

DECISION OF MUNICIPAL TAX HEARING OFFICER

April 21, 2014

Taxpayer's Representative
Address of Taxpayer's Representative

Taxpayer
MTHO ## 784 (refund denial) & 785 (assessment)

Dear Mr. Taxpayer's Representative,

We have reviewed the evidence and information presented by *Taxpayer* and the City of Phoenix (Tax Collector or City) at the hearing on October 23, 2013 and in post-hearing memoranda. The review periods covered were August 2008 through June 2011 (refund claim) and December 2008 through November 2012 (assessment). Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer sells natural gas to large natural gas consuming customers located in Arizona and other Western states. One of Taxpayer's customers is located in Phoenix, Arizona. The customer uses the gas in its business of heat-treating metal. Taxpayer had paid city privilege tax on its sales to the customer under the retail classification. Because the customer's use of the gas was exempt from tax on retail sales, Taxpayer filed a claim for refund. The City denied the claim for refund stating that Taxpayer was taxable under the utilities classification and the retail exemption for the gas was not available under the utilities classification. Because the tax rate under the utilities classification was higher than the retail classification, the City issued an assessment for the difference. Taxpayer is not a utility but sells tangible personal property (gas) at retail. Taxpayer is therefore not subject to tax under the utility classification. The sale of the gas to the customer is exempt under the City Tax Code. Even if the exemption did not apply, Taxpayer's sales were non-taxable sales for resale.

Tax Collector's Response

The tax under the utilities classification is imposed on the activity of providing or furnishing utility services, including electricity, electric lights, current, power, gas (natural or artificial), or water to consumers or ratepayers who reside within the City. Taxpayer provides or furnishes gas to its customer, who resides in Phoenix. Taxpayer is taxable under the utilities classification. Because Taxpayer is taxable under the utilities classification, the retail exemption does not apply. Taxpayer does not sell the gas for resale to another utility. The City's denial of the claim for refund and the additional assessment should be upheld.

Discussion

Taxpayer sells natural gas to large natural gas consuming customers including **Big Company ABC** (Customer) located in Phoenix, Arizona. The Customer uses the gas in its business of heat-treating metal. The primary issue in both the assessment and Taxpayer's claim for refund is whether Taxpayer's activity falls under the retail classification in Phoenix City Code (PCC) Section 14-460 or the utilities classification under PCC § 14-480.

If Taxpayer falls under the retail classification, then the question is whether Taxpayer's sales of gas to its Customer was exempt either as sale of income producing capital equipment or sales for resale. If Taxpayer falls under the utilities classification, then the question is whether Taxpayer's sales were exempt as sales for resale of utilities services. For the reasons that follow, we hold Taxpayer was subject to the City privilege tax under the utilities classification (PCC § 14-480) and uphold both the City's denial of Taxpayer's claim for refund and the assessment of additional tax and interest. We grant Taxpayer's request for penalty abatement.

PCC § 14-480 imposes the City privilege tax on the business activity of producing, providing, or furnishing utility services, including gas (natural or artificial) to consumers or ratepayers who reside within the City. PCC § 14-100 defines "utility services" as the producing, providing, or furnishing of electricity, electric lights, current, power, gas (natural or artificial), or water to consumers or ratepayers. The code does not define the terms "providing" or "furnishing". The definition of "providing" in Dictionary.com includes "to make available" or to "furnish." The definition of "furnishing" includes "to provide or supply."

Taxpayer arranges for and makes available the gas for its Customer. Taxpayer purchases natural gas out-of-state and the gas is transported to the Arizona border. At that point, Taxpayer has title to the gas. Taxpayer uses the El Paso Pipeline to transport the gas from the Arizona border to an interconnect point (Receipt point) located in Phoenix, Arizona. At the Receipt point title to the gas passes to the Customer and control and possession of the gas passes to **XYZ Gas Company (XYZ)** for transportation to the Customer's location (Delivery point). The gas is placed in a large pool at the Receipt point and comingled with gas belonging to others.

Based on the facts in the record, Taxpayer makes available or furnishes natural gas to the Customer.¹ The Customer resides within the City. Taxpayer purchases the gas needed by the Customer and provides the necessary quantity of gas for the Customer at the Receipt point. The gas is at that point available for transportation to and for use by the Customer. Taxpayer is thus clearly taxable under PCC § 14-480. Because Taxpayer is taxable under PCC § 14-480, it is not taxable under the retail classification. PCC § 14-460(c)(4).

