

## Arkansas court holds proppants used in fracking are exempt from sales tax

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The Supreme Court of Arkansas recently affirmed a lower court decision, holding that for the tax periods at issue (2006 through 2009) proppants used in hydraulic fracturing<sup>1</sup> were exempt from Arkansas gross receipts tax (sales/use tax) pursuant to Ark. Code Ann. § 26-52-402(a) (the Manufacturing Exemption Statute).<sup>2</sup> In relevant part, the statute provides an exemption for purchases of “machinery and equipment used directly” in producing, manufacturing, and processing “articles of commerce at manufacturing or processing plants or facilities . . . in Arkansas . . . .” The court ruled that the proppants purchased by the taxpayer were “equipment used directly” in the process of extracting oil and gas and, accordingly, such purchases were exempt from Arkansas sales/use tax under the Manufacturing Exemption Statute.<sup>3</sup> The Arkansas high court also affirmed the lower court’s finding that Ark. Gross Receipts Tax Rule GR-57(E)(5), which characterized proppants as nonexempt, is invalid and unenforceable.<sup>4</sup>

The case is significant because it appears to bring proppants within the Manufacturing Exemption Statute for tax periods that pre-date the amendment of that statute to expressly include proppants. Under the law as amended, the sales/use tax exemption for machinery and equipment used directly in manufacturing includes “Sand and other proppants used to complete a new oil or gas well or to re-complete, redrill, or expand an existing oil or gas well.”<sup>5</sup>

### Considerations

The Arkansas Rules of the Supreme Court provide that a petition for rehearing may be “filed within 18 calendar days from the date of the decision” (thus, in this instance, on or before June 22).<sup>6</sup> As of the date of this alert, a petition has not been filed, but the filing period remains open. Accordingly, the case is not yet final. Although the case remains pending, providers of oil field services involving hydraulic fracturing in Arkansas may wish to consider whether based on the reasoning contained in this court decision they should file refund claims for Arkansas sales/use tax paid on their purchases of proppants for periods that precede the effective date of the amended Manufacturing Exemption Statute.

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<sup>1</sup> Proppants (a solid material typically consisting of sand or ceramic material) and fracking fluids are used to provide hydraulic fracturing, or fracking, services performed as part of an oil or gas extraction process.

<sup>2</sup> *Walther v. Weatherford Artificial Lift Systems, Inc.*, 215 Ark. 255 (Jun. 4, 2015), slip op. at 8-9. The court’s opinion is available [here](#). Note that the court addressed the application of the Manufacturing Exemption Statute as in effect prior to amendment in 2014 and 2015.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*, slip op. at 9, ruling that an “administrative regulation cannot be contrary to a statute.”

<sup>5</sup> Ark. Code Ann. § 26-52-402(c)(2)(B)(vi). Note that there is some discrepancy regarding the effective date of this law change. Subsection (vi) (which references proppants) was initially added by 2014 Ark. Acts 300, Sec. 16 (HB 1048) available [here](#). HB 1048 was approved by the governor on Mar. 17, 2014, with the exception of Section 16 (the Section that added subsection (vi)), which was disapproved by governor by line-item veto. The Legislature overrode the governor’s line item veto on Mar. 19, 2014. Some sources refer to this law change as effective Jul. 1, 2014. In 2015 the state enacted 2015 Ark. Act 1125, Sec. 1 (SB 801), available [here](#), which strikes and then adds back Subsection (vi). Sec. 2 of 2015 Ark. Act 1125 provides that Sec. 1 is “effective on the first day of the calendar quarter following the effective date of this act.” According to the Arkansas Department of Finance and Administration website, available [here](#), this change per 2015 Ark. Act 1125 Sec. 1, is effective Oct. 1, 2015. See also, *Walther v. Weatherford Artificial Lift Systems, Inc.*, slip op. at 4, n.1, citing 2015 Ark. Act 1125 Sec. 1 and stating: “In 2015, the statute was amended to provide that machinery and equipment ‘used directly’ in the manufacturing process included [s]and and other proppants used to complete a new oil or gas well or to re-complete, redrill, or expand an existing oil or gas well.” Accordingly, the court views the law change as having occurred in 2015, but does not specify an effective date.

<sup>6</sup> Ark. Rules of Supreme Court, Rule 2-3.

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