Cite as Det. No. 02-0106, 24 WTD 115 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 02-0106
	)	
. . .	)	Registration No. . . .
	)	Docket No. . . .
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	)	

[1] RULE 17902; RCW 82.12.022, RCW 82.14.230: USE TAX ON NATURAL OR MANUFACTURERED GAS – COMMERCE AND EQUAL PROTECTION CLAUSES. Washington's use tax on brokered natural gas does not discriminate against interstate commerce and does not deny equal protection to persons who buy natural gas from unregulated distributors operating outside Washington rather than from regulated distributors operating in Washington.

[2] RULE 17902; RCW 82.12.022, RCW 82.14.030, RCW 82.16.020: USE TAX ON NATURAL OR MANUFACTURED GAS – CREDITS. Washington's use tax on brokered natural gas is properly apportioned and internally consistent by providing credits for gross receipts taxes similar to those imposed by RCW 82.16.020 and for use taxes similar to the one imposed by RCW 82.12.022 that are paid to other states.

[3] RULE 17902; RCW 82.12.022, RCW 82.14.030, RCW 82.16.020: USE TAX ON NATURAL OR MANUFACTURED GAS – CREDITS. RCW 82.12.022 provides credits for taxes paid to other states similar to the ones imposed by RCW 82.16.020 and RCW 82.12.022. The law is clear what types of taxes qualify for the credits. Such taxes do not include income taxes and severance taxes.

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.

NATURE OF ACTION:

A consumer of brokered natural gas seeks a refund of use taxes it paid on the gas it purchased from out-of-state vendors and consumed in Washington.[1]

FACTS:

De Luca, A.L.J. -- The taxpayer owns and operates a pulp and paper mill in Washington. To operate the mill, the taxpayer uses large quantities of natural gas. At the time the taxpayer purchased the mill and for some time afterwards, the taxpayer purchased its natural gas from a natural gas company regulated by the Washington Utilities and Transportation Commission (WUTC). Due to federal deregulation of the natural gas market, the taxpayer began by the late 1980's to purchase its natural gas from out-of-state vendors that were brokers or producers of natural gas.[2] These types of sales are commonly referred to as "brokered natural gas" sales. These out-of-state vendors/brokers were not public utilities regulated by the WUTC and they did not pay to Washington the public utility tax imposed by RCW 82.16.020 on persons engaged in the gas distribution business. Due to the federal deregulation, the state of Washington and its cities were losing tax revenue from sales of natural gas by the out-of-state vendors. Similar revenue losses occurred in other states as well. In response, the Washington legislature in 1990 imposed a use tax (RCW 82.12.022 (state) and RCW 82.14.230 (local)) on consumers of natural gas in Washington when the seller of the natural gas did not pay the public utility tax under RCW 82.16.020, *infra*

Since the enactment of RCW 82.12.022, the taxpayer has paid the both the state and local components of the use tax on the natural gas it consumed in Washington. The taxpayer timely filed a refund claim with the Department of Revenue (the Department) for the use tax it paid from January 1, 1992 through December 31, 1995, and during the pendency of this claim.

TAXPAYER'S EXCEPTIONS:

The taxpayer makes the following arguments against the use tax imposed on the consumption of brokered natural gas.

1. The taxpayer contends the use tax on brokered natural gas violates the Commerce Clause (U.S. Const. art I. § 1, cl 1) and the Equal Protection Clause (U.S. Const. amend. XIV, § 2) of the United States Constitution. The taxpayer argues the use tax is facially discriminatory against interstate commerce because consumers who buy natural gas from

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

[2] Deregulation began when Congress passed the Natural Gas Policy Act of 1978, *see* 15 USC § 3301, et seq. Prior to 1985 the taxpayer was required by Federal Energy Regulatory Commission (FERC) rules to purchase all natural gas from in-state gas distribution companies. In 1985 FERC enacted Order No. 436 (50 Fed. Reg. 42408), allowing purchases from out-of-state producers or brokers.

distributors/vendors operating in Washington are exempt from the use tax, but consumers who buy their natural gas from distributors/vendors operating outside Washington are not exempt from the use tax.

