



Does Natural Gas Drilling Equipment qualify for a sales tax exclusion?

Answer ID 2867 | Published 04/02/2012 11:42 AM | Updated 08/28/2013 12:17 PM

Does Natural Gas Drilling Equipment qualify for a sales tax exclusion?

The commonwealth's sales and use tax laws provide an exclusion from sales and use tax for tangible personal property and services predominately used directly in a mining operation (the "mining exemption"). Department Regulation 61 Pa. Code § 32.35 governs the scope of the mining exemption. Extracting natural gas qualifies as mining for sales and use tax purposes. Property such as drilling equipment is considered directly used in a natural gas extraction operation. The mining exemption, like all business exclusions (manufacturing, processing, public utility operations, etc.), is limited. Section 201(k)(8)(A) of the Tax Reform Code of 1971 provides that the mining exemption may only be claimed by a purchaser who uses or consumes the property directly in a mining operation.

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What gas recovery activities qualify as mining for sales and use tax purposes?

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What gas recovery activities qualify as mining for sales and use tax purposes?

The law defines mining to include exploring for, drilling, extracting and refining of natural resources such as natural gas. The Department considers the actual mining process to begin with the drilling of the wellbore and ends with the last physical change of the gas prior to being sold and transferred by the miner to another.

Generally, the following gas recovery activities are considered mining activities:

- A. Drilling
- B. Cementing, i.e., pumping cement slurry to bond casing or piping to the wall of the bore hole.
- C. Fracking, i.e., the use of a fluid, a mixture of water and chemicals, to crack the rock formation and the injection of proppants such as sand and ceramic materials into cracks in the formation to open channels through which the gas flows.
- D. Acidizing, i.e., the injection of acid below rock fractures to create flow channels within the rock formation.
- E. Extraction of gas from underground.
- F. Removal of water and hydrocarbons from gas prior to its transfer from a miner to its customers.

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What are examples of exempt mining equipment and supplies in gas recovery activities?

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What are examples of exempt mining equipment and supplies in gas recovery activities?

Department Regulation 61 Pa. Code § 32.35 governs the scope of the mining exemption and limits the exemption to mining equipment and supplies that are predominantly used directly in a mining operation.

The following is a list of commonly-used mining equipment and supplies that are directly used and exempt:

- A. Drilling rig unit and all repair parts
- B. Drilling head
- C. Cutting bits
- D. Drilling extensions
- E. Fuel used to run the drilling unit
- F. Casing
- G. Cement to encase the casing
- H. A frack unit (affixed to the back of a truck chassis) and all repair parts and fuel used in running the frack unit
- I. Pump (placed at the bottom of the well)
- J. Pump rod (connected to the pump)
- K. Sucker pipe (pipe that allows oil to flow to the surface)
- L. Cap (affixed to the top of wellhead)
- M. Pump jack (provides upward and downward movement to the pump rod directly resulting in the operation of the pump)
- N. Electricity and off-road fuel used to run the pump jack
- O. Fishing or extraction tools used exclusively to retrieve and remove objects from drilled hole
- P. Gathering lines connecting wellhead to the last fluids and hydrocarbons removal system prior to miner selling and transferring gas
- Q. Pit liner used in the sludge holding pond.
- R. Silt fence and stakes only when used as pollution control devices.

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What are examples of equipment or services that are NOT considered directly used in mining and therefore taxable?

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What are examples of equipment or services that are NOT considered directly used in mining and therefore taxable?

- A. Site preparation (e.g., removal of timber, and road and well-site preparation):
 - i. Bull dozer
 - ii. Backhoe/front loader
 - iii. Stone, except stone directly under exempt equipment
 - iv. Road fabric
 - v. Sluice pipe
 - vi. Security fencing
 - vii. Bridges and bridge construction materials
- B. Pipe racks/pipe boats for pipe storage
- C. Fuel storage units
- D. Sand or gravel storage units
- E. Truck chassis to which drilling unit, frack unit, or service rig is affixed and repair parts
- F. Oil storage tank connected to the wellhead through a pipe. Both the storage tank and the connecting pipe from the wellhead to the tank are taxable
- G. Water storage ponds used to store water prior to being used in the drilling operation, including construction materials and rubber liner
- H. Water transportation system pumping water from the river or creek to the water storage pond

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Is the pick-up and hauling of waste taxable?

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Is the pick-up and hauling of waste taxable?

Hauling is a non-taxable service.

Here is the link to the PA Code Section 31.6:

<http://www.pacode.com/secure/data/061/chapter31/s31.6.html>

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§ 32.35. Mining.

