

**M e m o r a n d u m****415.0080**

To: Mr. T. P. Putnam

Date: March 4, 1968

From: J. Kenneth McManigal

Subject: Application of Sales Tax to the Sale of Processed Gas by Co-owned Gas Plants to Their Respective Owners Therein

The question as to what constitutes a "person" as defined by Sales and Use Tax Law Section 6005 for purposes of that law arises herein from the business practices of independent oil companies which have jointly agreed to construct, maintain, and/or operate co-owned gas plants, gas gathering systems, and gas extraction plants. Should these co-owned gas plants be treated as "persons" for purposes of Sales and Use Tax Law under that portion of Section 6005 defining the term "person" as including "any other group or combination acting as a unit?"

The terms and conditions pursuant to which these plants and systems are operated are set forth in written agreements executed by representatives of the participating oil companies. In general, ownership of the plants and systems is held by the companies as tenants in common, although actual operation is effected by operators, usually participating companies, which act as agents for each owner. The operators' authority as agents extends solely to the operation and protection of each owner's interest in the plant operation and facilities, and the owners retain certain management powers over the plant administration. Each owner pays that part equal to its participating equity of all costs and expenses of the plant operation and of operations authorized by the agreements to be incurred or paid. In addition, the operators receive a monthly sum from the owners as reimbursement for overhead costs. The operators, as such, are not liable to any owners for any loss or damage. The advantages gained from these joint-practices are evident in the reduced processing costs for each company, together with the regulation of proper cycling and maximum production from each company's property. Also, non-owners' gas may be processed by the plants upon terms and conditions specified by the owners.

Each owner furnishes its natural gas to the operator, who then processes it and redelivers it in kind. The processing operation consists of the withdrawal of wet gas through processing wells, the extraction of the liquid contents from the gas, and the return of the residue or dry gas to the reservoir by means of injection wells. The principal purpose of the operation is to maintain the

reservoir pressure so that the heavier hydrocarbon content of the gas will not condense in the reservoir and become unrecoverable. The extraction of the liquid content of the gas (processing) occurs as the wet gas moves into the co-owned processing plants where it is passed through separators which remove the liquid content and return the residue or dry gas under pressure to the reservoir.

I have reviewed the points and authorities advanced by "L" in his letter dated December 28, 1967 concerning the interpretation of California Sales and Use Tax Law Section 6005. After this review, my opinion is that, under that part of Section 6005 defining "person" as "any other group or combination acting as a unit", the jointly owned gas plants in question should be considered as separate entities (persons) for purposes of determining the applicability of California Sales and Use Tax Law to the gross receipts from the transactions in which they engage.

In his letter, "L" suggests that an analogy should be drawn with Revenue and Taxation Code, Part 11 (Bank and Corporation Tax Law), in determining what constitutes a separate entity for the purposes of the Sales and Use Tax Law. The Bank and Corporation Tax Law, however, is concerned only with corporations and with associations equivalent to corporations, while the Sales and Use Tax Law is concerned with individuals and various forms of organizations, including corporations, partnerships and "any other group or combination acting as a unit". Since the definition of "person" in the Sales and Use Tax Law is much broader than the definition of "corporation" in the Bank and Corporation Tax Law, I do not think that an appropriate analogy can be drawn between the definitions in the respective laws.

As for the question as to whether operation of these co-owned gas plants is carried on for "gain, benefit or advantage", these terms were discussed by the court in *Union League Club v. Johnson*, 18 Cal. 2d 275. In that case, plaintiff asserted that the statute applied only to those engaged in business for profit because the taxable activity was required to be "with the object of gain, benefit or advantage."

In rejecting this contention, the court stated at page 278:

"It is significant that the statute does not include the word 'profit' in its definition but imposed a tax upon the transactions of one conducting business 'with the object of gain, benefit or advantage, either direct or indirect.' Assuming that no profit was either intended or realized by the club from the operations of its dining room and bar, it does not follow that there was no 'gain, benefit or advantage.'"

Thus, sales tax applied to sales made by plaintiff, even though no profit was realized therefrom, since there was taxable activity with the object of gain, benefit or advantage within the meaning of the statute. As the furnishing of meals and liquor by a club to its members at or below cost is a taxable activity, so also should the processing of gas by a co-owned gas plant for its owners at cost be a taxable activity. Gain, benefit or advantage occurs in the form of reduced operating costs and expenditures plus conservation of natural resources.

I do not view the case of *Cooperative Power Plant v. Commissioner of Internal Revenue* (1940) 41 B.T.A. 1143, as support for "L"'s position. In that case it was held that a jointly operated

power plant, which supplied water, steam, electricity and other services at the cost of production was not an association (a separate entity) taxable as a corporation for income tax purposes. However, as I have previously noted, what is a corporation or association for income tax purposes is not determinative of what is a person for sales and use tax purposes.

By the same token the term "gain" may be seen to have a different meaning for income tax purposes than for sales and use tax purposes. Thus, in *Cooperative Power Plant v. Commissioner of Internal Revenue*, supra, where services were supplied at cost, gain was only through savings in the cost of water, steam, electricity, etc. For income tax purposes, gain, as the term is generally understood, was not an object of the jointly operated plant. For sales tax purposes, however, the concept of profit, gain, as the term is generally understood, was distinguished from the concept of gain by the court in *Union League Club v. Johnson*, supra, and in addition the statute involved referred then as now, to "gain, benefit or advantage, either direct or indirect." Under the present operation of these co-owned gas plants, it is my opinion that the owners thereof are receiving "gain, benefit or advantage" from these operations in a manner contemplated by the Sales and Use Tax Law.

The agreements under which these plants were operated created what would have constituted partnerships except for the fact that no "profit" in the ordinary sense of the term was to be derived by the members. Under Sales and Use Tax Law, the element of profit seeking is immaterial in determining whether a person is taxable. Since the organizations in question contained all of the elements of partnerships except for the "profit" element, it is entirely reasonable to regard them as "persons" under the concluding phrase of Section 6005, namely, "any other group or combination acting as a unit."

As these co-owned gas plants are "persons" for purposes of Sales and Use Tax Law, all processing of gas furnished by the various oil companies constitutes taxable retail sales within the meaning of Section 6006(b), and all plant processing charges are includible in the measure of tax.

JKM : smk [ Ib ]