COLORADO
Department of Revenue
Taxation Division

Office of Tax Policy
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PLR-09-003

June 30, 2009

XXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXXX
XXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXX

Re: XXXXXXXXXXX

Dear XXXXXXXXXXX,

Your firm submitted on behalf of XXXXXXXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Regulation 24-35-103.5. This letter is the Department's private letter ruling.

Issue

Can the Company and its customers enter a contract using the following language:

1. Colorado 2.9% sales or use tax as additional purchase price in lieu thereof per Colorado department of revenue, and

2. XXXXXXXX County 2.0% sales or use tax as additional purchase price in lieu thereof per the Colorado department of revenue,

to increase the purchase price on hydraulic fracturing jobs if the Colorado courts ultimately uphold the district court decision in *Noble Energy, Inc. v. Department of Revenue*, (Denver district court civil action no. 2008 CV 559) (hereinafter referred to as "*Noble Energy*")?

Conclusion

The Company must collect state use tax on fracturing materials pending a final decision in the *Noble Energy*. If the Colorado appellate court(s)[1] finally conclude that sales tax is due on fracturing materials, then the department will credit the state use tax paid by the Company against the Company's state sales tax obligation. The base upon which the Company's sales tax obligation will be calculated shall not include the state use tax surcharge to its customers. The Company shall continue to collect XXXXXX County sales tax pending a final decision in *Noble Energy*.

[1] The *Noble Energy* case is presently before the Colorado court of appeals. Parties may also petition the Colorado supreme court to review the decision of the court of appeals.

Background

The Company provides pressure pumping services and related material to oil companies operating in Colorado. One service provided by the Company is hydraulic fracturing. Hydraulic fracturing is a process in which material is injected into oil and gas wells to facilitate the extraction of those minerals. In prior years, the Company's predecessor company, at the direction of the department, charged its customers sales tax on the fracturing materials.

Noble Energy, Inc. owns and operates oil and gas wells in Colorado and has paid Colorado state and local sales taxes on its purchases fracturing materials. Noble Energy filed a claim for sales tax alleging that sales tax was not due on its purchases because Colorado law exempts materials that become part of real property. The department denied the refund claim and Noble Energy appealed the matter to the Denver district court. In *Noble Energy*, the district court concluded that Noble Energy was not liable for sales tax. The department appealed the decision to the Colorado court of appeals and the case is pending. Pending the appeal, the department assessed the Company use tax for the fracturing materials in order to avoid being foreclosed by the statute of limitation from collecting use tax.

The Company seeks certainty regarding its tax obligation for fracturing materials and, therefore, has requested a binding private letter ruling on this issue.[2]

Discussion

The *Noble Energy* case creates substantial difficulties for the Company. If the district court decision is affirmed on appeal, the Company is liable for state use tax for the fracturing material. If the decision is reversed, then the Company, as a retailer, must collect sales tax from well operators and is, itself, liable to the extent that it did not collect and remit the sales tax. On first appearance, this would not appear to be a problem because the tax rates for both taxes are the same. However, the manner in which these taxes are levied is different and these differences can create substantial difficulties for the Company.

If the Company continues to collect sales tax pending an appellate decision in *Noble Energy*, well operators will likely seek a refund of the sales tax if the district court decision is affirmed on appeal. This also means that the Company is then liable for state use tax for these materials. The difficulty for the Company arises because it would not then be able to pass[3] the cost of the use tax on to well operators for services already performed and, at the same time, cannot claim the sales tax previously collected as an offset against the use tax liability because the sales tax will be refunded to the well operators.

For this reason, the department advises the Company to collect state use tax pending a final decision in *Noble Energy*.[4] If the district court decision is upheld, the Company will have

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[2] The department is not estopped from collecting a tax otherwise due and owing even though the department has previously provided erroneous advice to a taxpayer regarding its tax obligation. *Woodmen of the World v. Colorado Department of Revenue et al*., 893 P2d 1349 (Colo. 1994). However, a taxpayer may request a private letter ruling which is binding on the department. §24-35-103.5, C.R.S.

