



GLENN HEGAR TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

INTEROFFICE MEMO

Memorandum for Discussion

DATE: June 13, 2025
TO: Emma Fuentes, Audit Division
FROM: Jenny Burleson, Tax Policy Division
SUBJECT: Taxability of Sand, Dirt, Gravel, Rock, and Other Solid Materials after *Westmoreland* Decision

Issue:

This memo provides guidance on the taxability of solid materials extracted or severed from the earth such as sand, dirt, gravel, and rock.

Background:

“Tangible personal property” is defined as “personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner....” Section 151.009 (Tangible Personal Property).¹ Sand, dirt, gravel, and other similar natural materials are tangible personal property. However, a 1988 administrative decision made *unprocessed* types of these materials nontaxable. *See* STAR Accession No. 8806L0884E01 (June 30, 1988). As a result, equipment used to extract or gather these types of materials was taxable because it was not used in a manufacturing process. *See* STAR Accession No. 200006438L (June 28, 2000). The equipment was considered used before production of tangible personal property began. Processed materials were still considered taxable.

In addition, the agency's position was that washing, drying, screening for size, and sorting of these materials were not processing activities. STAR Accession No. 9212L1233B12 (Dec. 7, 1992). Only after cutting, crushing, or mixing with other materials were the sand, dirt, gravel, or other materials considered processed. *See* Comptroller Decision No. 44,432 (2005) and STAR Accession No. 200006438L (June 28, 2000). Once the material was processed, the material became subject to sales tax.

Analysis:

Hegar v. Texas Westmoreland Coal Co.

In a recent case, Texas Westmoreland Coal Co. (Westmoreland) leased excavators to extract coal from seams in the ground and to break apart the coal as it was extracted. The excavators had large buckets with teeth. Operators dragged the excavator buckets across the exposed lignite coal formation to crack, break, or rip apart the lignite coal formation.

¹ Unless otherwise indicated, all references to “Section” are to the Texas Tax Code, and all references to “Rule” are to Title 34 of the Texas Administrative Code.

Once the buckets were filled with pieces of coal, they dumped the coal into trucks from a height of ten or twelve feet to further break it apart.

Westmoreland filed a tax-refund claim for sales tax paid on leases of the excavators used to mine lignite. Westmoreland claimed the equipment was directly used in processing of tangible personal property for ultimate sale and exempt from sales and use tax under Section 151.318(a)(2)(A) (Property Used in Manufacturing).

The agency denied the refund and determined the excavators did not qualify for the exemption because they were not processing personal property, but real property, when initially digging into the lignite formation. As a result, Westmoreland sued the agency. District and appellate courts ruled for Westmoreland. *See Hegar v. Texas Westmoreland Coal Co.*, 636 S.W.3d 61 (Tex. App.—Austin 2022, pet. denied).

The appeals court disagreed with the agency’s argument that the excavators did not qualify for exemption because they were used in the processing of real property instead of tangible personal property. The appeals court agreed with Westmoreland that the processing of tangible personal property can include the severance of minerals or other physical materials from the earth when the other exemption requirements in Section 151.318(a)(2) are met. The Texas Supreme Court denied the agency’s petition for review.

Impact of Westmoreland Decision

The sale of equipment directly used in the manufacturing, processing, or fabrication of tangible personal property is exempt from sales and use tax. The equipment must be used in or during the actual processing of materials (e.g., sand, lignite, or other similar materials) for ultimate sale and necessary or essential to the processing operation and make or cause a chemical or physical change to the materials. Section 151.318(a)(2)(A).

Section 151.318(d) defines manufacturing to include each operation beginning with the first stage of production and ending with the completion of tangible personal property. Rule 3.300(a)(9) provides, “The first production stage means the first act of production, and it shall not include those acts in preparation for production.”

Prior to *Westmoreland*, the agency did not allow an exemption for equipment, such as excavators, used to extract raw materials from the earth’s surface. The agency determined that processing could not be performed on real property. *See* Comptroller’s Decision No. 105,221 (2012). Even if it could, it would be in *preparation* for production of those materials, and therefore, prior to the first stage of production. *See* Section 151.318(d) and Rule 3.300(a)(9).

In *Westmoreland*, the court ruled that the identity of the lignite as real property was without effect because Westmoreland’s ultimate product offered for sale was tangible personal property. Since Westmoreland was processing tangible personal property for ultimate sale, any equipment that caused a physical or chemical change, including the excavators, qualified for the manufacturing exemption.

The effect of this ruling is that processing can be performed on real property. As a result, activities that were previously considered to be in preparation of production may now be considered processing allowing exemptions on previously taxed equipment. To meet the exemption requirements, the item (e.g., equipment) must directly make or cause a chemical or physical change to the product (e.g., materials) being produced and the product must be tangible personal property held for ultimate sale.

