

FINAL PRIVATE LETTER RULING

REQUEST LETTER

14-001

PRIVATE LETTER RULING REQUEST

October 14, 2014

Bruce Johnson Commission Chair
Utah State Tax Commission
210 North 1950 West
Salt Lake City, UT 84134

Dear Commissioner,

COMPANY 1 and COMPANY 2 are in the business of manufacturing and dispensing high pressure Compressed Natural Gas (CNG) to the public at establishments throughout the state of Utah for use in powering vehicles that use CNG as a fuel source. The process of compressing and dispensing natural gas is an integrated manufacturing process. Pipeline natural gas is received at the compression site and converted into a marketable product.

COMPANY 1 and COMPANY 2 purchase assets which are used in the manufacturing and dispensing of CNG. Utah code R865-19S-85 allows for a sales tax exemption on machinery and equipment purchased for use in manufacturing. COMPANY 1 and COMPANY 2 respectfully request the Tax Commission to issue a Private Letter Ruling as to whether these assets qualify for sales and use tax purposes as machinery and equipment used in a manufacturing process. Also at issue is whether the electricity used throughout the integrated manufacturing process to power the equipment qualifies for a sales and use tax exemption.

The Integrated Manufacturing Process

CNG is manufactured through a compression process which utilizes equipment with a useful life of more than three years. CNG is a product different from natural gas, just as gasoline is a product different from crude oil. CNG is produced from pipeline natural gas (the raw material) which is processed and compressed from a typical pipeline pressure of 45 psi to approximately 4200 psi before it is in a form that can power a vehicle on the road. CNG is then dispensed to the retail customer at either 3000 psi or 3600 psi depending upon the specific vehicle configuration requirements. Without the increase in pressure, pipeline natural gas would not be in a form that could be used to power a vehicle on the road. The customer is not able to take natural gas directly from a pipeline and use it in its current form to power a vehicle. The customer would have to utilize a similar manufacturing process to increase the pressure of the natural gas to a new manufactured product, CNG, to be in useable form for powering a vehicle. The manufacturing process of creating CNG is typically cost

prohibitive for a normal customer, which is why public CNG fueling sites came into existence.

The integrated manufacturing process for CNG starts with receiving "raw" or pipeline natural gas from COMPANY 3. The pipeline natural gas is pulled from the street at 45 psi and flows through a High Pressure Gas Meter which regulates how much natural gas will flow to the Compressor. A regulated amount of gas then flows from the High Pressure Gas Meter to the Compressor where it is pumped through a series of chambers equipped with specially designed membranes which constrict in sequence until the pipeline gas has been compressed to approximately 4200 psi. The compressed gas is then pumped into special tanks which maintain the compression of the gas until it is dispensed through the Gas Dispenser to the customers. The customers use a Card Reader to pay for their purchase, triggering the release of the CNG to the Gas Dispenser which is used to fill the fuel tanks in customer vehicles with CNG at the appropriately regulated pressure for each vehicle configuration.

Equipment Used in the Integrated Manufacturing Process

1. High Pressure Gas Meter – regulates the amount of pipeline natural gas flowing to the Compressor .
2. Compressor -converts the pipeline natural gas to CNG
3. Pressurized Tanks -receives CNG and actively maintains the compression of the gas
4. Card Reader – processes credit and debit card payment information and upon approval of payment triggers the release of the CNG from the Pressurized Tanks to the Gas Dispenser
5. Gas Dispenser – maintains and regulates the compression of the gas as the CNG is transferred into the fuel tanks of customer vehicles

Conclusion

As noted above, COMPANY 1 and COMPANY 2 respectfully request the Tax Commission to issue a Private Letter Ruling as to whether or not the following assets, all of which have useful lives exceeding three years, qualify for sales and use tax purposes as machinery and equipment used in an integrated manufacturing process and whether the electricity used throughout the integrated manufacturing process also qualifies for a sales and use tax exemption.

- High Pressure Gas Meter
- Compressor
- Pressurized Tanks
- Card Reader
- Gas Dispenser
- Electricity

This ruling will enable COMPANY 1 and COMPANY 2 to calculate and remit their sales and use tax to the state of Utah with accuracy.

NAME 1, TITLE 1
COMPANY 1
ADDRESS 1
CITY 1, STATE 1 ZIP CODE 1

NAME 2, TITLE 2
COMPANY 2
ADDRESS 2
CITY 2, STATE 1 ZIP CODE 2

RESPONSE LETTER

PRIVATE LETTER RULING 14-001

February 11, 2015

NAME 1
TITLE 1
COMPANY 1
ADDRESS 1.
Wanship, UT 84017

Mr. NAME 2
TITLE 2
COMPANY 2
ADDRESS 2
CITY 2, STATE 1 ZIP CODE 2

Re: Private Letter Ruling Request on Whether the Manufacturing Equipment Exemption, found in Utah Code § 59-12-104(14), would Exempt from Utah Sales and Use Tax the Purchases of Certain Equipment for Compressed Natural Gas.

Dear NAME 1 and NAME 2,

In your request letter, you explain that your companies, COMPANY 1 and COMPANY 2, “are in the business of manufacturing and dispensing high pressure Compressed Natural Gas (CNG) to the public at establishments throughout the state of Utah for use in powering vehicles that use CNG as a fuel source.” You inquire about the applicability of the Utah manufacturing equipment exemption found in Utah Code § 59-12-104(14) (“manufacturing exemption”) to your

companies purchases of specific items relating to the compression and dispensing of the CNG. You also inquire about whether the electricity used for the compression process qualifies for an exemption. In subsequent communications, you explained that you registered the companies as having SIC Code 2999, which is “Products of Petroleum and Coal, not elsewhere classified.”

