Ohio Department of TAXATION

P.O. Box 530
Columbus, Ohio 43216-0530

Opinion of the Tax Commissioner

Date Issued: December 14, 2009

Opinion No: 09-0005

Tax: Commercial Activity

Subject: Natural Gas Marketer

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This request for an Opinion of the Tax Commissioner was received on December 15, 2008 and supplemental information was provided on July 28, 2009. The request concerns whether the business operations of XXXX ("Taxpayer") comply with the commercial activity tax ("CAT").

TAXPAYER STATEMENT OF THE FACTS

Taxpayer is a full-service natural gas marketing company providing supply and asset management services to utilities, industrial facilities, government agencies, power plants, and gas producers. Taxpayer is a fiscal year-end (September 30th) taxpayer that does business in multiple jurisdictions within the United States, including the State of Ohio. Taxpayer has timely filed returns for the CAT and the Ohio corporate franchise tax for all applicable prior tax periods. Taxpayer is a Delaware-based corporation with its principal place of business in [State-1]. Taxpayer does not own any gas stored or inventoried in the state and has no physical presence within the State of Ohio. The only gas owned by Taxpayer that may be present in Ohio would be gas in the stream of interstate commerce that is in the process of being transported into or through the state. In prior tax periods, Taxpayer has generated more than five hundred thousand dollars in taxable gross receipts within the State of Ohio. Taxpayer estimates that it will continue to generate more than five hundred thousand dollars in taxable gross receipts in the State of Ohio in future tax years.

As part of its supply services, Taxpayer sells natural gas products through a variety of transaction types to a wide range of customers. Some of its customers include wholesalers, as well as municipal and state governments. For purposes of characterizing Taxpayer's sales of natural gas products, the transactions are divided into two types: transactions where Taxpayer is supplying natural gas products to a buyer who will be the ultimate consumer of the products ("Retail Sale"); and transactions where the buyer will resell the product to another buyer, thereby

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making Taxpayer unaware of the final disposition of the products ("Wholesale Sale"). In each Retail Sale transaction, the ultimate consumer of the natural gas products may be located within or outside the State of Ohio.

Taxpayer retains ownership and title to the natural gas products through the distribution and transportation process. Ownership and title of the natural gas products transfer to the purchaser at a contractually specified delivery point, which is a specific geographic location, typically a gas terminal, pooling point, or storage facility along the transportation route.

Taxpayer's gross receipts include all charges invoiced to customers. These charges include receipts related to the amount charged for the natural gas products, delivery charges, penalty charges, sales taxes, and all other fees and charges billed to Taxpayer's customers. In determining taxable gross receipts, Taxpayer follows the sourcing of the charges for the natural gas products for purposes of sourcing all other fees, charges, and miscellaneous items included on the invoice.

Where applicable, Taxpayer currently includes the additional costs associated with the CAT, including Taxpayer's estimated CAT liability, in the price it charges for its natural gas products. The amount added is separately stated on each invoice as "GRF Recovery." Taxpayer's taxable gross receipts, as calculated for purposes of the CAT, are based upon the total invoice amount and include any amounts received as a "GRF Recovery" line item. Taxpayer plans on continuing its practice of recovering the costs associated with the CAT from its customers in future tax periods.

QUESTIONS PRESENTED BY TAXPAYER

1. Does Taxpayer have "bright-line presence" in Ohio pursuant to R.C. 5751.01(I)(3)?

2. Are any of the receipts Taxpayer references in the request eligible for exclusion from the definition of "gross receipts" pursuant to R.C. 5751.01(F)(2)?

3. Given that Taxpayer, as a gas marketer, does not produce or manufacture products, but merely purchases and resells commodity natural gas to its wholesale and retail customers, is the Ohio CAT liability based upon the gross margin between Taxpayer's purchase price and the sales price?

4. How should each type of Taxpayer's gross receipts be sitused for purposes of the CAT?

5. Is Taxpayer entitled to recover its Ohio CAT liability from its customers? Can Taxpayer invoice the CAT liability recovery as a separately stated item labeled "GRF Recovery" on the bill?

