PRIVATE TAXPAYER RULING LR95-014

January 30, 1996

The following private taxpayer ruling is in response to your letter dated October 9, 1995. In your request you ask for clarification of the taxability of income received from the sale of electricity at the ... to customers in ....

The following is a restatement of the facts in your letter.

Statement of Facts:

..., a ..., ...a public utility company incorporated in the State of .... is principally engaged in the business of producing, transmitting and distributing electrical energy to wholesale and retail customers ....

... is considering making retail and wholesale sales of electricity to customers in .... The retail sales would be direct sales to large industrial customers for consumption at their facilities in .... The wholesale sales would be to the ..., ...

For retail sales, ... will interconnect with another entity's distribution line which runs adjacent to ... substation near ..., and then near the ... extend a tap line to the .... The point of delivery for the individual industrial customers will be at the ... and meters will be installed on the ... of the .... The customers will construct a power line or lines from the ... to their facilities. The lines in ... will be owned by the customers and be their responsibility. ... will assume responsibility for loss of power up until the point of delivery at the .... The customers assume responsibility for the power from that point on. ... has two reasons for providing power this way, rather than extending ... lines into .... First, owning property, such as meters and lines, in ... could subject ... to ... jurisdiction with respect to regulatory, tort, tax and other laws. Second, ... law permits electrical power to be imported into the country only by ... or the end consumer of the electricity.

For wholesale sales to ..., ... will construct separate distribution lines which will directly connect with ... lines at the .... Sales of electricity would take place at the ... with both ... and ..., installing meters in their respective substations closest to the ....

Your Position:

On the basis of Arizona Administrative Code (A.A.C.) R15-5-2104 which provides an exemption for foreign sales, electricity exported by ... to customers in ... is exempt from transaction privilege tax. Section 10, Article 1, of the United States Constitution (import-export

clause); *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946); *McDonnell Douglas Corporation v. State Board of Equalization*, 13 Cal. Rptr. 2d 399 (1992); and *Gough Industries, Inc. v. State Board of Equalization*, 51 Cal. 2d 746, 336 P.2d 151 (1959 S. Ct.); further support an exemption. The transaction involved in the request is the exportation of electricity to a foreign country. The electricity is dedicated to a continuous and unbroken process of exportation and is not used or consumed in the United States. The parties to the transaction have no other objective than the exportation of electricity from ... to .... A tax upon any incident of that export is forbidden by the import-export clause.

While Arizona has the right to impose a tax upon an individual or corporation for the privilege of conducting a retail business within the state, it may not tax the privilege of exporting goods or services from the state to a foreign country.

Issue:

Whether ... sale of electric power at the ... to customers in ... is exempt from transaction privilege tax.

Applicable Law:

Arizona Revised Statutes (A.R.S.) § 42-1310.03 provides that the business of producing and furnishing or furnishing to consumers electricity is taxable under the utilities classification of the transaction privilege tax. The tax base is the gross proceeds of sales or gross income derived from the business. The sale of electricity to a person for resale is excluded.

A.R.S. § 42-1301 defines "gross income" and "gross proceeds of sales" for purposes of transaction privilege tax.

A.R.S. § 42-1329 provides that it is presumed that all gross proceeds 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.A.C. R15-5-2104 provides that sales of electricity delivered by the producer or distributor through transmission lines to a point in another state or country, from a point in this state and used outside this state, are not subject to the transaction privilege tax.

Article I, Section 10, clause 2 of the United States Constitution (import-export clause) provides that "no state shall without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing it's inspection laws."

In *Richfield Oil Corporation v. State Board of Equalization*, 329 U.S. 69 (1946), the United States Supreme Court held that a California sales tax on oil that was pumped into the hold of a

vessel owned by a foreign purchaser for use outside of the United States was unconstitutional based on the import-export clause. The court focused on the fact that the delivery of the oil into the vessel marked the commencement of the movement of the oil abroad; therefore, the oil was an export at the time the tax was imposed. The means of shipment is unimportant as long as the certainty of the foreign destination is plain.

The United States Supreme Court in *Michelin Tire Corporation v. W. L. Wages*, 423 U.S. 276 (1976), upheld Georgia's ad valorem property tax on imported tires held in a Georgia warehouse. The court stated that the "Import-Export Clause clearly prohibits state taxation based on the foreign origin of the imported goods, but it cannot be read to accord imported goods preferential treatment that permits escape from uniform taxes imposed without regard to foreign origin for services which the State supplies." The court stated that the ban is on "Imposts or Duties" and not all taxes.

