



**Revenue Ruling  
No. 04-009  
December 2, 2004  
Sales and Use Tax**

**Gas Compression Contracts**

This Revenue Ruling discusses the sales tax treatment of contracts involving the furnishing of gas compression services. This Revenue Ruling supersedes department Policy and Procedure Memorandum 70.3 (effective date November 18, 1985).

**Issue**

When the pressure of a natural gas field is less than the pressure of the pipeline system that transports this product, the gas is delivered into the system by a compressor. Questions arise over whether compressor units set up in gas fields that operate continuously for weeks or months without stopping are non-taxable service transactions or the lease or rental of tangible personal property that is subject to state and local sales taxes. La. Rev. Stat. Ann. § 47:301(7) defines a lease or rental as a transaction allowing another person to possess or use tangible personal property for a consideration without transferring title to the property. Conversely, providing a service where the owner maintains control over the tangible personal property would not be a lease or rental.

**Facts**

A natural gas compressor owner (hereafter owner) and a natural gas well owner (hereafter customer) enter into an agreement for use of a compressor that will deliver natural gas collected from the customer's well into a pipeline gathering system. The agreement lists the model of equipment used and the expected volume and pressure of gas delivered into the pipeline based on the specifications of the well being served. The length of the contract is for 24 months at which time it may be extended by mutual agreement or continued on a monthly basis until terminated by one of the parties. The owner delivers and installs the compressor at a location designated by the customer and provides a mechanic to maintain and adjust the compressor during the operating period. The mechanic is also available 24 hours per day in the event of a malfunction or shut down. An adjustment in the monthly charge is made if the equipment remains down for an excessive period of time. The customer agrees to protect the owner's property, provide fuel to power the unit, and allow access to the equipment by the owner's employees. The customer or his employees are not allowed to make adjustments to the compressors except to turn them off in case of an emergency.

The owner receives a flat monthly fee for use of the compressor. In addition to the monthly fee, the customer is separately billed for delivery, installation, monitoring, and servicing of the equipment. Servicing includes cleaning, calibrating, adjusting, routine maintenance, and minor repairs.

## Questions

The following questions have been asked regarding this issue:

1. Is the monthly charge for the compressor a taxable lease or rental of tangible personal property or nontaxable gas compression services?
2. Are the separate charges for delivering, installing, monitoring, and servicing, the equipment subject to sales and use tax?
3. Does this ruling conflict with prior pronouncements by the Department of Revenue and if so, will this ruling be enforced retroactively or prospectively?

## Analysis

According to La. Rev. Stat. Ann. § 47:301(7)(a), “Lease or rental’ means the leasing or renting of tangible personal property and the possession or use thereof by the lessee or renter, for a consideration, without transfer of the title of such property.” Breaking the statute into its component parts, four conditions are necessary for a taxable lease or rental to exist. They are:

1. *Possession or use;*
2. *of tangible personal property;*
3. *for a consideration;*
4. *without the transfer of title.*

In providing this analysis, it is assumed that the property involved is tangible personal property, that the customer pays a consideration to the owner of the property, and that title to the property is not transferred to the lessee or renter. Instead what is at issue is the extent and scope of the words “possession or use.”

Section 47:301(7)(a) requires that the lessee or renter must have “... possession or use ...” of the owner’s tangible personal property. “Possession” or “use” as defined in § 47:301(7)(a) can be understood in light of the Civil Code definitions of “lease” and “to let out a thing.” According to La. Civ. Code Ann. art. 2669, “*Lease or hire* is a synallagmatic contract, to which consent alone is sufficient, and by which one party gives to the other the enjoyment of a thing, or his labor, at a fixed price.” La. Civ. Code Ann. art. 2673 separates leases into the “letting out of things” and the “letting out of labor or industry.” Regarding the letting out of things, La. Civ. Code Ann. art. 2674 states, “To let out a thing is a contract by which one of the parties binds himself to grant to the other the enjoyment of a thing during a certain time, for a certain stipulated price which the other binds himself to pay him.”

Thus, enjoyment of a thing for a certain time helps to clarify “possession” or “use” in § 47:301(7)(a). The dictionary definition of these two terms also provides clarification on the meaning of § 47:301(7)(a).

## Possession

Because Louisiana’s sales tax statutes do not define possession, the generally prevailing meaning of this term should be used.<sup>1</sup> Webster’s Unabridged Dictionary 1405 (2d ed. 1983) defines

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<sup>1</sup> See *Cox Cable New Orleans, Inc. v. City of New Orleans*, 624 So.2d 890, 894 (La. 1993).

possession as, “*n.* 1. a possessing or being possessed; ownership, occupancy, hold, etc.” This implies that a person may have control over property legally (by ownership) or physically (by occupancy and hold). Black’s Law Dictionary 1183 (7<sup>th</sup> ed. 1999) describes “possession” as follows:

**possession, 1.** The fact of having or holding property in one’s power; the exercise of dominion over property. **2.** The right under which one may exercise control over something to the exclusion of all others; the continuing exercise of a claim to the exclusive use of a material object. **3.** (*usu. pl.*) Something that a person owns or controls; PROPERTY (2).

