



---

**STATE BOARD OF EQUALIZATION**

May 21, 1969

U--- M--- S---  
P. O. Box XXX  
---, CA XXXXX

Attention: Mr. R--- G. M---  
Certified Public Accountant

SR --- XX XXXXXX

Gentlemen:

Your letter dated April 22, 1969, addressed to Mr. Vern Decker, State Board of Equalization, has been referred to me for reply.

You state that the S--- O--- Company (S---) has requested that in billing for drilling fluids which you sell to it, you bill separately for engineering service charges which are presently billed as part of your sales price, and not compute tax on those charges. You ask that we render an opinion concerning the propriety of your billing in this manner.

We understand that the drilling fluids are used by S--- in the course of its drilling operations. The fluids perform various functions, including cooling the drill bit, bringing up cuttings from the hole, and lining the walls of the hole. The fluids are mechanically cycled into the hole, removed from the hole, processed, analyzed, reconstructed when necessary, and recycled. When purchasing these fluids, S--- also engages the services of your field engineers (chemical engineers) to maintain the fluid properties which are required for the specific job. Their duties primarily consist of analyzing the fluids, and adding and/or extracting chemicals and other catalysts to the fluids, and are in the nature of quality control operations.

You presently bill S--- and others for a lump sum, which includes the price of the fluids, chemicals and engineering service charges, and compute sales tax on the total sum. In requesting you to change your billing procedure, S--- has relied, in part, on an opinion of its legal and tax section which concluded that these engineering service charges were service charges for an activity similar to installation or application of the fluids, and that that portion of the lump sum related thereto was not subject to tax.

Sales and Use Tax Law section 6012 provides that gross receipts mean the total amount of the sales price which includes any services that are part of the sale. Gross receipts do not include the price received for labor or services used in installing or applying the property sold. On the basis of the information we have, namely, that the fluids are put into use through a mechanical process,

U--- M--- S---  
SR --- XX XXXXXX

-2-

May 21, 1969  
515.0640

the operation of which is the responsibility of the particular drilling contractor, the duties of the engineers primarily are in the nature of quality control operations, and the oil companies would probably not purchase fluids from a supplier if it did not furnish engineers as part of the sale, it is our opinion that the services provided by your engineers are services that are part of the sale and not services rendered in installing or applying the property sold. Accordingly, tax applies to your total lump-sum charges and you should continue to bill S--- and your other customers as you have done in the past.

Very truly yours,

J. Kenneth McManigal  
Tax Counsel

JKM:smb

**M e m o r a n d u m****515.0640**

To: Mr. Ed Pedeupe

January 3, 1991

From: David Levine  
Senior Tax CounselSubject: P--- Inc.  
SR -- XX-XXXXXX

This is in response to your memorandum dated December 4, 1990. P--- sells drilling fluid products and related services to oil companies. The services consist primarily of testing and analysis of mud samples taken from the customers' wells in order to advise the customers as to which fluids the customers need for their drilling.

P---'s services are apparently available to all its customers and are not contingent upon the purchase of fluids. Nevertheless, most customers who contract for the services also purchase the fluids. P--- separately states its charges for the services and the district notes that P--- has always treated these charges as not subject to tax.

Annotation 515.0640 (5/21/69) states that an engineering service charge for quality control operations by a seller of fluids for oil drilling operation is includable in the seller's measure of sales tax as a charge for services that are part of the sales of the fluid. The district asks whether this annotation is still valid. If so and if P---'s charges come within the annotation, the district asks whether the charges should be included in P---'s measure of tax in the current audit. The district also notes that P--- has routinely been audited for at least the last three audit cycles and these charges have not been made an issue.

You note that although the annotation indicates that the charge for the services may be subject to tax, you see some distinctions between the present case and the case involved in the annotation. We agree that there appear to be some distinctions. However, we believe that the meaning of the annotation is that the type of services involved here are so intimately entwined with the sale of the fluids that they must be regarded as part of the sale. We believe that the annotation covers the transactions involved here notwithstanding the distinctions. Thus, we

Mr. Ed Pedeupe

-2-

January 3, 1991  
515.0640

believe that the charges for these services should be included in the measure of tax. Nevertheless, in light of the audit history of this taxpayer, we recommend that this conclusion be prospective and not include the present audit.

If you have further questions, feel free to write again.

DHL:cs  
0079E