Each customer of Taxpayer individually arranges with **XYZ** to have **XYZ** take possession of the gas at the Receipt point and transport the gas to the customer's location. **XYZ** thus has possession and control of the gas until it is delivered at the Customer's location.

¹ The record does not have a copy of the contract or agreement between Taxpayer and the Customer or between the Customer and **XYZ**. Taxpayer did submit selected portions of **XYZ**'s tariff with the Arizona Corporation Commission.

Taxpayer contends that since the gas is placed into a large pool of gas at the Receipt point and XYZ has control and possession of the gas, the Customer will not be receiving the same gas (the same molecules of gas) that Taxpayer had transferred at the Receipt point. Taxpayer therefore contends that Taxpayer is selling the gas to the Customer who then sells the gas to XYZ, paying money and gas to receive different molecules of gas at the Delivery point.

A sale is defined as a transfer of title or possession or both to tangible personal property for a consideration. There is nothing in the record to support Taxpayer's argument that XYZ paid the Customer any consideration to receive possession of the gas so it can transport the gas for the Customer. The Customer paid XYZ to transport the gas and gave XYZ possession of the gas so that the gas could be transported. The record does not disclose any authority for XYZ to exercise rights of ownership of the gas. Not all transfers of possession and control constitute a sale (e.g., transfer of possession for storage or repair.)

In addition, the fact that the Customer does not receive the same molecules of gas as were placed in the gas pool by Taxpayer is not legally relevant and does not change the nature of the transaction. Natural gas is fungible, each particle is identical with every other particle. The Customer has an amount of gas placed in the XYZ pool and the Customer is entitled to receive at its Delivery point a similar amount of gas.²

Arguments similar to Taxpayer's have been rejected by courts in other states. In *Sparks v. Louisville & Nashville Railroad Company*, 277 Ala. 25 166 So.2d 865 (1964) the question was whether transactions whereby a railroad by contract with independent contractors sent its journal bearings and wheels to a repairer by weight, and received identical but not the same repaired wheels or journal bearings from the contractor, was a repair transaction or a sale. The wheels and journal bearings were intermingled with other like items. The court held the intermingling was immaterial because the wheels and journal bearings were entirely fungible. The state therefore erroneously contended that the intermingling of wheels and journal bearings at the repair plant indicated a purchase or exchange of different wheels and bearings.

Mississippi State Tax Commission v. Columbia Gulf Transmission Company, 249 Miss. 88, 161 So.2d 173 (1964) and *Columbia Gulf Transmission Company v. Bridges*, 28 So.3d 1033 (2009) both involved the taxation of gas being transported by a gas pipeline for others. During the course of transportation, the pipeline company withdrew and used small amounts of gas to power compressors to keep the pipeline pressurized. This was agreed to among the parties. The courts held that there was a sale to the pipeline company of the gas it withdrew and used to power the compressors. There was no sale of gas to the pipeline company of the gas it was simply transporting.³

Finally even if the Customer were selling the gas to XYZ when the gas was provided to XYZ for transportation, Taxpayer's sale to the Customer would not be an exempt resale of utility services under PCC § 14-480(c). PCC § 14-480 (c) is limited to sales to another provider of the same utility service. Here the Customer is not "another provider of the same utility service."

² The Customer and XYZ make an accounting of any over and under estimates of the quantity of gas the Customer needs.

³ There was no indication in the record that XYZ withdrew any gas for its use.

Taxpayer also requested an abatement of the penalty included in the assessment. Taxpayer argues that it had a reasonable basis to believe that the tax did not apply because it had applied for a privilege tax license under the retail classification, had consistently paid tax under the retail classification and the only reason the Tax Collector reviewed Taxpayer was because Taxpayer filed a claim for refund. The penalty should therefore be abated.

The Tax Collector is authorized to assess penalties pursuant to PCC § 14-540. PCC § 14-540(f) sets out specific circumstances for penalty abatement and further provides that a taxpayer may request a waiver for a reason thought to be equally substantive to those listed. We believe the facts advanced by Taxpayer are sufficient to abate the penalty included in the assessment.

Based on the above, the Tax Collector's denial of Taxpayer's claim for refund for the period August 2008 through June 2011 and assessment of tax and interest for the period December 2008 through November 2012 are upheld. The penalty included in the assessment is abated.

