STATE OF NEW MEXICO
ADMINISTRATIVE HEARINGS OFFICE
TAX ADMINISTRATION ACT

IN THE MATTER OF THE PROTEST OF
TUCSON ELECTRIC POWER COMPANY **No. 16-29**
TO THE DEPARTMENT'S DENIAL OF REFUND ISSUED
UNDER LETTER ID NO. L1108271152

DECISION AND ORDER

A formal hearing on the above-referenced protest was held on May 25, 2016 before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department ("Department") was represented by Marek Grabowski, attorney for the Department and Tucson Electric Power Company ("Taxpayer") was represented by Timothy R. Van Valen, Gallagher & Kennedy, P.A. Danny Pogan, protest supervisor appeared and testified as a witness for the Department. Josh Cohen, from the Ryan, LLC professional tax consulting firm, appeared and testified for Taxpayer. The record was held open for the filing of briefs which were filed on June 17, 2016.

The Exhibits introduced into the record are Exhibits 1-3 and A and B. In addition to the pleadings and filings referred to in the Findings, the record contains the Notice of Telephonic Scheduling Conference issued on September 11, 2015, Scheduling Order and Notice of Administrative Hearing issued on October 26, 2015, New Mexico Taxation and Revenue Department's Preliminary Witness and Preliminary Exhibit Lists filed on November 20, 2015, Substitution of Counsel filed on February 2, 2016, Stipulation of Counsel filed on February 2, 2016, Certificate of Service filed on March 4, 2016, Stipulation for Extension of Time to File Motions filed on April 1, 2016, The New Mexico Taxation and Revenue Department's Response

to Petitioner's First Set of Interrogatories filed on April 1, 2016, The New Mexico Taxation and Revenue Department's Response to Petitioner's First Set of Requests for Production filed on April 1, 2016, Notice of Reassignment of Hearing Officer for Administrative Hearing issued on May 4, 2016, and Joint Prehearing Statement filed on May 6, 2016. The parties entered into Stipulated Facts which are set out in the Joint Prehearing Statement filed on May 6, 2016 and some of which are incorporated into the Findings below.

Based on the evidence in the record, IT IS DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1. On December 19, 2014, Taxpayer applied for a refund of compensating tax in the amount of $434,860.92 for tax period July 1, 2011 through December 31, 2011. **[Exhibit 1]**.

2. On June 17, 2015, the Department denied the refund because the refund request was in the same time frame of the managed audit performed by the New Mexico Taxation and Revenue Department. **[Letter ID No. L1108271152]**.

3. The Department has abandoned this reason for the denial of the protest, and instead argued that the refund was properly denied because no deduction applied to Taxpayer.

4. Taxpayer protested the denial of the refund on July 29, 2015.

5. The Department acknowledged the protest on July 31, 2015. **[Letter ID No. L0479014960]**.

6. The Department requested a hearing with the Administrative Hearings Office on September 10, 2015.

7. Taxpayer paid compensating tax on the purchase of natural gas during the tax period.

8. Taxpayer, along with other entities, purchased the Luna Energy Facility ("Facility"), a 570-megawatt power plant located near Deming, NM, from Duke Energy in November 2004. **[Stip. Fact #1]**.

9. The Facility is a low-emission, natural-gas-fired, combined-cycle electricity generating plant. **[Stip. Fact #2]**.

10. Electricity is produced at the Facility by means of converting natural gas, supplied to the Facility via a pipeline, into electricity. **[Stip. Fact #3]**.

11. The natural gas supplied to the Facility is used to produce an exothermic chemical reaction. **[Stip. Fact #4]**.

12. The purchase of natural gas is the purchase of chemicals or reagents.

13. The reaction of methane (CH_4, a major component of natural gas) with molecular oxygen (O_2) produces carbon dioxide (CO_2) and water and can be depicted by the chemical equation $CH_4(g) + 2O_2(g) \rightarrow CO_2(g) + 2H_2O(l)$. Chemical reaction, www.britannica.com/chemical-reaction/The-conservation-of-matter (06/22/16).

14. The weight of natural gas listed on each invoice included in the claim for refund exceeds eighteen tons. **[Stip. Fact #5]**.

15. During the tax period at issue, Taxpayer primarily purchased natural gas from Citigroup Energy, Inc. and Occidental Energy Marketing, Inc. for use at the Facility. **[Affidavit of Dickens, ¶5]**.

16. Taxpayer purchased natural gas from other companies, e.g., ConocoPhillips Co., Macquarie Energy LLC, EDF Trading North America LLC, Chevron Natural Gas, and BP Energy Company. **[Exhibit #2, page 1]**.

