Statement of Non-Acquiescence
No. 04- 001
Sales and Use Tax
December 2, 2004

***Hanover Compressor Company v. Department of Revenue, State of Louisiana*,**
02-0925 (La. App. 3 Cir. 2/05/03), 838 So. 2d 876

Purpose: The purpose of this statement is to announce that the Department of Revenue will not acquiesce in the decision of the Louisiana Board of Tax Appeals in *Hanover Compressor Company v. Department of Revenue* that was subsequently affirmed by the Fifteenth Judicial District Court and the Third Circuit Court of Appeal. The department disagrees with the Board's holdings that:

- a mixture of natural gas and liquids that is produced from a Louisiana well has no taxable value;
- a business transaction in which the producer of the mixture transfers the mixture to another for use in providing services to the producer is preempted from sales and use taxation because the mixture has borne a severance tax; and
- the decision by the Louisiana Supreme Court in *Columbia Gulf Transmission Co. v. Broussard*, 94-1650 (La. 4/10/95) 653 So. 2d 522, holding that sales or use taxes were due on the customer-supplied natural gas that a pipeline transportation company withdrew from its pipelines for use in powering its pipeline compressor engines, has no jurisprudential value in determining the sales taxability of a customer-supplied natural gas mixture that a gas compression company similarly withdrew from a wellhead and consumed in providing gas compression services to the producer of the natural gas mixture.

Analysis/Discussion: Hanover Compressor Company was engaged in the compression of natural gas produced from its customers' wells. The compression occurred at the wellheads after a liquid/gas mixture was obtained from wells. The liquids and gas were separated after the mixture was obtained from the well. The gas was still in "wet" form when it was compressed by Hanover's equipment. A portion of that wet gas mixture was used to fuel Hanover's compression equipment. The remaining liquid was then removed from the mixture. The natural gas then traveled through meters that monitored the volume of the gas.

Hanover's compression services were performed pursuant to a contract entered into with customers entitled "Contract Gas Compression Master Equipment & Operating Agreement". The contract provided that the natural gas producers who engaged Hanover's compression services were required to furnish to Hanover a sufficient quantity of suitable, sweet, dry natural gas for use in powering Hanover's compression equipment. The question of taxability of the customer-supplied gas mixture that was used to power Hanover's compression equipment formed the dispute between Hanover and the Louisiana Department of Revenue.

In determining that the tax was due, the department viewed the facts surrounding the use of the gas mixture to power the natural gas compression equipment in this situation as being akin to the facts in *Columbia Gulf*. In that case the Louisiana Supreme Court held that taxes were due on the natural gas that the Columbia Gulf Transmission Co., a company that transports natural gas

through interstate pipelines, obtained from its customers and consumed in powering its pipeline compressor stations.

The department considered the taxable value of the natural gas mixture that Hanover used as the difference between the amount that Hanover actually charged for its compression services, and the amount that Hanover would necessarily have charged for its compression services had the company been required to obtain natural gas to power its equipment from an outside source. The department argued that the transfer of the gas mixture to Hanover was a barter transaction in which Hanover accepted the gas in exchange for Hanover's providing gas compression services or the use of gas compression equipment at prices lower than would otherwise have been possible.

Following a hearing, the Louisiana Board of Tax Appeals found in favor of Hanover, vacating the department's assessment of taxes on the natural gas mixture. The department appealed the decision of the Board to the Fifteenth Judicial District Court, which affirmed the Board's decision. The Third Circuit Court of Appeal subsequently affirmed the decision of the Fifteenth Judicial District Court.

