

5703-9-63

**Crude oil and natural gas production.**

(A)

- (1) For the purposes of Chapters 5739 and 5741 and this rule, all purchases of tangible personal property are taxable, except those in which the purpose of the consumer is to use or consume the thing transferred directly in the production of crude oil and natural gas for sale. This means that a person who buys tangible personal property and directly uses or consumes it in the production of crude oil and natural gas for sale does not have to pay sales or use tax on the thing purchased.
- (2) “Production” means operations and tangible personal property directly used to: expose and evaluate an underground reservoir that may contain hydrocarbon resources; prepare the wellbore for production; and lift and control all substances yielded by the reservoir to the surface of the earth.
- (3) Additionally, this rule applies to persons engaged directly in rendering services in the exploration for and production of crude oil and natural gas for others. To that end, persons engaged in rendering the exploration or production services can take advantage of this exemption if the person directly uses or consumes the item in the production of crude oil and natural gas for sale.
- (4) Nothing in this rule prohibits a taxpayer to avail themselves of other exemptions, including but not limited to, the exemptions found in Chapter 5709. of the Revised Code.

(B) Any term not defined below has the same meaning as in Chapters 5739. or 5741. of the Revised Code. For purposes of this rule, the following definitions apply:

- (1) “Acidizing” includes acid fracturing, matrix acidizing, and acid washing.
- (2) “Artificial lift system” includes the process used on oil and gas wells to encourage oil or gas to the surface, including beam pumping, hydraulic pumping, electric submersible pumping, and gas lift injection.
- (3) “Casing” means a pipe placed in an oil or gas well as drilling progresses to prevent the wall of the hole from caving in during drilling, to prevent seepage of fluids, and to provide a means of extracting oil or gas if the well is productive. Types of casing include conductor casing, intermediate casing, production casing, and surface casing.
  - (a) “Conductor casing” means one or more strings of casing set and cemented to provide a base for an air body for diversion of shallow naturally occurring

natural gas including coalbed methane and to accomplish one or more of the following well construction objectives:

(i) Stabilize unconsolidated sediments;

(ii) Isolate shallow aquifers that provide or are capable of providing groundwater for water wells and springs in the vicinity of the well;  
or

(iii) Isolate groundwater before penetrating the workings of an active underground mine.

(b) "Intermediate casing" means one or more strings of casing set after surface casing has been cemented through the base of the deepest underground source of drinking water, but before drilling into the permitted hydrocarbon reservoir(s) to isolate hydrocarbon or brine bearing flow zones, stabilize the wellbore, to isolate protected groundwater if encountered after drilling below surface casing, isolate lost circulation zones or other potential geologic hazards, or serve as a base for well control equipment.

(c) "Production casing" means a string of casing set to isolate the permitted hydrocarbon bearing reservoir(s), and other pressurized flow or corrosive, hydrogen sulfide-bearing zones not effectively isolated by previous casing(s).

(d) "Surface casing" means a string of casing set and cemented to isolate and protect the deepest underground source of drinking water and to serve as a base for well control equipment.

(4) "Centralizing equipment" means any device used to keep downhole equipment in the center of the tubing, casing, or wellbore.

(5) "Completing a well" includes the steps taken to transform a drilled well into a producing one. The steps of completion include but are not limited to casing, cementing, perforating, gravel packing and installing a production tree

(6) "Drilling" means the use of a rig for exposing the underground reservoir.

(7) "Drilling byproducts" includes wastewater, brine, fracking water, mud, cuttings, natural gas, oil, hydrocarbons, hydrogen sulfide and all other chemicals. Liquids that flow back from the wellbore during the drilling or fracturing process that are recirculated downhole in a continuous process are not considered drilling byproducts.