2. The taxpayer recognizes RCW 82.12.022 (state) and RCW 82.14.230 (local) provide a credit against the use tax in the amount of any tax paid by a seller or distributor of natural gas to any other state, if that tax is a gross receipts tax similar to the tax imposed by RCW 82.16.020. However, the taxpayer contends the credit is merely a "myth" because other states cannot impose a tax on the distribution of gas within Washington. The taxpayer cites *Tennessee Gas Pipeline v. Urbach*, 96 N.Y.2d 124, 750 N.E.2d 52; 726 N.Y.S.2d 350 (2001) and *Tug Buster Bouchard Corp. v. Wetzler*, 217 A.D.2d 192; 636 N.Y.S.2d 803 (N.Y. App.Div.1996), *aff'd* 89 N.Y.2d 830, 675 N.E.2d 1223, 653 N.Y.S.2d 271 (1996) to support its argument that the lack of a meaningful credit results in a lack of internal consistency in the tax, making it mal-apportioned and a burden on interstate commerce.

3. The taxpayer claims if the use tax on brokered natural gas is valid, then the taxpayer should receive a credit against the income taxes, severance taxes, and similar excise taxes levied by other states upon the price received by the vendors/distributors from the sales of gas for consumption in Washington.

ISSUES:

1. Do the brokered natural gas statutes, RCW 82.12.022 and RCW 82.14.230, violate the Commerce Clause and Equal Protection Clause of the U.S. Constitution?

2. Are the same statutes mal-apportioned and a burden on interstate commerce because they lack effective credits against taxes similar to those imposed by RCW 82.16.020 and paid to other states for the sale or distribution of natural gas that is consumed in Washington?

3. Is the taxpayer entitled to credit against the use taxes for income taxes, severance taxes, and similar excise taxes levied by other states upon the price received by the vendors/distributors from the sales of natural gas consumed in Washington?

DISCUSSION:

[1] We first note an administrative body does not have the authority to declare the statutes it administers to be unconstitutional; only the courts have that power. *Bare v. Gorton*, 84 Wn. 2d 380, 526 P.2d 379 (1975). However, we will provide reasons below why we conclude RCW 82.12.022 is valid [as applied] and not in violation of the Commerce Clause or the Equal Protection Clause.[3] RCW 82.12.022 provides in pertinent part:

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[3] Because the governing use tax statutes, RCW 82.12.022 (state) and RCW 82.14.230 (local), are very similarly worded we will reference only RCW 82.12.022 to simplify our discussion.

> **Natural or manufactured gas--Use tax imposed--Exemption.** (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.
>
> . . .
>
> (4) The tax levied in this section shall not apply to the use of natural or manufactured gas if the person who sold the gas to the consumer has paid a tax under RCW 82.16.020 with respect to the gas for which exemption is sought under this subsection.
>
> (5) There shall be a credit against the tax levied under this section in an amount equal to any tax paid by:
>
> (a) The person who sold the gas to the consumer when that tax is a gross receipts tax similar to that imposed pursuant to RCW 82.16.020 by another state with respect to the gas for which a credit is sought under this subsection; or
>
> (b) The person consuming the gas upon which a use tax similar to the tax imposed by this section was paid to another state with respect to the gas for which a credit is sought under this subsection.
>
> (6) The use tax hereby imposed shall be paid by the consumer to the department.

See also WAC 458-20-17902 (Rule 17902).

The taxpayer, as the consumer, paid the use tax on the natural gas because its out-of-state vendors did not pay either the public utility tax under RCW 82.16.020 or, to another state, a gross receipts tax similar to that imposed by RCW 82.16.020. Likewise, the taxpayer did not pay a use tax to another state similar to the tax imposed by RCW 82.12.022.

