

103 KAR 30:270. Oil and gas extraction machinery.

RELATES TO: KRS 139.010, 139.200, 139.260, 139.270, 139.280, 139.290, 139.310,
STATUTORY AUTHORITY: KRS 131.130(1)

NECESSITY, FUNCTION, AND CONFORMITY: KRS 131.130(1) authorizes the Department of Revenue to promulgate administrative regulations necessary for the administration and enforcement of Kentucky tax laws. This administrative regulation establishes the sales and use tax requirements for transactions relating to the oil and gas extraction industry.

Section 1.

(1) Definitions. "Contract driller" means a person performing a drilling service for the owner or operator of an oil or gas well under a contractual relationship for consideration.

(2) "Repair, replacement, or spare parts" is defined by KRS 139.010(34).

Section 2. Eligible Property for Exemption. The storage, use, or other consumption of tangible personal property for use in the extraction or production process for oil or natural gas which will be for sale shall be exempt from the sales and use tax according to the provisions of KRS 139.010, 139.470(9), and 103 KAR 30:120.

(1) The extraction or production process for oil shall be considered as beginning with the erection of the drilling rig at the drilling location and shall be considered as terminating at the settling tank immediately prior to transportation. Oil tanks used for storage alone shall be subject to tax.

(2) The extraction or production process for natural gas shall be considered as beginning with the erection of the drilling rig at the location of the well and shall be considered as continuing until the gas leaves the outlet on the discharge side of the final gathering compressor station. The pipeline from the outlet to the transmission line shall be subject to tax.

(3) The list in this subsection shall serve as examples of machinery used in the extraction or production process:

- (a) Drilling rigs;
- (b) Casings;
- (c) Tubing;
- (d) Well head equipment;
- (e) Pumps;
- (f) Compressors;
- (g) Production and gathering pipe;
- (h) Cleaning equipment; and
- (i) Oil settling tanks.

(4) The list in this subsection shall serve as examples of other tangible personal property used in the extraction or production process:

- (a) Drilling bits;
- (b) Explosives;
- (c) Drilling muds;
- (d) Chemicals; and
- (e) Fracking fluids, including water and sand.

(5) Tangible personal property shall not be exempt from sales and use tax if it is used as "repair, replacement, or spare parts".

Section 3. The extraction or production process shall include the following operations:

(1) Drilling and equipping wells, to include:

- (a) Drilling of the hole by the drilling rig to the producing formation;
- (b) Installing casing and tubing in the hole;

- (c) Stimulating production by explosives or other means;
 - (d) Hydraulic fracturing or fracking; and
 - (e) Completion of the well by the installation of machinery and equipment; and
- (2) Pumping, gathering, and cleaning.
- (a) Pumping shall include the use of separate pumps on individual wells, group well pumps, and auxiliary pumps at other points on the gathering system. The machinery and appurtenant equipment used in secondary methods of recovery including gas repressuring or water-flooding shall be considered part of the extraction or production process.
 - (b) The gathering system shall consist of a series of pipelines connecting several different wells with settling tanks grouped together for production purposes. Compressors used to stimulate production and to continue in effect the processing production operation shall be considered part of the gathering system.
 - (c) Cleaning operations shall occur in the final settling tank where impurities are removed from oil by chemical heating and settling processes. If a well produces both oil and gas, separator equipment shall be necessary at appropriate points in the gathering lines to separate the oil and gas. In addition, various types of machinery may be used at different points in the gathering system to clean oil or gas.

Section 4. Nonproduction Process. Preliminary work, transportation, and marketing shall not be considered part of the oil or gas extraction or production process.

- (1) Preliminary work shall include:
- (a) Geological and geophysical work;
 - (b) Leasing or purchasing operations;
 - (c) Determination of drilling sites; and
 - (d) Surface work preparatory to drilling.
- (2) The transportation of oil shall be considered as commencing when the oil is pumped from the settling tank into transportation facilities, which may be truck, rail, or pipeline, or a combination thereof.
- (3) The transportation of natural gas shall be considered as commencing at the point where the production or gathering system ceases, and it is delivered into pipelines for transportation to the retail distribution system.
- (4) The marketing of natural gas shall be considered as commencing when the pressure in the transportation line is reduced and the gas is delivered into a low-pressure system for distribution to the ultimate retail consumer.

Section 5. Contract Drillers.

- (1) The exemptions provided in KRS 139.470(9) and 139.480(10) shall not apply to purchases made by a contract driller since a contract driller is providing a service and is the consumer of the machinery and materials used to provide the service.
- (2) A contract driller may jointly execute a "Certificate of Exemption Machinery for New and Expanded Industry," Form 51A111, with an oil or gas well owner or operator to purchase machinery used to provide drilling services to the oil or gas well owner or operator only if the oil or gas well owner or operator is the actual title owner of the machinery used to provide the drilling services after the contract between the contract driller and the oil or gas well owner or operator has been completed.

Section 6.

- (1) This administrative regulation shall replace Revenue Circular 51C013.
- (2) Revenue Circular 51C013 is rescinded and shall be void.

Section 7. Forms. The form listed within this administrative regulation may be inspected, copied, or obtained, subject to applicable copyright law, at:

- (1) The Kentucky Department of Revenue, 501 High Street, Frankfort, Kentucky 40601;

(2) A Kentucky Taxpayer Service Center; or

(3) The department Web site at <http://revenue.ky.gov>.

(33 Ky.R. 2813; 3157; eff. 5-4-2007; TAm eff. 6-22-2016; Crt eff. 1-28-2020; 46 Ky.R. 1289; 2025; eff. 4-1-2020.)