STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
TEXAS EASTERN TRANSMISSION CORP.	:	DECISION DTA NO. 815098
for Redetermination of a Deficiency or for Refund of Corporation Tax under Article 9 of the Tax Law for the Years 1989 through 1991.	:	

Petitioner Texas Eastern Transmission Corporation, Attention: Harley H. Priesmeyer, P. O. Box 1642, Houston, Texas 77251, filed an exception to the determination of the Administrative Law Judge issued on September 18, 1997. Petitioner appeared by Harold M. Seidel, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (James P. Connolly, Esq., of counsel).

Petitioner filed a brief in support of its exception and a reply brief. The Division of Taxation filed a brief in opposition. Oral argument, at petitioner's request, was heard on May 14, 1998 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioner was principally engaged in the business of supplying gas through mains or pipes or principally engaged in the conduct of a transportation business.

II. Whether, if petitioner was principally engaged in the business of supplying gas, the imposition of the tax imposed by Tax Law § 186 on petitioner's gross earnings from all sources within New York violates the Commerce Clause of the United States Constitution.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, Texas Eastern Transmission Corporation, and the Division of Taxation ("Division") entered into a stipulation of facts. The stipulated facts have been substantially incorporated into this determination and supplemented by additional facts to more completely reflect the record.

Petitioner is a Delaware Corporation with its principal office and place of business in Houston, Texas. Petitioner had no offices or employees in New York State during the years in issue, 1989 through 1991.

Before October 1985, petitioner was in the business of supplying natural gas to its customers in New York and other states. These customers were primarily utility companies. Petitioner purchased natural gas at the wellhead in Texas and Louisiana and transported it through its system of interstate pipelines to purchasers in other states. Because it was principally engaged in the business of supplying natural gas through mains or pipelines, it was subject to the taxes imposed by sections 186 and 186-b of the Tax Law. In the industry, petitioner was known as a "merchant" of natural gas, a term that will be adopted here.

As a merchant of natural gas, petitioner was subject to the regulatory jurisdiction of the Federal Energy Regulatory Commission ("FERC").

In October 1985, FERC issued an "Open Access Order" (Order 436) which required interstate pipeline companies to use their pipelines to transport natural gas owned by third parties on a nondiscriminatory basis. Under this order, petitioner acted as a common carrier in transporting natural gas owned by others. The natural gas was transported from the producing areas in the south to a delivery point designated by the owner of the gas, usually a conjunction point between petitioner's pipeline and the distribution system of a local gas distributing company.

During the years under consideration, petitioner was engaged in two businesses: (1) buying, transporting and selling gas as a natural gas merchant, and (2) transporting the natural gas owned by third parties as a common carrier.[1]

During the relevant years, the pipeline system owned and operated by petitioner extended from Texas to the Northeast and Midwest United States, terminating on Staten Island, New York. The pipeline located in New York State was about 2.5 miles long. The total length of petitioner's pipeline system was about 1,900 miles. The terminus of the pipeline system in New York was a meter and regulating station located at North Washington and Western Avenues on Staten Island. From there, the pipeline was connected to a pipeline system owned by Brooklyn Union Gas Company. This, in turn, was part of a pipeline network owned by Brooklyn Union Gas Company, Consolidated Edison Company of New York and Long Island Lighting Company, known as the New York Joint Distribution Facilities System.

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[1]During the same period, petitioner operated natural gas storage facilities in Pennsylvania and Maryland. Storage of gas was not a separate business but was incidental to petitioner's businesses of functioning as a natural gas merchant and as a common carrier.

Petitioner could and did accurately measure (by use of meters and other devices) the volume of gas that it bought, transported and sold and the volume of third-party gas that it transported as a common carrier.

Petitioner filed 1989, 1990 and 1991 New York corporation tax reports as a supplier of natural gas under Tax Law § 186. In those years, petitioner's gross receipts from the sale of natural gas exceeded its gross receipts from the transportation of gas for third parties. In 1989, 84.6 percent of petitioner's total revenues were from the sale of natural gas; in 1990, 79.7 percent of petitioner's total revenues were from the sale of natural gas; and in 1991, 67.4 percent of petitioner's total revenues were from the sale of natural gas. The parties stipulated to the accuracy of the figures in the following table which compares petitioner's sales receipts with revenue from other sources. Figures are expressed in millions.

