

TAX EXEMPTIONS: FUEL USED IN PIPELINE COMPRESSORS

House Bill 4642 as enrolled (Vetoed)
Sponsor: Rep. Kirk A.Profit

House Bill 4643 as enrolled (Vetoed)
Sponsor: Rep. Charles Perricone

House Committee: Tax Policy
Senate Committee: Finance (Discharged)
Second Analysis (1-5-98)

THE APPARENT PROBLEM:

Legislation has been introduced prompted by a dispute between the Department of Treasury and the Great Lakes Gas Transmission Company over the tax status of natural gas that fuels the compressors that are used in the transmission of natural gas through pipelines. (The company says it "operates a 2,000-mile pipeline that transports Canadian natural gas for delivery to customers in the midwestern and northeastern United States and eastern Canada" and transports gas to and from storage fields in Michigan.)

The fuel used to power these large compressors, according to industry testimony, is withdrawn from the pipeline. According to the company, a 1975 Michigan Court of Appeals decision said that fuel used in pipeline compressors was not subject to the state sales or use tax. However, recent treasury audits resulted in the department assessing use tax on fuel for compressors for 1987-1991. The company has said that it settled the audit in 1995 without agreeing that compressor fuel should be taxed. Meanwhile, as a result of federal deregulation initiatives, the pipeline company stopped buying and selling natural gas and became transporters or common carriers of natural gas. The company also stopped purchasing the fuel used to power compressors and began requiring the shippers of fuel to provide it to them. This led to the determination by the Department of Treasury, as part of the 1995 audit settlement, that the company was no longer liable for the tax on the compressor fuel but that the shippers of the fuel were liable for sales tax on compressor fuel. Reportedly, in February of this year, based on information provided by the pipeline company, the department sent letters to the shippers saying that they were liable for the tax. The pipeline company official has testified, however, that the shippers don't own the gas either and cites the case of the shipper that provides it with 60 percent of its natural gas. That shipper transports

gas on behalf of over 200 customers. As a result, says the company official, "the determination of legal ownership of the commingled gas stream used as compressor fuel is impossible." Some critics of the department view this case as another example of changing tax policy by administrative fiat rather than through legislation, and have proposed amendments to the sales and use tax acts addressing the subject. The Department of Treasury, for its part, sees the issue differently and says it is following newer case law than that cited by the industry (see [Arguments](#)).

THE CONTENT OF THE BILLS:

The bills would provide sales tax and use tax exemptions for gas purchased, used, or consumed to compress, pump, or otherwise produce motive power to extract, gather with pipelines, or transport through pipelines natural gas or natural gas liquids. [House Bill 4642](#) would amend the General Sales Tax Act (MCL 205.54a) to provide a sales tax exemption. [House Bill 4643](#) would amend the Use Tax Act (MCL 205.94) to provide a use tax exemption.

FISCAL IMPLICATIONS:

There is no information at present.

ARGUMENTS:

For:

The bills, say its proponents, would preserve a 1975 Michigan Court of Appeals decision on the subject and maintain the status quo for interstate pipelines; prevent costly and time-consuming administrative procedures that result in no taxes collected from interstate pipelines for

compression fuel; and will remind the Department of Treasury that changes in the interpretation of tax laws should be carried out using appropriate administrative procedures. If the department does decide it is going to change the way in which it enforces a tax, it should at the very least provide a warning to the affected industries and educate the businesses subject to the tax. It should not retroactively impose a new interpretation and, in essence, levy a "new" tax on a segment of taxpayers. Audits should be used to enforce tax laws and collect taxes, not to develop creative interpretations of longstanding state tax policies.

Against:

The Department of Treasury has a different view of the issue from the industry representatives and the sponsors of the legislation. They make the following points.

-- If pipeline compressors were powered by some other energy source, such as electricity, then the purchase of energy would be taxed. The pipeline company does not own the natural gas that it uses to power its compressors. It draws the gas owned by someone else out of the pipeline and puts it to use. So, the sale or use of the natural gas used to power the compressors should be subject to tax.

-- The 1975 court decision upon which the industry relies has been superseded by subsequent court decisions and a different test is now applied by the courts to determine what is taxable. (See Governor Engler's veto message below)

-- The department did not unilaterally impose a new tax on pipeline companies or natural gas shippers; the department responded to changes in tax case law and to changes in the way the pipeline company does business. The current application of the law is consistent with published departmental policies that go back to 1944.

-- The department acknowledges that recent changes in the natural gas industry result in the tax liability being shifted to shippers of natural gas and not to the pipeline company, so legislation is not needed to protect the pipeline company.

Against:

Governor Engler vetoed these bills and his veto message, dated December 29, 1997, included the following statement.

"The authority of the state to tax compressor gas used in interstate commerce was tested in Michigan courts over 20 years ago and found not to exist. However, the 1977 U.S. Supreme Court ruling in Complete Auto Transit, Inc. v. Brady replaced the standard of authority for states

to impose certain taxes on interstate commerce activity. As a result, the Michigan Court of Appeals in Kellogg Company v Department of Treasury, 1994, adopted the Complete Auto Transit standard.

The Kellogg opinion, by clarifying what is and what is not taxable in interstate commerce, effectively rules that compressor gas is taxable property. To allow special interest tax exemptions such as those sought for compressor gas in Enrolled House Bills 4642 and 4643 not only undermines significant judicial holding but also starts the state down a path that, if allowed, would invite other taxpayers to seek similar treatment."

Earlier in the same message, the governor noted that the bills would provide exemptions from the sales and use taxes for "natural gas sold and used to power engines operated to compress gas through a pipeline to an end source, the customer. Such natural gas is tangible personal property and is specifically sold and used to operate engines designed to transport the customer-owned natural gas. The taxation of natural gas and similar properties sold and used in the state has been a historical part of Michigan public policy. The taxation of the sale and use of compressor gas is no different."

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.