Opinion No. 65-148

August 6, 1965

BY: OPINION OF BOSTON E. WITT, Attorney General Joel M. Carson, Assistant Attorney General

TO: Honorable Harold Runnels, State Senator, Lea County, Lovington, New Mexico

QUESTION

QUESTIONS

1. Are acids in acidizing oil wells deductible for the purpose of computing the school tax due from the company acidizing the oil well?

2. Are chemicals used in processing gas at a natural gasoline plant exempt from taxation by N.M.S.A. 72-16-15(14)?

3. May the gross receipts from the sale of chemicals used in water disposal wells, gas wells, injection wells, and water supply wells be deducted for the purpose of computing emergency school tax?

4. Is lease oil or free oil, with adomite or other material spearheaded by acid used in fracturing an oil well considered a chemical or reagent?

5. Is gelled acid used in fracturing exempt by N.M.S.A. 72-16-15(14)?

6. May the scale of chemicals be accumulated over a period of time for the purpose of coming within the terms of the section 72-16-15 and 12-17-4 exemptions for chemicals sold in lots of 18 tons or over?

CONCLUSIONS

1. See Analysis.

2. See Analysis.

3. See Analysis.

4. No.

5. No.

6. No.

OPINION

*{*248}* ANALYSIS

Subsection 14 of Section 1 of Chapter 67 Laws, of 1965, which is compiled as N.M.S.A. 972-16-15(14) provides:

There are exempted from the taxes imposed by the Emergency School Tax Act, as amended, the following:

(14) The gross receipts derived from the retail sales of all chemicals and reagents sold to any mining, milling or oil company for use or consumption in processing ores or oil in mill, smelter, or refinery, or in acidizing oil wells and retail sales of chemicals and reagents in lots in excess of eighteen tons. . . .

Subsection (J) of Section 1 of Chapter 68, Laws of 1965, which is compiled as N.M.S.A. 72-17-4(J) provides:

The storage, use or other consumption in this state of the following tangible personal property is specifically exempted from the tax imposed by the Compensating Tax Act of 1939 as amended:

(J) All chemicals and reagens procured or purchased by any mining, milling, or oil company for use or consumption in processing ores or oil in mill, smelter or refinery, or in acidizing oil wells and all chemicals and reagents sold in lots in excess of eighteen tons. . . .

Subsection J of N.M.S.A. 72-17-4 has been a compensating tax exemption for many years. The 1964 session of the legislature amended it to add an additional exemption for chemicals and reagents sold in lots in excess of eighteen tons. The school tax exemption is a product of the 1965 legislature and was obviously meant to equalize the tax burden between in-state and out-of-state merchants and to eliminate the discrimination against New Mexico merchants which had heretofore existed because of the preferential treatment given to chemical sales under the Compensating Tax Act. See N.M.S.A. 72-17-1 and **Edmunds v. Bureau of Revenue,** 64 N.M. 454, 330 P.2d 131. Eighteen tons of chemicals is usually a car-load lot. The additional exemption for chemicals sold in lots in excess of eighteen tons was intended to have the effect of treating chemicals sold in car-load lots as exempt sales in order to conform the wholesale-resale concept of the school tax law to the wholesale-retail concept of the chemical industry. With this history in mind and in order to conform the construction of these two statutes to the requirements of the United States Constitution, the two acts will be construed together and given the same interpretation. See **Halliburton Oil Well Cementing Co. v. Reilly,** 373 U.S. 64.

You first ask "Are acids used in acidizing oil wells deductible for the purpose of computing the tax due from the company acidizing the oil well?

Oil wells are acidized to increase the flow of oil from the well. Hydrochloric acid is customarily put into the well to enlarge and reopen the pores of an oil bearing limestone formation. The mechanics of the process are to first fill the well with oil, using inhibited acid to prevent corrosion of the tubing and then to apply pressure from a pump truck to force the hydrochloric acid into the rock channels and pores of the formation which cause the soft parts of the formation to become soluble. After a predetermined time, the acid is *{*249}* flowed or pumped out, leaving enlarged pores in the oil bearing strata. See **Empire Oil and Refining Company x. Hoyt,** 112 F.2d 356 (1940), Williams & Meyers, **Oil and Gas Law,** Manual of Terms.

Does this process then involve the sale of a service, making the person performing the service the consumer of the chemicals in the performance of the service, and making the cost of the chemicals purchased by him a part of the gross receipts which he receives from the well operator, or is the process one which involves both the sale of tangible personal property and the sale of a service?