In holding that the tax was not due on the natural gas mixture, the Board of Tax Appeals cited several arguments against the assessment:

- That Hanover was provided "free use" of natural gas that was at all times owned by Hanover's customers, and that the natural gas mixture was never sold to or owned by Hanover. Since Hanover was not the owner of the gas, the company argued, Hanover could not be liable for the payment of sales or use tax on the "sales price" or "cost price" of the natural gas mixture.
- That there was no market for the natural gas mixture, such that a use tax could become due that was based on the lower of the actual cost or market value of tangible personal property;
- That the imposition of a tax on the natural gas mixture was barred by La. Const. Art 7, § 4(B) that authorizes the levy of a severance tax on natural resources, and further provides that "no further or additional tax or license shall be levied or imposed upon oil, gas, or sulphur leases or rights". In propounding this argument, Hanover cited the Supreme Court decision in *Bel Oil Corp. v. Fontenot*, 238 La. 1002, 117 So. 2d 571 (La. 1959), in which an assessment of gas gathering tax issued to Bel Oil was vacated on the basis of essentially identical language from the 1921 Constitution of Louisiana.
- That the facts and circumstances surrounding the consumption of this natural gas mixture in Hanover's compressors was sufficiently distinct from the facts and circumstances surrounding the consumption of the natural gas in powering Columbia Gulf Transmission Co.'s pipeline compressor stations, such that the Louisiana Supreme Court's determination of taxability in *Columbia Gulf* has no jurisprudential value in this case.

A trial court's jurisdiction to review a decision of the Board of tax Appeals is provided by La. Rev. Stat. Ann. 47:1435, as follows:

> "The district courts shall have exclusive jurisdiction to review the decisions or judgments of the board, and the judgment of any such court shall be subject to further appeal,

> suspensive only, in accordance with law. If a suspensive appeal is taken from a judgment of the district court no further bond need be posted and the bond originally posted remains in full force and effect to guarantee the payment of any tax, interest, and penalty until final decision of the court.
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> "Upon such review, such courts shall have the power to affirm or, if the decision of the judgment of the board is not in accordance with law, to modify, or to reverse the decision or judgment of the board, with or without remanding the case for further proceedings as justice may require."

The Third Circuit Court of Appeal pointed out in its written reasons for its affirmation of the Board and trial court decisions in this case that a trial court which reviews a decision of the Board of Tax Appeals is required to conduct its review and render its decision only upon the record that was before the Board. The reviewing trial court, the Third Circuit Court correctly observed, can consider only facts on the Board's record and questions of law. The Third Circuit Court cites the strict standard of review that the Louisiana Supreme Court handed down in *St. Pierre's Fabrication and Welding, Inc. v. McNamara,* 495 So. 2d 1295 (La.1986). Under that review standard, the Board's findings of fact are to be accepted by the reviewing trial court where there is substantial evidence in the record to support them. The Third Circuit, quoting the Louisiana Supreme Court in *St. Pierre's Fabrication and Welding* observes that these findings of fact are not to "be set aside unless they are manifestly erroneous in view of the evidence on the entire record." The courts similarly held in *Collector of Revenue v. Murphy Oil Co*., 351 So. 2d 1234 (La.App. 4 Cir. 1977), and *Crawford v. American Nat. Petroleum Co.*, 00-1063 (La.App. 1 Cir. 12/28/01), 805 So. 2d 371, that the Board's decision must be affirmed absent legal error or a failure to follow the correct procedural standards.

It is clear that the decisions of the reviewing courts in *Hanover Compressor* were limited by the above standards of review to the facts and arguments presented to the Board of Tax Appeals. The purpose of this Statement of Non-Acquiescence is to announce that the department in any future litigation concerning the sales or use taxability of gas mixtures consumed by compressor companies will articulate additional facts and arguments that were not available for consideration by the Board or the reviewing courts in the *Hanover Compressor* matter.