The court cited prior examples of activities the agency determined to be processing. Those examples include equipment used to shatter limestone and explosives used to blast rock out of formations. Under *Westmoreland*, the following are examples of equipment that qualify for the manufacturing exemption:

- Excavators used to sever or break materials from the earth;
- Cutting equipment used to extract stone at a quarry; and
- Dynamite used to blast material from the earth.

Sand, dirt, gravel, rock, and other solid materials are now considered processed materials when extracted from the earth in a way that causes a chemical or physical change to those materials (i.e., processing). The sale of these materials will be subject to sales tax. For example, frac sand, also called silica or industrial sand, is processed by washing, sorting, and drying, into round and uniform shape and size to meet specifications for fracturing. Therefore, the comptroller will presume the sale of frac sand is a sale of processed material and subject to sales and use tax.

In addition, activities such as washing, drying, and separating materials are processing when the activities cause a chemical or physical change to the material. For example, washing sand to remove impurities such as clay and silt or using high-powered streams of water to separate or resize individual sand grains is processing. These activities are like the activities of a separator that removes solid impurities or separates oil, gas, and water. Equipment performing these activities which were previously taxed, may now be purchased tax free under the manufacturing exemption.

The manufacturing exemption does not apply to equipment that does not cause a chemical or physical change to the materials as required under Section 151.318(a)(2). Equipment used in activities such as gathering loose materials would not be exempt. Loose sand and other materials gathered in this manner, and which do not require processing, will remain nontaxable under the 1988 administrative decision. STAR Accession No. 8806L0884E01 (June 30, 1988).

The manufacturing exemption does not apply to equipment such as excavators, bulldozers, and draglines used to remove overburden. Removing overburden is still performed before the first stage of production and does not cause a chemical or physical change to materials beneath the overburden such as coal. *See*, for example, Comptroller's Decision No. 45,944 (2006) and *Sabine Mining Co. v. Strayhorn*, 2007 WL 2390686 (Tex. App.—Corpus Christi 2007, no pet.) (mem. op.).

Any exempt manufacturing equipment is subject to divergent use provisions if the property is purchased tax free but then used in a taxable manner. Section 151.3181 (Divergent Use

of Property Used in Manufacturing). For example, tax would be due on the divergent use of exempt excavators used in the transportation or loading of materials for distribution.

Implementation:

The taxability determinations discussed above in this memo will be applied prospectively beginning October 1, 2025. Previously nontaxable materials may be treated as taxable, processed materials after October 1, 2025, because they were extracted from the earth and/or washed, dried, or separated in a manner that caused a chemical or physical change. Therefore, the following guidelines should be followed by Audit and Hearings and Tax Litigation to resolve open and future assignments.

Periods before October 1, 2025

Sellers of Materials

To close out a particular assignment, the auditor should examine a seller's purchase and sales transactions over the entire audit period.

The auditor should not make adjustments if the seller consistently handled the transactions the same way, i.e., paying tax on purchases of equipment and not charging tax on the sale of materials *or* not paying tax on equipment and collecting tax or accepting resale/exemption certificates on sales of materials. If a seller considered itself to be selling unprocessed material, the auditor should not make an assessment for sales but will need to make adjustments for any equipment purchases for which no tax was paid.

If the seller considered itself to be selling processed material, adjustments will *not* be made on sales unless the seller does not have documentation (e.g., valid resale or exemption certificates) to support any nontaxed sales. Under this fact pattern, the auditor should allow credit for tax paid or accrued on these sellers' purchases of manufacturing equipment.

If the seller sold processed and unprocessed material, the auditor must examine sales and purchases and make adjustments as necessary. For example, the auditor will need to make adjustments on any tax-free purchases of equipment unless the seller provides evidence to establish that it used the equipment exclusively to process material for ultimate sale.

Purchases of Materials

Auditors should not assess tax on purchases of sand, dirt, gravel, rock, and other solid materials, unless a purchaser provided a resale/exemption certificate claiming an exemption that did not apply. Additionally, auditors should *not* allow a credit or refund for tax paid or accrued on the purchases of sand, dirt, gravel, rock, and other solid materials unless the purchaser can provide evidence that the materials were unprocessed.

Periods on or after October 1, 2025

Sellers of Materials

For a seller of sand, dirt, gravel, rock, and other solid materials, auditors should verify the seller's operations to determine how the seller gathers, processes, or extracts the material and whether a chemical or physical change has occurred. Auditors should conduct a plant tour whenever possible to review and confirm the seller's processes and the types of equipment used to gather, process, or extract material. Auditors may also review any licenses or permits issued by the Texas Commission on Environmental Quality or Texas Railroad Commission. Through these types of verifications, the auditor should be able to determine whether a seller's product is processed or unprocessed.