Findings of Fact

1. Taxpayer is in the business of selling natural gas to its customers.
2. Taxpayer does not have gas facilities but arranges for the purchase of gas for its customers.
3. Taxpayer's Customer, **Big Company ABC**, is located in Phoenix Arizona.
4. Taxpayer is located in **Small Town ABC**, Arizona.
5. Taxpayer is not regulated by the Arizona Corporation Commission as a utility.
6. Taxpayer purchases natural gas out-of-state and takes title to the gas at the Arizona border.
7. Taxpayer uses the El Paso Pipeline to transport the gas from the Arizona border to an interconnect point (Receipt point) located in Phoenix, Arizona for sales to the Customer.
8. Title to the gas transfers from Taxpayer to the Customer at the Receipt point in Phoenix, Arizona.
9. Taxpayer testified that the **XYZ** Tariff is a specific contract between **XYZ** and its customers that governs **XYZ's** gas service.
10. Each customer of Taxpayer must individually arrange with **XYZ**, consistent with the **XYZ** tariff, to have **XYZ** take possession of the natural gas at the Receipt point.
11. The Customer transfers the gas it received from Taxpayer at the Receipt point to **XYZ**.
12. The gas is placed in a pool of gas and commingled with gas belonging to others.
13. The Customer is entitled to receive at its Delivery Point an amount of gas similar to the amount of gas put in the **XYZ** pool of gas.
14. The amount of gas the Customer put into the **XYZ** pool at the Receipt point would be a very minutely small portion of the total put into the system at any given time.
15. All the gas put into the **XYZ** pool gets commingled to such a degree that it would be almost impossible for even a small fraction of the Customer's "gas in" to actually be a part of the "gas out" at the Delivery Point (the Customer's location).

16. Taxpayer argued that because the gas XYZ delivered at that Delivery point was not the same molecules of gas put in the XYZ pool at the Receipt point, there was a trade or barter of gas.
17. Taxpayer Exhibit 2: XYZ Tariff; Sheet No. 67, ¶ 10 titled “Possession of Gas and Responsibility” provides in part:

As between the Utility and the customer, the customer shall be deemed to be in control and possession of the gas until it has been delivered to the Utility for transportation at the Receipt Point. The Utility shall thereupon be deemed to be in control and possession of the gas until the gas shall have been delivered to the customer at the Delivery Point(s), after which the customer shall be deemed to be in control and possession. The customer shall have no responsibility with respect to any gas after it has been delivered to the Utility at the Receipt Point on account of anything which may be done, happen or arise with respect to said gas, until said gas is delivered to the customer at the Deliver Point(s).
18. Taxpayer Exhibit 2: XYZ Tariff; Sheet No. 68, ¶ 11 “Warranty of Title” provides in part:

The Utility accepts the customer’s gas at the Receipt Point subject to the understanding that the customer warrants that it will, at the time of delivery of gas to the Utility for transportation, have good title to all gas so delivered to the Utility free and clear of all liens, encumbrances and claims whatsoever, that it will at such time of delivery have the right to deliver such gas to the Utility and that it will indemnify the Utility and hold the Utility harmless from all adverse claims of any and all persons to such gas.
19. Taxpayer had submitted a privilege tax license application to the City indicating it was taxable under the retail classification.
20. Taxpayer believed its activities fell under the retail classification.
21. Taxpayer had been paying the City privilege tax on its sales to the Customer under the retail classification.
22. Taxpayer believed its sales to the Customer were excluded from tax under the retail classification as sales of income producing capital equipment. Taxpayer therefore filed a claim for refund for the taxes it had paid on its sales of gas to the Customer.
23. The Tax Collector reviewed Taxpayer’s claim for refund and concluded Taxpayer was taxable under the utilities classification and denied Taxpayer’s claim for refund.
24. The tax rate under the utilities classification is higher than the tax rate under the retail classification. The Tax Collector issued an assessment for the difference in the tax rates.
25. Taxpayer timely protested both the denial of the claim for refund and the assessment arguing that it was not taxable under the utilities classification and its transaction with the Customer was exempt under the retail classification.

