Cite as Det No. 09-0361E, 29 WTD 44 (2010)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Letter Ruling of	)	FINAL EXEC LEVEL DETERMINATION
. . .	)	No. 09-0361E
	)	Registration No. . . .

RULE 17902; RCW 82.12.022(2): BROKERED NATURAL GAS USE TAX – VALUE OF ARTICLE USED – MEASURE – TRANSPORTATION SERVICES – RESERVATION CHARGE. An additional charge paid to a pipeline to reserve pipeline capacity is part of the price paid to a pipeline for gas transportation services and must be included in the measure of the brokered natural gas use tax in accordance with WAC 458-20-17902.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

DIRECTOR'S DESIGNEE:
Mary C. Barrett, Assistant Director of Appeals Division

Okimoto, A.L.J. – A consumer of natural gas appeals a Taxpayer Information and Education (TI&E) letter ruling that brokered natural gas use tax is due on amounts paid to an interstate pipeline for reserving pipeline capacity (demand/reservation charge). We rule that the demand/reservation charge is part of the amount paid to Pipeline for gas transportation services and must be included in the measure of the brokered natural gas use tax in accordance with WAC 458-20-17902 (Rule 17902).[1]

ISSUES

1) Under Rule 17902, must monthly pipeline demand/reservation charges be included in the measure of the brokered natural gas use tax?

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

2) Did the Department exceed its authority in enacting Rule 17902?

FINDINGS OF FACT

[Taxpayer] operates a natural gas electricity generation plant in . . . Washington. Taxpayer purchases natural gas that it consumes from various out-of-state suppliers and contracts with [Pipeline] for gas transportation services. Pipeline transports Taxpayer's gas from a point outside the state of Washington. . . . Taxpayer pays brokered natural gas use tax on the natural gas consumed in Washington under RCW 82.12.022 and WAC 458-20-17902.

On May 8, 2008, Taxpayer submitted a letter ruling request to TI&E asking whether monthly demand/reservation charges paid to Pipeline for reserving pipeline capacity had to be included in the measure of brokered natural gas use tax paid on the natural gas consumed at its . . . plant.

TI&E stated the facts upon which its letter ruling was based as follows:

> Facts Provided
>
> [Taxpayer] used natural gas in Washington, purchasing it from a company other than a Washington utility and transporting it into the state through a pipeline . . . . Taxpayer pays [brokered natural gas] use tax on the natural gas under Revised Code of Washington (RCW) 82.12.022.
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> In exchange for the right to use the pipeline, Taxpayer pays amounts to [Pipeline] per a published schedule of tariffs. These amounts include a monthly transportation contract demand charge (also known as a reservation charge) and a volumetric charge for actual natural gas transportation.
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> . . . The monthly demand charge is paid regardless of whether any gas transportation service is actually provided to Taxpayer for a particular day or month and does not vary based on the actual volume of natural gas transported. The demand charge reserves a guaranteed right to transport a specified volume of gas on each day.
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> When natural gas is transported to Taxpayer's Washington location, Taxpayer pays a volumetric charge to Pipeline. This is a separate and distinct charge from the demand charge and is based on the actual volume transported by Taxpayer. (Footnote and bracketed material added.)

TI&E Letter Ruling . . . .

Based on these facts, TI&E ruled that the monthly demand/reservation charge in addition to the volumetric-based transportation charge had to be included in the measure of brokered natural gas use tax due on natural gas consumed by Taxpayer . . . . TI&E treated the demand charge as

being part of the purchase price of the gas and therefore required to be included in the value of the article used (natural gas).

Taxpayer timely appealed the TI&E ruling to the Department's Appeals Division and made the following arguments as to why the demand charges should not be included in the value of natural gas consumed at its plant.

> a) Demand charges do not relate to "use" of natural gas. Demand charges only guarantee Taxpayer the right to transport a specified volume of gas through the pipeline during a specified month.
> b) Demand charges are not part of the "purchase price" of the natural gas.
> c) The demand charges include amounts attributable to non-Washington use because some of the natural gas is transported through the pipeline and used outside the state of Washington.

