced. The use tax applies to the amount paid for the material including all delivery and handling charges.

Use tax on services is on the total amount paid for the service including labor, equipment, supplies, and travel charges such as mileage, meals, motels, and plane tickets.

You will owe additional use tax if the material is used at a location that imposes a higher use tax than was previously paid on the material.

When purchasing material or equipment outside South Dakota that is delivered into South Dakota by a transportation company or by the supplier, be careful that the seller does not charge you the other state's sales tax. That material and equipment will be subject to the South Dakota sales or use tax even if the supplier charges another state's sales tax. South Dakota will not give a credit for taxes paid to another state if the material is delivered into South Dakota.

If a purchase is made out-of-state and you or your employees take possession of the property out-of-state, the supplier will most likely charge that state's sales tax. If the other state's sales tax is the same or more than South Dakota's tax, you will not owe any additional South Dakota use tax. However, if you are charged less tax in the other state than what is charged in South Dakota, you will owe the difference in use tax to South Dakota. South Dakota 4% state sales tax plus applicable municipal taxes must be added together to determine if additional tax is owed.

Credit for sales or use tax paid to another state, up to the amount of use tax due South Dakota, is applied towards the amount of South Dakota state use tax first, then against the municipal tax due. Credit is not allowed for use tax paid to Nevada and Wyoming. They do not allow credit for use tax paid to South Dakota.

Examples

1. You purchase material in Minnesota and pay the Minnesota sales tax to the supplier. You then use the material in Buffalo, SD. If the use tax due in Buffalo is higher than the sales tax paid to the Minnesota supplier, you will owe additional use tax.
2. You purchase material from an unlicensed business in Ohio. The material is shipped by common carrier to Buffalo where it is used in a project. Because the supplier did not charge sales tax the contractor owes the 4% state use tax plus the Buffalo use tax. The tax applies to the total paid for the material including delivery and handling charged by the supplier.

Municipal Tax

Many municipalities in South Dakota have a sales and use tax in addition to the state sales tax. If the customer receives a product or service in one of these municipalities, the product or service is subject to that municipality's sales tax. A list of municipal tax rates is available on our website at www.state.sd.us/drr or by calling 1-800-TAX-9188.

In an effort to ease the burden retailers may encounter trying to identify which South Dakota addresses are inside a city with a sales tax, the department created a Geographic Information System (GIS) called TaxMatch that is easily accessible by computer over the Internet.

It can help users quickly find the correct tax rate and city tax codes for locations throughout South Dakota. Users enter any South Dakota address into the Tax Match system; the system then provides all the applicable tax codes and rates for that address. For quick and easy access, look for the GIS icon on the department's web site at www.state.sd.us/drr.

Required Records

Records, such as purchase and sales invoices, bills of lading, books of all receipts and sales, cash register receipts, and other pertinent papers and documents, are required to be kept for at least three years and be available for inspection during business hours.

Businesses must keep adequate documentation to support that products are delivered outside city limits. Examples of documentation that shows delivery of products include: truck driver log books; directions to delivery point; contract carrier bills of lading; and shipping invoices.

Talk to Us!

If you have a tax problem or question, call the South Dakota Department of Revenue toll-free at 1-800-TAX-9188. Visit us on the web at www.state.sd.us/drr, email us at bustax@state.sd.us or write us:

**South Dakota
Department of Revenue
445 East Capitol Ave.
Pierre, SD 57501-3185**

Aberdeen
419 Moccasin Drive
Aberdeen, SD 57401

Sioux Falls
300 S. Sycamore, St 102
Sioux Falls, SD 57110

Mitchell
417 N. Main, Suite 112
Mitchell, SD 57301-2600

Watertown
1505 10th Ave. SE, Suite 1
Watertown, SD 57201

Rapid City
4447 S. Canyon Road, Suite 6
Rapid City, SD 57702

Yankton
1900 Summit Street
Yankton, SD 57078-1951