

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 12-03**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether the retail sale in Tennessee of natural gas purchased outside of Tennessee and transported into Tennessee is subject to the Tennessee natural gas distribution tax.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[TAXPAYER] (the "Taxpayer") uses [REDACTED] interstate pipelines that serve customers in Tennessee [REDACTED]. The Taxpayer does not own the pipelines; rather, the Taxpayer has contractual access to the pipelines. The Taxpayer purchases natural gas originating in [LOCATION – NOT TENNESSEE] and transports that natural gas via the interstate pipeline

system to a point in Tennessee designated by a local distribution company¹ (“LDC”) as a citygate² for deliveries, where the natural gas is then delivered to the Taxpayer’s customers served by that LDC. The Taxpayer is unrelated to the LDC.

The Taxpayer transfers to the LDC equitable title to all gas delivered. Legal title in the gas remains with the Taxpayer until it is burned by the end-user customer. The Taxpayer receives meter readings from the LDC and bills the customer for the gas used. The LDC bills the customer for local pipeline distribution fees.

RULING

Is the Taxpayer’s retail sale in Tennessee of natural gas purchased outside of Tennessee and transported into Tennessee via interstate pipelines and intrastate pipelines owned and maintained by a local distribution company subject to the 1.5% Tennessee gross receipts tax on gas distribution found under TENN. CODE ANN. § 67-4-405(a)(2) (2011)?

Ruling: Yes. The Taxpayer’s retail sale in Tennessee of natural gas is subject to the 1.5% Tennessee gross receipts tax on gas distribution found under TENN. CODE ANN. § 67-4-405(a)(2) (2011).

ANALYSIS

TENN. CODE ANN. § 67-4-405(a)(2) (2011) provides in pertinent part that “[p]ersons engaged in the business of manufacturing gas or of distributing manufactured gas or natural gas shall ... pay an amount equal to one and one-half percent (1.5%) of the gross receipts derived from intrastate business” in Tennessee.³ TENN. CODE ANN. § 67-4-405(c) states that it is the intention of the law “to levy a tax for the privilege of engaging in intrastate commerce carried on wholly within this state and not a part of interstate commerce.”

Accordingly, in order for the Taxpayer’s retail sale of natural gas to be subject to the Tennessee gross receipts tax on gas distribution, the following requirements must be met: 1) the Taxpayer must be a person engaged in the business of manufacturing gas or of distributing manufactured gas or natural gas; and 2) the Taxpayer must be exercising the privilege of engaging in intrastate commerce carried on wholly within Tennessee, and not as part of interstate commerce.

For the reasons set forth below, the Taxpayer is a person engaged in the business of distributing natural gas. Additionally, in making sales of gas to its customers, the Taxpayer exercises the

¹ LDCs are companies involved in the delivery of natural gas to consumers within a specific geographic area. LDCs typically transport natural gas from delivery points along interstate and intrastate pipelines through thousands of miles of distribution pipe.

² Citygates are delivery points to LDCs, especially for large municipal areas. Typically, LDCs take ownership of the natural gas at the citygate and deliver it to each individual customer’s location of use. However, in this case, the LDC does not purchase the natural gas or take ownership of it.

³ TENN. CODE ANN. § 67-4-405(d) provides that there “shall be credited upon the tax imposed by [TENN. CODE ANN. § 67-4-405] any taxes paid by the owner of such business on any gas, water or electric company businesses” under the Tennessee franchise and excise tax laws, during the calendar year in which the tax levied becomes due.

privilege of engaging in intrastate commerce carried on wholly within Tennessee, and not as part of interstate commerce. Accordingly, the Taxpayer's retail sale in Tennessee of natural gas is subject to the 1.5% Tennessee gross receipts tax on gas distribution found under TENN. CODE ANN. § 67-4-405(a)(2).

1. *Distributor of natural gas*

The Taxpayer is engaged in the business of distributing natural gas for purposes of TENN. CODE ANN. § 67-4-405(a)(2).

The first requirement of TENN. CODE ANN. § 67-4-405(a)(2) is that the Taxpayer be a person engaged in the business of manufacturing gas or of distributing manufactured gas or natural gas. The Taxpayer is not a manufacturer of natural gas; therefore, to be subject to the Tennessee gross receipts tax on gas distribution, the Taxpayer must be a distributor of manufactured gas or natural gas.