Taxpayer argued in the alternative that the demand/reservation charges should be included in the measure of use taxes due for only those days during which Taxpayer actually shipped natural gas into the state.

ANALYSIS

TI&E concluded in its letter ruling that the monthly demand/reservation charges paid by Taxpayer to the pipeline to reserve daily pipeline capacity were part of the purchase price of the natural gas and therefore had to be included in the measure of use taxes paid. Although we agree with TI&E's conclusion that demand/reservation charges generally must be included in the measure of use taxes paid on natural gas consumed at Taxpayer's . . . plant, our analysis differs in part from TI&E's reasoning.

RCW 82.12.022[2] imposes a brokered natural gas use tax for the privilege of using natural gas purchased and transported via pipeline to a consumer in Washington. It provides:

> (1) There is hereby levied and there shall be collected from every person in this state a use tax for the privilege of using natural gas or manufactured gas within this state as a consumer.
>
> (2) The tax shall be levied and collected in an amount equal to the value of the article used by the taxpayer multiplied by the rate in effect for the public utility tax on gas distribution businesses under RCW 82.16.020. The "value of the article used" does not include any amounts that are paid for the hire or use of a gas distribution business as defined in RCW 82.16.010(7) in transporting the gas subject to tax under this subsection if those amounts are subject to tax under that chapter.

[2] RCW 82.14.230 imposes a similar local use tax.

> (3) The tax levied in this section shall not apply to the use of natural or manufactured gas delivered to the consumer by other means than through a pipeline.

RCW 82.12.022(2) provides that the measure of the brokered natural gas use tax is to be computed based on "the value of the article used by the taxpayer." RCW 82.12.010(2) defines the term "value of the article used."

> (2)(a) "Value of the article used" shall be the purchase price for the article of tangible personal property, the use of which is taxable under this chapter. The term also includes, in addition to the purchase price, the amount of any tariff or duty paid with respect to the importation of the article used. In case the article used is acquired by lease or by gift or is extracted, produced, or manufactured by the person using the same or is sold under conditions wherein the purchase price does not represent the true value thereof, the value of the article used shall be determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character **under such rules as the department may prescribe**.

(Underlining and bolding added.)

Pursuant to the authority conveyed in RCW 82.12.010(2)(a) and RCW 82.12.022(9), the Department promulgated WAC 458-20-17902 (Rule 17902) dealing with the brokered natural gas use tax. In its interpretation of RCW 82.12.022(9), Rule 17902 uses a new definition of "value of gas consumed or used" that is specifically applicable to the measure of the brokered natural gas use tax imposed under RCW 82.12.022.

Rule 17902(2)(b) defines "value of gas consumed or used" and states:

> (b) "Value of gas consumed or used" means the purchasing price of the gas to the consumer and generally must include all or part of the transportation charges as explained later.

Thus, with certain exceptions, Rule 17902 provides that transportation charges are to be included in the value of gas consumed or used and must be included in the measure of the brokered natural gas use tax. We disagree with Taxpayer's assertion that the measure of brokered natural gas use tax is limited to the purchase price paid by Taxpayer to the out-of-state natural gas supplier. We note that Rule 17902 clearly provides otherwise.

Next, we disagree with Taxpayer's assertion that Rule 17902(2)(b) is invalid because it goes beyond the scope of the use tax imposition statute. When determining the validity of agency rules, the Washington Supreme Court has stated:

> The party challenging a rule has the burden to prove it is invalid. RCW 34.05.570(1)(a); Wash. Pub. Ports Ass'n v. Dep't of Revenue, 148 Wash.2d 637, 645, 62 P.3d 462 (2003). "This court may declare an agency rule invalid if it: (1) violates constitutional provisions,

> (2) exceeds statutory authority of the agency, (3) was adopted without compliance to statutory rule-making procedures, or (4) is arbitrary and capricious." *Id.* at 645, 62 P.3d 462 (citing RCW 34.05.570(2)(c)). "Determining the extent of DOR's rule-making authority is a question of law" which is reviewed de novo. Id.

Ass'n of Washington Bus. v. Dep't of Revenue, 155 Wn. 2d 430, 437~~;~~, 120 P. 3d 46 (2005).

In this case, Taxpayer does not contend that Rule 17902 violates constitutional provisions or that it was adopted without compliance with statutory rule-making procedures. Instead, Taxpayer relies on the remaining two grounds for invalidating an agency rule, that Rule 17902 exceeds the statutory authority of the agency or that it is arbitrary and capricious. We disagree with both arguments.

First, Rule 17902 is wholly within the rule-making authority granted to the Department by the Washington State Legislature. RCW 82.12.022(9) specifically authorizes the Department to adopt rules covering the administration and enforcement of use taxes imposed on natural or manufactured gas. In addition, RCW 82.12.010(2)(a) also authorizes the Department to promulgate rules for determining the "value of the article used" when such article is sold under conditions wherein the purchase price does not represent the true value of the article used. Rule 17902 recognizes that natural gas purchased from an out-of-state supplier is sold under such conditions. This is because the out-of-state purchase price does not reflect the true value of the natural gas in Washington as it fails to include the pipeline transportation costs necessary to move the natural gas from a supplier's out-of-state location to the consumers' place of use in Washington. The legislature authorized the Department to address conditions when the true value of the natural gas is not reflected in its purchase price. In addition, the Department's need to address transportation costs in Rule 17902 was to ensure "an equality of taxation between interstate and intrastate transactions" as instructed by RCW 82.12.022. Therefore, we conclude that the Department promulgated Rule 17902 within its statutory authority.

Furthermore:

> When an agency acts within its authority, a rule is presumed to be valid and, therefore, the "burden of demonstrating the invalidity of agency action is on the party asserting the invalidity." RCW 34.05.570(1)(a). The party asserting the invalidity must show compelling reasons why the rule conflicts with the intent and purpose of the legislation. *Weyerhaeuser Co. v. Dep't of Ecology*, 86 Wash.2d 310, 317, 545 P.2d 5 (1976). Any rule that is "reasonably consistent" with the underlying statute should be upheld. *Green River Comty. Coll.*, 95 Wash.2d at 112, 622 P.2d 826.

Washington Fed'n of State Employees v. Dep't of Gen. Admin., 152 Wn. App. 368, 216 P.3d 1061, 1066-7 (2009).

> A rule is arbitrary and capricious "if it is willful and unreasoning and taken without regard to the attending facts or circumstances." *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wash.2d 887, 905, 64 P.3d 606 (2003). If "there is room for two

> opinions, an action taken after due consideration is not arbitrary and capricious." *Hillis v. Dep't of Ecology*, 131 Wash.2d 373, 383, 932 P.2d 139 (1997).

D.W. Close Co., Inc. v. Dep't of Labor & Indus., 143 Wn. App. 118, 130, 177 P.3d 143 (2008).

In this case, Rule 17902 is entirely consistent with RCW 82.12.022's stated legislative intent and purpose. Prior to 1985 a Washington consumer of natural gas was required by Federal Energy Regulatory Commission (FERC) rules to purchase all natural gas from an in-state gas distribution company. The gas distribution business recovered from the consumer its cost of the gas plus transportation costs and paid public utility tax on its gross income. RCW 82.16.020(c). In 1985 FERC enacted Order No. 436 (50 Fed. Reg. 42408), allowing consumers to purchase gas directly from out-of-state producers or brokers and to contract with interstate pipelines for transportation into the state. *See* Det. No. 02-0106, 24 WTD 115, 116 n.2 (2005).

In response to the anticipated loss of public utility tax revenue by cities caused by the revised FERC regulations, the Washington State Legislature enacted RCW 82.12.022. The intent section of RCW 82.12.022 explains its purpose:

> Due to a change in the federal regulations governing the sale of brokered natural gas, cities have lost significant revenues from the utility tax on natural gas. It is therefore the intent of the legislature to adjust the utility and use tax authority of the state and cities to maintain this revenue source for the municipalities and provide equality of taxation between intrastate and interstate transactions.

Significant in this section is the clearly stated intent of the Legislature to "provide equality of taxation between intrastate and interstate transactions." To accomplish this goal, both the tax rates and tax measure should be equal. For intrastate transactions, the tax measure for gas distribution companies included both the costs of the natural gas and also their related transportation costs. Consequently, in order to provide equality of taxation, the tax measure of interstate transactions must similarly include both the cost of the natural gas and also their related transportation costs. The intent of the legislature to maintain an equal tax burden on both intrastate and interstate natural gas transactions is also reflected in RCW 82.12.022(2), which provides in part:

> The 'value of the article used' does not include any amounts that are paid for the hire or use of a gas distribution business as defined in RCW 82.16.010(7) in transporting the gas subject to tax under this subsection if those amounts are subject to tax under that chapter.

We note that this language allows transportation charges to be excluded from the measure of brokered natural gas use tax when they have been subjected to Washington's public utility taxes. This language would be meaningless if the measure of the brokered natural gas use tax did not include transportation charges. In interpreting and construing a statute, we must give effect to all of the language rendering no portion meaningless or superfluous. *City of Seattle, v. State*, 136 Wn.2d 693, 965 P. 2d 619 (1998). Because we conclude that the Department promulgated Rule 17902 within its statutory authority and Rule 17902 is "reasonably consistent" with the purpose

and intent of RCW 82.12.022, we find no merit in Taxpayer's claim that Rule 17902 exceeds the scope of the Department's authority.

Next, although Taxpayer argues that the monthly demand/reservation charge is not paid for transporting its natural gas into Washington, we cannot agree. [The] Contract . . . between . . . Pipeline and [Taxpayer] explains the terms and conditions covering Taxpayer's purchase of pipeline transportation services from Pipeline [and] provides in pertinent part:

> Shipper [Taxpayer] agrees to pay Transporter [Pipeline] for all natural gas transportation service rendered under the terms of this Agreement in accordance with Transporter's [Pipeline's] Rate Schedule . . . filed with the FERC, and as such rate schedule may be amended or superseded from time to time. . . .
>
> The Agreement shall be subject to the provisions of **such Rate Schedule** and the General Terms and Conditions applicable thereto . . . **which by reference are incorporated herein** and made a part hereof.

(Underlining and bolding added.)

[Thus] Taxpayer's natural gas transportation service contract with Pipeline incorporates by reference Pipeline's Rate Schedule . . . into the terms of its transportation contract. Consequently, the amounts paid and transportation services received by Taxpayer from Pipeline are more fully explained in the tariffs filed by Pipeline with [FERC]. The tariff under which Taxpayer pays Pipeline for natural gas pipeline transportation services describes the price paid for the service

After reviewing the tariff filed by Pipeline with FERC, we conclude that the amount paid by Taxpayer for "Firm Transportation" services of natural gas through Pipeline's main transmission system is the sum of several different charges, two of which are the Reservation Charge and the Volumetric Charge. #3.1 and 3.2. The individual charges are essentially individual components of a single natural gas transmission service provided by Pipeline to Taxpayer. Under these circumstances, Taxpayer may not separate the Reservation Charge from the Volumetric Charge or any other charge. The Department does not allow a taxpayer to separate into individually-taxed separate charges, what is essentially a single service or activity.[3] Det. No. 04-0022E, 23 WTD 198 (2004). Therefore, we conclude that the monthly demand/reservation charge that Taxpayer pays to Pipeline to reserve daily pipeline capacity is simply one part of the total transportation charge paid to Pipeline for natural gas transportation services. Taxpayer must include these demand/reservation charges in the measure of use taxes due on natural gas consumed in Washington in the same manner as other transportation charges.

[3]Taxpayer relies on Det. No. 89-426, 8 WTD 165 (1989) for the proposition that membership fees that entitle a member "the mere opportunity" to buy goods and services are separately taxed from the sale of the goods and services. Taxpayer's case is easily distinguished, since, in contrast to 8 WTD 165, Taxpayer's case involves a published tariff that specifically includes reservation charges as part of the total charge for the transportation services rendered.

