

FILED
MAY 27 2004

IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

PHILIP G. URRY, CLERK
By B. Leland

EL PASO NATURAL GAS COMPANY, LICENSE)	1 CA-TX 03-0016
No. 10-009535-E,)	
)	DEPARTMENT T
Plaintiff-Appellant,)	
)	MEMORANDUM DECISION
v.)	(Not for Publication -
)	Rule 28, Arizona Rules
ARIZONA DEPARTMENT OF REVENUE,)	of Civil Appellate
)	Procedure)
Defendant-Appellee.)	
)	

Appeal from the Arizona Tax Court
Cause No. TX 99-000296

The Honorable Paul A. Katz, Judge

AFFIRMED

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E H R L I C H, Judge

¶1 El Paso Natural Gas Company appeals from a tax court ruling that El Paso's sales of natural gas to end-users are taxable according to the utilities classification of the transaction privilege tax. For the reasons below, we affirm.

FACTS AND PROCEDURAL BACKGROUND

¶2 El Paso owns and operates an interstate gas pipeline for the transportation of natural gas. During the time in issue, it also sold natural gas to customers in Arizona, including Arizona Public Service ("APS") and Salt River Project ("SRP") for use in their power plants according to written contracts between the parties. El Paso did not sell gas to APS or SRP that it did not also transport to them. Both APS and SRP were "end-users," meaning that they did not resell the gas.

¶3 El Paso filed a tax refund claim with the Arizona Department of Revenue ("ADOR") for \$391,509.83 in privilege taxes paid for the transportation of gas to APS and SRP in Arizona for the tax years 1989, 1990 and 1991. The basis for the claim was that Arizona could not tax interstate pipeline transportation activities. After ADOR denied the claim, El Paso protested and an administrative law judge ("ALJ") issued a decision and order in favor of ADOR. El Paso appealed to the tax court.

¶4 El Paso moved for summary judgment, and ADOR responded with a cross-motion for summary judgment, each party seeking a determination whether El Paso's sales of gas and its interstate transportation of that gas were taxable according to the utilities classification or the retail sales classification of Arizona's transaction privilege tax. The tax court rejected El Paso's argument that the activities were taxable according to the retail sales

classification. It partially granted ADOR's motion and ruled that the utilities classification applied. The court noted, however, that there was an unresolved issue of fact whether El Paso had divided its business into two separate businesses, one being sales and the other transportation, such that interstate transportation activities would be excluded from taxation.¹

¶5 El Paso amended its complaint to include an alternative theory supporting a refund. It asserted that all of its activities, including sales and transportation, were within the pipeline classification.

¶6 El Paso then filed a motion for summary judgment and a motion requesting reconsideration of the earlier ruling. The tax court denied both motions, agreeing with ADOR that the pipeline classification does not apply and refusing to reconsider the prior ruling.

¶7 The parties prepared a joint pretrial statement with contested and uncontested facts, contested issues and exhibits, and submitted the case for a non-jury trial based on the stipulated evidence and without testimony. The tax court subsequently ruled that El Paso had different lines of business, that its sales of gas to end-users were taxable under the utilities classification and

¹ The court stated that it was unable to rule on the proper classification if "the direct sale and transportation ... are determined to be separate businesses."

that the tax base for that category included transportation costs. El Paso appealed.

DISCUSSION

¶8 When material facts are undisputed, we review issues of law de novo and determine whether the tax court correctly applied the law to those facts. *Brink Elec. Constr. Co. v. Ariz. Dep't of Revenue*, 184 Ariz. 354, 358, 909 P.2d 421, 425 (App. 1995). One such issue of law is the interpretation of the gas sales agreements that El Paso entered with APS and SRP. See *Ahwatukee Custom Estates Mgmt. Ass'n v. Turner*, 196 Ariz. 631, 633-34 ¶5, 2 P.3d 1276, 1278-79 (App. 2000).

I. *El Paso Properly Paid the Privilege Tax on All of Its Direct Sales Revenues; It is Not Entitled to a Refund.*

A. *El Paso "Furnished" Natural Gas to APS and SRP*

¶9 Arizona's transaction privilege tax is akin to a business privilege tax upon gross receipts from taxable activity. See *S. Pac. Transp. Co. v. Ariz. Dep't of Revenue*, 202 Ariz. 326, 333 ¶25, 44 P.3d 1006, 1013 (App. 2002). The tax court found that El Paso's gross receipts from its direct sales are subject to the transaction privilege tax under the utilities classification, Arizona Revised Statutes ("A.R.S."). § 42-5063(A) (1999 & Supp. 2003), which provides that "[t]he utilities classification is comprised of the business of: 1. Producing and furnishing or furnishing to consumers natural or artificial gas." The statute defines the tax base for

this classification as "the gross proceeds of sales or gross income derived from the business," and it does not provide a deduction for transportation costs. A.R.S. § 42-5063(C).

