



STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

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MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751
ANTITRUST: 296-5299

ATTORNEY GENERAL OPINION NO. 83- 144

The Honorable Frank D. Gaines
State Senator, Sixteenth District
P. O. Box 219
Augusta, Kansas 67010

Re: Taxation -- Retailers' Sales Tax -- Exemptions;
Property Consumed in Process of Production

Synopsis: The sale of acid which is used to treat a salt water disposal well, which well is utilized in the process of oil production, is exempt from the Kansas Retailers' Sales Tax Act under the provisions of K.S.A. 1982 Supp. 79-3602(m) and 79-3606(n). Cited herein: K.S.A. 1982 Supp. 79-3602(m), 79-3606(n).

* * *

Dear Senator Gaines:

You seek our opinion concerning the applicability of the exemption prescribed in K.S.A. 1982 Supp. 79-3606(n) to the sale of acid which is used to treat salt water disposal wells, which wells are utilized in the process of oil production.

The statute about which you inquire provides, in relevant part:

"The following shall be exempt from the tax imposed by this act . . .

"(n) all sales of tangible personal property which is consumed in the production, manufac-

ture, processing, mining, drilling, refining or compounding of tangible personal property, the providing of services or the irrigation of crops for ultimate sale at retail within or without the state of Kansas; and any purchaser of such property may obtain from the director of taxation and furnish to the supplier an exemption certificate number for tangible personal property for consumption in such production, manufacture, processing, mining, drilling, refining, compounding, irrigation and in providing such services." (Emphasis added.)

In reference to this exemption, the legislature, in K.S.A. 1982 Supp. 79-3602(m), defines the phrase "property which is consumed," as follows:

"'Property which is consumed' means tangible personal property which is essential or necessary to and which is used in the actual process of and immediately consumed or dissipated in (1) the production, manufacture, processing, mining, drilling, refining or compounding of tangible personal property, (2) the providing of services or (3) the irrigation of crops, for sale in the regular course of business, and which is not reusable for such purpose. The following items of tangible personal property are hereby declared to be 'consumed' but the listing of such property shall not be deemed to be exclusive nor shall such listing be construed to be a restriction upon or an indication of, the type or types of property to be included within the definition of 'property which is consumed' as herein set forth:

"(1) Insecticides, herbicides, germicides, pesticides, fungicides, antibiotics, biologicals, pharmaceuticals, vitamins and chemicals for use in commercial or agricultural production of fruit, vegetables, feeds, seeds, animals or animal products whether fed, injected, applied or otherwise used; and

"(2) Electricity, gas and water."

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You indicate that the State Department of Revenue allows the exemption for the sale of acid which is used to treat wells producing oil, but does not allow the exemption for the sale of acid which is used to treat salt water disposal wells. You believe this is an unjustified interpretation of the statute, since the treating of salt water disposal wells is as integral a part of the process of producing oil as the treatment of producing wells. We concur.

While it is axiomatic that tax exemption provisions are to be construed strictly [see Topeka Cemetery Ass'n v. Schnellbacher, 218 Kan. 39, 42 (1975)] and this rule applies to exemptions granted in the Kansas Retailers' Sales Tax Act [see Warren v. Fink, 146 Kan. 716 (1937)], it also is settled that the "strict construction" rule does not warrant an "unreasonable construction." See, e.g., Trustees of The United Methodist Church v. Cogswell, 205 Kan. 847, Syl. ¶2 (1970). Moreover, the Kansas Supreme Court has held that the rule of strict construction simply means that ordinary words are to be given their ordinary meaning and a statute subject to strict construction should not be read to add that which is not readily found within it or to read out what, as a matter of ordinary English language, is in it. See State v. Finley, 199 Kan. 615 (1967).

The exemption provided in K.S.A. 1982 Supp. 79-3606(m) concerns "property which is consumed" in, among other things, the production of tangible personal property. The phrase "property which is consumed" is legislatively defined as tangible personal property which is "used in the actual process of . . . the production . . . of tangible personal property." (Emphasis added.) K.S.A. 1982 Supp. 79-3602(m).

In R. L. Polk & Co. v. Arnold, 215 Kan. 653 (1974), the Director of Revenue, predecessor to the Director of Taxation, denied a sales tax exemption in regard to certain items of tangible personal property which were used and consumed in the taxpayer's manufacturing process. One basis upon which the Director denied the exemption was his belief that "the processes wherein the materials were consumed were preliminary to the manufacturing." Id. at 656. The Court rejected this reasoning, since the processes were part of "an integrated manufacturing operation." Id. at 656. The Court labeled the Director's interpretation of the exemption language too "narrow." Id. at 656.

Like the "integrated manufacturing operation" involved in Arnold, supra, the production of oil involves an integrated

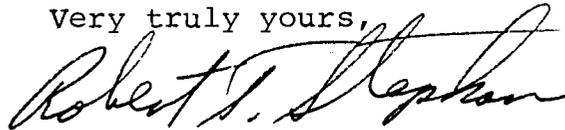
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production process, one phase of which is the proper disposal of salt water produced in conjunction with the production of oil. In fact, this phase of the production process is mandated by state law. See K.S.A. 1982 Supp. 55-901 et seq. and K.S.A. 55-1003. Without the proper disposal of such salt water, production must cease. K.S.A. 1982 Supp. 55-904(a)(1).

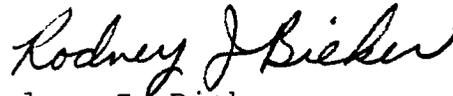
The legislative mandate concerning the proper disposal of salt water "produced in conjunction with the production of oil or natural gas" [K.S.A. 1982 Supp. 55-904(a)(1)], makes clear to us that such disposal is an integral part of the process of the production of oil and natural gas. Therefore, we are of the opinion that tangible personal property which is used in this phase of the production process is within the language of this sales tax exemption.

Therefore, we are of the opinion that the sale of acid which is used to treat a salt water disposal well, which well is utilized in the process of oil production, is exempt from the Kansas Retailers' Sales Tax Act under the provisions of K.S.A. 1982 Supp. 79-3602(m) and 79-3606(n).

Very truly yours,



ROBERT T. STEPHAN
ATTORNEY GENERAL OF KANSAS



Rodney J. Bieker
Assistant Attorney General

RTS:BJS:RJB:hle