Year	Gross Sales Receipts	Transportation Receipts	Other Revenue[2]	Total Revenue
1989	1722.0	205.9	107.5	2035.4
1990	1339.9	239.2	101.9	1681.0
1991	1066.2	370.9	144.0	1581.1

Petitioner's corporation franchise tax returns for 1989, 1990 and 1991 show an allocation of gross earnings from interest, dividends and other revenue based on an allocation percentage calculated by dividing gross earnings from operating revenues sourced to New York

[2]Other revenue represents amounts that were realized incidental to operation of petitioner's interstate natural gas pipeline. Specifically, they include income from the sale of high-BTU products removed from natural gas delivered to the pipeline in order to make the gas of pipeline quality; rent received from gas property; income from the sale of natural gasoline that is present in some natural gas but which condenses from the natural gas as it is transported by the pipeline; and transportation revenues from liquid hydrocarbons produced offshore which are transported under a transportation tariff in the following amounts: 1989- $700,000; 1990- $1,100,000; 1991- $300,000; and income from storage of gas.

by gross earnings from operating revenues everywhere. For 1989, petitioner calculated an allocation percentage of 6.8843 percent; for 1990, petitioner calculated an allocation percentage of 7.8062 percent; and for 1991, petitioner calculated an allocation percentage of 8.0782 percent. In calculating these percentages, petitioner apparently included sales receipts and transportation receipts in gross earnings from operating revenues sourced to New York and everywhere.

During the same three-year period, the volume of natural gas petitioner transported for third parties exceeded the volume of natural gas sold by petitioner. In 1989, 52.2 percent of the gas transported was for third parties; in 1990, 65.1 percent of the gas transported was for third parties; and in 1991, 79.9 percent of the gas transported was for third parties. The percentages are based on the following figures, representing billions of cubic feet of natural gas. Petitioner also transported relatively small amounts of liquid hydrocarbons which are not reflected in the table.

Year	Gas Transported for 3rd Parties	Gas Transported for Sale	Total Gas Transported
1989	574	525	1099
1990	677	363	1040
1991	778	196	974

On September 13, 1994, petitioner filed claims for refund of tax paid for the years 1989, 1990 and 1991. It claimed that it had improperly filed returns and paid tax as a supplier of gas under Tax Law § 186 when it should have filed and paid tax as a transportation business under sections 183 and 184 of the Tax Law. For each of the subject years, it filed a form CT-183 (Franchise Tax Return on Capital Stock), a form CT-184 (Franchise Tax Return on Gross Earnings), forms CT-183M and CT-184M (Metropolitan Transportation Business Tax Surcharge

Return[s]) and a CT-8 (Claim for Credit or Refund of Corporation Tax Paid).[3] Petitioner calculated refunds of tax as follows:

Year	1989	1990	1991
Section 186 Tax Paid	1,194,073.58	1,096,280.07	1,157,080.00
Section 183 Tax Due	44,172.00	50,695.00	45,358.00
Section 184 Tax Due	1,520.00	1,175.00	994.00
Refund Requested	1,148,381.58	1,044,410.07	1,110,728.00

By letter dated April 7, 1995, the Division denied petitioner's refund claims on the ground that petitioner's returns were filed properly under section 186 of the Tax Law. The Division reasoned that since petitioner derived more than 50 percent of its gross receipts from the sale of gas it was principally engaged in the business of supplying gas and, therefore, subject to the tax imposed on gas suppliers under section 186. As relevant, the refund denial letter explains the Division's position as follows:

> We have consistently applied a gross receipts test in order to determine which business a taxpayer is "principally engaged" in. Advisory opinions on this subject, including TSB-A-89(11)C attached, mention that "ordinarily" a corporation is deemed to be principally engaged in the activity from which it derives more than 50% of its gross receipts, however, we do not interpret "ordinarily" to mean that alternative methods may be more appropriate, as you have stated. Instead, we feel the word is used in the sense that, if a taxpayer were to fall below the 50%

[3]Sections 183-a, 184-a and 186-b of the Tax Law impose tax surcharges on companies doing business within certain metropolitan districts in the State. For ease of discussion, a reference to Tax Law §§ 183, 184 or 186 may be considered to include a reference to the provision imposing the corresponding surcharge.

> threshold in any given year (say to 49% while other years exceeded 50%) we would not hold them to a reclassification.

FERC issued its Order 636, effective June 1, 1993, requiring interstate pipelines such as petitioner to provide only common carrier transportation services and barring such pipelines from purchasing, transporting and selling natural gas.