[3] Although the incidence of taxation for use tax is on the user of the material, the economic burden of the tax for such taxes is typically passed on to the ultimate consumer. This is because any viable business must recover in its price, at least in the long term, its costs of operations.

[4] The department believes sales tax, not use tax, is due on these transactions. However, the department advises the Company to collect state use tax in order to avoid the dilemma noted here. The Company does not face this same dilemma for county sales tax and, therefore, the department advises the Company to collect the county sales tax pending the appeal.

properly paid the use tax and, more importantly, recovered that cost from well operators by means of a surcharge. On the other hand, if the district court decision is reversed, the department will be able to credit the Company the use tax against the Company's sales tax obligation.[5]

The Company seeks a ruling on the contractual terms the Company intends to employ to pass the economic burden of the state use tax on to the well operators. The incidence of taxation for use tax is on the person who uses, stores, or consumes the tangible personal property.[6] A service provider, for example, must pay use tax on tangible personal property it consumes to provide service to customers. However, service providers typically pass the economic burden of use tax on to the customers. For example, a service provider may, in its contract with customers, expressly set forth a surcharge for a use tax. Alternatively, the service provider may implicitly pass the tax on to the customer in the form of a higher price for the services and not separately stating a surcharge on the invoice. The department does not have an objection to a provider who passes the economic burden of a use tax on to the recipient of the services.[7]

If the district court decision in *Noble Energy* is reversed on the grounds that the well owner/operator owes sales tax, the question arises as to whether the state use tax should be included in the calculation of the state sales tax. The department believes that it would be inappropriate under the unique circumstances of this case to include the use tax in the base on which sales tax would be calculated.

With respect to county sales or use taxes, the department advises the Company to collect the county sales tax. We do so for two reasons. First, the department believes that the fracturing materials are subject to sales tax and that the *Noble Energy* case will be reversed on appeal. Second, the Company does not face the same dilemma in collecting county sales tax as it does collecting state sales tax. If the Company collects county sales tax and the district court decision is upheld, the department will, upon a timely and proper claim for refund, refund the county sales tax to well operators. However, unlike the state use tax, which applies to the fracturing materials[8] if the state sales tax does not apply, county use tax applies only to building materials and supplies. In *Board of County Commissioners of the County of Rio Blanco, Colorado v. ExxonMobil Oil Corporation,* 192 P3d 582 (Colo. Court of Appeals 2008), the court held that, in order to qualify as building materials or supplies, the materials or supplies must be used in creating "structures" or "buildings" that are associated with, and generally become a part of, the realty. Fracturing materials are not used to create a "building" or "structure." These materials are injected into the ground to facilitate extraction of oil and natural gas. It would appear, then, that the Company is not at risk for county use tax, as it is for state use tax, if the *Noble Energy* case is upheld on appeal. However, as noted earlier, the department does not administer the county use tax and cannot bind the county on its administration of that tax.

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[5] Although sales tax is primarily an obligation of the purchaser, a retailer is also liable for sales tax that is due but not collected and remitted to the department. §39-26-105(1)(a), C.R.S.

[6] Counties, home-rule cities and counties, and statutory cities may also levy use tax on building materials and supplies. The department does not administer or collect city or county use taxes.

[7] Form is important in this instance. In general, if a seller submits to a buyer an invoice that includes a charge for sales tax, the seller must remit the sales tax to the department, even if the transaction was, in fact, a non-taxable transaction. On the other hand, if a seller is simply passing the economic burden of a use tax on to the buyer (even if the surcharge is separately stated on the invoice), then the department typically does not treat the surcharge as a sales tax.

[8] State use tax is not limited to building materials or supplies and applies to the use, storage or consumption of all tangible personal property, unless otherwise exempt. §39-26-202(1)(a), C.R.S.

Miscellaneous

This ruling is premised on the assumption that the Company has completely and accurately disclosed all material facts. The department reserves the right, among others, to independently evaluate the Company's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue