

## PRIVATE TAXPAYER RULING LR02-006

May 8, 2002

The following private taxpayer ruling is in response to your request of February 8, 2002, as amended by your letter of March 6<sup>th</sup>. Your letter requests a ruling regarding the taxability of natural gas used by . . . in their electric generating plant.

Statement of Facts:

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

. . . presently leases and operates a . . ., natural gas fired, electric generating plant located in . . ., Arizona (the "Facility"). All electricity generated at the Facility will be sold by . . . to an affiliate or unrelated third parties for resale in Arizona and California.

To the extent possible, all natural gas used by . . . at the Facility will come from "Wells" (as that term is defined below) located outside of the State of Arizona and owned whether in whole or in part by . . . To the extent that . . . is not able to obtain sufficient natural gas from "Wells" that it owns, . . . will purchase gas from other sources. The ruling request relates only to the use of natural gas obtained from "Wells" owned in whole or part by . . .

. . . would acquire an ownership interest in out-of-state natural gas deposits by acquiring possessory oil and gas mineral interest (natural gas, coal bed methane gas, or otherwise) and associated permanent fixtures (including the existing wells), in the form of fee, mineral deed, lease, assignment of lease, or other recordable form of interest in realty, or of a working interest in the realty and would bear all operating costs attributable to its working interest, but would enter into a contractual relationship with one or more operators (whether an affiliate of . . . or third parties) for the exploration and production of gas from the realty from existing and new wells (the "Realty" or "Wells") located outside of the State of Arizona (e.g., New Mexico, Colorado, Oklahoma, and Texas). In either case, whether . . . acquired a possessory oil and gas mineral interest or a working interest, the natural gas deposits acquired are considered real property under the law of the state where the Realty is located.

Due to regulatory constraints, . . . may not engage in the business of transporting gas interstate. As a result, . . . will contract with an affiliate or third party for the interstate transportation of the gas from the Realty directly to the Facility.

. . . would bear all or its proportionate share, as applicable, of the operating costs associated with maintaining the Realty and would also be responsible for the payment of any applicable taxes on its gas extracted from the Realty to the state(s) where the Realty would be located.

Your Position:

Natural gas which . . . has withdrawn from Wells it owns located outside Arizona and used at the Facility in the generation of electricity is not subject to Arizona's use tax. The use tax is imposed 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. For use tax, 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 "[e]very 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."

Given the facts of this request, the use tax would not apply because the natural gas would come from Wells owned whether in whole or in part by . . . rather than being "purchased from a retailer." 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 its Realty to any non-affiliated third party or third parties for storage, use or other consumption. In short, there can be no use tax here because the gas would be extracted from wells owned by and operated on behalf of . . . instead of being bought from a natural gas vendor. Moreover, . . .'s acquisition of its ownership interest in the natural gas deposits by either acquiring a possessory mineral interest or a working interest in those deposits would not trigger the use tax because the interest acquired, under the laws of the applicable state where the Wells are located, are interests in real property and not tangible personal property (the use tax only applies to the in state use of tangible personal property purchased from an out-of-state retailer).

. . .'s use of natural gas at its Facility, which has been withdrawn from out-of-state Wells owned by . . . or in which . . . owns a working and/or possessory interest, will not be subject to Arizona transaction privilege tax under either the retail classification or the utility classification. The retail classification would not apply because the natural gas was not purchased by . . . from a retailer in Arizona (the natural gas was withdrawn by . . . from its own natural gas Wells located in other states). Additionally, the retail classification would not apply because there was no sale of tangible personal property since . . . withdrew the gas from its own wells.

The tax under the utilities classification would not apply for the same reasons as the retail classification does not apply. Specifically, there will be no sale of the natural gas in Arizona since . . . is using its own gas at its generation plant, and thus does not fall under the utilities

classification which is comprised of the business of "producing and furnishing or furnishing to consumers natural or artificial gas and water."

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 from out-of-state Wells owned by . . . or in which . . . owns a working and/or possessory interest, whether by fee, mineral deed, lease, assignment of lease, or other real property interest. . . . will contract with an affiliate or third party for the interstate transportation of the gas from the Realty directly to the Facility. 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 was withdrawn from Wells owned by . . . or in which . . . owns a working and/or possessory 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 owned by . . . or in which . . . owns a working and/or possessory interest, whether by fee, mineral deed, lease, assignment of lease, or other real property interest.

The department further rules that the use tax does not apply to . . .'s consumption of natural gas at its Arizona generating plant when the natural gas was withdrawn from out-of-state wells owned by . . . or in which . . . owns a working and/or possessory interest, whether by fee, mineral deed, lease, assignment of lease, or other real property 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 February 8, 2002, as amended by your letter of March 6<sup>th</sup>.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations are 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.

The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.