For example, materials that are only scooped from the ground and sold without any processing, are not processed. However, materials that require an excavator or dynamite to break or sever them from the ground are processed. Materials that have been washed, dried, or screened to remove impurities have also been processed. Materials that have been crushed, separated, mixed, or combined are also processed.

For sales of processed materials, an auditor should assess tax on all sales in which tax was not collected unless an exemption or exclusion applies. *See* Sections 151.051 (Sales Tax Imposed), .054 (Gross Receipts Presumed Subject to Tax). Examples of situations where the seller would not be required to collect tax include sales where the purchaser provided a resale or exemption certificate, the purchaser provided a direct payment exemptions certificate, or the materials were shipped out of state. Nonpermitted sellers of processed materials will be required to obtain a sales tax permit.

If tax was paid by the seller on processing equipment, the auditor should allow a credit for tax paid in error. A seller may dispute the audit assessment by providing evidence proving it is not making a chemical or physical change to the materials. If the seller proves it is not processing, the auditor should assess tax on the seller's equipment if no tax was paid.

For sales of unprocessed materials, an auditor should not assess tax. No refund or credit will be allowed to the seller for tax collected in error, unless the seller provides proof tax was refunded or credited to its customer. The auditor should assess tax on any equipment purchased tax free. A seller may dispute the audit assessment by providing proof it made a chemical or physical change to the materials held for sale. If the seller proves it is processing, the auditor should assess tax on the sales of processed materials if tax was not collected and not assess tax on the manufacturing equipment.

Under Section 151.3181 (Divergent Use of Property Used in Manufacturing), sellers will be responsible for tax on any divergent use of equipment purchased tax free under the manufacturing exemption. For example, an excavator could be used to sever materials from the earth and also to gather loose materials. Use of an excavator that was purchased tax free to gather loose materials is taxable divergent use. Using an excavator to transport or load materials is also taxable divergent use.

Purchases of Materials

Auditors should assess tax on purchases of processed materials if no tax is paid to the seller or accrued by the purchaser. An auditor may verify if materials were processed by reviewing invoices and contracts which should indicate if the materials are processed or

unprocessed. For example, an invoice or contract may have key phrases such as mixed sand, washed sand, or processed sand.

A purchaser may dispute the auditor's assessment by presenting documentation, such as an invoice which identifies the items purchased as unprocessed, to prove the material was not processed. An invoice by itself is not likely to be sufficient evidence and an auditor may also reach out to the seller of the materials to verify the type of material purchased. To show proof the purchaser accrued tax, a purchaser should provide documentation through its books and records along with a copy of a sales/use tax reports which tax was remitted to the agency.

Tax Policy will amend Rule 3.300 (Manufacturing; Custom Manufacturing; Fabricating; Processing) to incorporate the content of this memo. Tax Policy will also supersede or partially supersede a number of taxability letters issued between 1988, after the administrative decision regarding unprocessed materials was made, and 2013, when the formal private letter ruling process was adopted. Additionally, Tax Policy will supersede or partially supersede the following private letter rulings and Comptroller's Decisions:

STAR Accession No. 201901049L (Jan. 25, 2019)
STAR Accession No. 201901047L (Jan. 25, 2019)
STAR Accession No. 201901045L (Jan. 25, 2019)
STAR Accession No. 201901046L (Jan. 25, 2019)
STAR Accession No. 201902003L (Feb. 7, 2019)
STAR Accession No. 202007009L (July 2, 2020)

STAR Accession No. 8910H0975E08 (Hearing No. 25,342) (Oct. 10, 1989)
STAR Accession No. 9205091H (Hearing No. 27,940) (May 27, 1992)
STAR Accession No. 9405H1303A09 (Hearing No. 29,862) (May 26, 1994)
STAR Accession No. 9607H142D01 (Hearing No. 35,115) (July 22, 1996)
STAR Accession No. 9710787H (Hearing No. 36,005) (Oct. 6, 1997)
STAR Accession No. 200309186H (Hearing No. 41,977) (Sept. 24, 2003)
STAR Accession No. 200503110H (Hearing No. 44,432) (March 10, 2005)
STAR Accession No. 201909026H (Hearing No. 115,570) (Sept. 9, 2019)
STAR Accession No. 202012018H (Hearing No. 115,684) (Dec. 9, 2020)
STAR Accession No. 202108018H (Hearing No. 115,774) (Aug. 11, 2021)
STAR Accession No. 202309036H (Hearing No. 119,001) (Sept. 15, 2023)