As explained below, the manufacturing exemption does not apply to any of the items presented because the companies are not manufacturing facilities.

I. Applicable Law

Utah Code § 59-12-104(14) provides the manufacturing exemption. Section 59-12-104(14)(a)(i) limits that manufacturing exemption to “(a) amounts paid or charged for a purchase or lease: (i) by a manufacturing facility . . .” Utah Code § 59-12-102(64) defines “manufacturing facility” as follows in pertinent part: “‘manufacturing facility’ means: (a) an establishment described in SIC Codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual . . .”

In *Atlas Steel*, 61 P.3d 1053, 1059 (Utah 2002), the Utah Supreme Court directs the Utah State Tax Commission first to make factual determinations about a taxpayer’s activities, processes and products and then to make a legal determination about whether those activities, etc. conform to a SIC code in the range from 2000 to 3999. More specifically, the Court states:

¶ 26 In determining if an establishment is described in SIC Codes 2000 to 3999, the Commission must make factual determinations as to the activities in which the establishment is engaged, the extent to which an establishment is engaged in those activities, what processes are used in those activities, and what products result from those activities. From those factual determinations, the Commission must then make a legal conclusion as to whether the products created and processes utilized conform to those specified in SIC Codes 2000 to 3999 and whether the establishment is "primarily engaged in manufacturing" those specific products through those specific means.

Id.

II. Analysis

As explained below, your companies are not manufacturing facilities because they do not have a SIC code in the range from 2000 to 3999. Applying *Atlas Steel*, your companies’ activities, the activities’ extent, the companies’ processes, and the resulting products must be analyzed. Based on your request letter, two of your companies’ activities are the compression and the distribution of natural gas. Of these two activities, your companies are primarily engaged in the distribution of the natural gas; your companies perform the secondary activity of compression incident to that distribution. For the compression, your companies use a process that compresses the natural gas from a lower pressure to a higher pressure. The pipeline natural gas pulled from the street was already compressed by COMPANY 3 at the lower pressure. Your companies significantly increased the pressure of the natural gas to the pressure required to fuel a vehicle. However, the product before and after the companies’ compression is still natural gas;

the companies' additional compression did not create a new product. Based on these facts, your companies are not engaged in manufacturing, and they do not fall within the SIC codes ranging from 2000 to 3999.

You had registered your companies for SIC Code 2999, which includes “[e]stablishments primarily engaged in manufacturing . . . other products of petroleum and coal, not elsewhere classified.” However, your companies do not fall within SIC Code 2999 because your companies are not “primarily engaged in manufacturing,” but are instead primarily engaged in distribution, as explained above. Furthermore, even if your companies were primarily engaged in compression, the compression of natural gas is not manufacturing, also explained above. Thus, your companies do not meet the description of SIC Code 2999. Your registration of the companies using SIC Code 2999 is not dispositive; it does not change this analysis. In the ¶26 of *Atlas Steel*, quoted above, the Utah Supreme Court instructed the Utah State Tax Commission to make a legal conclusion about the applicable SIC code based on the facts about a company’s activities, processes, products etc.; the Court did not instruct the Commission to rely on a company’s registered SIC code. In summary, for the above reasons, your companies are not “manufacturing facilities”; thus, the items purchased by the companies for compression and disbursement of CNG do not qualify for the manufacturing exemption.

Furthermore, as explained below, the electricity used for the companies’ compression and dispensing activities is not exempt from sales and use tax, either. Utah Code § 59-12-104(39) exempts “sales of . . . electricity . . . for industrial use . . .” Utah Code § 59-12-102(55) defines industrial use as “the use of . . . electricity . . . (c) in manufacturing tangible personal property at an establishment described in SIC Codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual . . .” As discussed above, your companies are not manufacturing a product when they compress natural gas and the companies are not described in SIC Codes 2000 to 3999. Thus, the electricity used for compression and dispensing is not “electricity . . . for industrial use” and is, likewise, not exempt.

III. Conclusion

In conclusion, the purchases of all items you presented are not exempt from sales and use tax. The Tax Commission’s conclusions are based on the facts as you described them and the Utah law currently in effect. Should the facts be different or if the law were to change, a different conclusion may be warranted. If you feel we have misunderstood the facts as you have presented them, you have additional facts that may be relevant, or you have any other questions, please feel free to contact the Commission.

In addition to contacting the Commission about misunderstood or additional facts, you may also appeal the ruling in the two ways discussed below. First, you may file a petition for declaratory order, which would serve to challenge the commission's interpretation of statutory language or authority under a statute. This petition must be in written form, and submitted within 30 days of the date of this ruling by any of the means given below. Failure to do so could preclude your appeal rights. These appeal rights are discussed in Utah Administrative Code R861-1A-34 C., available online at <http://tax.utah.gov/commission/effective/r861-01a-034.pdf>, and in Utah Administrative Code R861-1A-31, available online

at <http://tax.utah.gov/commission/effective/r861-01a-031.pdf>. Second, you may file a petition for redetermination of agency action if the private letter ruling leads to an audit assessment, a denial of a claim, or some other agency action at a division level. This petition must be written and may use form TC-738, available online at <http://tax.utah.gov/commission/effective/r861-01a-034.pdf>. The petition must be submitted by any of the means given below, within 30 days, generally, of the date of the notice of agency action that describes the agency action you are challenging.

You may access general information about Tax Commission Appeals online at <http://tax.utah.gov/commission-office/appeals>. You may file an appeal through any of the means provided below:

- **Best way**—by email: taxappeals@utah.gov
- By mail: Tax Appeals
USTC
210 North 1950 West
Salt Lake City, UT 84134
- By fax: 801-297-3919

For the Commission,

D'Arcy Dixon Pignanelli
Commissioner

DDP/aln
14-001