Since a lease or rental consists of the possession or use of tangible personal property without the transfer of title, the exercise of control over property must be viewed in the context of actual or physical possession rather than legal possession through ownership.

Under La. Civ. Code Ann. art. 3421, “Possession is the detention or enjoyment of a corporeal thing, movable or immovable, that one holds or exercises by himself or by another who keeps or exercises it in his name.” This is consistent with La. Civ. Code Ann. art. 2669, which provides that one party gives to the other the enjoyment of a thing under a lease. A person has enjoyment of a thing when he controls it either by operating the property or detaining it at a place of his choosing. Webster’s Unabridged Dictionary 1253 (2d ed. 1983) defines an operator as “*n.* 1. one who or that which operates or produces an effect.” Regarding machinery, it defines an operator as “4. a person who works some machine; as, a telephone *operator*.” This latter definition suggests that the property is under the direct control of a person. Running a bulldozer is an example often used to demonstrate this situation. Bulldozers must be under the continuous and direct control of an operator who has possession regardless of where the property is at the time of use. An owner may provide personnel to monitor or supervise the operation of or to maintain the bulldozer, but the person sitting in the seat has control. If the renter or his agent operates the equipment, then the transaction is a lease or rental and is subject to tax.

But bulldozers require continuous human input to ensure that the machine performs correctly. Many items, like paintings, do not require someone to operate them. Paintings simply hang on walls to be viewed by admirers. As expressed in La. Civ. Code Ann. art. 3421, in these instances possession of the property belongs to the party that “detains” the item at a location of his choosing. Renters have possession of paintings because they detain them on their premises or at locations they designate.

## Use

Section 47:301(7)(a) implies that a customer can lease or rent tangible personal property by obtaining use without possession. However, the sales tax statutes do not offer a definition of use as it relates to leases and rentals. Under La. Rev. Stat. Ann. § 47:301(18), “use” is “...the exercise of any right or power over tangible personal property incident to the ownership thereof...” However, leases and rentals occur without the transfer of title, so “use” under § 47:301(7) has a different meaning than “use” under § 47:301(18). Black’s Law Dictionary 1540 (7<sup>th</sup> ed. 1999) defines “use” as “The application or employment of something...” As with possession, there are many forms of use, but beneficial use may occur without an exchange of ownership. “Beneficial use” is “The right to use property and all that makes that property

desirable or habitable, such as light, air, and access, even if someone else owns the legal title to the property.” When an owner relinquishes possession of tangible personal property, the customer is leasing or renting the property even though actual or physical possession of the property is not transferred to the customer.

### **Possession or Use of the Compressors**

Similar to the painting on the wall, no one really operates a compressor. It functions autonomously without human direction. A mechanic may start the compressor and occasionally make adjustments to its operation but he does not truly operate the unit. Unlike a bulldozer that must function under the direct and immediate control of an operator, a compressor does not. A compressor runs for weeks or months at a time without any human intervention. Therefore, possession or use of the compressor is determined by who detains the property at a place of their choosing instead of who operates it.

### **Response**

#### **Question #1 – Is the monthly charge for the compressor a taxable lease or rental of tangible personal property or nontaxable gas compression services?**

The charge for the compressor is a taxable lease or rental of tangible personal property because the customer has possession or use of the property for a certain period of time for a certain stipulated price. Utilizing the definitions and explanations above, one can analyze several possible scenarios where tangible personal property is used in various fashions and title does not transfer to the customer. First, the owner retains possession of the property and provides a nontaxable service, which can occur in two ways. The owner can personally operate the equipment or detain the property at a place of his choosing. An example of the first case is where the owner or his employee performs services for the customer by operating a piece of equipment, such as a bulldozer. Because the owner has direct and immediate control of the property, he retains possession even when the customer designates where the service will occur. But the owner also retains possession when he detains the tangible personal property at a location of his choosing such as gaming devices at a video arcade. The devices are tangible personal property and customers have use of them for a consideration, but the transaction is not a lease or rental because the owner has retained possession by detaining the devices at a location of his choosing. These examples fall into the category of a nontaxable service.