Conclusions of Law

1. PCC § 14-460(a) imposes the City privilege tax at the rate of two percent on every person engaging or continuing in the business of selling tangible personal property at retail.
2. The tax on sales of tangible personal property does not apply to the transfer of tangible personal property which is specifically included as the gross income of a business activity

- upon which another section of the tax code imposes a tax and the activity will be considered gross income from that other business activity. PCC § 14-460(c)(4).
3. PCC § 14-480 imposes the City privilege tax at the rate of 2.7% on the business activity of producing, providing, or furnishing utility services, including electricity, electric lights, current, power, gas (natural or artificial), or water to consumers or ratepayers who reside within the City.
 4. "Utility Service" means the producing, providing, or furnishing of electricity, electric lights, current, power, gas (natural or artificial), or water to consumers or ratepayers. PCC § 14-100.
 5. Taxpayer furnishes gas to a consumer in the City. Taxpayer is subject to the City privilege tax under PCC § 14-480 for its sales of gas.
 6. Because Taxpayer is subject to tax under PCC § 14-480, Taxpayer is not subject to tax under the retail classification. PCC § 14-460(c)(4).
 7. Sales of utility services to another provider of the same utility services for the purpose of providing such utility services either to another properly licensed utility provider or directly to such purchaser's customers or ratepayers shall be exempt and deductible from the gross income subject to the tax imposed by PCC § 14-480, provided that the purchaser is properly licensed by all applicable taxing jurisdictions to engage or continue in the business of providing utility services, and further provided that the seller maintains proper documentation, in a manner similar to that for sales for resale, of such transactions. PCC § 14-480(c).
 8. The Customer did not provide utility services within the meaning of PCC § 14-480(c).
 9. "Sale" means any transfer of title or possession, or both, exchange, barter, conditional or otherwise, in any manner or by any means whatsoever, including consignment transactions and auctions, of property for a consideration. PCC § 14-100.
 10. The intermingling of fungible items of personal property with other similar items does not indicate a purchase or exchange of different items of personal property. *See, Sparks v. Louisville & Nashville Railroad Company, supra.*
 11. In a sale of personal property which is part of a specific mass involving identical units, title to the part sold may pass upon delivery, apart from any separation or segregation of the portion sold from the part not sold, provided the parties so intend. *Mississippi State Tax Commission v. Columbia Gulf Transmission Company, supra.*
 12. The term 'fungible goods' defines goods of which each particle is identical with every other particle, such as grain and oil. 1 Williston, Sales (rev. ed. 1948), Secs. 155-159; *Mississippi State Tax Commission v. Columbia Gulf Transmission Company, supra.*
 13. The transfers of fungible natural gas do not involve the exchange of one commodity for another commodity or thing and therefore did not constitute a barter or an exchange. *Columbia Gulf Transmission Company v. Bridges, supra.*
 14. XYZ was hired to transport the Customer's gas from the Receipt point to the Delivery point, the Customer's location.
 15. The deductions and exclusions provided by PCC §§ 14-460 and 14-465 do not apply to the privilege tax under the utilities classification under PCC § 14-480.

16. *XYZ* was not shown to have paid a consideration to Taxpayer's Customer for the transfer of the gas or shown to have any authority to exercise rights of ownership of the gas it was transporting for the Customer.
17. The Customer's transfer of the gas to *XYZ* for purposes of delivering the gas to the Customer at the Delivery point was not a transfer of possession of the gas for a consideration.
18. The Customer did not sell the gas to *XYZ* when the gas was transferred into *XYZ*'s pool of gas to be delivered to the Customer.
19. The transfer of control and possession of the gas to *XYZ* was necessary for its transportation. The transfer of control and possession of the gas for transportation purposes is not the type of transfer contemplated by the definition of "sale" in PCC § 14-100. *See, Columbia Gulf Transmission Company v. Bridges, supra.*
20. Taxpayer was subject to the City privilege tax under PCC § 14-480 for furnishing natural gas to its Customer.
21. The penalty for failure to pay tax may be waived if the taxpayer can demonstrate reasonable cause for its failure to pay the tax. PCC § 14-540.
22. Taxpayer demonstrated reasonable cause for its failure to pay the tax that was assessed.
23. The City's denial of Taxpayer's claim for refund is upheld.
24. The City's proposed assessment is upheld in part. The Tax Collector shall abate the penalties included in the assessment.

Ruling

The protest by Taxpayer of the City's denial of its claim for refund for the period August 2008 through June 2011 is denied.

The protest by Taxpayer of the City's assessment for the period December 2008 through November 2012 is upheld in part and denied in part. The Tax Collector shall abate the penalties included in the assessment.

The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

Sincerely,

Hearing Officer

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c: ***Assistant City Attorney***
Municipal Tax Hearing Office