

AWC Fact Sheet on Brokered Natural Gas Use Tax and Natural Gas Utility Tax

Over the past few months the Association of Washington Cities has learned some cities have received large refund requests from entities paying a utility tax on natural gas. We believe this is due to a recent court decision relating to the brokered natural gas use tax, which in turn created a greater awareness of the brokered natural gas use tax as well as raised questions related to who pays the utility tax on natural gas.

This fact sheet provides an update about legislation and pending court cases concerning the brokered natural gas use tax. It also outlines some of the differences between the brokered natural gas use tax and the utility tax on natural gas.

Brokered Natural Gas Use Tax RCW 82.14.230

When did the brokered natural gas use tax originate and why?

The brokered natural gas use tax was imposed approximately twenty years ago after the deregulation of the natural gas industry in 1986. The deregulation allowed large commercial users to directly purchase natural gas from wholesalers, with shipment through pipelines provided by the utilities, instead of purchasing the gas from the local utility provider. This direct purchase meant that some gas purchases were not subject to the locally imposed natural gas utility tax.

Some cities lost considerable revenue and, as a result, the legislature passed a law, effective July 1, 1990, allowing cities to levy a use tax on the purchases of brokered natural gas by consumers. The tax rate is equal to the city's utility tax on natural gas, which must be 6% or less, unless a higher amount is approved by the voters. (There is a similar provision for the state which also lost utility tax revenues.)
(A Revenue Guide, p 24)

The use tax was created in order to establish tax fairness. Natural gas that is taxed under a city's utility tax is exempt from this use tax, which is capped at 6%, like the natural gas utility tax.

2008 Appeals Court decision

On May 20, 2008, the Court of Appeals Division II issued a decision impacting the City of Tacoma's brokered natural gas use tax, which has the potential to effectively eliminate the tax for cities (*G-P Gypsum Corp. v. Dep't of Revenue*, Cause No. 35883-2-II). The court held that the "place of use" for purposes of the local option brokered natural gas tax is the place of the customer's first exercise of dominion and control in the state, not the place of consumption. Since brokered natural gas customers can take delivery at the point of origin of the gas (outside the state), the place of first dominion and control in the state would be at the border.

In its ruling, the court did not focus on the legislative intent of the tax, which was enacted to replace the utility tax that would otherwise apply to the utility providing the natural gas if the gas had been purchased through the local provider. Instead it looked at the definition of "use" in the statute, which it concluded was the first exercise of dominion and control over the natural gas. Since Gypsum made decisions about allocation of the gas at the border location at Sumas before the gas was sent through the pipeline to the business location in Tacoma where it was consumed, the court found dominion and control to occur at Sumas, which does not impose the local option use tax.

The Department of Revenue filed a petition asking the Supreme Court to review this decision and the Supreme Court has indicated it will likely take up the case in 2010. If the Supreme Court upholds the Appeal Court decision, cities levying the brokered natural gas could face up to four years of refund requests. DOR has received several refund requests based on the Gypsum case, and it is holding action on those requests pending the outcome of the Supreme Court case.

2009 legislative session

Clarifying the definition of use for the brokered natural gas use tax has been a priority for AWC throughout the legislative session. **HB 1422** was the original bill introduced to achieve this “fix,” but died on the House calendar earlier in the legislative session.

Since that time AWC worked along other cities to amend the “fix” onto other bills. Early in April this issue was part of **2SSB 5433**, but did not make it into the final bill that passed the Legislature. In the last week of the session, AWC attempted to amend the “fix” onto **SHB 1597**, concerning the administration of state and local tax programs, but this bill failed to pass prior to adjournment.

AWC will continue to pursue legislation to clarify this “fix” during a special session if the legislature is called back into session related to the budget.

What is the tax base?

Natural or manufactured gas that is consumed within the state is subject to the tax, provided that they were not also subject to the utility tax. The tax is measured by the value of the gas when delivered to the customer and paid by the in-state user.

How is the tax administered?

The Department of Revenue (DOR) administers this tax. Cities contract with DOR for collection of the tax, and distributions are made by DOR on a monthly basis. The state and local taxes are reported on a separate state excise tax return.

Who levies this tax and at what rate?

Cities may levy the brokered natural gas use tax at a maximum rate of 6% (the rate must be the same as the city applies to natural gas businesses under the municipal natural gas utility tax). Currently approximately 50 cities throughout the state levy the tax.

Utility Tax RCW 35.21.870

A utility tax is levied on the gross operating revenues earned by utilities from operations within the boundaries of a city, as well as the city’s own utilities. Cities may levy the utility tax rate at a rate of 6% on natural gas, electric, steam energy, and telephone, unless a higher rate is voter approved.

How is the tax administered?

Local utility taxes are locally levied and collected.

Who levies this tax and at what rate?

The rate of utility tax is determined by each city’s ordinance, although cities are limited to a rate of 6% on natural gas and other utilities (note above), unless a higher rate is approved by the voters. According to AWC’s 2008 Tax and User Fee Survey, 137 cities levied a utility tax on natural gas as of January 1, 2008. The

average rate was 5.88% (high: 14.75%; low: 2%). (See the AWC Tax and User Fee Survey for more information about other utility tax rates, www.awcnet.org/tufs).

What is the tax base? -- Not all city ordinances the same

Not all cities have structured their city ordinances the same, which impacts who should be paying the utility tax on natural gas and who should be paying the brokered natural gas use tax. For example, some city ordinances are similar to the state definition of natural gas utility and require only entities owning the natural gas utility infrastructure to pay the utility tax. Other city ordinances required any entity owning or selling natural gas to pay the utility tax.

The breadth of a city's utility tax ordinance will, in part, determine when the utility tax is paid versus when the brokered natural gas use tax is paid.

Who pays? The same gas can't be taxed twice

Brokered natural gas use tax: In cities that impose the brokered natural gas use tax, users pay the use tax instead of the utility tax when gas is purchased out of state or used within a city and a utility tax has not been paid. Both individual residents and businesses are legally obligated to pay the brokered natural gas use tax.

Utility tax: In cities that levy a utility tax, privately-owned utilities pay a utility tax based on the gross revenues within the boundaries of the city. On city-owned utilities, the utility tax is based on the gross revenues of the utility in or outside of the city boundaries.