In a case similar to the present one, *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997), General Motors was the consumer of natural gas in Ohio that it purchased from out-of-state independent marketers rather than public utility companies regulated by Ohio. Under Ohio law, purchases of natural gas from state-regulated utilities are exempt from sales tax and use tax, but purchases of natural gas from the non-regulated vendors are subject to sales tax or use tax. General Motors argued the Ohio tax scheme was facially discriminatory and violated the Commerce Clause and Equal Protection Clause of the U.S. Constitution.

The United States Supreme Court sustained the Ohio tax scheme and ruled it did not violate either of the constitutional clauses. 519 U.S. 310-12. The Supreme Court explained the Ohio law did not violate the Commerce Clause because the Court and Congress had long recognized the value of state-regulated monopoly arrangements for natural gas sales and distribution directly to local consumers. 519 U.S. at 290-94. The Court further declared it had an obligation to proceed cautiously in examining the Ohio law to avoid imperiling the regulated companies' ability to deliver gas to their noncompetitive captive market. 519 U.S. at 304. "Prudence thus counsels against running the risk of weakening or destroying a regulatory scheme of public service and protection recognized by Congress despite its noncompetitive, monopolistic character." 519 U.S. at 309. The Court described the noncompetitive captive market as the vast majority of consumers who had neither the capacity to buy natural gas on the interstate market nor the resilience to forgo the reliability and protection that state regulation provided. 519 U.S. at 294.

The Court also explained that any notion of discrimination under the Commerce Clause assumes a comparison of substantially similar entities. 519 U.S. at 298-99. The Court found the regulated public utilities served a different market than the non-regulated independent vendors. 519 U.S. at 297-98 and 304. On the one hand, the regulated utilities bundled their products to meet the demand of a core market that is typified by residential customers to whom stability of rate and supply is important. The Court stressed that even if it were to remove the supposedly discriminatory burden that General Motors claimed the Ohio law created between the different types of natural gas vendors, competition would not have been served because the residential market is not susceptible to competition by the interstate vendors. The Court found such a captive market is not likely to be served except by the regulated natural monopolies that have historically supplied its needs. 519 U.S. at 303.

On the other hand, the Court explained, eliminating the tax differential might intensify the competition between the regulated utility companies and the independent marketers for the non-captive market of bulk buyers like General Motors, which have no need for the protection offered by regulation. However, the Court expressed its strong reluctance to take such action for fear of jeopardizing service to the state-regulated captive market of residential consumers. 519 U.S. at 303-09. In sum, the Court held regulated utilities and their singular role in serving their captive markets were so distinct from the independent marketers and their bulk buyers that it would treat the two types of vendors dissimilarly for Commerce Clause purposes. Without substantially similar entities, there was no facial discrimination against interstate commerce. 519 U.S. at 310.

Finally, the Supreme Court ruled the Ohio tax scheme that distinguishes the two different types of entities selling natural gas did not violate the Equal Protection Clause because "state classifications require only a rational basis to satisfy the Equal Protection Clause." The Court emphasized "'in taxation, even more than in other fields, legislatures possess the greatest freedom in classification.' [citation omitted]" The Court concluded "and in any event, there is unquestionably a rational basis for Ohio's distinction between these two kinds of entities." 519 U.S. at 311-12.

We find the Supreme Court's reasoning in *General Motors* applicable in the present matter. RCW 82.12.022 does not discriminate against interstate commerce, facially or otherwise. As explained in that case, we find the taxpayer's interstate vendors are not substantially similar to gas companies regulated by the WUTC pursuant to RCW 80.04.010-.520 and RCW 80.28.010-.260. . . .

Likewise, RCW 82.12.022 does not violate the Equal Protection Clause because, as explained in *General Motors,* there is a rational basis for the state of Washington to distinguish between the different kinds of entities selling natural gas to their respective, but very different markets. We further note the legislature's rationale in enacting RCW 82.12.022 when it added the following comment to the statute:

> 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.