In a sworn affidavit, Greg P. Bilinski, petitioner's general manager for over 21 years, states that the transportation of a cubic foot of natural gas by petitioner uses the same amount of labor and assets whether the gas is owned by petitioner or a third party. He also states that the amount of assets and labor employed by petitioner's two businesses, gas merchant and common carrier, was directly proportional to the volume of gas transported by the pipeline in each business. Other statements made in the affidavit were stipulated to by the parties.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In her determination, the Administrative Law Judge noted that Tax Law § 186(1) imposes a tax on "gross earnings from all sources within this state" and "the amount of dividends paid upon the actual amount of paid-in capital employed in this state" of a corporation formed for or “principally engaged in the business of” supplying gas when delivered through mains or pipes for the privilege of exercising its corporate franchise or carrying on its business. However, if petitioner is "principally engaged in the conduct of a transportation or transmission business," then it is subject to a franchise tax on its capital stock pursuant to Tax Law § 183 and an additional tax on gross earnings pursuant to Tax Law § 184. Thus, the Administrative Law Judge determined that the principal issue to be resolved was whether petitioner was principally engaged in the business of supplying gas through mains or pipes or principally engaged in the conduct of a transportation or transmission business.

Although the Appellate Division stated in ***McAllister Bros. v. Bates*** (272 App Div 511, 72 NYS2d 532, ***lv denied*** 272 App Div 979, 73 NYS2d 485) that the classification of a corporation for franchise tax purposes is to be determined by the nature of the corporation's business, the Court did not identify the factors to be considered in making that determination where, as here, petitioner was engaged in two distinct business activities, each taxed by different sections of Article 9. Petitioner claimed that it was principally engaged in the business to which it dedicated more of its assets and employees and that its use of assets and employees was directly proportional to the amount of gas traveling through its pipeline. The Division, however, argued that petitioner's gross receipts provided the best measure of petitioner's business activity and since over 50 percent of petitioner's gross receipts were from its supply activity, petitioner was principally engaged in the business of supplying gas and properly taxed under Tax Law § 186.

The Administrative Law Judge agreed with the Division's position, finding that it was consistent with the Division's long-standing policy of categorizing corporations by gross receipts. The Administrative Law Judge noted that the term "principally engaged" is not defined by statute and concluded that the legislative history of Article 9 provided little insight into the legislative intent in using this term. The Administrative Law Judge then applied established principles of statutory construction which require that, where possible, words of a statute should be interpreted in their ordinary, everyday sense. Relying on ***Matter of Aetna Cas. & Surety Co. v. Tax Appeals Tribunal*** (214 AD2d 238, 633 NYS2d 226, ***lv denied*** 87 NY2d 811, 644 NYS2d 144), the Administrative Law Judge concluded that if the Division's interpretation of the statute is reasonable, petitioner has the burden of showing that its own

construction of the statute is the only reasonable one or that the Division's interpretation is unreasonable.

The Administrative Law Judge accepted the Division's arguments that the use of gross receipts provides a single standard for comparing different business activities of the same taxpayer and of different taxpayers. The Administrative Law Judge noted that the use of gross receipts as a measure of business activity was indirectly adopted in ***Matter of Stat Equip. Corp.*** (Tax Appeals Tribunal, January 25, 1996) and that judicial opinions, especially ***Matter of RVA Trucking v. New York State Tax Commn.*** (135 AD2d 938, 522 NYS2d 689), support the use of gross receipts as a measure of the petitioner's activities. The Administrative Law Judge concluded that petitioner did not establish that its own construction of the statute is the only reasonable one because petitioner did not show that more of its assets and labor were used in its transportation business than in its gas supply business

The Administrative Law Judge also noted that the use of gross receipts as a measure of business activity is consistent with the intent of Tax Law § 186. Since the tax is imposed on the taxpayer's gross receipts, it is reasonable to construe the statute to mean that a taxpayer is "principally engaged" in the activity from which it receives more than 50 percent of its gross receipts. In this case, over 65 percent of petitioner's gross receipts were from its merchant activity in each year under review. The Administrative Law Judge concluded that while the use of gross receipts might produce a distorted picture of petitioner's business activity because its gross receipts included the cost of gas sold, legislative history showed that the Legislature specifically intended to include the cost of goods sold in the tax base. Thus, any distortion of

petitioner's business activities is equally applicable to the business activities of every other supplier of gas taxed under Tax Law § 186 as well.

