

Date Issued: July 2, 1982 (AGO 82-55)

Requested by: Kent Conrad, State Tax Commissioner

- QUESTIONS PRESENTED -

I.

Whether a retail sales tax must be paid on that part of the refined gas consumed in the operation of the refinery if the gas is owned by the refiner from extraction from the earth through the completion of the refining process.

II.

Whether a retail sales tax must be paid on that part of the refined gas consumed in the operation of the refinery if the raw gas is purchased from another person who extracts it from the earth for processing by the refiner.

III.

Whether a retail sales tax must be paid on that part of the refined gas consumed in the operation of the refinery if the raw gas is owned by others and processed by the refiner under contracts that authorize the refiner to use some of the refined gas to operate the refinery.

IV.

Whether either section 57-39.2-04(10) or section 57-51-03 of the North Dakota Century Code exempts a refiner from the requirement to pay sales tax on the refined gas consumed in the operation of the refinery as a result of payment of the five percent gross production tax imposed by chapter 57-51, N.D.C.C., on the value of raw gas extracted from the earth.

- ATTORNEY GENERAL'S OPINION -

I.

It is my opinion that a retail sales tax need not be paid on that part of the refined gas consumed in the operation of the refinery if the gas is owned by the refiner from extraction from the earth through the completion of the refining process.

II.

It is my further opinion that a retail sales tax must be paid on that part of the refined gas consumed in the operation of the refinery if the raw gas is purchased from another person who extracts it from the earth for processing by the refinery.

III.

It is my further opinion that a retail sales tax must be paid on that part of the refined gas consumed in the operation of the refinery if the raw gas is owned by others and processed by the refiner under contracts that authorize the refiner to use some of the refined gas to operate the refinery.

IV.

It is my further opinion that sections 57-39.2-04(10) and 57-51-03, N.D.C.C., do not exempt a refiner from the requirement to pay sales tax on the refined gas consumed in the operation of the refinery as a result of payment of the five percent gross production tax imposed by chapter 57-51, N.D.C.C., on the value of raw gas extracted from the earth.

- ANALYSIS -

I.

Section 57-39.2-02.1(1), N.D.C.C., imposes a three percent sales tax on the gross receipts of a retailer received from sales at retail of tangible personal property, including gas, to consumers and users. Clearly, if there is a retail sale of gas it is subject to the sales tax except as otherwise expressly provided in the sales tax law. For a sales tax to be applied, a retail sale must take place. A person who owns the right to minerals in place in the earth who then converts the minerals to tangible personal property by severing or extracting them from the earth and who consumes those severed minerals without transferring ownership or possession of them to anyone else, makes no sale at retail since the person consuming them is the same person who extracted them.

II.

Section 57-39.2-02.1, N.D.C.C., of the sales tax law, imposes the sales tax "upon the gross receipts of retailers from all sales at retail." Section 57-39.2-01(3), N.D.C.C., defines "retail sale" and "sale at retail" as meaning the sale "to a consumer or to any person for any purpose, other than for processing or for resale, of tangible personal property," and it defines "processing" as meaning "any tangible personal property including containers which it is intended, by means of fabrication, compounding, manufacturing, producing, or germination shall become an integral or an ingredient, or component part of other tangible personal property intended to be sold ultimately at retail."

Under these sales tax definitions, if raw gas extracted from the earth is purchased by a refiner and processed into refined gas and other products that it is intended will be sold ultimately at retail, the purchase of the raw gas by the refiner is a purchase for processing that is not subject to the tax because it is not a sale at retail. If, however, instead of selling some of the refined gas, the refiner consumes it by using it in the operation of the refinery,

the refiner then incurs a sales tax obligation on the purchase price it paid for the raw gas that was processed into the refined gas used.

Directly in point with this conclusion is the reasoning of the Court in International Business Machines Corporation v. Charnes, 601 P.2d. 622 (Colo. 1979), in which the plaintiff, IBM, was held liable for Colorado use tax on the cost to it of the raw materials and components it purchased and manufactured into business equipment that, instead of selling, it withdrew from inventory and diverted to its own internal use. In referring to the purchase by IBM of the raw materials and components that were manufactured into equipment sold by it, the Court said:

Where, as here, the buyer's ultimate disposition of the item purchased cannot be known at the time of purchase, the transaction's tentative characterization as "wholesale" may be corrected to "retail" by considering later events. 601 P.2d. 622, 625.

The price paid by the refiner for the raw gas that it processed into refined gas and which was consumed in the refining process is the price on which the tax is computed, which conclusion is consistent with the following sales tax provision rule set out in section 81-04-02-05 of the North Dakota Administrative Code.

81-04-02-05. PROCESSING. Tangible personal property, including nonreturnable containers in which sold, is sold for processing, and is exempt from the sales tax only when it is intended that such property, by means of fabrication, compounding, manufacturing, producing, or germination shall become an integral or an ingredient or component part of other tangible personal property intended to be sold ultimately at retail.

This provision of the sales tax rules has been a part of the Tax Department's sales tax rules for more than thirty-four years.

III.