17. These companies, e.g., Citigroup Energy, Inc., Occidental Energy Marketing, Inc., ConocoPhillips Co., Macquarie Energy LLC, EDF Trading North America LLC, Chevron Natural Gas, and BP Energy Company have no nexus with New Mexico and are out-of-state companies. **[Post-Hearing Brief of Tucson Electric Power Company page 2, III A]**.

18. During the tax period at issue, Taxpayer purchased natural gas in bulk quantities needed to produce a target megawatt (MW) output at the Facility for one gas day. **[Affidavit of Dickens, ¶6]**.

19. One gas day is 24 consecutive hours, beginning each day at 9:00 am Central Clock Time. **[Affidavit of Dickens, ¶7]**.

20. Natural gas purchased for use at the Facility on Monday through Thursday was purchased in bulk for one gas day only. In cases where the Facility was required to operate over a weekend, Taxpayer purchased in bulk 3 days' worth of natural gas, covering Saturday through Monday. **[Affidavit of Dickens, ¶8]**.

21. Taxpayer took ownership of all natural gas originating from the Keystone Pool in West Texas at the Keystone Pool when the price and quantity were agreed to, before it was transported to the Luna Energy Facility. **[Affidavit of Dickens, ¶9]**.

22. In some cases, Taxpayer took ownership of the natural gas originating from the Blanco Pool at the point that it was delivered to the Luna Energy Facility. **[Affidavit of Dickens, ¶10]**.

23. There is insufficient evidence introduced in the record on how natural gas is delivered to Taxpayer, other than it was delivered by pipeline.

DISCUSSION

Taxpayer argues that it is not subject to the compensating tax on its use of tangible personal property (natural gas), because had the seller been subject to the gross receipts tax, the transactions would have been deductible under either NMSA 1978, Section 7-9-65 (1969) or NMSA 1978, Section 7-9-46 (1996).

Compensating Tax and Gross Receipts Tax

The Gross Receipts and Compensating Tax Act, NMSA 1978, Sections 7-9-1 to 114 (1966, as amended through 2011), imposes a compensating tax on the buyer or the person using property "acquired inside or outside of this state as a result of a transaction with a person located outside of this state that would have been subject to the gross receipts tax had the tangible personal property been acquired from a person with nexus with New Mexico" NMSA 1978, Section 7-9-7(A)(2) (2011). The gross receipts tax and the compensating tax create a complementary consumption tax scheme, with gross receipts tax being imposed on the seller of goods and compensating tax being imposed on the buyer of goods. *Dell Catalog Sales, LP v. N.M. Taxation & Revenue Dep't*., 2009-NMCA-001, ¶53, 145 N.M. 419, 199 P.3d 863. Compensating tax is imposed when gross receipts tax cannot be imposed because the seller has no nexus with New Mexico and the goods are destined for New Mexico and used in New Mexico. In *Dell Catalog Sales, LP v. N.M. Taxation & Revenue Dep't*., 2009-NMCA-001, ¶30, 145 N.M. 419, 199 P.3d 863, the court used the same "destination principle" to apply to transactions taxable under the compensating tax.

Deductions that are applicable to the gross receipts tax may be used to determine whether compensating tax is due on a transaction. In the case of *Western Elec. Co. v. N.M. Bureau of Revenue*, 1976-NMCA-047, ¶14, 90 N.M. 164, 561 P.2d 26, the court said that "[T]he legislature intended to make our gross receipts tax and our compensating tax correlates: an exemption from the

gross receipts tax must also be treated as an exemption from the compensating tax." *See also, Ranchers-Tufco Limestone Project Joint Venture v. Revenue Div.*,1983-NMCA-126, 100 N.M. 632, 674 P.2d 522.

There is no issue that Taxpayer paid compensating tax on its purchase of natural gas from Citigroup Energy, Inc., Occidental Energy Marketing, Inc., ConocoPhillips Co., Macquarie Energy LLC, EDF Trading North America LLC, Chevron Natural Gas, and BP Energy Company (collectively known as "Companies"). There is also no issue that these companies have no nexus with New Mexico and are out-of-state companies. Finally, there is no issue that Taxpayer used the natural gas at its Facility in New Mexico.

Burden of Proof and Standard of Review

The courts have held that "where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer." *Wing Pawn Shop v. Taxation and Revenue Dep't.*, 1991-NMCA-024, ¶16, 111 N.M. 735, 809 P.2d 649.

Selling Chemicals or Reagents in Lots

Taxpayer argues that Section 7-9-65 applies because it purchased chemicals or reagents in lots in excess of eighteen tons. Section 7-9-65 provides that:

> Receipts from selling chemicals or reagents to any mining, milling or oil company for use in processing ores or oil in a mill, smelter or refinery or in acidizing oil wells, and ***receipts from selling chemicals or reagents in lots in excess of eighteen tons*** may be deducted from gross receipts. Receipts from selling explosives, blasting powder or dynamite may not be deducted from gross receipts.