Petitioner asserted that to the extent the section 186 tax applies to sales in New York of gas brought into the state from another state, that section is unconstitutional as applied because it is an unapportioned gross receipts tax which violates the Commerce Clause. The Administrative Law Judge concluded that petitioner did not meet its burden of explaining why, in relation to the specific facts or circumstances of petitioner's case, section 186 fails to meet the test of fair apportionment necessary for a tax to apply to interstate transactions. Absent this, the Administrative Law Judge concluded that petitioner's challenge was to the facial constitutionality of Tax Law § 186 and, since legislative enactments are deemed to be constitutional at the administrative level, she did not address the merits of petitioner's argument.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that the Administrative Law Judge improperly concluded that petitioner's classification for franchise tax purposes could be determined by measuring petitioner's gross receipts for the years at issue. Although more than 50 percent of petitioner's gross receipts were derived from its supply business during these years, more than 50 percent of the total volume of gas transported by petitioner's pipeline was owned by third parties. Petitioner argues that case law requires that a taxpayer's classification must be determined based on the nature of the taxpayer's business, viewing the business in its entirety from the perspective of its customers and not on the contents of its certificate of incorporation or by focusing on one aspect of its business. Petitioner argues that, in the instant case, petitioner's principal business was the one in which more of its assets were employed. Since petitioner's assets employed in each

business were employed in proportion to the volume of gas transported through its pipes and mains, that volume should be the determining factor in petitioner's classification for franchise tax purposes. Petitioner argues that its evidence of employment of business assets is uncontradicted and should have been conclusively accepted by the Administrative Law Judge.

Petitioner argues that the Division implicitly recognizes that gross receipts are not always an appropriate measure in its advisory opinions by stating that gross receipts measure principal activity "ordinarily." Petitioner argues that consideration of gross receipts when determining principal business activity has been, at best, dicta in the cases relied on by the Administrative Law Judge. Further, petitioner argues that under sections 183 and 184, "gross earnings" are not the same as gross receipts under section 186. Therefore, the use of gross receipts without deduction for the costs of materials sold has no application for purposes of sections 183 and 184.

If petitioner is held to be liable for franchise tax under section 186, then it argues that such tax is imposed unconstitutionally because it is an unapportioned franchise tax which violates the interstate commerce clause, relying on ***Complete Auto Transit v. Brady*** (430 US 274, 51 L Ed 2d 326) and ***Oklahoma Tax Commn. v. Jefferson Lines*** (514 US 175, 131 L Ed 2d 261). Although the component of the section 186 tax imposed on excess dividends is apportioned, the tax levied on gross receipts is not. Petitioner argues that section 186 is unconstitutional as applied to it, although it remains constitutional as applied to intrastate transactions.

The Division, in opposition to petitioner's arguments, asserts that the Administrative Law Judge's determination was correct. The Administrative Law Judge, argues the Division, properly accorded little weight to petitioner's evidentiary affidavit. The Division states that although it did not raise an objection to its admittance into evidence, it did not necessarily accept the

accuracy of the statements contained therein. It argues that the absence of the introduction of contradictory evidence by the Division does not diminish petitioner's burden to prove its case by clear and convincing evidence. Further, it argues that the Administrative Law Judge is free to disregard even uncontroverted evidence.

The Division asserts that the Administrative Law Judge correctly concluded that gross receipts provide the appropriate measure of the business in which petitioner was principally engaged during the years in question. The use of volume of gas transported as a determinative factor does not necessarily take into account any of the other revenue producing activities engaged in by petitioner. However, gross receipts is, in effect, a common denominator for all such activities. Further, the Division argues that petitioner has cited no authority for its use of volume as a measuring device herein. On the contrary, Tribunal and judicial decisions have acknowledged gross receipts as a factor in determining a taxpayer's principal business activity for purposes of Article 9 and implicitly accepted gross receipts as a test.

The Division also argues that petitioner's constitutional challenge is not to section 186 as applied to it, but rather, to the facial constitutionality of that statute. The Division argues that petitioner has not provided any evidence or specific argument to show that the statute, as applied to its particular circumstances, violates the Commerce Clause. Nor has petitioner shown that its receipts from sales of natural gas in New York are not gross earnings from New York sources or how the taxation of those receipts reaches beyond the economic activity in the State.

OPINION

Tax Law § 186(1) provides, in relevant part, as follows:

> Every corporation . . . formed for or principally engaged in the business of supplying water, steam or gas, when delivered through

> mains or pipes, . . . shall pay [a tax] for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this state (emphasis added).

Transportation companies are subject to a franchise tax on capital stock (Tax Law § 183) and an additional tax on gross earnings (Tax Law § 184). As pertinent to the issues raised here, companies subject to the taxes imposed by sections 183 and 184 are those "principally engaged in the conduct of a transportation or transmission business" (Tax Law § 183[1][b]; § 184[1]).