- (8) “Downhole” includes equipment, materials, or processes that are used inside the well.
- (9) “Expose and evaluate” includes drilling activities used in the search for a viable well that may produce crude oil or natural gas.
- (10) “Field” means the general area underlaid by one or more pools.
- (11) “Float” means a valve , collar, joint, shoe or similar component of a casing string that is used during cementing or downhole chemical injections to prevent backflow during a drilling operation.
- (12) “Gas” means all natural gas and all other fluid hydrocarbons that are not oil, including condensate.
- (13) “Hydraulic fracturing” means the use of fluid and material to create or restore small fractures in a formation in order to stimulate production from new and existing crude oil and natural gas wells.
- (14) “Hydrocarbon gas” means a combustible organic gas containing only one carbon and one hydrogen. Hydrocarbon gas includes, but is not limited to, propane, compressed natural gas, liquified petroleum gas, methane, or any chemically similar gas, but does not include gasoline or diesel fuel.
- (15) “Hydrocarbon resource” includes a resource that contains hydrocarbon molecules, such as a fossil fuel resource, natural gas, oil, or coal.
- (16) “Lift and control” includes all methods used to raise oil, gas, or other comingled substances to the surface after a well ceases to flow; techniques used to control and manage the unexpected release of natural gas or crude oil pressure; and operations that monitor the pressure throughout the life of the exploratory or productive phase of the well.
- (17) “Mud logging” means recording information derived from the examination and analysis of formation cuttings made by the bit and of mud circulated out of a borehole.
- (18) “Oil” means crude petroleum oil and all other hydrocarbons, regardless of gravity, that are produced in liquid form by ordinary production methods, but does not include hydrocarbons that were originally in a gaseous phase in the reservoir.
- (19) “Perforation” means a hole made in the casing, cement, and formation through which formation fluids enter a wellbore.

- (20) "Pool" means an underground reservoir containing a common accumulation of oil or gas, or both, but does not include a gas storage underground reservoir. Each zone of a geological structure that is completely separated from any other zone in the same structure may contain a separate pool.
- (21) "Prepare the wellbore" includes the drilling of initial conductor pipe (or casing to support the surface formations) or surface holes, and placement of the conductor strings and pipes.
- (22) "Pressure pumping equipment" includes equipment used in the propagation of fractures through layers of rock using pressurized fracturing fluid and pumping the cement into the wellbore to complete the well.
- (23) "Production equipment" means wellhead and wellsite equipment used to refine, stabilize, pump and compress hydrocarbon resources, including phase management and produced water.
- (24) "Reservoir stimulation" includes hydraulic fracturing, acidizing, and any means by which the reservoir is acted upon, by chemicals, gases, pressure related services, or otherwise as a way to stimulate production of the hydrocarbons.
- (25) "Subsurface wellbore" means a wellbore created below the surface of the ground.
- (26) "Temporary Impoundment" means all water, sediment, slurry, or other liquid or semi-liquid holding structures and depressions, either naturally formed or artificially built, that will not remain as part of the land use after the exploration for or production of crude oil or natural gas.
- (27) "Tubular" means any type of pipe, such as drill pipe, drill collars, pup joints, casing, production tubing, and pipeline.
- (28) "Underground reservoirs" means the stratum and subsurface area that are used or are to be used for or in connection with the underground storage of oil or natural gas.
- (29) "Wellbore" means a bore, whether drilled or bored, within the state for production or extraction of gas or liquid mineral.
- (30) "Wellbore pathway" means the manmade trail created to access underground reservoirs at surface level.
- (31) "Well site" means the area near the wellbore, including but not limited to, the well pad and production operations that are directly associated with the well pad.

(32) “Workover services” means the repair or stimulation of an existing production well for the purpose of restoring, prolonging, or enhancing the production of hydrocarbons.

(33) “Wireline evaluation” means a cabling technology service used to lower equipment or measurement devices into the well for the purpose of reservoir evaluation.

(C) In order to determine whether an item qualifies for an exemption, it is important to review how the item is used or consumed. Simply because an item is an enumerated thing transferred under division (B)(42)(q) of section 5739.02 of the Revised Code does not automatically mean that the item is directly used or consumed in the production of crude oil and natural gas for sale. The following items and examples are intended to illustrate different scenarios that are applicable to an exemption analysis under this section.

(1) Services provided in the construction of permanent access roads; services provided in the construction of the well site; and services provided in the construction of temporary impoundments, when sold, are never, by themselves, considered taxable transactions. To the extent an item is transferred in the use of these services, the item may be directly used or consumed in the production of crude oil and natural gas for sale.

For example, Company B is in the business of selling crude oil and natural gas. Company B hires Company A to clear, level and stabilize the site. Company A also constructs the well pad and drills the wellbore. The fees charged by Company A for site clearing, leveling and stabilizing services are generally not taxable.

Any tangible personal property Company A utilizes in creating the wellbore such as a drill or casing for the wellbore are considered exempt because those items are directly used or consumed in the production of crude oil and natural gas for sale. In addition, the sale or transaction whereby Company B acquires the wellbore is also considered exempt, because the wellbore is directly used in the production of crude oil and natural gas for sale.

The well pad is part of the wellsite, but is considered a business fixture and not directly used in production of crude oil or natural gas. Accordingly, the materials Company A purchases and consumes in creating the well pad are not directly used or consumed in the production of crude oil and natural gas for sale so the materials are not considered exempt under division (42)(q) of section 5739.02 of the Revised Code. Furthermore, the sale or transaction whereby

Company B acquires the well pad is also not considered exempt under division (42)(q) of section 5739.02 of the Revised Code.

Company A also provides for the seeding of the grass after these activities described above are complete. Such service is considered a taxable service pursuant to section 5739.01 of the Revised Code. A grass seeding service is not directly used or consumed in the production of crude oil and natural gas for sale so the service is not considered exempt pursuant to division (42)(q) of section 5739.02 of the Revised Code.

- (2) Equipment and rigging used for the specific purpose of creating with integrity a wellbore pathway to underground reservoirs may be directly used or consumed in the production of crude oil and natural gas for sale.

For example, well integrity begins with design and moves to properly constructed wellbore pathways. A company utilizes computer software for wellbore placement and to test the stress felt on the wellbore pathways. The same company also uses cement on the wellbore pathway to ensure that the groundwater is protected from the chemicals and product being removed from the underground reservoir.

Here, the computer software utilized to determine placement is taxable because drilling has not commenced and is therefore not directly used or consumed in the production of crude oil or natural gas for sale. The computer software used to test the stress felt on the wellbore pathways and the cement that encases the wellbore pathway is exempt because it is directly used or consumed in the production of crude oil and natural gas for sale by interacting with a necessary function of the integrity of the wellbore pathway

- (3) Drilling and workover services used to work within a subsurface wellbore are never, by themselves, considered taxable transactions. To the extent tangible personal property is directly used in providing such services and directly used or consumed in the production of crude oil and natural gas for sale, the item is exempt.

For example, Company B is in the business of selling crude oil and natural gas. Company D provides the equipment and crew that drills a well and will also workover a well when restricted flow begins. These activities take place within the wellbore. The fees charged for these services are not taxable. Such services are not considered taxable services pursuant to section 5739.01 of the Revised Code. Additionally, any rig Company D utilizes is considered exempt because that rig is directly used or consumed in the production of crude oil and natural gas for sale.

- (4) Casing, tubulars, and float and centralizing equipment that are directly used or consumed in the production of crude oil or natural gas for sale are exempt.

For example, a company installs a float collar to prevent over-displacement of the cement and a float shoe to prevent cement from flowing back into the casing after placement in the wellbore. The float collar and the float shoe are exempt.

- (5) To the extent production equipment is exempt under division (B)(42)(q) of section 5739.02 of the Revised Code, the trailers to which production equipment is attached are also exempt.

For example, a company leases a pumpjack on a trailer that is used to lift liquid out of the wellbore, as well as electrical equipment on a trailer used to light up operations in the evening. The pumpjack and corresponding trailer are exempt because the pumpjack is used directly in the production of crude oil or natural gas for sale. The lighting and corresponding trailer are taxable because the lighting is not used directly in the production of crude oil or natural gas for sale.

- (6) Services provided to complete a well, including the services of cementing a well casing are not, by themselves, considered taxable transactions. To the extent tangible personal property is directly used in providing such services and directly used or consumed in the production of crude oil and natural gas for sale, the item is exempt.

For example, Company B is in the business of selling crude oil and natural gas. Company G is hired to insert production tubing and safety valves to complete the well. The fees charged for these services are not taxable. Such services are not considered taxable services pursuant to section 5739.01 of the Revised Code. Additionally, the tubing and safety valve Company G utilizes in its services are considered exempt because those items are directly used or consumed in the production of crude oil and natural gas for sale.

- (7) Services provided to perform wireline evaluation, mud logging, and perforation are not, by themselves, considered taxable transactions. To the extent tangible personal property is directly used in providing such services and directly used or consumed in the production of crude oil and natural gas for sale, the item is exempt.

For example, Company B is in the business of selling crude oil and natural gas. Company H is hired to lower equipment down the wellbore and operate such equipment for testing. The fees charged for these services are not taxable. Such services are not considered taxable services pursuant to section 5739.01 of the Revised Code. Additionally, the cable used to lower the logging equipment and

the logging Company H utilizes in its services are exempt because those items are directly used or consumed in the production of crude oil and natural gas for sale.

- (8) Services to perform reservoir stimulation, hydraulic fracturing, and acidizing services are not, by themselves, considered taxable transactions. To the extent tangible personal property is directly used in providing such services and directly used or consumed in the production of crude oil and natural gas for sale, the item is exempt.