Department Position:

- La. Rev. Stat Ann § 47:301(12) defines the term "sale" to include the transfer of possession by barter. La. Rev. Stat. Ann § 47:302(A), 321(A), 331(A) and the sales tax ordinance of the Louisiana Tourism Promotion District each levy a tax upon the "sales price" of each item or article of tangible personal property when the property is sold at retail in Louisiana, and upon the "cost price" of each item or article of tangible personal property when the property is not sold, but is used, consumed, distributed, or stored for use or consumption in the state, provided that both the sales tax and the use tax are not duplicated on the same transaction. The Board of Tax Appeals correctly concluded in *Hanover* that there was a transfer of possession of the natural gas mixtures to Hanover, but failed to recognize that the transfers were taxable sales for consideration. The department will show in future cases that the transfers of gas mixtures are made for valuable consideration that forms the taxable price of the gas mixtures.

- La. Rev. Stat. Ann. § 47:301(13) defines "sales price" as the total amount for which tangible personal property is sold. Although the liquid/gas mixtures obtained from wellheads must be processed in order to become the sweet, dry, natural gas that is widely sold to industrial, commercial, and residential customers, there is a market for the natural gas mixtures among gas compression companies and others that are able to adapt the gas mixtures for use in powering their compression equipment, and among those that are able to further process the mixtures for resale. Thus, the natural gas mixtures have value. The "lower of cost or market" rule that applies to the definition of "cost price" under La. Rev. Stat. Ann. § 47:301(3) for use tax purposes does not apply in the case of sales or barter transactions in Louisiana that are subject to sales tax.

- La. Const. Art 7, § 4(B) bars an additional tax on natural gas that is levied upon the person who is directly liable to the state for the payment of the severance tax on the gas. The gas gathering tax that the Louisiana Supreme Court declared unconstitutional in *Bel Oil* was a tax that the Court determined was levied directly on the gas producer in violation of the barring constitutional language. In contrast, the sales tax that the department sought to collect in *Hanover* was levied not on the producer of the gas, but on the gas compression company that acquired the gas in a barter transaction. In the department's view, neither La. Const. Art 7, § 4(B) nor the Supreme Court decision in *Bel Oil* prohibit the levy of the sales tax on gas compression companies' consumption of fuels acquired from their customers in barter transactions.

- The Louisiana Board of Tax Appeals, and the two courts that reviewed the Board's decision in *Hanover*, all interpreted the Louisiana Supreme Court decision in *Columbia Gulf* as having no application to the facts of *Hanover*. The department respectfully disagrees, and intends in any future litigation regarding the sales taxability of natural gas mixtures consumed by gas compression companies to more fully develop the reasons why the decision in *Columbia Gulf* should be accorded full jurisprudential value in regard to the sales taxability of the natural gas mixtures.

  The Louisiana Supreme Court held in *Columbia Gulf* that a tax levied by the state on natural gas used by a pipeline company in powering its compressor stations would survive a test under the commerce clause of the United States Constitution if the tax could be shown to meet the four-pronged test set out by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S. Ct. 1076, 51 L. Ed. 326 (1977): (1) the tax is applied to an activity having a substantial activity with the taxing state; (2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to the state's services.

  In commenting that the tax on the natural gas sought in *Columbia Gulf* met the fair apportionment test, the Supreme Court said that the tax was fairly apportioned because it was levied only on gas consumed in Louisiana compressor stations. Evidence that the gas was levied only on Louisiana-consumed gas, the Court said, was that the gas was measured as it was removed from the pipeline for consumption by the compressor stations.

The Board of Tax Appeals in *Hanover* focused on the differences in the way natural gas mixtures are measured when coming from wellheads as compared to the way gas is measured when being withdrawn from pipelines and cited those differences as the reason that the decision in *Columbia Gulf* has no jurisprudential value in determining whether the sales tax is due on the consumption by compression companies of gas mixtures derived from their customers' wellheads. The department believes that in cases of withdrawals from both pipelines and wellheads, the tax is fairly apportioned in that the tax is applied only to Louisiana consumption. The department further believes that both the natural gas withdrawn from pipelines and the natural gas mixture withdrawn from wellheads should be taxable without regard to the differences in the timing of the measurement of the two products.

Questions concerning this matter can be directed to the Policy Services Division at (225) 219-2780.

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