

PRIVATE TAXPAYER RULING LR01-004

May 14, 2001

The following private taxpayer ruling is in response to your request of January 18, 2001, as supplemented by your letter of February 20th. Your letter requests a ruling regarding the taxability of natural gas used by . . . in their electric generating plant.

The following is a restatement of the facts presented in your letter.

Statement of Facts:

. . . will be constructing a 620 MW to 1240 MW combined cycle natural gas fired electric generating plant in Western Maricopa County (the "Facility"). All electricity generated by the Facility will be for resale into wholesale markets.

All natural gas used to fuel the Facility will be acquired through . . .'s ownership of a working interest in natural gas well(s)/reserve(s) located outside the State of Arizona ("Wells"). . . . will bear the operating costs associated with maintaining the Wells. . . . will also be responsible for the payment of any applicable taxes on gas extracted from the Wells to the state(s) where the Wells are located. Finally, as the natural gas will come directly from . . .'s own Wells, it will be unnecessary for . . . to purchase the gas from retailers.

. . . plans to enter into a contract with a pipeline company for the interstate transportation of gas from its Wells to the Facility. . . . is not in the business of selling, nor does it intend to sell, natural gas from the Wells to any third party or third parties. Rather, gas from . . .'s interest in the Wells will be used solely for the production of electricity at the Facility.

Your Position:

Arizona's use tax is imposed on the storage, use or consumption in this state of tangible personal property purchased from a retailer or utility business. A "purchase" is defined as any transfer, exchange or barter, conditional or otherwise, in any manner or by any means, of tangible personal property for a consideration, including transactions by which the possession

of property is transferred but the seller retains the title as security for payment. A "retailer" is defined as every person engaged in the business of making sales of tangible personal property for storage, use or other consumption or in the business of making sales at auction of tangible personal property owned by that person or others for storage, use or other consumption.

Because the natural gas will come from Wells owned by . . . rather than being purchased from a retailer, the use tax does not apply. Indeed, there is no "purchase" because nothing is exchanged for a consideration. Further, . . . is not a "retailer" because it is not in the business of selling, nor does it intend to sell, natural gas from the Wells to any third party or third parties for storage, use or other consumption. The use tax does not apply because the gas will be extracted from Wells owned and operated by . . . instead of being bought from a natural gas vendor.

Additionally, . . .'s use of the natural gas at the Facility will not be subject to transaction privilege tax under either the retail classification or the utility classification. The retail classification does not apply because the natural gas will not be purchased by . . . from a retailer in Arizona (the natural gas will be withdrawn by . . . from its own natural gas Wells located in other states). Also, . . .'s use of natural gas at the Facility will not be subject to tax under the utilities classification for the same reason.

Applicable Statutory Provisions:

Arizona Revised Statutes (A.R.S.) § 42-5008 levies a transaction privilege tax measured by the amount or volume of business transacted by persons on account of their business activities.

A.R.S. § 42-5061 imposes the transaction privilege tax under the retail classification. The retail classification is comprised of the business of selling tangible personal property at retail.

A.R.S. § 42-5001(13) defines "sale" as any transfer of title or possession, or both, of tangible personal property for a consideration.

A.R.S. § 42-5063 imposes the transaction privilege tax under the utilities classification. The utilities classification is comprised of the business of:

1. Producing and furnishing or furnishing to consumers natural or artificial gas and water.
2. Providing to retail electric customers ancillary services, electric distribution services, electric generation services, electric transmission services and other services related to providing electricity.

A.R.S. § 42-5155 imposes a use tax on the storage, use or consumption in this state of tangible personal property purchased from a retailer or utility business, as a percentage of the sales price.

A.R.S. § 42-5151(13) defines "purchase" as any transfer, exchange or barter, conditional or otherwise, in any manner or by any means, of tangible personal property for a consideration, including transactions by which the possession of property is transferred but the seller retains the title as security for payment.

A.R.S. § 42-5151(17)(a) defines "retailer" to include every person engaged in the business of making sales of tangible personal property for storage, use or other consumption.

A.R.S. § 42-5151(21) defines "utility business" to mean a person that is engaged in the business of providing electric utility services to retail electric customers or natural gas utility services to retail natural gas customers.

Discussion:

Arizona's transaction privilege tax is a tax on the privilege of conducting business in the State of Arizona. It is a tax on the seller, not on the purchaser. The seller may pass the burden of the tax on to the purchaser; however, the seller is ultimately liable to Arizona for the tax.

The transaction privilege tax is imposed on the business of selling tangible personal property at retail. The term "sale" means any transfer of title or possession, or both, of tangible personal property for a consideration. [A.R.S. § 42-5001(13)]

The natural gas will be withdrawn by . . . from natural gas wells in which it has a working interest and transported by a pipeline company to Arizona. Under a working interest, a person acquires the right to search, develop and produce oil and gas and has the obligation to pay all associated costs. When a person produces gas for their own use there is no transfer of title or possession of tangible personal property for a consideration, hence, there is no sale.

The transaction privilege tax is imposed on the business of producing and furnishing or furnishing to consumers natural or artificial gas. [A.R.S. § 42-5063] . . . produces natural gas for its own self-consumption. No person is producing and furnishing or furnishing natural gas to consumers. Therefore, there is no activity occurring that is subject to tax under the utilities classification.

Arizona's use tax is imposed on the storage, use or consumption in this state of tangible personal property purchased from a retailer or utility business. [A.R.S. § 42-5155]

"Purchase" means any transfer, in any manner or by any means, of tangible personal property for a consideration. "Retailer" means every person engaged in the business of making sales of tangible personal property for storage, use or other consumption. "Utility business" means a person that is engaged in the business of providing natural gas utility services to retail natural gas customers. [A.R.S. § 42-5151]

When . . . consumes natural gas that came from wells in which it has a working interest, there has been no use or consumption in this state of tangible personal property that was purchased from a retailer or utility business.

Conclusion and Ruling:

The department rules that the transaction privilege tax does not apply under either the retail classification or the utility classification, when . . . withdraws natural gas from out-of-state wells in which it has a working interest and has it transported by a pipeline company to Arizona.

The department further rules that the use tax does not apply to natural gas that is consumed by . . . in its electric generating plant when such gas was withdrawn from out-of-state wells in which it has a working interest.

The conclusions in this private taxpayer ruling do not extend beyond the facts as presented in the request for a private taxpayer ruling dated January 18, 2001, and supplemented by your letter of February 20th.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.