Rule 17902(6) explains how transportation charges are treated in determining the value of gas consumed or used. It provides:

> (6) Transportation charges.
>
> (a) If all or part of the transportation charges for the delivery of the brokered natural gas are separately subject to the state's and cities' public utility taxes (RCW 82.16.020 (1)(c) and RCW 35.21.870), those transportation charges are excluded from measure of the use tax. The transportation charges not subject to the public utility taxes are included in the value of the gas consumed or used.
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> (b) Examples. The following examples identify a number of facts and then state a conclusion. These examples should be used only as a general guide. In actual practice, the tax status of a situation must be determined after a review of all of the facts and circumstances.
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> (i) Public university purchases natural gas from an out of the state source through a broker. The natural gas is delivered by interstate pipeline to the local gas distribution system who delivers it to the university. The university pays the supplier for the gas, the pipeline for the interstate transportation charge, and the gas distribution system for its local transportation charge. The transportation charge by the pipeline is not subject to public utility tax because it is an interstate transportation charge. The transportation charge paid to the local gas distribution system is subject to the public utility taxes as an intrastate delivery. The value of the gas consumed or used is the purchase price paid to the supplier plus the transportation charge paid to pipeline company.
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> (ii) The above factual situation applies except that the natural gas is delivered directly by the interstate pipeline to the university. The university pays the supplier for the gas and the pipeline for the transportation charge. As the transportation charge is not subject to the public utility tax, it will be included in the measure of the tax. The value of the gas consumed or used is the purchase price plus the transportation charge paid to the pipeline.

In this case, Taxpayer stated during the hearing and in its original ruling request that the pipeline transportation services used to transport its natural gas into the state were interstate in nature and not subject to Washington's public utility taxes.[4] Therefore, Rule 17902(6)(a) requires that the transportation charges be included in the value of the gas consumed or used.

[4] …[I]f the pipeline transportation services purchased by Taxpayer were wholly intrastate and therefore subject to Washington public utility tax, Rule 17902(6)(a) allows the transportation charges to be excluded from the measure of use tax. We note, however, that for purposes of reviewing TI&E letter rulings, we limit our analysis to the information available to TI&E. Therefore, we do not independently verify facts provided by taxpayers in letter ruling requests.

Next, Taxpayer states that even if the Department rules that the demand/reservation charge is part of the transportation charge of the natural gas, the monthly demand/reservation charge should only be included in the value of natural gas consumed on those days that Taxpayer actually transported natural gas into the state.

Although Taxpayer characterizes the charges paid on days during which it does not transport natural gas into the state as unused demand/reservation charges, we disagree with that characterization.

We have examined Taxpayer's contract with Pipeline and find no provision overruling this section of the tariff in Taxpayer's contract. Therefore, we conclude that during those days during which Taxpayer does not transport natural gas into the state, the Reservation Charge specified in Section 3.1 constitutes a "Minimum Monthly Bill" for all transportation services rendered during the entire month and not an unused demand/reservation charge. We conclude that the entire monthly demand/reservation charge (including days where no gas is transported) must be treated as a transportation charge in accordance with Rule 17902.

Finally, Taxpayer states that some of the natural gas transported through the pipeline is subsequently consumed outside the state of Washington. Taxpayer argues that demand/reservation charges attributable to gas consumed outside the state should not be included in the measure of use taxes paid on natural gas consumed in Washington. In this case, we note that RCW 82.12.022 only imposes a use tax for the privilege of using natural gas within this state as a consumer. Therefore, to the extent that demand/reservation or other charges are attributable to transporting natural gas used or consumed outside the state of Washington, we agree that those charges may be excluded from the measure of use taxes due on natural gas consumed in Washington. Taxpayer will be required to keep and maintain adequate records to document any charges excluded, however. WAC 458-20-254.

DECISION AND DISPOSITION

Taxpayer's petition for correction of TI&E letter ruling is denied.

Dated this 4th day of January 2010.