Section 57-39.2-02.1, N.D.C.C., of the sales tax law, imposes the sales tax "upon the gross receipts of retailers from all sales at retail." Section 57-39.2-01(3), N.D.C.C., provides that "retail sale" or "sale at retail" means the sale, including the leasing or renting, to a consumer or to any person for any purpose, other than for processing or for resale, of tangible personal property. It also defines "processing" as meaning "any tangible personal property . . . which it is intended, by means of fabrication, compounding, manufacturing, producing, or germination shall become an integral or an ingredient, or component part of other tangible personal property intended to be sold ultimately at retail.

The term "sale" as used in the above definition of "retail sale" is defined in section 57-39.2-01(2), N.D.C.C., as meaning "any transfer of title or possession, exchange or barter, conditional or otherwise, in any manner or by any means whatever, for a consideration, and includes the furnishing or service of steam, gas, . . ."

When a refiner for a charge or fee takes raw gas belonging to others and processes it into refined gas and other products for them and the contracts for doing so provide that the refiner may divert some of the refined gas for its use in operating the refinery, there is a sale to the refiner within the meaning of "sale" as defined above in section 57-39.2-01(2), N.D.C.C., of the refined gas which the refiner consumes. All the elements of that definition are present. There is a transfer of title or possession, or both, of the refined gas to the refiner that is clearly within the language "exchange or barter, conditional or otherwise, in any manner or by any means whatever", and there is a consideration for the transfer because if the refiner had to purchase refined gas from a different source his charge for refining the raw gas would undoubtedly be higher. This consumption of the refined gas by a refiner is a retail sale within the definition of "retail sale", above, because it is a transfer for consideration to a person who consumes it for a purpose other than processing or resale. As such it is subject to the sales tax.

If the sales tax on the refined gas "sold" to the refiner is not charged to the refiner and collected from the refiner by the seller of the refined gas, the tax then is collectible as a use tax from the refiner by the Tax Commissioner because the use tax exemption provided in section 57-40.2-04(1), N.D.C.C., for retail sales that were taxed under the sales tax law cannot apply, nor does any other exemption in the use tax law apply. See *The North Dakota Sales and Use Tax* by John T. Singer and John F. Due, a report prepared for the North Dakota Legislative Research Committee, September 1, 1963, in which, on page 35, the authors recommended an amendment to section 57-40-03(1), N.D.C.C., which was enacted by the 1965 N.D. Session Laws, Chapter 435. Also see the 1965 Report of the North Dakota Legislative Research Committee, page 132, second paragraph.

IV.

Section 57-39.2-04(10), N.D.C.C., of the sales tax law, provides as follows:

57-39.2-04. EXEMPTIONS. There are specifically exempted from the provisions of this chapter and from computation of the amount of tax imposed by it the following:

10. Gross receipts from the sale of gasoline, insurance premiums, or any other article or product, except as otherwise provided, upon which the state of North Dakota imposes a special tax.

The above provision exempts from the sales tax the "gross receipts" from sales of articles or products upon which the State of North Dakota imposes a special tax. The term "gross receipts" is defined in section 57-39.2-01(6), N.D.C.C., of the sales tax law as meaning "the total amount of sales of retailers, valued in money, whether received in money or otherwise." Section 57-39.2-02.1(1), N.D.C.C., imposes the sales tax "upon the gross receipts of retailers." Thus, it is clear that the sales tax exemption provided in section 57-39.2-04(10), N.D.C.C., applies with respect to an article or product only if the gross receipts from the same retail sale are subjected to a special tax by North Dakota.

A five percent gross production tax is imposed by chapter 57-51, N.D.C.C., on gas extracted from the earth. This is not a tax on the gross receipts from the sale of that gas even though the measure of the tax is the value at the well of the gas extracted, as represented, usually, by the sale of the gas. The measure of a tax does not by itself determine the nature of the tax. In Southern Ry. Co. v. Watts, 260 U.S. 519, 529, 43 S. Ct. 192, 197 (1923), the Court said:

. . . But a privilege tax is not converted into a property tax because it is measured by the value of the property. . . .

In 85 C.J.S. Taxation, Section 1089, page 698, it is stated that:

. . . The fact that income is used as a measure of the tax does not make it an income tax. . . .

Rather than being a sales tax, the five percent gross production tax imposed on gas by section 57-51-02, N.D.C.C., is a tax on property. See Federal Land Bank of St. Paul v. State of North Dakota, 274 N.W.2d. 581 (N.D. 1979). The five percent gross production tax on gas extracted from the earth is, therefore, not a special tax on the amount received from the first sale of the gas so as to bring it within the exemption for gross receipts provided in section 57-39.2-04(10), N.D.C.C.

That "in lieu" tax provision in section 57-51-03, N.D.C.C., of the oil and gas gross production tax law provides that the gross production tax is in lieu of all ad valorem taxes on the properties described in that section, and includes the following sentence at the end of the section:

It is expressly provided that the gross production tax shall not be in lieu of income taxes nor excise taxes upon the sale of oil and gas products as retail.

The retail sales tax and the use tax imposed by chapter 57-39.2 and 57-40.2, N.D.C.C., are not property taxes, rather they are excise taxes imposed with respect to a retail sale made to a consumer.

-EFFECT-

This opinion is issued pursuant to section 54-12-01, N.D.C.C. It governs the actions of public officials until such time as the question presented is decided by the courts.

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