(a) *Equipment, machinery, parts and foundations therefor and supplies used directly in mining.* The purchase or use of tangible personal property or services performed thereon by a person engaged in the business of mining is exempt from tax if the property is predominantly used directly by the person in mining operations. Purchases of a vehicle required to be registered under 75 Pa.C. S. § § 101—9909 (relating to Vehicle Code), as well as supplies and repair parts for the vehicles is subject to tax. There is no exemption for maintenance facilities or for materials or supplies to be used or consumed in construction, reconstruction or remodeling of real estate other than machinery, equipment and parts therefor that may be affixed to the real estate. Beginning March 4, 1971, foundations for equipment and machinery became subject to tax and remained taxable until February 9, 1981. Effective February 7, 1981, foundations used to support equipment, machinery and parts used directly in mining are exempt from tax.

(1) *Direct use.* In determining whether property is directly used, consideration shall be given to the following factors:

- (i) The physical proximity of the property in question to the production process in which it is used.
- (ii) The proximity of the time of use of the property in question to production processes which precede and follow its use.
- (iii) The active causal relationship between the use of the property in question and the production of the mined product. The fact that particular property may be considered essential to the conduct of the business of mining because its use is required either by law or practical necessity does not, of itself, mean that the property is used directly in mining operations.

(2) *Property directly used; predominant use.* The purchase or use by a mine operator of property in the following categories, when predominantly used directly in mining, is exempt from tax. Where a single unit of the property is put to use in two different activities, one of which is a direct use and the other of which is not, the property is not exempt from tax unless the mine operator makes use of the property more than 50% of the time directly in mining operations.

(i) *General.* Machinery, equipment, parts and foundations therefor, and supplies which are used in the actual mining production, to transport or convey the product or production personnel, or to handle or store the product during the production are considered to be directly used in mining operations. Repair parts which are installed and become an integral part of the property are also exempt from tax. Exempt property includes:

(A) Digging and extracting equipment, machinery and tools, such as power coal cutting machines, picks, sledges and shovels, and earthmoving equipment and machinery used to remove the overburden in strip mining.

- (B) Blasting and dislodging equipment and supplies, such as air compressors, compressed air tubes and dynamite or other explosives.
 - (C) Drainage pumps, pipes, valves, fittings and packing.
 - (D) Timber (props), roof-bolts and roof-bolting machines and their accessories, roof jacks, torque wrenches and impact tools used to test roof bolts and make them secure.
 - (E) Rock dust and rock-dusting equipment.
 - (F) Trolley and mine telephones used predominantly in mining activities, other than for managerial direction and supervision, such as for dispatching purposes on mine railways and work coordination among production employees of equal authority.
 - (G) Ventilation equipment used to extract impure air from the mine and extend production operations to the mine face.
 - (H) Transportation devices and equipment used to haul the ex-tracted product from the mine face or pit to the preparation plant, tippie or breaker, except vehicles required to be registered under the Vehicle Code.
 - (I) Lighting equipment and supplies used to light production activities.
 - (J) Protective devices worn by production personnel in their work, such as miners' lamps and respirators.
 - (K) Preparation plant machinery and equipment.
 - (L) Waste extraction and removal equipment and machinery used in the course of production operations.
 - (M) Water well drilling rigs, bits, drills, casings, casing covers and lubricants.
 - (N) Machinery and equipment—such as dozers and graders—and materials—such as fill, seedlings, grass seed, shrubs, stone, concrete and soil nutrients—used in backfilling and reclamation of underground shafts, stripping pits and other directly used mining facilities when required by law.
- (ii) *Pollution control devices.* Equipment, machinery and supplies, designed and used to control, abate or prevent air, water or noise pollution generated in the mining operation are deemed to be directly used in mining and, therefore, is not subject to tax. In order for property to qualify as exempt pollution control devices, it is not necessary that the pollutants be recycled or used in any manner.
- (iii) *Testing and inspection.* Property used to test and inspect the product during actual mine production is considered to be directly used in the mining operation.
- (iv) *Cleaning of returnable containers.* Property used to wash, sterilize or inspect returnable containers prior to their being filled shall be exempt when used in packaging the product if the container will be delivered to the ultimate consumer.

(v) *Packaging.* Wrapping equipment and supplies, including internal packing materials and returnable containers, used in packaging which passes to the ultimate consumer are directly used and therefore shall be exempt.

(vi) *Research.* Property which is used directly in research activities is exempt from tax, provided that the object of the research is the production of a new or improved product or method of producing a product. The exemption does not apply to property used in market research or in other research which is conducted with the objective of improving administrative efficiency.

(3) *Property not directly used.* Property in the following categories is not used directly in mining operation, and the purchase or use of the property is subject to tax.

(i) *Real estate.* The term mining does not include the construction, reconstruction, alteration, remodeling, servicing, repairing, maintenance or improvement of real estate. The purchase or use of tangible personal property by a miner for such purpose shall be subject to tax, even though the structure may house or otherwise contain equipment or other facilities used directly in mining. Equipment, machinery, tools and other property used in logging and timbering activities including property used to remove trees and clear ground preparatory to extraction activities is not deemed to be directly used.

