**Private Letter Ruling**

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| **Ruling Number:** | **P-2006-008** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Interstate pipeline company's purchases of electricity.** |
| **Keywords:** |  |
| **Approval Date:** | **05/18/2006** |

**Body:**

Office of Policy & Research

May 18, 2006

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RE: Your letter dated March 22, 2006

Dear XXXX:

I have been asked to respond to your March letter. In it, you ask how sales tax applies to an interstate pipeline company's purchases of electricity. You pose two questions. The first is whether the purchase of electricity for use in the company's cathodic protection equipment is taxable or not. These purchases are taxable, as is reflected in the following Question and Answer. The Q & A is published in the department's Policy Information Library, which can be accessed through the department's website --- www.ksrevenue.org:

17. Q. Is the sale and installation of a cathodic protection system taxable? Is electricity used to power the system taxable?

A. Yes. Cathodic protection equipment is not processing equipment. Sales of cathodic protection equipment are taxable. Services performed to install cathodic protection equipment on production or processing equipment during the original construction of a well are not subject to the sales tax. Installation services performed to install such equipment on an existing well are taxable. Any electricity consumed to provide cathodic protection is taxable since cathodic protection is not a processing, mining, drilling, or a refining process. The sale, installation, and operation of cathodic protection equipment on pipelines are always subject to sales tax. *(Underlining added).*

This Q & A applies to both interstate and intrastate pipelines, since cathodic equipment is used to inhibit corrosion in pipelines and pipeline equipment.

The Kansas Supreme Court has recognized that Kansas sales tax applies to an interstate pipeline's purchases of pipe, paint, pipe-covering, nuts, bolts, compressors, and other things that the company uses to build an interstate pipeline conveyance system in Kansas. *Natural Gas Pipeline Co. of America v State Commission of Revenue and Taxation, 163 Kan. 458, 183 P.2d 234 (1947).*The company's purchases of the same things to use *to maintain, service or repair* its interstate pipeline are also taxable. *See Southwestern Bell v. State Commission of Revenue and Taxation*,*212 P.2d 363, 168 Kan. 227 (1949) (Purchases of durable items and consumables that are used in the operation and maintenance of a telephone system are taxable.).* Taxing electricity that an interstate pipeline company uses to power cathodic equipment that protects and maintains its pipeline system is little different from taxing the company's purchases of paint, rust inhibitors, coverings, and other items that the company uses to maintain the same system. There are no constitutional prohibitions against taxing this use of electricity, since the cathodic system protects property that is wholly within the state and never leaves Kansas. See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

Your second question is whether electricity that an interstate-pipeline company uses to pump natural gas into and out of underground storage is exempt from Kansas sales tax. As with electricity purchased to operate cathodic equipment, an interstate pipeline's purchase of electricity that is used to inject or remove natural gas from underground storage is taxable.

The only exemption that might apply to an interstate pipeline's purchase of electricity for use in injecting or removing natural gas from underground storage is K.S.A. 2005 Supp. 79-3606(f). This provision exempts tangible personal property that is purchased "for consumption or movement directly, and immediately in interstate commerce." The consumed-in-production exemption, which is found at K.S.A. 79-3606(n), does not exempt electricity used in warehousing or storage operations. This exemption only exempts electricity and other items that are consumed in "the production, manufacture, processing, mining, drilling, refining or compounding of tangible personal property." *K.S.A. 2005 Supp. 79-3602(dd).*

A Federal Energy Regulatory Commission Staff Report, dated September 30, 2004, and titled: *"Current State of and Issues Concerning Underground Natural Gas Storage,"* Docket No. AD04-11-000, contains the following discussion:

Because not all storage is under the Commission's jurisdiction, we have to look to other sources of information to get nationwide totals of storage capacity. The EIA reports that as of 2002 (the latest data available), interstate pipelines operated nearly 55 percent of the nation's gas storage capacity but had contractual rights to use only 8 percent of the working gas capacity for their own purposes. Local distribution companies (LDCs) and intrastate pipeline companies operated about 10 percent of working gas capacity. However, most of the pipeline's storage capacity, about 73 percent, is contractually committed to LDC's. Marketers also hold a significant percentage of storage capacity under contract, about 15 percent. *Current State of and Issues Concerning Underground Natural Gas Storage, p. 7.*

This discussion shows that interstate pipeline operate their underground storage facilities primarily to store natural gas for local distribution companies, marketers, intrastate pipeline companies, and other third parties. They utilize less than ten percent of the underground storage capacity for interstate-pipeline purposes. Thus, very little of the electricity that a pipeline company used to inject and remove natural gas into an underground facilities can be attributed to the pipeline's interstate operations.

In addition, even if a small percentage of electricity usage can be attributed to the company's interstate operations, that percentage is not exempt. Here, the pipeline company consumes all of the electricity as part of its underground-storage operations. Its underground-storage facilities are wholly within Kansas and its acts of injecting and removing natural gas from storage take place wholly within Kansas. The electricity being consumed performs the same function as the electricity that the pipeline company uses to meet its contractual storage obligations, which accounts for more than ninety-percent of the use of the underground storage facility. This electricity is being used for storage and marketing reasons rather than "for consumption or movement directly, and immediately in interstate commerce." *K.S.A. 2005 Supp. 79-3606(f) .*

In *Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977),* the United States Supreme Court ruled that a state tax on interstate commerce is not unconstitutional if the tax is (1) applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state. When these principles are applied to an interstate pipeline's use of electricity for underground storage, the nexus element is provided by the fact that company owns and operates underground natural gas storage facilities and pipelines throughout Kansas. Taxing this electricity is fairly apportioned because the electricity is consumed wholly within Kansas and only electricity consumed in Kansas is subject to the tax. An interstate pipeline must shown how the tax discriminated against interstate commerce or how the tax was not fairly related to the services and protection provided by the state. Here, there is no discrimination since electricity consumed in underground storage is taxed the same way whether the facility is owned by an interstate pipeline, an intrastate pipeline, or some other entity. An interstate pipeline company cannot show that the tax is not fairly related to the services it receives from Kansas, since the company benefits by its use of Kansas roads, police and fire protection, and other public works infrastructure. *See Pledger v. Arkla, Inc, 309 Ark 10, 827 S.W.2d 126 (1992)*.

Taxing an interstate pipeline's use of electricity to inject natural gas into an underground storage facility is constitutionally permissible and is consistent with the Kansas statute, which limits exemption to an interstate pipeline company's purchase of electricity "for consumption or movement directly, and immediately in interstate commerce." *K.S.A. 2005 Supp. 79-3606(f).*

This is a private letter ruling pursuant to K.A.R. 92-19-59. It is based solely on the facts provided in your request. If it is determined that undisclosed facts were material or necessary to an accurate determination by the department, this ruling is null and void. This ruling will be revoked in the future by the operation of law without further department action if there is a change in the statutes, administrative regulations, or case law, or published revenue ruling, that materially effects this private letter ruling.

Sincerely,

Thomas E. Hatten

Attorney/Policy & Research

**Date Composed: 05/19/2006 Date Modified: 05/19/2006**