The second scenario is where the customer obtains actual or physical possession of the tangible personal property. As described above, possession can occur in two ways. First, the customer secures the tangible personal property for a fee and personally operates the equipment. Using the bulldozer example, the customer or his agent operates the machine. Since the customer has direct and immediate control of the equipment, he has possession and is leasing the property even if the owner provides personnel to maintain or supervise the operation of the equipment. The customer can also possess tangible personal property by detaining it at a location of his choosing. An example of this is the lease or rental of a painting. The customer does not operate the painting but still has possession by detaining it at a location of his choosing.

Although more theoretical than the first two, the third scenario is that neither the owner nor the customer has actual or physical possession of the tangible personal property. La. Rev. Stat. Ann. § 47:301(7)(a) defines a lease or rental as possession *or* use of tangible personal property by the

lessee or renter. If neither party has possession, the transaction is a lease or rental whenever the customer receives a beneficial use from it. As such, the owner of the property must retain possession by either having direct and immediate control over the property or retaining it at a place of his choosing to remove the transaction from the classification of a lease or rental.

In this case, the gas compression contract represents a lease or rental because the compressor is detained at a location chosen by the customer, which indicates that he has possession of the property. Even though a mechanic regularly visits the compressor to maintain or adjust it, this does not rise to the level of operating the equipment. But even if the property is not in the possession of the customer, he has use of it. Thus, if neither party has possession, the transaction is still considered a lease or rental since the customer has use of the property.

**Question #2 – Are the separate charges for delivering, installing, monitoring, and servicing, the equipment subject to sales and use tax?**

Installation—This matter was litigated in the *Department of Revenue v. Baton Rouge SMSA Limited Partnership d/b/a BellSouth Mobility*, No. 423,577 (19<sup>th</sup> Judicial District Court Jun. 18, 1998). The case involved the sales and use tax treatment of separately stated charges for the installation of cellular telephones into vehicles. The court ruled that separately stated installation charges are not, as the Department contended, fabrications of tangible personal property but are services explicitly excluded from the definition of sales price under La. Rev. Stat. Ann. § 301(13)(a). Although this case involved the sale of tangible personal property, the installation of an item that is rented would also qualify for this treatment.

Delivery—In *Secretary of Revenue v. Patterson Services, Inc., dba Patterson Rental Tools*, 382 So.2d 971, (La. App. 1 Cir. 1980), the Department sought to tax transportation charges for the delivery of rental equipment from the lessor to his customers whether made by common carriers or the lessor’s own vehicles. The court ruled that the transportation charges were not part of the lease or rental and were not subject to tax. The Department acquiesced with this decision and there has been no statutory change altering the taxability of this item. Therefore, separately stated delivery charges are not subject to tax even for rental equipment.

Monitoring—La. Rev. Stat. Ann. §§ 302(B), 321(B), 331(B) and the sales tax ordinance of the Louisiana Tourism Promotion District levy the sales tax on the “gross proceeds” derived from the lease or rental of tangible personal property. In keeping with these statutes’ taxation of “gross proceeds,” La. Admin. Code tit. 61, § I.4303 provides, “Operating expenses and maintenance costs for keeping leased property in repair cannot be deducted from gross proceeds in arriving at the taxable base.” When an owner-lessor personally provides or contracts with another party to provide monitoring service in conjunction with the lease or rental in order to assure operation or continued suitability of his leased property, the monitoring charge is a component of the taxable base even when separately billed to the customer. If the owner charges a fee for monitoring equipment he is leasing to the customer, this charge is part of the lease or rental and is included in the taxable sale.

Service—The charges for most other services rendered and charged for by lessors in connection with their leases of compressors and other tangible personal property form part of the “gross proceeds” from leasing and renting. These taxable charges include, by way of example and not limitation,

those for inspection, calibration, cleaning, repairing, and adjusting the leased or rented property. The charges for these services are part of taxable “gross proceeds” even if separately stated.

**Question #3 – Does this ruling conflict with prior pronouncements by the Department of Revenue and if so, will this ruling be enforced retroactively or prospectively?**

The position described in this Revenue Ruling replaces Policy and Procedure Memorandum 70.3 (effective November 18, 1985). Therefore, the position asserted in this Revenue Ruling should be construed as applying to transactions for the furnishing of gas compression equipment occurring on and after the effective date of this Revenue Ruling.

**Conclusion**

The gas compression contract represents a taxable lease or rental under La. Rev. Stat. Ann. § 47:301(7)(a). A lease or rental exists when the owner relinquishes possession of the property and allows the customer to operate or detain it or allows the property to operate autonomously. Leases and rentals are taxable on the entire “gross proceeds” paid by lessees or renters, without any deductions for operating expenses and maintenance costs. The ruling is applicable to transactions for the furnishing of gas compression equipment occurring on and after the effective date of this ruling.

For more information regarding this topic, taxpayers should contact the Taxpayer Services Division at 225.219.7356.

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