(ii) *Maintenance facilities.* Maintenance, service and repair work is not a mining operation. Maintenance facilities either underground or surface, including tools, equipment and supplies predominantly used in performing the work (For example: chain hoists, tire spreaders, welding equipment, welding oxygen and acetylene, drills, sanders, wrenches, paint brushes and sprayers, oilers, absorbent compounds, dusting compounds, air blowers and wipers) is subject to tax. However, replacement parts which are used to replace worn parts upon exempt machinery and equipment (For example: motors, belts, screws, bolts, cutting edges, air filters or gears) and operation supplies which are actively and continuously used in the operation of exempt machinery and equipment (For example: fuel, lubricants, paint and compressed air) is exempt from tax. Equipment and supplies, including soaps and cleaning compounds, brushes, brooms, mops and similar items, used in general cleaning and maintenance of mining property is subject to tax.

(iii) *Managerial, sales or other nonoperational activities.* Property used in managerial, sales or other nonoperational activities is not directly used in mining and therefore shall be subject to tax. This category includes but is not limited to property used in any of the following activities:

(A) *Mine management and administration.* Office furniture, supplies and equipment, textbooks and other educational materials, books and records, and other property used in mining recordkeeping and other administrative and managerial work shall be subject to tax. The property includes, but is not limited to supplies used to record the quality and quantity of work in production or goods in storage, the flow of work, the results of inspection, or to instruct workers in routing work, or other production activities.

(B) *Selling and marketing.* Property used in advertising mining products for sale, or in marketing, transporting the products to a market or to customers or selling the products, is not within the scope of the mining exemption.

(C) *Exhibition of mine products.* Property used in the exhibition of mining products or

of mining operations is subject to tax.

(D) *Safety and fire prevention.* Property used to prevent or fight fires and equipment and supplies used for the programs as safety, accident prevention or fire prevention shall be subject to tax, even though the equipment or property is required by law.

(E) *Employe use.* Property used for the personal comfort, convenience or use of employes shall be subject to tax. Property used in bath houses and lamphouses is included in this category. However, protective equipment, such as face masks, helmets, gloves, coveralls, goggles and the like, worn by production personnel is exempt from tax.

(F) *Space heating, cooling, ventilation and illumination.* Property, including machinery, equipment, fuel or power used to ventilate buildings, lighting for general illumination or air conditioning and other space cooling, space heating and similar property, is subject to tax, unless it is established that the use of the property bears an active causal relationship to the mining operation.

(G) *Premining activities.* Property used to transport personnel or to collect, convey or transport other property, and storage facilities or devices used to store the property, prior to the actual mining operation is subject to tax.

(H) *Property used during mining operation.* Property used in managerial, sales or other nonmining activities, is subject to tax even though it is used during mining operations. Illustrations of the property include safety, heating and ventilation equipment; planking or grating for crosswalks or platforms; and maintenance equipment or facilities.

(I) *Post-mining activities.* Property used to transport or convey the mined product after the final mining operation, which includes but does not extend beyond the operation of packaging for the ultimate consumer, and storage facilities or devices used to store the product, are not used directly in mining and is taxable. For example, equipment which loads packaged products into cases or cartons for ease of handling in delivery is subject to tax. Machinery, equipment, supplies and other property used to convey, transport, handle or store the packaged product are also taxable.

(J) *Waste disposal.* Property used for waste handling and disposal of pollutants other than in the course of production operations is not deemed to be directly used and is subject to tax unless the property qualifies for an exemption under subsection (a)(2)(ii).

(b) *Use of exemption certificate.* When a miner purchases exempt property under this section, the miner shall prepare and deliver to the vendor a properly executed exemption certificate.

Source

The provisions of this § 32.35 amended April 15, 1977, effective April 16, 1977, 7 Pa.B. 1047; amended August 21, 1981, effective August 22, 1981, 11 Pa.B. 2912; amended July 1, 1983, effective July 2, 1983, 13 Pa.B. 2066; amended March 9, 1984, effective March 10, 1984, 14 Pa.B. 843. Immediately preceding text appears at serial pages (83018), (63094) to (63095) and (83019) to (83020).

Notes of Decisions

Mining

The equipment used by a hard rock extractor in making possible the access to and extraction of bituminous coal is involved in mining for purposes of the sales and use tax exclusion. *Commonwealth v. R. G. Johnson Company*, 433 A.2d 465 (Pa. 1981).

Residential Use

Purchase of utilities on behalf of tenants and included in the tenants' monthly rental fee does not constitute a "residential use," and landlords are not entitled to a refund for taxes paid. *Adelphia House Partnership v. Commonwealth*, 709 A.2d 967 (Pa. Cmwlth. 1998); exceptions overruled, decision adhered by 719 A.2d 833 (Pa. Cmwlth. 1998).

Cross References

This section cited in 61 Pa. Code § 32.25 (relating to steam, gas, electricity, fuel oil and kerosene).

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