Neither the Tennessee courts nor the Tennessee Code have defined the terms “distribute” or “distribution” for purposes of the Tennessee gross receipts tax on gas distribution. The Tennessee Supreme Court has stated that when a statute does not define a term, it is proper to look to common usage to determine the term's meaning. *See, e.g., Tennessee Farmers Assur. v. Chumley*, 197 S.W.3d 767, 782-83 (Tenn. 2006); *Beare Co. v. Tennessee Dept. of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993). The term “distribute” commonly means “to give out or deliver” by “separation of something into parts, units or amounts.” MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 364 (11th ed. 2007). Similarly, BLACK'S LAW DICTIONARY (8th ed. 2004) defines the term “distribute” in pertinent part as “to deliver.” “Delivery” in turn is defined as “the giving or yielding possession or control of something to another.” *Id.*

Thus, to be a distributor of natural gas, the Taxpayer must deliver the gas. The Taxpayer has stated that it purchases natural gas originating in [LOCATION – NOT TENNESSEE] and transports the gas via the interstate pipeline system to a point in Tennessee designated by an LDC as a citygate for deliveries. At that point, the natural gas is delivered to the Taxpayer's customers via the LDC's pipelines. The Taxpayer has contractual access to the pipelines used to transport the gas to the end users. Legal title in the gas remains with the Taxpayer until it is burned by the end-user customer; the Taxpayer receives meter readings from the LDC and bills the customer for the gas used.

These facts indicate that the Taxpayer delivers the gas for purposes of the Tennessee gross receipts tax on gas distribution. The Taxpayer holds legal title to the gas until possession of the gas is yielded to the purchaser at the time of sale; the Taxpayer is therefore the party that makes delivery of the gas to the customer. While the Taxpayer does not own the pipelines, the Taxpayer does have contractual access to the pipelines and in fact uses those pipelines to transport natural gas for sale to its customers. In other words, the Taxpayer uses the pipelines to *deliver* gas. Because the Taxpayer is the party that makes delivery of the gas to the end users, it is properly characterized as a distributor.

Accordingly, the Taxpayer is engaged in the business of distributing natural gas for purposes of TENN. CODE ANN. § 67-4-405(a)(2).

2. *Intrastate commerce*

In making sales of natural gas to its retail customers in Tennessee, the Taxpayer exercises the privilege of engaging in intrastate commerce carried on wholly within Tennessee, and not as part of interstate commerce.

TENN. CODE ANN. § 67-4-405(c) states that it is the intention of the law “to levy a tax for the privilege of engaging in intrastate commerce carried on wholly within this state and not a part of interstate commerce.” The Tennessee Supreme Court, discussing the intrastate commerce requirement in *Memphis Natural Gas Co. v. McCanless*, 177 S.W.2d 841, 842-843 (Tenn. 1944), observed that the United States Supreme Court has generally held that “the transmission of natural gas from one State to another and its sale at wholesale at the State of destination has been held to be interstate commerce upon which the States could lay no burden.” Importantly, however, the United States Supreme Court has also generally held that if “the interstate carrier, however, undertook in the State of destination to distribute and sell the gas at retail, the latter activity was said to be local in its nature and not protected as interstate commerce.” *Id.* at 843. The Tennessee Supreme Court added that “the distribution of gas through service pipes in a particular locality and sale at the burner tips was intrastate commerce.” *Id.* Thus, the courts make a distinction between the transportation of gas from one state to another and the distribution and sale of the gas within a single state. The United States Supreme Court considers these actions to be two distinct activities. *See, e.g., East Ohio Gas Co. v. Tax Comm’n of Ohio*, 283 U.S. 465 (1931) (upholding an Ohio excise tax on the privilege of carrying on an intrastate business, where the taxpayer transported gas via an interstate pipeline and then sold the gas at retail in Ohio).

Here, the Taxpayer purchases natural gas originating in [LOCATION – NOT TENNESSEE] and transports it via the interstate pipeline system to a point in Tennessee designated by an LDC as a citygate for deliveries. Once the gas reaches the citygate, it is delivered to the Taxpayer’s Tennessee customers via the LDC’s local pipelines.

The Taxpayer clearly engages in interstate commerce when it transports the natural gas from [LOCATION – NOT TENNESSEE] to Tennessee via the interstate pipeline system. However, once the gas reaches the citygate in Tennessee, the Taxpayer undertakes to distribute and sell the gas at retail in Tennessee. The Taxpayer’s activities from the time the gas reaches the citygate in Tennessee to the time it is sold at retail in Tennessee are local in nature. Accordingly, the Taxpayer exercises the privilege of engaging in intrastate commerce carried on wholly within Tennessee, and not as part of interstate commerce.

Kristin Husat
Director of Legal Services

APPROVED: Richard H. Roberts
Commissioner of Revenue
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