Indeed, we believe the basis of the Washington taxes on the distribution of natural gas to be as rational, if not more, than the Ohio taxes examined by the Supreme Court in *General Motors*. For example, Ohio exempted consumers from the sales/use tax on the natural gas that they purchased from regulated utility companies. It was only when the consumers in Ohio purchased their natural gas from private marketers that the sales/use tax was due. In Washington, if a regulated utility company sells natural gas to a consumer, the company pays the public utility tax on the sale and no use tax is due. If the consumer buys natural gas from a source other than one regulated by the WUTC, the consumer pays use tax at the same rate as the public utility tax. Thus, Washington's use tax on natural gas and its public utility tax on the gas distribution business are compensatory taxes with their equal rates, which was the legislature's intent. Ohio does not have such equality in the rates the regulated natural gas companies pay on their gross receipts (4.75%) and the state's general sales/use tax rate (5%) paid by its natural gas consumers. *See* Ohio Rev. Code Ann. (Anderson 2002) §5727.24 and Ohio Rev. Code Ann. §§5739.02, 5739.025 and 5741.02 (Anderson 2002). Nonetheless, the U.S. Supreme Court declared the Ohio tax scheme valid. Surely, if the Ohio tax scheme does not discriminate against commerce and does not deny equal protection, neither does Washington's.

[2] We next address the taxpayer's claim that the credits provided by RCW 82.12.022(5) are fictional, resulting in a mal-apportioned tax and a burden on interstate commerce. The taxpayer cites two New York state cases, *Tennessee Gas Pipeline Co. v. Urbach*, 97 N.Y.2d 124, 750 N.E.2d 52, 726 N.Y.S.3d 350 (N.Y. 2001) and *Tug Buster Bouchard Corp. v. Wetzler*, 217 A.D.2d 192, 635 N.Y.S.2d 803 (N.Y. App. Div. 1996), *aff'd* 89 N.Y.2d 830, 675 N.E.2d 1223, 653 N.Y.S.2d 271 (N.Y. 1996). The New York Court of Appeals in *Tennessee Gas* explained that with federal deregulation of natural gas sales, the state of New York was losing tax revenue, like other states. Prior to deregulation New York imposed a franchise tax on the utilities' gross earnings and a tax on their gross income from natural gas sales in that state. The utilities passed the taxes on to their customers in the rates they charged. Deregulation allowed industrial consumers that purchased their gas from out-of-state producers or brokers to avoid the New

York taxes. In an attempt to recapture those taxes and to equalize the tax burden on all gas consumers, New York enacted a natural gas import tax imposed on the privilege or act of importing gas through pipelines for the importer's own use or consumption within that state. The tax is imposed on the price paid for the gas. The tax rate on importing natural gas equaled the combined tax rate that the utilities paid.

Tennessee Gas is a natural gas pipeline company that primarily transports natural gas from Texas and Louisiana through New York into New England. Tennessee Gas has a number of pumping stations along the way, including several in New York, that increase pressure in the line. The compressors are powered by natural gas drawn off the line. Consequently, the New York State Tax Department found Tennessee Gas was a gas importer under New York law and was liable for the natural gas import tax.

Tennessee Gas argued to the court the import tax discriminated against interstate commerce by showing that the statute imposed the tax on the out-of-state purchase of gas consumed in New York while not taxing the in–state purchase of gas used in New York. The New York Court of Appeals rejected that argument. The court found that although the import tax was based on the price of the gas while the in-state taxes were calculated by the utilities' gross receipts, they both were, in essence, taxes from the sales of gas because the utilities passed their gross receipts taxes through to their customers. The Court of Appeals also found the taxes were mutually exclusive because the consumer either buys the gas instate or imports it and the different taxes cannot overlap. We note this mutually exclusive feature also applies to RCW 82.12.022 and RCW 82.16.020. Consequently, the Court of Appeals found the import tax was a valid compensatory tax that did not discriminate in violation of the Commerce Clause. 751 N.E.2d at 58.