¶10 El Paso contends that it does not "furnish" gas within the meaning of the utilities classification. Rather, it asserts, it sells a commodity and the gross proceeds from those sales are taxable under the retail classification.

¶11 For purposes of Article 15, Section 2 of the Arizona Constitution,² the Arizona Supreme Court defined "furnish" as "'to provide or supply with what is needed, useful or desirable.' ... It connotes a transfer of possession." *Williams v. Pipe Trades Indus. Program of Ariz.*, 100 Ariz. 14, 20, 409 P.2d 720, 724 (1966) (citation omitted). El Paso quite clearly "furnishes" natural gas because it provides or supplies its customers with it.

¶12 The decision in *Tucson Electric Power Co. v. Arizona Department of Revenue* bolsters this interpretation. 170 Ariz. 145, 822 P.2d 498 (App. 1991). Tucson Electric Power ("TEP"), the taxpayer, contended that charges collected pursuant to a contract with a mining company were not business income taxable under the utilities classification. Like El Paso, it argued that selling or furnishing electricity did not include this expense and asserted

² Article 15, Section 2 of the Arizona Constitution provides that "[a]ll corporations other than municipal engaged in furnishing gas, oil, or electricity for light, fuel, or power; ... shall be deemed public service corporations."

that it should pay tax only for the sale of electricity actually furnished to the customer. We rejected this contention and concluded that the utilities classification embraces more than the sale of tangible personal property; otherwise, the income would be within the retail classification. *Id.* at 149, 822 P.2d at 502. "[T]he business of 'producing and furnishing ... electricity' logically includes not only the actual selling of electricity as a commodity, but also providing the numerous continuing services necessary to deliver the electricity to the customer reliably and in a useful form." *Id.*

¶13 Similarly, El Paso's delivery of natural gas was a critical component because, just like TEP, El Paso provided continuing service to deliver the gas to the customer reliably. El Paso had agreed to supply its customers' natural gas fuel requirements each day to stated volumes and to use its best efforts to deliver greater volumes if requested. El Paso also maintained and installed measuring equipment, and delivered gas gauge pressures. El Paso's transportation and delivery of natural gas are incidental to its sale of the gas.

¶14 El Paso nevertheless contends that only the retail classification should apply. The Arizona legislature has provided, however, that the retail classification does not apply to any business activity that is properly included in any other classification of the transaction privilege tax code. A.R.S. § 42-5061

(A) (6) (1999 & Supp. 2003). Because El Paso's activities are properly included in the utilities classification, only that provision applies.

¶15 El Paso argues that the utilities classification applies only to public service corporations as defined by Article 15, Section 2 of the Arizona Constitution. Because El Paso is not a public service corporation, *Southwest Gas Corp. v. Arizona Corp. Commission*, 169 Ariz. 279, 288, 818 P.2d 714, 723 (App. 1991), it reasons that it cannot be taxed pursuant to that classification.

¶16 We give effect to a statute as written. *Paging Network of Ariz., Inc. v. Ariz. Dep't of Revenue*, 193 Ariz. 96, 97 ¶8, 970 P.2d 450, 451 (App. 1998). In *Paging Network*, a taxpayer argued that its one-way radio paging business was not taxable pursuant to the telecommunications classification, which it contended applied only to two-way communications. We rejected the argument because the taxpayer's construction did not comport with the statute's plain language. *Id.* at 98 ¶13, 970 P.2d at 452.

¶17 Section 42-5063, A.R.S., does not limit itself to public service corporations as El Paso asserts. The statute unambiguously imposes a tax on any person in the business of furnishing natural gas, such as El Paso.