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ANALYSIS

Bright-Line Presence

The CAT is imposed on persons with gross receipts sitused to the state of Ohio.[1] For purposes of the CAT, the term "gross receipts" is broadly defined as the "total amount realized by a person, without deduction for cost of goods sold or other expenses incurred, that contributes to the production of gross income ***."[2]

Ohio law provides that a person is subject to the CAT when that person has substantial nexus with the State of Ohio. Specifically, R.C. 5751.01(H) sets forth the legal standard of substantial nexus used to determine whether a person is subject to the CAT. One of the legal standards utilized to determine whether a person is subject to the CAT is "bright-line presence".[3] Bright-line presence is defined in R.C. 5751.01(I). A person has "bright-line presence" in this state if any of the following standards apply to the person:

1. Has at any time during the calendar year property in this state with an aggregate value of at least $50,000.[4]
2. Has during the calendar year payroll in this state of at least $50,000.[5]
3. Has during the calendar year taxable gross receipts in this state of at least $500,000.[6]
4. Has at any time during the calendar year within this state at least 25 percent of the person's total property, total payroll, or total gross receipts.[7]
5. Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.[8]

As bright-line presence is satisfied when the person meets any of the criteria, a person may have substantial nexus even if the person does not have property or payroll in this state. Taxpayer meets bright-line presence by having taxable gross receipts of at least $500,000 during the calendar year.

Excludable Gross Receipts

When calculating gross receipts for the tax period, certain items are specifically excluded from the definition of "gross receipts". Such exclusions are found in R.C. 5751.01(F)(2). There are no specific exclusions for gross receipts related to natural gas products, delivery charges, penalty charges, or fees invoiced by Taxpayer. However, under R.C. 5751.01(F)(2)(p), Taxpayer may exclude sales tax collected as a vendor or an out-of-state seller on behalf of the

[1] R.C. 5751.01.
[2] R.C. 5751.01(F).
[3] R.C. 5751.01(H)(3).
[4] R.C. 5751.01(I)(1).
[5] R.C. 5751.01(I)(2).
[6] R.C. 5751.01(I)(3).
[7] R.C. 5751.01(I)(4).
[8] R.C. 5751.01(I)(5).

State of Ohio from a customer from the definition of gross receipts. Therefore, sales tax collected as a vendor or an out-of-state seller on behalf of the State of Ohio invoiced by Taxpayer may be excluded from taxpayer's gross receipts but all other amounts invoiced by Taxpayer are included in Taxpayer's gross receipts and subject to the CAT to the extent that they are sitused to Ohio pursuant to the R.C. 5751.033.

Calculation of CAT Liability

Taxpayer's CAT liability is not computed on gross margin or net income. As stated above, the CAT is imposed on persons with gross receipts sitused to the state of Ohio.[9] For purposes of the CAT, the term "gross receipts" is broadly defined as the "total amount realized by a person, without deduction for cost of goods sold or other expenses incurred, that contributes to the production of gross income ***."[10] An example of gross receipts includes "amounts realized from the sale, exchange, or other disposition of a taxpayer's property or to or with another". Therefore, Taxpayer's CAT liability is based on the gross receipts related to the sales of natural gas products, delivery charges, penalty charges or fees sitused to Ohio, with no deduction allowed for the acquisition cost or purchase price of the commodity resold by Taxpayer.

Situsing of Gross Receipts

R.C. 5751.033 governs the situsing of gross receipts. Specifically, R.C. 5751.033(E) addresses the situsing of gross receipts from the sale of tangible personal property. Such gross receipts shall be sitused to Ohio if:

> the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has been completed shall be considered the place where the purchaser receives the property.

Here, Taxpayer not only provides natural gas products to retail customers (i.e., the end user), it also provides natural gas products to wholesale customers.

In regard to Taxpayer's retail customers, the location where the natural gas products are received is easily determined. The retail customers to whom the natural gas products are disbursed have a known location within or outside of the state of Ohio. Therefore, natural gas products provided to retail customers are sitused to Ohio if the natural gas product is received by a retail customer at a location in Ohio.