NMSA 1978, §7-9-65 (1969) (emphasis added). The first question is whether natural gas is a chemical or reagent. The Department stipulated that natural gas was used to produce a chemical reaction. **[Stip. Fact #4]**. Taxpayer's website did not provide information on if natural gas is a chemical or a reagent. In reviewing, the on-line Encyclopedia Britannia, the burning of fuels is given as an example of a chemical reaction. Chemical reaction, www.britannica.com/science/chemical-reaction (06/22/16). The Encyclopedia Britannia also explained that the formula for the chemical reaction of burning natural gas is described as "(t)he reaction of methane (CH_4, a major component of natural gas) with molecular oxygen (O_2) produces carbon dioxide (CO_2) and water and can by depicted by the chemical equation $CH_4(g) + 2O_2(g) \rightarrow CO_2(g) + 2H_2O(l)$." Chemical reaction, www.britannica.com/chemical-reaction/The-conservation-of-matter (06/22/16). Thus the purchase of natural gas qualifies as the purchase of chemicals or reagents.

For a deduction to apply under Section 7-9-65, the chemicals or reagents must be sold in "lots." A "lot" is defined as "a parcel or single article." Regulation 3.2.223.7(A)(1) (06/14/01). The definition of "lot" is amorphous. Taxpayer argues that the definition of "lot" should be interpreted broadly and the definition from Merriam Webster should be applied: "a company, collection or group of persons, animals or things." The Department contends that the definition for "lot" can be found in the Oxford Dictionary, which defines a "lot" as "a particular item or object, typically one of a specified type," and Taxpayer offered that the Oxford Dictionary also includes within the definition of "lot" "a portion of a larger body of air other fluid considered as a discrete element." None of these definitions are very helpful.

The Department argues that the term "lot" is derived from the Uniform Commercial Code ("U.C.C."), and that the U.C.C. controls the definition of "lot." Taxpayer agreed that the U.C.C.

applies, but for different purposes. The U.C.C. defines a "lot" as "a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract." U.C.C. §2-105(5) (1994). For U.C.C. purposes natural gas is considered a "good" and not a "lot." U.C.C. §2-107(1) (1994). *Prenalta Corp. v. Colorado Interstate Gas Co.*, 944 F. 2d 677, 687 (10th Cir.1991) (gas purchase contracts are contracts for the sale of goods and are governed by Article 2, but parties can vary the provisions of the UCC by agreement). *See also, Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*, 925 S.W.2d 565, 567-579 (Tex., 1996) (describing the application of Article 2's good faith and proportionality provisions to an output contract between an exactor and processor of natural gas and an interstate pipeline company). For bankruptcy purposes, natural gas is considered only a "good" under the U.C.C., and therefore not a "lot." *In re Pilgrim's Pride Corporation*, 421 B.R. 231 (Bankr. N.D. Tex. 2009). Thus, there is support within the U.C.C. to find that natural gas is not treated as lots but as goods, but the Hearing Officer makes no finding since there is insufficient evidence on how the contracts with Taxpayer treat the purchase of natural gas.[1]

In addition there was no evidence offered on the process of transportation of the natural gas once it was purchased by Taxpayer. It was stipulated by the parties that the natural gas was transported via pipeline. **[Stip. Fact #3].** The Department offered that the natural gas was "commingled with other natural gas belong to the Taxpayer and to other entities." **[New Mexico Taxation and Revenue Department's Closing Statement, page 3].** While this may be true, there is no fact witness to support this statement. There are common carriers (pipelines) that

[1] Taxpayer's contracts with the Companies were not introduced and it is not clear if the purchase of natural gas is treated as a "good."

transport others' energy over their distribution networks, which may or may not affect whether natural gas is purchased in lots. *See*, Edward Kahn, Electric Utility Planning & Regulation 16-19, note 5, at 308 (Carl Blumstein ed., American Council for an Energy-Efficient Economy 1988); See also, Alfred Kahn, *The Economics of Regulation: Principles and Institutions,* vol. II, 152-171 (Massachusetts Institute of Technology 2d ed. 1989) (1971) (discussing the function of the interstate pipeline system); *Id*. at 276-280 (describing how gas is transported from seller to user without the "pipes" company taking ownership of the gas). Therefore without more evidence on how natural gas is delivered from the seller to the buyer, a finding cannot be made one way or the other as to whether the natural gas is sold or purchased in "lots." Taxpayer has failed to present sufficient evidence that the natural gas or chemicals or reagents it purchased was purchased in lots.

