

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION  
BUSINESS TAXES APPEALS REVIEW SECTION

|                               |   |                             |
|-------------------------------|---|-----------------------------|
| In the Matter of the Petition | ) |                             |
| for Redetermination Under the | ) | DECISION AND RECOMMENDATION |
| Sales and Use Tax Law of:     | ) |                             |
|                               | ) |                             |
| ABC, INC.                     | ) | No. SR REDACTED TEXT        |
|                               | ) |                             |
| <u>Petitioner</u>             | ) |                             |

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel H. L. Cohen on March 11, 1993 in Houston, Texas.

Appearing for Petitioner:

Mr. A  
Assistant Vice President  
ABC, Inc.

Mr. B  
Assistant Manager  
Tax Audit & Litigation  
ABC, Inc.

Mr. C  
Senior Tax Attorney  
ABC, Inc.

Mr. D

Appearing for the  
Sales and Use Tax Department:

Mr. S. Zigelman  
Area Administrator  
Houston Area Office

Mr. J. Clayton  
Supervising Tax Auditor  
Houston Area Office

Mr. W. Hopkins  
Supervising Tax Auditor  
Out-of-State District

Ms. A. Paras  
Senior Tax Auditor  
Houston Area Office

Protested Item

The protested tax liability for the period April 1, 1987 through June 30, 1990 is measured by:

| <u>Item</u>  | <u>State, Local<br/>and County</u> |
|--|------------------------------------|
| C. Deduction claimed for consumption of waste by-products disallowed | \$3,814,166                        |

Contentions

Petitioner contends that the self-produced butane and propane which it consumes constitute waste by-products or still gas that are exempt from tax. Petitioner also contends that these gases are exempt because they are delivered through pipelines.

Summary

Petitioner is a corporation which operates a petroleum refinery in Hercules, California. The name was formerly DEF. The last prior audit was for the period through September 30, 1985.

Petitioner purchases crude oil which is transported by ship to a wharf near Hercules. The crude oil is pumped from the wharf to the refinery through a 24-inch pipeline which is owned by petitioner. During the refining process, petitioner produces butane and propane. Some butane is used in gasoline blending. Both butane and propane are sold for heating purposes. The amount of butane and propane produced exceeds the demand for blending and heating purposes. Petitioner purchases natural gas from Pacific Gas & Electric Company (PG&E) for petitioner's heating needs in the refinery. The excess butane and propane which petitioner produces is used as a substitute for the natural gas purchased from PG&E when the economics of such use are advantageous to petitioner.

The auditor regarded petitioner's use of butane and propane for heating purposes in the refining process as a taxable use and applied tax to the cost to petitioner of these components of the crude oil. Petitioner does not contest the method of allocating costs to the gases. The auditor based this application of tax on the position taken by the Board in the prior audit of petitioner. The notice of redetermination in the prior audit dated December 26, 1990 states:

"The Board concluded that the 'on-spec' propane and butane produced in your refining process are commercial grade products of the type ordinarily produced in the refining process, are commercially marketable, and therefore cannot be classified as 'waste by-products'. Accordingly, the Board ordered the tax redetermined without adjustment."

Petitioner had requested a rehearing before the Board on this decision, but the Board denied the request on January 9, 1992 stating:

"The Board has denied the request for rehearing because (1) the Board's redetermination was not based on the butane and propane in question being nonmarketable; (2) the market grade butane and propane in question is not 'still gas' within Section 6358.1(b), and (3) the Board fully considered and adopted the test from the Union Oil case in deciding that the butane and propane in question were moderate-to-high value by-products, rather than low value by-products, and thus were not a 'waste by-product' within the meaning of Section 6358.1."

Petitioner contends that since the crude oil is brought into the refinery through a pipeline and the butane and propane are transported inside the refinery by pipeline, the use of the butane and propane is exempt under Section 6353 of the Revenue and Taxation Code. That section applies to gas delivered through pipes.

Petitioner also contends that the consumption of the butane and propane is exempt under Section 6358.1 which exempts still gas and waste by-products from manufacturing from tax. Petitioner contends that the butane and propane qualify as both manufacturing waste by-products and still gas. Petitioner submitted a copy of the American Petroleum Institute (API) definition of still gas. It reads as follows:

"Any form or mixture of gas produced in refineries by distillation, cracking, reforming and other processes, the principal constituents of which are methane, ethane, ethylene, propane, propylene, butanes, butylene, etc. Statistically, still gas is reported in two categories as follows:

"a. **Petrochemical Feedstock Use**--Includes all refinery gas streams which are sold to or directed to chemical or rubber manufacturing operations for further processing, *less* the amount of such streams returned to the source refinery.

"b. **Other Use**--All other still gas including that used as refinery fuel."

#### Analysis and Conclusions

Section 6353 provides in pertinent part:

"There are exempted from the taxes imposed by this part the gross receipts from the sales, furnishing, or service of and the storage, use, or other consumption in this state of gas, electricity, and water, including steam and geothermal steam, brines, and heat, when delivered to consumers through mains, lines, or pipes...."

The crude oil which petitioner purchases is not a gas, it is a liquid. Further, it is not furnished by the seller to petitioner through a pipe. The pipe belongs to petitioner. The fact that petitioner transports the butane and propane inside the refinery through pipes does not qualify the gases for exemption. Petitioner is not delivering gas to consumers. It is transporting its own property from one location to another location.

Section 6358.1 provides:

"(a) There are exempted from taxes imposed by this part the gross receipts from the sale of and the storage, use, or other consumption in this state of either of the following:

"(1) Organic products grown expressly for fuel purposes.

"(2) Waste byproducts from agricultural or forest products operations, municipal refuse, or manufacturing, which are used in an industrial facility as a fuel source in lieu of the use of either oil, natural gas or coal.

"(b) In addition to subdivision (a), the exemption under this section shall include the use of still gas produced in the refining process from purchased crude oil."

In the appeal of the prior audit, the Board concluded that butane and propane which are produced in the refinery process and which meet commercial specifications are products of the type ordinarily produced in the refinery process and commercially marketed. They cannot, therefore, be classified as manufacturing waste by-products. The Board concluded that the holding in the case of Union Oil Company of California v. State Board of Equalization, 224 Cal.3d 665, distinguishes between low value by-products and high value by-products and justifies the denial of the exemption for butane and propane.

The API defines still gas as a mixture including "methane, ethane, ethylene, propane, propylene, butanes, butylene" and so forth. Petitioner's propane and butane are not mixtures. They do not meet the definition of still gas.

Recommendation

Deny the petition.

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H. L. Cohen, Senior Staff Counsel

\_\_\_\_\_  
Date