B. *El Paso Cannot Shift Delivery Charges Associated with the Sale of Natural Gas to the Pipeline Classification.*

¶18 The privilege tax statutes provide that "all gross pro-

ceeds of sales and gross income derived by a person from business activity classified under a taxable business classification comprise the tax base for the business until the contrary is established." A.R.S. § 42-5023 (1999). "Person" is defined as "any ... corporation, association, partnership, joint venture, syndicate ... or other entity under which business or other activities may be conducted." A.R.S. § 42-4001(8) (1999). Thus all gross proceeds and gross income derived from El Paso's Arizona business activities are presumed to be taxable without adjustment. Notwithstanding this presumption, El Paso argues that it does not owe a privilege tax on the transportation and fuel costs associated with direct sales of gas.

¶19 This argument is like one rejected in *Valencia Energy Co. v. Arizona Department of Revenue*, 189 Ariz. 79, 938 P.2d 474 (App. 1996), vacated in part on other grounds, 191 Ariz. 565, 959 P.2d 1256 (1998). *Valencia Energy* contracted to sell coal to its customer but remitted the privilege tax only for the cost of the coal. It contended that it was not liable for tax on the alleged service activities, including handling and transportation, to deliver the coal to its customer. We decided that "[t]he transaction privilege tax is imposed on Valencia's gross receipts from sales, not its cost of purchasing materials." *Id.* at 82, 938 P.2d at 477. Similarly, El Paso owes the tax on all income derived from the sale of natural gas with no deductions for transportation costs. See *id.*

¶20 This result does not change simply because a taxpayer engages in the transportation of natural gas as well as its sale. "One's activities may be such as to constitute more than one business and the taxpayer be obligated to pay the appropriate tax on each." *Trico Elec. Coop. v. State Tax Comm'n*, 79 Ariz. 293, 297, 288 P.2d 782, 784 (1955). A taxpayer's activities may not be taxed as a separate business, however, if the "activities are incidental in the sense that they are inseparable from the principal business and interwoven in the operation thereof to the extent that they are in effect an essential part of the major business." *Id.*

¶21 The tax court determined that El Paso's transportation charges, which were incidental to direct sales, were not deductible, and the evidence supports its determination. El Paso contracted for the direct sale of natural gas. In several of its contracts with APS and SRP, the price of gas specifically identifies the transportation fuel costs and charges as components of the sale price. Moreover, El Paso did not sell any gas to APS or SRP that it did not also transport to them. Consequently, the transportation of gas was not a separate service to these customers but incidental to the sale.

C. *The Structure of El Paso's Business Determines the Tax It Will Pay.*

¶22 El Paso excoriates ADOR for "exalting form over substance," claiming that it could have structured the sales differ-

ently by contracting with a third party for delivery. Had the sale been so structured, El Paso would have receipts only for the sale, and we would independently analyze the taxability of the transportation provided by the third party.

¶23 In tax law, however, form can be substance, and similar business transactions may be taxed differently depending upon their structures. For instance, taxpayers without purchasing agreements are not entitled to be taxed as though they had them. See *Brink Elec. Constr. Co.*, 184 Ariz. at 362, 909 P.2d at 429. We also held in *ADVO System, Inc. v. City of Phoenix*, that a direct mail marketer could not exclude postage charges from its advertising tax base for mailing its customers' circulars even though it could have used its customers' postage meters for the mailings because the taxpayer "is not entitled to be taxed as if its business were structured differently than it actually is." 189 Ariz. 355, 361, 942 P.2d 1187, 1193 (App. 1997).

¶24 ADOR applied the transaction privilege tax code to El Paso in the manner delineated by the legislature, and the legislature chose to specify that transportation charges are generally taxable as a part of gross receipts. Section 42-5002(A)(2) (1999), A.R.S., excludes from gross receipts "[f]reight costs billed to and collected from a purchaser by a retailer for tangible personal property which, upon the order of the retailer, is shipped directly from a manufacturer or wholesaler to the purchaser." Thus the

result is different if a manufacturer ships the tangible personal property or if a retailer ships it directly to a customer.

¶25 The statute also demonstrates that El Paso's direct sales of natural gas, including the transportation components, are taxable in their entirety whether characterized within the retail classification or the utilities classification. There is no basis to exclude transportation costs from gross receipts.

II. The Pipeline Classification Does Not Encompass any of the Business Activities at Issue.

A. The Unambiguous Statutes Require No Extrinsic Aids to Construction.

¶26 During the refund period, El Paso operated an interstate pipeline as its primary business. It posits that its natural gas activities are within the pipeline classification, A.R.S. § 42-5067 (1999), which provides:

A. The pipeline classification is comprised of the business of operating pipelines for transporting oil or natural or artificial gas through pipes or conduits from one point to another point in this state. The pipeline classification does not include sales of natural gas or liquefied petroleum gas used to propel a motor vehicle.