This type question has seldom been easily resolved. See Hellerstein, **The Scope of the Taxable Sale Under Sales and Use Tax Act; Sales as Distinguished from Service,** 11 Tax Law Rev. 261; Hellerstein, **State and Local Taxation,** page 352. The Bureau of Revenue uses, to the extent that such practice is compatible with the Emergency School Tax Act, what is known as the "community appraisal test" for determining the difference between the sale of tangible personal property and the sale of a service. The "community appraisal test" looks to the custom of the trade and the custom of the industry to determine whether any given business should be treated as a service business or a business which makes sales of property. Applying this test, we believe that the acidizing of oil wells is a service taxable under N.M.S.A. 72-16-4.10 and New Mexico Emergency School Tax Regulation 4.10-1 et seq. New Mexico Emergency School Tax Regulation No. 4-10-2 defines "service".

For the purposes of these regulations and the administration of the Emergency School Tax Act the term "service" shall mean the utilization, for the benefit of the customer, of labor or mechanical equipment, or time or effort, or a combination of all of the above, and may include expenditures, materials, and things furnished, necessary to produce the benefit sought or ordered by the recipient of the service.

Where the taxpayer must use tangible personal property in the performance of his service, he must compute his school tax under Section 72-16-4.10 on the total receipts derived from the performance of the service and gross proceeds of sales of tangible personal property unless the industry of which he is a part has a common practice of billing material and labor separately. Where separate billing of material and labor is the trade practice, the taxpayer shall report gross receipts from labor under Section 72-16-4.10, N.M.S.A., 1953 Compilation, and gross receipts from materials under Section 72-16-4.5, N.M.S.A., 1953 Compilation. In the latter situation the taxpayer may execute a resale certificate under Section 72-16-4, N.M.S.A., 1953 Compilation for the tangible personal property which he purchases and includes in the billing as materials.

EXAMPLES

(A) X is engaged in the business of repairing shoes. A comes to him with a pair of shoes. The shoes need new soles. X put new soles on the shoes and bills A in following manner:

Materials $ 1.00
Labor $ 3.00

$ 4.00

X says that he should report emergency school taxes both as the retailer of tangible personal property and as a person performing a business service. X is in the business of performing a service. He should report all of his taxes as one performing a business service under N.M.S.A. 72-16-4.10. As a person performing a business *{*250}* service he is considered to be the consumer of the material which he uses to repair the shoes. **Note, however,** that if it were the custom of the shoe repairing industry in this state to bill labor separately from materials the shoe repairman would be allowed to segregate his labor from his materials.

. . .

(C) Sam owns a heavy equipment repair shop. He repairs heavy equipment and also sells parts for the equipment. He repairs a road grader for Z. As is the custom in the equipment repair business he bills Z for parts and for labor. Sam is to be treated as the retailer of the parts which he used in repairing Z's equipment, and must report emergency school tax on the sales of parts under Section 72-16-4.5. The gross receipts which Sam receives from his services in repairing the equipment are taxable under N.M.S.A. 72-16-4.10.

We have requested samples of invoices issued prior to the passage of Senate Bill 146 and 147 (Chapters 67 and 68, Laws of 1965). It is apparent from looking at these invoices that it has for sometimes been the custom of the acid companies to bill acid separately from pump time and other service charges. It is, therefore, our opinion that the acid company may be permitted to continue this type billing and pay emergency school tax under N.M.S.A. 72-16-4.10 measured by only those gross receipts which it receives for pumping the acid into the well and other service charges. Under the regulation of the Bureau of Revenue there is no necessity for the acid company to include the price of the acid sold in its gross receipts for the purpose of computing emergency school tax, so long as the acid is used in the acidizing of oil wells.

The gross receipts derived from chemicals sold and delivered to gasoline refineries in lots in excess of eighteen tons are, of course, exempt from both school and compensating taxes regardless of the usage of the chemicals.

Chemicals sold in lots of less than eighteen tons are exempt from the two taxes only so long as they are actually used in the processing of oil or gas in the refinery. In Opinion of the Attorney General No. 59-144 we held that chemicals sold to a mining company for use in preparing water for use in processing ores in the mill were not within the purview of the exemption. The same rule that is applicable to the construction of the compensating tax exemption is also applicable to the construction of the school tax exemption. We must, therefore, advise that chemicals sold to refiners are exempt from taxation by reason of N.M.S.A. 72-16-15(14) only so long as those chemicals are actually used in the physical treatment of oil and gas in the refinery.

In your third question you ask if the gross receipts from the sale of chemicals used in water disposal wells, gas wells, injection wells, and water wells may be deducted for the purpose of computing emergency school taxes. If the chemicals are sold and delivered in lots in excess of eighteen tons the gross receipts derived from the sale of the chemicals is of course deductible in computing gross receipts for school tax purposes. Are chemicals sold and delivered in lots of less than eighteen tons within the terms of the exemption? We think that they are not. It is a well established rule of statutory construction that a statute of exemption from taxation must receive a strict construction and that no claim of exemption should be sustained, unless within the express letter of the exemption clause. See **Samosa v. Lopez,** 19 N.M. 312, 142 P.927, **Peisker v.** N.M. 312, 142 P.927, **Peisker v. Unemployment Compensation Commission,** 45 N.M. 307, 115 P.2d 62 (1945), Opinion of the Attorney General No. 59-144, N.M.S.A. 72-16-15(14) and N.M.S.A. 72-17-4(J) *{*251}* exempt gross receipts derived from the sale of chemicals for use in acidizing **oil wells.** We believe that this language does not include water wells, gas wells, injection wells, and water supply wells. The language is obviously not meant to apply to all chemicals used in any type of well, but only to chemicals used in the **acidizing of oil wells.**

In your fourth question you ask if lease oil or frac oil with adomite or like materials spearheaded by acid used in fracturing any oil well is considered a chemical or reagent.

The term "chemical" or terms "chemicals and reagents" as they are used in N.M.S.A. 72-16-15 (14) and N.M.S.A. 72-17-4(J) should be given their generally accepted meaning. **Crescent City Selts & Mineral Water Company v. City of New Orleans.** 48 La. Ann. 768, 19 So. 943, **Shreveport Gas, Electric Light & Power v. Assessor of Caddo Parrish,** 47 La. Ann. 65, 16 So. 650; 6 **Words and Phrases** 740, and should not be given a technical construction. We do not believe that lease oil or frac oil with adomite spearheaded by acid should be considered a chemical or reagent within the meaning of the above mentioned sections. Neither lease oil nor frac oil are commonly thought of as chemicals. We have already said that exemptions should be given a strict construction and that the person or thing exempt must come within the express letter of the exemption. **Samosa v. Lopez,** supra, **Peisker v. Unemployment Compensation Commission,** supra. We understand that in the parlance of the oil field, acidizing and fracturing of formations are two different processes. In construing the exemption sections with which we are here dealing we must also resort to the use of the maxim "expressio unius es exclusio alterius" which means that if the statute expresses that

certain items are exempt, then only those items are exempt and all others are excluded from the exemption. **Black's Law Dictionary** 692.

The term fracturing or fraccing is not used in this section. Neither is there any suggestion in the statute that the legislature intended that the exemption cover fracturing. Therefore, acid used in fracturing is not covered by the exemption for chemicals sold for acidizing of oil wells. If, however, the chemicals used for fracturing are sold and delivered in lots in excess of eighteen tons they would come within the general exemption for chemicals and reagents sold in excess of eighteen tons. Question number five must therefore be answered in the negative.

We are told by members of the oil and gas industry that most frac jobs are preceeded by acidizing which will clean the tubing and a part of the formation so that the formation can be properly fractured. We wish to make it clear that we consider this portion of the total job to be acidizing within the meaning of the school and compensating tax exemptions, therefore gross receipts derived from these sales of chemicals are deductible for the purpose of computing either school or compensating tax liability.

We also wish to point out that our conclusions to questions four and five have in part been dictated by our analysis of the differences between fracturing and acidizing as those terms are used in the oil industry. Thus, either gelled acid or adomite or like materials used in the acidizing of oil wells are not necessarily to be considered as being without the terms of the exemptions quoted above.

In your sixth question you ask if invoices for chemicals can be accumulated over a period of time to take advantages of that portion of N.M.S.A. 72-16-15(14) and 72-17-4(J) which provide respectively:

N.M.S.A. 72-15-15(14)

There are exempted from the taxes imposed by the Emergency School tax Act, as amended, the following:

*{*252}* (14) . . . retail sales of chemicals and reagents in lots in excess of eighteen tons. . . .

N.M.S.A. 72-17-4(J)

(J) . . . chemicals and reagents sold in lots in excess of eighteen tons . . .

Eighteen tons of concentrated hydrochloric acid makes a car load of the acid. The above quoted exemption, as we have already noted, was passed to conform the school tax concept of wholesale-resale activities to the chemical industry concept of a wholesale-retail sales of chemicals. We must give effect to all parts of the statute and give it the meaning that the legislature intended. To construe the statute to allow the accumulation of invoices until eighteen tons is reached would render the statute

meaningless. We cannot give it that construction. We must, therefore, advise that invoices for chemical sales may not be accumulated over a period of time for the purpose of obtaining an eighteen-ton lot. On the contrary, the seller of the chemicals must sell and deliver the chemicals to the purchaser in lots in excess of eighteen tons if the above quoted provisions are to be taken advantage of.