For example, Company B is in the business of selling crude oil and natural gas. Company J is hired to perform hydraulic fracturing and acidizing services at the well site. The fees charged for these services are exempt. Such services are not considered taxable services pursuant to section 5739.01 of the Revised Code. Additionally, the chemicals and equipment used to perform hydraulic fracturing and acidizing services at the well site are considered exempt because those items are directly used or consumed in the production of crude oil and natural gas for sale.

- (9) All material pumped downhole during reservoir stimulation, hydraulic fracturing, and acidizing are exempt.

For example, drilling mud, fracking solution, pumping fluids and acid a company pumps downhole during drilling, fracking or to complete the well would be exempt.

- (10) Pressure pumping equipment directly used or consumed in the production of crude oil and natural gas for sale is exempt.

For example, a company is in the business of selling crude oil and natural gas. The company utilizes a frac pump that is paired with an engine used to power the pump that stimulates the well. The frac pump is exempt because it is used to pump the hydraulic fracking fluids into the well and is therefore directly consumed in the production of crude oil or natural gas. The engine used to power the pump is exempt because it functions in unison to create the high-pressure injection that actually fractures the rock formation and frees the crude oil and natural gas.

- (11) Artificial lift systems equipment directly used or consumed in the production of crude oil and natural gas for sale is exempt. These systems alter pressure within the reservoir and encourage oil or natural gas to the surface. These systems are exempt because they are directly used in the production of crude oil and natural gas.



(12) Equipment used to separate, stabilize, and control hydrocarbon phases and produced water at the wellhead and well site, when the equipment is directly used or consumed in the production of crude oil and natural gas for sale, is exempt.

For example, a company is in the business of selling crude oil and natural gas. At the wellhead, the company utilizes a condensate stabilizer to reduce the vapor's pressure of natural gas for insertion into the storage tanks. The condensate stabilizer is exempt.

(13) Tangible personal property directly used to control production equipment is exempt.

For example, a company is in the business of selling crude oil and natural gas. The company purchases a software package that programs and operates the drilling rig. Additionally, the company purchases software that monitors the level of fracking fluid that is distributed into the blenders. The software that programs and operates the drilling rig is exempt as directly used in the production of crude oil and natural gas. The equipment that monitors the fracking fluid is used before actual fracturing takes place. Therefore, the software that monitors the fracking fluid is taxable.

(D)

(1) In contrast to the items described herein, items that are statutorily not considered things transferred are enumerated in division (B)(42)(q)(ii) of section 5739.02 of the Revised Code.

(2) Unless another exemption exists for the items enumerated in division (B)(42)(q)(ii) of section 5739.02 of the Revised Code or the entity utilizing or consuming such items, the items are taxable.

(E) Repair and installation services for items directly used or consumed in the production of crude oil and natural gas for sale are not considered taxable. Divisions (B)(3)(a) or (b) of section 5739.01 of the Revised Code states that the repair or installation of an item of tangible personal property is not a taxable service if the purchase of the underlying item would not be subject to the tax imposed by section 5739.02 of the Revised Code.

(F) Pursuant to division (SS) of section 5739.01 of the Revised Code, "lease" or "rental" means any transfer of the possession or control of tangible personal property for a fixed or indefinite term, for consideration. "Lease" or "rental" includes future options to purchase or extend, and agreements described in 26 U.S.C. 7701(h)(1) covering

motor vehicles and trailers where the amount of consideration may be increased or decreased by reference to the amount realized upon the sale or disposition of the property. "Lease" or "rental" does not include providing tangible personal property along with an operator for a fixed or indefinite period of time, if the operator is necessary for the property to perform as designed. For purposes of that division and this rule, an operator has to do more than maintain, inspect, or set-up the tangible personal property in order for the transaction to fall outside a "lease" or "rental" and instead, be considered the sale of a service. Leased or rented tangible personal property without an operator may still be taxable or exempt based upon its function or use in the hands of the lessee.

For example, Company B is in the business of selling crude oil and natural gas. Company B hires Company C, and Company C is responsible for the operation of a compressor. However, the use of the compressor by Company B in the business of selling crude oil and natural gas does not warrant an onsite employee to operate the compressor. Therefore, this is the lease or rental of this tangible personal property without an operator and is a taxable retail sale. Company B's lease or rental of the compressor may be taxable or exempt based upon its function or use in the hands of Company B.

(G) The enumeration of certain tangible personal property in this rule is not intended to be exhaustive. Any tangible personal property not enumerated in this rule is not necessarily construed to be a "thing transferred" or not a "thing transferred" for the purposes of the exemption discussed herein.

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CERTIFIED ELECTRONICALLY

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Certification

01/31/2022

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Date

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