According to El Paso, its activities are within this classification but, because the statute only covers transportation of natural gas from one point to another within Arizona, removed from it because of their interstate nature. El Paso's activities are outside the scope of this classification and therefore not taxable in Arizona, but El Paso did make direct sales of natural gas to end-users in

Arizona and properly remitted privilege taxes from these sales.

¶27 El Paso insists that the pipeline classification and the utilities classification are ambiguous. During the refund period, the pipeline classification was "comprised of the business of operating pipelines for transporting oil or natural or artificial gas through pipes or conduits from one point to another point in this state." A.R.S. § 42-1310.07(A) (renumbered as A.R.S. § 42-5067(A) (1997)). The utilities classification was "comprised of the business of producing and furnishing or furnishing to consumers electricity, natural or artificial gas and water." A.R.S. § 42-1310.03 (A) (renumbered and amended as A.R.S. § 42-5063(A)). "There is no opportunity for construction or interpretation of a statute if the meaning of the statutory language is clear on its face." *Collins v. Stockwell*, 137 Ariz. 416, 420, 671 P.2d 394, 398 (1983). The meaning of these statutes is clear: The Arizona legislature intends to tax the sale of natural gas to consumers according to the utilities classification, and the transportation of natural gas within this state under the pipeline classification. Because El Paso's direct sales operations do not fall within the pipeline classification, there is no need to consider the extraneous aids of construction upon which El Paso relies.

B. *El Paso's Historical Analysis Does Not Illustrate that the Pipeline Classification Governs the Retail Sales of Natural Gas.*

¶28 El Paso claims that the pipeline classification was

intended to encompass all receipts from a pipeline operator's sales of natural gas. The history that El Paso relies upon is irrelevant, however, to the application of the pipeline classification because, even accepting that from 1929 through the mid-1970s interstate pipeline operators were almost exclusively gas merchants, it does not overcome the intent conveyed by the legislature's plain language. "The intent evidenced by the language [of a statute] is conclusive absent a clear and express intent to the contrary." *Ariz. Dep't of Revenue v. Superior Court*, 189 Ariz. 49, 52, 938 P.2d 98, 101 (App. 1997).

¶29 El Paso claims that, when the pipeline and utilities classification statutes were enacted, it had income from sales alone with no transportation charges. Therefore, it contends, the pipeline classification had to include intrastate and interstate operations or it would be meaningless.

¶30 There are tax statutes that generate no or very little revenue; it is a legislative decision. For instance, railroads and aircraft and timber classifications generate less than one-half of one percent of total revenues, and the legislature has left the commercial lease classification in the privilege tax code although the applicable tax rate is zero percent. A.R.S. § 42-5010(A)(4) (1999 & Supp. 2003).

C. *ADOR's Construction is Consistent with the Historical Structure and Taxation of the Natural Gas Industry.*

¶31 The law supports the division of gas sales between the utilities and pipeline classifications. When the natural gas industry began to develop, several states sought to regulate it. *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 290 (1997). While recognizing the states' rights to regulate and tax direct sales of natural gas within their borders, the courts forbade the regulation of interstate transportation or sales for resale of natural gas. *Id.* "The business of supplying, on demand, local consumers is a local business, even though the gas be brought from another state and drawn for distribution directly from interstate mains; and this is so whether the local distribution be made by the transporting company or by independent distributing companies." *East Ohio Gas Co. v. Tax Comm'n of Ohio*, 283 U.S. 465, 472 (1931) (quoting *Missouri ex rel. Barrett v. Kansas Natural Gas Co.*, 265 U.S. 298, 309 (1924)). Accordingly, sales to end-users were regulated and taxed differently from other activities of interstate pipelines.

¶32 This dichotomy is also reflected in the Natural Gas Act ("NGA"), 15 U.S.C. § 717 (1997). As the Court stated in *Tracy*:

Congress's purpose in enacting the NGA was to fill the regulatory void created by the Court's earlier decisions prohibiting States from regulating interstate transportation and sales for resale of natural gas, while at the same time leaving undisturbed the recognized power of the States to regulate all in-state gas sales directly to consumers.

519 U.S. at 292.

¶33 The Arizona legislature enacted these statutes against the backdrop of evolving federal law. When construed in this light, the pipeline classification logically includes the transportation and sales for resale traditionally conducted by pipeline companies, but it does not include sales to end-users. The utilities classification has always encompassed those sales.