In *Department of Revenue of the State of Washington v. Association of Washington Stevedoring Companies*, 435 U.S. 734 (1978), the United States Supreme Court held that a tax on the service of loading and unloading ships was not unconstitutional. The court stated that the use of the *Richfield* case ignored the central holding of *Michelin* that the absolute ban is only on 'Imposts or Duties" and not all taxes. To include all taxes in the definition of "Imposts or Duties" would make superfluous several of the terms of Art. I, § 8, cl. 1 of the constitution, which grants Congress the "Power To lay and collect Taxes, Duties, Imposts and Excises." "In particular, the Framers apparently did not include 'Excises,' such as an exaction on the privilege of doing business, within the scope of 'Imposts' or 'Duties.' The court expressly held that the *Michelin* approach applies to taxation involving exports as well as imports. A tax relating to exports should not be considered an "Impost or Duty" unless the tax disrupts the foreign policy of the United States or the tax creates conflicts and trade barriers among the states. The court stated that the tax in this case did not hinder the foreign policy of the Federal Government . The tax applied to virtually all businesses in the State and it had not created any special protective tariff. The assessments were only upon business conducted entirely within Washington and no foreign business or vessel was taxed.

The Court of Appeals of Arizona in *Arizona Department of Revenue v. Robinson's Hardware*, 721 P.2d 137 (Ariz. App. 1986), upheld Arizona transaction privilege tax that arose from sales to Mexican customers. The taxpayer argued that the sales to Mexican factories were clearly exports and therefore, under *Richfield*, are not subject to Arizona's transaction privilege tax. The court stated that *Richfield* is no longer the proper standard. Rather, *Michelin* is the proper standard to be used in this case. Arizona's transaction privilege tax is not a direct tax upon the goods sold. The volume of goods sold or receipts taken is merely the measure on which the amount of the tax is based. The goods themselves are not taxed. For purposes of the import-export clause analysis, the court found no distinction between Arizona's transaction privilege tax and the tax upheld by the United States Supreme Court in *Michelin*.

Discussion:

Arizona's transaction privilege tax is a tax imposed on the privilege or right to engage in certain specifically identified business classifications. Persons engaged in the business of producing and furnishing electric power are subject to transaction privilege tax under the utilities classification. The tax base for the utilities classification is the gross proceeds of sales or gross income derived from the business. The sale of electricity to a person for resale is excluded. Therefore, ... sales of power to ... will be excluded from transaction privilege tax as sales for resale. The balance of this discussion will be related to ... sale of power to end consumers in ....

The Court of Appeals of Arizona stated in *Robinson's Hardware* that the correct standard to use when determining whether Arizona's transaction privilege tax violates the import-export clause is the standard enumerated by the United States Supreme Court in *Michelin*. The court in *Michelin* provided that a tax related to imports must be an "impost or duty" in order to be considered unconstitutional under the import-export clause. The court in Washington Stevedoring explained the Michelin case and expressly held that the *Michelin* approach applies to taxation involving exports as well as imports. A tax relating to exports should not be considered an "Impost or Duty" unless the tax does one of the following two things:

1. Disrupts the foreign policy of the United States?

> Arizona's transaction privilege tax is a tax on the privilege of doing business in the state. The application of the transaction privilege tax to ... sale of power delivered to the ... with ... for use by end consumers in .... does not appear to disrupt the foreign policy of the United States. The entire activity that would be subject to the transaction privilege tax, the producing and furnishing of electricity, will occur within .... is not responsible for any power loss that occurs after the power enters .... Also, no foreign business or activity would be taxed.

2. Creates conflicts and trade barriers among the states?

> ... is the only state that would have any connection with the electric power that would be sold. Therefore, the application of the transaction privilege tax to the sale could not create any conflicts and trade barriers among the states.

Since the imposition of Arizona's transaction privilege tax, on ... sale of electricity delivered to the ... for use by end consumers in ..., would not disrupt the foreign policy of the United States or create any conflicts with other states the tax cannot be considered an "Impost or Duty." Therefore the imposition of the transaction privilege tax on ... in this situation would be constitutionally permissible.

A.A.C. R15-5-2104 provides that sales of electricity delivered by the producer or distributor through transmission lines to a point in another state or country, from a point in this state and

used outside this state, are not subject to the transaction privilege tax. However, the sales of electricity by ... to ... customers will not be delivered to a point in ...; the electricity will be delivered to the ... side of the ... with .... Therefore, this rule is not applicable to ... situation.

Conclusion and Ruling:

The following ruling is given based on the facts presented in your request.

The department rules that ... sales of electricity to ... will be excluded from transaction privilege tax as sales for resale.

The department also rules that ... will be subject to transaction privilege tax on sales of electricity delivered to the ... side of the ... for use by end consumers in ....

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your letter dated October 9, 1995.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from the date of issuance except as set out herein. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.