Ingredient or Component Part of the Product

Taxpayer argues that had the seller of natural gas had nexus and if the gross receipts tax had applied to the transaction, then the seller would be entitled to a deduction under Section 7-9-46(A). Compensating tax is only applicable if no gross receipts tax deduction could be applied. Section 7-9-46 provides that:

> Receipts from selling tangible personal property may be deducted from gross receipts or from governmental gross receipts if the sale is made to a person engaged in the business of manufacturing who delivers a nontaxable transaction certificate to the seller. The buyer delivering the nontaxable transaction certificate must incorporate the tangible personal property as an ingredient or component part of the product that the buyer is in the business of manufacturing.

NMSA 1978, §7-9-46 (1992). This Section was amended in 2013 to specifically exclude the generation of power. NMSA 1978, §7-9-46(F)(2)(A) (2013). The law at the time the tax was

paid is applied and the 2013 changes are not applied to Taxpayer. The general rule is that statutes which affect vested or substantive rights operate only prospectively. *Swink v. Fingado,* 1993-NMSC-013, ¶13, 115 N.M. 275, 850 P.2d 978. But there are exceptions to this rule depending upon whether the statue's application of a "newly enacted law retrospectively would diminish rights or increase liabilities that have already accrued," then prospective application may be required by the Constitution. *Id.* ¶55; N.M. Const. art. II, § 19 ("No ex post facto law, bill of attainder nor law impairing the obligation of contracts shall be enacted by the legislature."). In *Gallegos v. Pueblo of Tesuque*, 2002-NMSC-12, 132 N.M. 207, 46 P.3d 668, the Court held that an injury that predated the compact, interpreted as a statute, would not be applied retroactively. However, statutes delineating remedial procedure are to be retroactively applied. *Wilson v. N.M. Lumber & Timber Co*., 1938-NMSC-040, ¶4, 42 N.M. 438, 81 P.2d 61.

For the purposes of addressing the Taxpayers' argument, it will be assumed, but not decided, that the earlier version of Section 7-9-46 will be applied to the facts of this case. The definition of manufacturing is "combining or processing components or materials to increase their value for sale in the ordinary course of business, but does not include construction." NMSA 1978, Section 7-9-3(H) (2007). For this deduction to apply, the person must be engaged in the business of "manufacturing." Taxpayer is in the business of processing natural gas in order to produce electricity and not in the business of manufacturing. *Alba v. Peoples Energy Resources Corp.*, 2004-NMCA-084, ¶19, 136 N.M. 79, 94 P.3d 822. Thus, Taxpayer is not engaged in the manufacturing business.

Secondly, Section 7-9-46 requires that a nontaxable transaction certificate be delivered to the seller. There is no evidence that a nontaxable transaction certificate exists between the buyer

and seller. Therefore, this deduction cannot apply, and the compensating tax applies to the purchase of natural gas from the Companies. Taxpayer's refund claim is **DENIED.**

CONCLUSIONS OF LAW

A. Taxpayer filed a timely written protest to the Department's denial of a claim for refund issued under Letter Id No. 11108271152 and jurisdiction lies over the parties and the subject matter of this protest.

B. The hearing was timely set as required by NMSA 1978, Section 7-1-24.1(A) (2013).

C. The telephonic scheduling hearing held on October 23, 2015 satisfies the 90-day hearing requirement found in NMSA 1978, Section 7-1B-8 (2015).

D. Pursuant to regulation 3.1.8.10(A) NMAC (8/30/01), it is Taxpayer's burden to come forward with evidence and legal argument to establish that it was entitled to a refund.

E. The purchase of natural gas is the purchase of chemicals or reagents.

F. The natural gas supplied to the Facility is used to produce an exothermic chemical reaction.

G. There was insufficient evidence offered as to how the natural gas was delivered or transported to Taxpayer from the Companies, where it was purchased.

H. Taxpayer is engaged in the business of processing natural gas in order to produce electricity.

I. The Department properly denied Taxpayer's claim for refund for gross receipts tax in the amount of $434,860.92 for tax period July 1, 2011 through December 31, 2011.

For the foregoing reasons, the Taxpayer's protest **IS DENIED.**

DATED: June 24, 2016

Monica Ontiveros

Monica Ontiveros
Hearing Officer
Administrative Hearings Office
P. O. Box 6400
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NOTICE OF RIGHT TO APPEAL

Pursuant to NMSA 1978, Section 7-1-25 (2015), the Taxpayer has the right to appeal this decision by filing a notice of appeal with the New Mexico Court of Appeals within 30 days of the date shown above. *See,* NMRA, 12-601 of the Rules of Appellate Procedure. If an appeal is not filed within 30 days, this Decision and Order will become final. A party filing an appeal shall file a courtesy copy of the Notice of Appeal with the Administrative Hearings Office contemporaneously with the filing of the Notice with the Court of Appeals so that the Administrative Hearings Office may prepare the record proper. The Notice of Appeal should be mailed to John Griego, Administrative Hearings Office at P.O. Box 6400, Santa Fe, New Mexico 87502. Mr. Griego may be contacted at 505-827-0466.