However, the New York court did invalidate the natural gas import tax because it found the tax was mal-apportioned. The court ruled the tax was not internally consistent and, therefore, burdened interstate commerce. The court quoted *Oklahoma Tax Commn. v. Jefferson Lines, Inc.*, 514 U.S. 175 at 184-85 (1995) for its discussion of the "internal consistency test."

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate. A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction.

The New York court then explained:

> Tennessee correctly argues that the taxes in question run afoul of the internal consistency test. If the consumers buy gas in a State with a provision identical to Tax Law § 186 [the gross receipts taxes on the utilities] they would pay a pass-through tax even though they

> exported the gas to New York and consumed it here. Because the import tax contains no credit for taxes assessed on the purchase of gas out-of-State, a double tax occurs; the statute crosses over from a permissible exercise of the State's taxing powers to an unconstitutional burden on interstate commerce.

750 N.E.2d at 58-59.

Unlike New York's import tax, RCW 82.12.022 is properly apportioned and internally consistent by providing credit for taxes paid elsewhere. As shown, RCW 82.12.022(5)(a) provides credit for gross receipts taxes similar to RCW 82.16.020 that the sellers of the natural gas pay to other states. RCW 82.12.022(5)(b) also provides credit to the consumer of the gas upon which it has paid to another state a use tax similar to the tax imposed by RCW 82.12.022. Therefore, Washington does not tax more than its fair share of taxes from the interstate sales of natural gas. Furthermore, as *Jefferson Lines, id.* and *Tennessee Gas,* 750 N.E.2d at 59 explain, the internal consistency test is measured by hypothetically employing the taxes in question as if they existed in all states. The test is not about the degree of economic reality surrounding the tax. We reject the taxpayer's claim that RCW 82.12.022 is invalid because it does not provide realistic credits. The statute provides what is constitutionally required.

The other New York case the taxpayer cites is *Tug Buster, supra.* The court in *Tug Buster* was concerned with the interstate sale of petroleum fuel products to a company that towed barges. Tug Buster purchased fuel in New Jersey, but consumed it in New York. New York assessed a tax on the privilege of purchasing and consuming imported fuel. The court found the New York law facially discriminated against interstate commerce because consumers who bought fuel from instate petroleum dealers did not pay an equivalent tax. The court also found the tax not to be internally consistent because the law did not provide credit for equivalent taxes paid to other states.

We do not find *Tug Buster's* holding about facial discrimination persuasive in the present matter. As explained in detail in *General Motors, supra,* the facts, the history, the Court's great concern for public safety and welfare, and the federal and state statutory schemes concerning sales of regulated and unregulated natural gas are unique to the natural gas distribution industry. Those facts are not applicable to the facts in *Tug Buster*. Moreover, *Tug Buster* pre-dates *General Motors*. Therefore, even if *Tug Buster* were applicable to the present matter, which it is not, the case does not have the benefit of the U.S. Supreme Court's reasoning in *General Motors* about discrimination against interstate commerce and equal protection regarding sales of natural gas. Furthermore, we again note that RCW 82.12.022, unlike the New York statutes, is internally consistent because it does provide credits for similar taxes paid to other states.

[3] Finally, the credits RCW 82.12.022 provides are for gross receipts taxes similar to that imposed by RCW 82.16.020 and for use taxes similar to the one imposed by RCW 82.12.022 when such taxes are paid to other states with respect to the gas for which a credit is sought. The law is clear as to what types of taxes qualify for the credits. Such taxes do not include income taxes and severance taxes paid to other states as claimed by the taxpayer. The taxpayer stated at

the hearing that it had not paid use taxes similar to RCW 82.12.022 to other states, and its vendors had not paid gross receipts taxes similar to that imposed by RCW 82.16.020. The taxpayer is not entitled to the credits.

DECISION AND DISPOSITION:

The taxpayer's petition for refund is denied.

Dated this 27th day of June 2002.