D. The 1993 Amendment to the Pipeline Classification Applies to Wholesale Sales as well as to Sales to End-Users.

¶34 El Paso further contends that the 1993 amendment establishes that the pipeline classification was intended to include direct sales as well as transportation of natural gas. The legislature amended the retail, pipeline and utilities classifications to provide an exemption for the "[s]ales of natural gas or liquefied petroleum gas used to propel a motor vehicle," 1993 Ariz. Sess. Laws, ch. 206, but that exemption applied to all sales of motor vehicle fuel and was not limited to sales to end-users.

¶35 The federal definition of "vehicular natural gas" ("VNG") bolsters this interpretation because a federal statute defines VNG as "natural gas that is ultimately used as a fuel in a self-propelled vehicle." 15 U.S.C. § 717a(10) (1997). Congress further provided that the NGA does not apply to a person with respect to sales or transportation of VNG if that person is subject to state regulation "over the sale, sale for resale, or transportation of

vehicular natural gas." 15 U.S.C. § 717(d)(2). By separately listing sales and sales for resale, Congress clarified that this type of commodity could be sold at wholesale and not just to end-users as El Paso contends.

E. *El Paso Misapplies Various Rules of Statutory Construction.*

¶36 As a threshold matter, El Paso contends that ambiguities in the scope of a statute imposing a tax are to be construed against the government. This is irrelevant to determining the applicability of business activity classifications, and there is no support for El Paso's argument that the pipeline classification is more specific than the utilities classification. The tax court properly construed the categorizations in a manner that gives effect to both.

¶37 El Paso also contends that the tax court failed to give the statutes their ordinary meaning because it did not construe "operating pipelines for transporting . . . gas" to include the sales to end-users. The one definition that El Paso offers defines "operating" as "engaged in active business (as manufacturing, transportation, merchandising)," listing these activities as separate business operations. See *John E. Shaffer Enters. v. City of Yuma*, 183 Ariz. 428, 432, 904 P.2d 1252, 1256 (App. 1995) (citing *Webster's Third New International Dictionary* 1581 (G. & C. Merriam

& Co. 1969)).³ The ordinary meaning of the statutes' words supports the tax court's decision that revenues from transportation of gas are within the pipeline classification but the separate business receipts from the sale of natural gas are within the utilities classification.

¶38 El Paso relies on the 1935 Arizona tax code as evidence that the pipeline classification was intended to encompass all of the sales and operations of a pipeline, both intrastate and interstate. The 1935 Code imposed the privilege tax on intrastate pipeline activities, Arizona Code Annotated ("A.C.A.") § 3138c(c)(5), and interstate pipeline activities, A.C.A. § 3138c(c)(9). This argument improperly collapses these provisions into one pipeline classification. Section 3138c(c)(5), A.C.A., is the remote predecessor of the current pipeline provision in A.R.S. § 42-5067. By contrast, A.C.A. § 3138c(c)(9), later recodified as A.C.A. § 73-1303(c)(9) (1939), has no modern counterpart. See *S. Pac. Transp. Co.*, 202 Ariz. at 337 ¶45, 44 P.3d 1017. Section 3138c(c)(9), A.C.A., was renumbered A.C.A. § 73-1303(b)(9) (Supp. 1952) and repealed in 1954. *Id.* at 335 ¶34 n.5, 44 P.3d at 1015.

¶39 Finally, El Paso argues that the tax court's ruling circumvents the decision in *Southern Pacific Transportation*. In that

³ El Paso no longer directly sells gas but is strictly an open-access pipeline company, transporting natural gas for third parties.

case, the court analyzed whether Arizona could tax, in whole or in part, transportation that started and ended in Arizona but went through New Mexico. In contrast, the question presented to us now is whether Arizona's utilities classification applies when all elements of the sale of natural gas occur in Arizona. ADOR does not seek to apportion El Paso's activities. Rather, the issue is whether the sales are a business that is separate from El Paso's business of operating its pipeline to transport natural gas for others. *Southern Pacific* does not control.

CONCLUSION

¶40 We affirm the judgment and therefore deny as moot El Paso's request for attorneys' fees on appeal.

Susan A Ehrlich
SUSAN A. EHRLICH, Judge

CONCURRING:

Donn Kessler
DONN KESSLER, Presiding Judge

Philip Hall
PHILIP HALL, Judge

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