In regard to Taxpayer's wholesale customers, Taxpayer states that natural gas products are fungible commodities that are sold with the purchaser obtaining the rights to receive a fixed

[9] R.C. 5751.01.
[10] R.C. 5751.01(F).

quantity of natural gas products at a contractually specified terminal or delivery point. Additionally, Taxpayer states that the natural gas products may not be disbursed from that terminal or delivery point, but that such right to a volume of natural gas products may be sold to another wholesale customer. Furthermore, Taxpayer states that the relevant volume of natural gas products may not actually physically move within the pipeline system before ultimately being disbursed to a retail consumer. After reviewing the contract provided, it appears Taxpayer's natural gas products should be sitused to Ohio if the contractually specified terminal or delivery point is located in Ohio. Because of the fungible nature of natural gas products, it is irrelevant that the natural gas product is not physically the same natural gas product that entered the pipeline. A comparison can be drawn between Taxpayer's wholesale customers and Taxpayer's retail customers. When Taxpayer's retail customers receive the natural gas product, they are removing the natural gas product from the pipeline system. The situation is similar to Taxpayer's wholesale customers, but the wholesale customers may choose not to remove their volume of natural gas from the pipeline system. Additionally, pursuant to the contract provided the responsibility for the natural gas product shifts from Taxpayer to the wholesale customers at the contractually specified terminal or delivery point (Base Contract for Sale and Purchase of Natural Gas Section 4.1). Therefore, based on the preceding analysis, natural gas products provided by Taxpayer to a wholesale customer should be sitused to Ohio if the wholesale customer has the right to receive the natural gas product from a contractually specified terminal or delivery point in Ohio.

If the situsing provisions in R.C. 5751.033 do not fairly represent the extent of Taxpayer's activity in this state, Taxpayer may request, or the tax commissioner may require, an alternative methodology pursuant to R.C. 5751.033(J). Should Taxpayer wish to employ an alternative method, it must request permission in writing within the applicable statute of limitations.

Finally, please note that pursuant to R.C. 5751.013 and Ohio Adm. Code 5703-29-06, the tax commissioner may require the value of property brought into the state within one year after it is received outside Ohio to be included as a taxable gross receipt if the commissioner finds that such transfer within one year was intended in whole or in part to avoid the CAT.

Separately Stating the CAT

Taxpayer may not continue to invoice its CAT liability recovery as a separately stated item labeled "GRF Recovery" on its bills. Pursuant to R.C. 5751.02(A), the CAT is levied on persons "with taxable gross receipts for the privilege of doing business in this state." R.C. 5751.02(A) further states that the CAT "is not a transactional tax" and "is not a tax imposed directly on the purchaser." The burden of the CAT lies on the person with taxable gross receipts. Taxpayer is entitled to recover its estimated CAT liability from its customers. However, R.C. 5751.02(B) requires that "the tax imposed by this section is a tax on the taxpayer and shall not be billed or invoiced and separately stated to another person." Nonetheless, such requirement under R.C. 5751.02 does not prohibit Taxpayer from increasing its price of natural gas in an amount sufficient to recover the CAT.

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ANSWER

1. Taxpayer meets bright-line presence by having taxable gross receipts of at least $500,000.

2. Sales tax collected as a vendor or an out-of-state seller on behalf of the State of Ohio invoiced by Taxpayer may be excluded from Taxpayer's gross receipts but all other amounts invoiced by Taxpayer are included in Taxpayer's gross receipts and are subject to the CAT to the extent that they are sitused to Ohio pursuant to R.C. 5751.033.

3. Taxpayer's CAT liability is based on the gross receipts related to the sales of natural gas products, delivery charges, penalty charges or fees sitused to Ohio, with no deduction allowed for the acquisition cost or purchase price of the commodity resold by Taxpayer.

4. Natural gas products provided to retail customers are sitused to Ohio if the natural gas product is received by a retail customer at a location in Ohio. Additionally, natural gas products provided to Taxpayer's wholesale customers should be sitused to Ohio if the wholesale customer has the right to receive the natural gas product from a contractually specified terminal or delivery point in Ohio. Taxpayer may timely request in writing, or the tax commission may require, use of an alterative situsing method if the standard method does not fairly reflect Taxpayer's activity in this state.

5. Taxpayer is entitled to recover its estimated CAT liability from its customers. However, Taxpayer may not continue to invoice its CAT liability recovery as a separately stated item labeled "GRF Recovery" on its bills.

CLOSING

This Opinion applies only to Taxpayer. It may not be transferred or assigned. In addition, the tax consequences stated in this Opinion are subject to change for any of the reasons provided in R.C. 5703.53(C). It is the duty of Taxpayer to be aware of such changes pursuant to R.C. 5703.53(E).

Richard A. Levin
Tax Commissioner