Thus, petitioner asks us to conclude that, in the absence of specific statutory guidelines, the Division's use of gross receipts to determine the principal business in which petitioner is engaged is unreasonable. Instead, petitioner argues that the Division must rely on the volume of gas shipped by petitioner as indicative of the fact that it is principally engaged in a transportation business rather than in the business of supplying gas. Thus, petitioner argues that it is appropriately taxed under sections 183 and 184 rather than under section 186. We decline to accept petitioner's position for the reasons noted by the Administrative Law Judge in her determination, i.e., that petitioner has not met its burden to show that the Division's position is unreasonable or that petitioner's interpretation is the only reasonable interpretation of the statute (***see***, ***Dental Society of State of N.Y. v. New York State Tax Commn***., 110 AD2d 988, 487 NYS2d 894, ***affd*** 66 NY2d 939, 498 NYS2d 797, ***quoting Matter of Blue Spruce Farms v. New York State Tax Commn.***, 99 AD2d 867, 472 NYS2d 744, ***affd*** 64 NY2d 682, 485 NYS2d 526).

There is no statutory or regulatory definition of "principally engaged in the conduct of" either a transportation or transmission business or that of supplying gas through mains or pipes, and the application of the normal tools of statutory construction and interpretation such as the words of the act, legislative history and precedent shed little light on the meaning of the phrase.

At best, we can conclude that petitioner's interpretation is one of several methods that might have been chosen by the Division in applying the provisions of sections 183, 184 and 186. However, that is not sufficient for petitioner to be successful in its challenge.

Moreover, we believe the Administrative Law Judge was correct in her conclusion that petitioner did not meet its burden to show that more of its assets and labor were used in its transportation business than in its gas supply business. Petitioner's evidentiary affidavit stands for the proposition that in effecting the shipment of gas through its pipelines, the same amount of labor is employed to ship a cubic foot of gas owned by petitioner as for a cubic foot of gas owned by another entity. This is not sufficient to conclude that petitioner employs all of its business assets in direct proportion to the amount of gas shipped which is owned by others versus the amount of gas shipped which is owned by petitioner.

The premise of petitioner's argument requires us to assume that it conducts no other activities or employs no assets other than in the movement of gas through its pipelines. The record contains no foundation that would support such a conclusion. To the contrary, the stipulation entered into by the parties indicates that in the years at issue, petitioner's gross receipts from "other revenue" ranged from 38 percent to over 50 percent of its gross receipts from its transportation business. No explanation is offered of how petitioner's business assets are allocated to the activities which produced these "other revenues."

Perhaps most important is the lack of data concerning the transportation activities themselves. Petitioner's proportional activity argument is based on its overall shipments of gas to all locations. Although petitioner asserts that the same amount of resources are employed in moving a cubic foot of gas through its pipes regardless of the ownership of such gas, we cannot

simply conclude that all gas was moved through these pipes for the same distance. For example, we know from the record that the gas owned by petitioner was transported from wellheads in Texas and Louisiana to New York, a considerable distance. The gross receipts from the New York sales of this gas were part of the section 186 tax base. However, if gas owned by others was introduced into the pipeline system at the same point as the gas owned by petitioner and if such gas was delivered to customers at points closer to the wellhead than New York, how much of petitioner's assets were employed to transport such gas? The record is silent on this point. Petitioner would have us conclude that the same amount of labor and resources were employed in moving a given volume of gas through the pipeline not only without regard as to who owned it but regardless of whether it was transported one mile, 100 miles or 1,000 miles. There is no support for such a premise in the record and it appears counterintuitive for us to make such a conclusion.

As to petitioner's constitutional argument that section 186 is an unapportioned gross receipts tax which impermissibly discriminates against petitioner in violation of the Commerce Clause, we agree with the Administrative Law Judge that this challenge is to the facial constitutionality of section 186. Petitioner's arguments necessarily apply to all corporations subject to the tax who engage in interstate commerce and there are no specific facts in the record which demonstrate that the application of section 186 impermissibly discriminates only in its application to petitioner. Thus, if petitioner were correct that section 186 fails to meet the fair apportionment test prescribed by the Supreme Court in ***Complete Auto Transit v. Brady (supra)***, the statute would be struck down as unconstitutional on its face. Consideration of such an issue

is beyond the jurisdiction of the Tax Appeals Tribunal (***Matter of Fourth Day Enters.***, Tax Appeals Tribunal, October 27, 1988).

As a result, we affirm the determination of the Administrative Law Judge for the reasons set forth therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Texas Eastern Transmission Corp. is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Texas Eastern Transmission Corp. is denied; and

4. The denial of Texas Eastern Transmission Corp.'s claims for refund of tax is sustained.

DATED: Troy, New York
November 12, 1998

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner