**Opinion Letter**

|  |  |
| --- | --- |
| **Letter Number:** | **O-2013-003** |

|  |  |
| --- | --- |
| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Set-up and pick-up charges for rentals of water pumps subject to sales tax.** |
| **Keywords:** |  |

**Body:**

Office of Policy & Research

July 16, 2013

XXXX
XXXX
XXXX

RE: Your e-mail received on May 14, 2013

Dear XXXX:

Thank you for your recent e-mail. You ask if set-up and pick-up charges that you bill for rentals of water pumps are taxable. The water pumps are used when new wells are being drill. Because of this, the answer to your question is yes. The line-items charges for set-up and pick-up are taxable.

Under Kansas law, leases and rentals are treated as recurring charges for the sale of tangible personal property. See *K.S.A. 79-3602(kk)(“Sale” includes “the sale of the use of tangible personal property by way of a lease, license to use or the rental thereof. . . .”).*By definition, set up and take down charges, as well as delivery and pick up fees, are included in the tax base. The “tax base” or “measure of tax” is the amount that is multiplied by the tax rate to determined the amount of tax to bill to the customer and remit to the State of Kansas as part of your gross receipts.

Apparently, your lease agreements or industry practice requires you to deliver and set up the leased pumps and confirm the pumps are in working order before you leave the well site. This is logical because if you do not provide a working pump, you haven’t carried out your duties under the lease agreement. No one will pay lease charges billed for pumps that don’t work.

K.S.A. 79-3603(ll) defines “sales or selling price,” which is the “tax base” or “measure of tax” for a taxable retail sale or lease:

(ll) (1) "Sales or selling price" applies to the measure subject to sales tax and means the total amount of consideration, including cash, credit, property and services, for which personal property or services are sold, leased or rented, valued in money, whether received in money or otherwise, without any deduction for the following:
(A) The seller's cost of the property sold;
(B) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller and any other expense of the seller;
(C) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
(D) delivery charges; and
(E) installation charges. . . .

Subsection (D) shows that any separately stated “delivery charge” for leased equipment that you bill to a customer is part of the tax base, and is taxable if the periodic lease charges are taxable. Similarly, any set-up charge that you bill as a separate line-item charge is made part of the tax base by Subsection (E), which includes “installation charges” in the tax base, and by Subsection (C), which includes “any *[other]*services necessary to complete the sale.” The scope of Subsection (C) is also broad enough to include the take-down charges in the tax base. All of these charges are part of the tax base even though you bill them as separate line-item charges that are billed as additions to lease charges billed at a per diem rate.

That set up and take down charges, as well as delivery and pick up fees, are required to be included in the tax base for taxable lease charges is also clearly established by an administrative regulation, K.A.R. 92-19-55b(d)(1):

(d) Computation of the tax.
(1) Sales tax shall be computed on the total amount of each lease charge billed to the lessee without any deduction for mandatory insurance, damage waiver fees, property taxes, maintenance, service, repair, pickup, delivery, and other handling charges, administrative charges, late payment charges or penalties, reinstatement fees, late return charges, fuel charges, surcharges, and other charges or expenses whether paid by the lessor or lessee. Each of these fees or expenses shall be considered to be part of a taxable lease charge, even when the fee or expense is separately stated on an invoice given to a lessee or when separate contracts are entered into for the rental or lease and for the payment of one or more of these fees or expenses.

This means all of the charges you ask about are taxable if the lease of the pump is taxable. The lease of the pumping units is taxable because they are used to pump water to the drilling rigs. There is no exemption for equipment used in oil and gas exploration or drilling.

However, if you lease or rent pumps to remove water from storage tanks that hold oil and water at a well production site, your lease or rental charges would be exempt under K.S.A. 79-3606(kk). K.S.A. 79-3606(kk)(2)(D) provides an exemption for production equipment used in certain processing operations, including,

operations at an oil well, gas well, mine or other excavation site where the oil, gas, minerals, coal, clay, stone, sand or gravel that has been extracted from the earth is cleaned, separated, crushed, ground, milled, screened, washed, or otherwise treated or prepared before its transmission to a refinery or before any other wholesale or retail distribution.

See *In re Edmiston Oil,.* 46 Kan.App.2d 969, 269 P.3d 833 (2012). Thus, whether your equipment leases are taxed or exempted is determined by how the equipment will be used. The fact the taxability and exemption of your leases is based on how the equipment will be used is the source of confusion in the oil patch.

Another cause of confusion is the fact that oil and gas drilling operations qualifies for the original construction exemption, which exempts labor services performed during the first or initial construction of a “facility.” *K.S.A. 79-3603(p)(1).*“Facility” is defined to include an “oil or gas well.” *K.S.A. 79-3603(p)(3).*Thus, labor service charges billed for setting up drilling equipment and drilling a new oil or gas well are exemption.

Nevertheless, the set up and take down charges, as well as delivery and pick up fees, continue to be part of the tax base for leased equipment, and are taxable if the equipment is used to drill oil or gas wells. Taxable leases include the leases of water pumps used for drilling. These “service-like” charges remain part of the tax base for the taxable lease of equipment, even though other service charges, like those billed by welders or by a set up crew, are exempt as part of original construction. You could possibly avoid this problem by setting per diem charges that decrease the longer the pumps are leased. This would allow you to fix a per diem charge for a week at a higher rate than the per diem charge that you bill for a month, since both per diem charges would recover your per current diem rate, plus the set up, take down, delivery and pick up charges. The weekly rate would be higher because it would include the set up, take down charges, delivery, and pick up fees plus the current per diem for seven days. The lower monthly rate would spread this additional cost over 30 days, instead of seven days, thus reducing the overall all-inclusive per diem rate for 30 days. .

Your business is located in Oklahoma. Operating an oil service or oil equipment leasing business in multiple states is another cause of confusion. State sales tax laws in this area may differ. Accordingly, you did the correct thing by requesting written clarification from the department.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 07/16/2013 Date Modified: 07/16/2013**