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ATTORNEY GENERAL OPINION NO. 88- 158

The Honorable Tim Shallenburger
State Representative, First District
2027 Fairview
Baxter Springs, Kansas 66713

Re: Taxation--Property Exempt from Taxation--Machinery
and Equipment Used in the Operation of an Electric
Utility Company

Taxation--Kansas Retailers' Sales Tax--Exempt
Sales; Purchase and Installation of Machinery and
Equipment Used in the Operation of an Electric
Utility Company

Synopsis: The purchase of machinery and equipment used by a
utility in the production of electricity is subject
to taxation under the Kansas retailers' sales tax
act unless it is exempted pursuant to L. 1988, ch.
386, §3(mm) or is purchased for installation at a
qualified business facility located within an
enterprise zone and which qualifies for an income
tax credit under K.S.A. 1987 Supp. 79-32,153, as
amended. The service of installing such machinery
and equipment is taxable under the sales tax act
unless purchased for installation at a qualified
business facility as described above, or unless it
is installed in connection with the original
construction of a facility as defined by K.S.A.
1987 Supp. 79-3603(p)(3), as amended.

The machinery and equipment used exclusively by a
municipality in the operation of an electric
utility is exempt from property tax, while the
machinery and equipment of a privately owned and

operated electric utility is generally subject to such taxation unless included within an economic development exemption granted pursuant to article 11, section 13 of the Kansas Constitution or is purchased with IRB moneys or is otherwise exempted due to extenuating circumstances. Cited herein: K.S.A. 79-101, K.S.A. 1987 Supp. 79-201a; K.S.A. 79-5a01; K.S.A. 1987 Supp. 79-32,153; 79-32,154, as amended by L. 1988, ch. 99, §60; K.S.A. 1987 Supp. 79-3602, as amended by L. 1988, ch. 386, §1; K.S.A. 1987 Supp. 79-3603, as amended by L. 1988, ch. 386, §2; K.S.A. 1987 Supp. 79-3606, as amended by L. 1988, ch. 386, §3; Kan. Const., Art. 11, §§1, 13.

* * *

Dear Representative Shallenburger:

You have requested our opinion regarding sales and property taxes owing upon the purchase and installation of equipment and machinery used in the operation of an electric utility company. For the sake of clarity and convenience, we will address the taxes separately.

K.S.A. 1987 Supp. 79-3603, as amended by L. 1988, ch. 386, §2, states in pertinent part:

"For the privilege of engaging in the business of selling tangible personal property at retail in this state or rendering or furnishing any of the services taxable under this act, there is hereby levied and there shall be collected and paid a tax as follows:

"(a) A tax at the rate of 4% upon the gross receipts received from the sale of tangible personal property at retail within this state;

. . . .

"(p) a tax at the rate of 4% upon the gross receipts received for the service of installing or applying tangible personal property which when installed or applied

is not being held for sale in the regular course of business, and whether or not such tangible personal property when installed or applied remains tangible personal property or becomes a part of real estate, except that no tax shall be imposed upon the service of installing or applying tangible personal property in connection with the original construction of a building or facility or the construction, reconstruction, restoration, replacement or repair of a bridge or highway.

"For purposes of this subsection:

. . . .

"(3) 'facility' shall mean a mill, plant, refinery, oil or gas well, waterwell, feedlot or any conveyance, transmission or distribution line of any cooperative, nonprofit, membership cooperation organized under or subject to the provisions of K.S.A. 17-4601 et seq., and amendments thereto, or of any municipal or quasi-municipal corporation, including the land improvements immediately surrounding such facility."

Unless otherwise exempted, the above-quoted provisions would require the imposition of sales tax on the purchase of machinery and equipment for use by an electric utility company, as well as on the service of installing such equipment and machinery except when installed in connection with the original construction of a "facility" as defined above.

While we have found no provisions which clearly exempt from sales tax the purchase and installation of machinery and equipment used in a utility for the production of electricity, several exemptions are worthy of consideration. Subsections (b) and (d) of K.S.A. 1987 Supp. 79-3606, as amended by L. 1988, ch. 386, §3, serve to exempt certain purchases of tangible personal property by and for political subdivisions of the state. However, subsection (b)(2) specifically denies the exemption for property used by political subdivisions in

the business of furnishing electricity to others. Subsection (d) exemption provisions do not apply unless the purchase would be exempt from sales tax if made by the political subdivision directly. Thus, K.S.A. 1987 Supp. 79-3606(b) and (d), as amended, do not operate to exempt from the payment of sales tax purchases of machinery and equipment for use in a municipally-owned facility. See City of Chanute v. Commission of Revenue and Taxation, 156 Kan. 538 (1943); Attorney General Opinions No. 80-237, 75-88.

K.S.A. 1987 Supp. 79-3606(f), as amended, exempts from sales tax tangible personal property purchased by a public utility "for consumption or movement directly and immediately in interstate commerce." The term "property which is consumed" is defined by K.S.A. 1987 Supp. 79-3602(m), as amended by L. 1988, ch. 386, §1, as

"tangible personal property which is essential or necessary to and which is used in the actual process of and immediately consumed or dissipated in . . . (2) the providing of services. . . ."

Equipment and machinery used in the production of electricity is not "immediately consumed or dissipated" and thus would not fall within the subsection (f) exemption. See Polk v. Arnold, 215 Kan. 653, 658 (1974) (permanent machinery or equipment is subject to depreciation, breakage, wearing out or obsolescence rather than to consumption or dissipation).

Similarly, K.S.A. 1987 Supp. 79-3606(m), as amended, provides an exemption for the sale of personal property "which becomes an ingredient or component part of . . . services produced, manufactured, or compounded for ultimate sale at retail. . . ." The term "ingredient or component part" is defined by K.S.A. 1987 Supp. 79-3602(1), as amended, as

"tangible personal property which is necessary or essential to, and which is actually used in and becomes an integral and material part of . . . services produced, manufactured or compounded for sale. . . ."

Equipment and machinery used in the production of electricity does not become an "integral and material part" of the service provided; it is ultimately used by the buyer-operator of the utility and is not resold. Thus, K.S.A. 1987 Supp.

79-3606(m), as amended, is also inapplicable to the purchase of such machinery and equipment. See Southwestern Bell Tel. Co. v. State Commission of Revenue and Taxation, 168 Kan. 227, 234, 235 (1949), and cases cited therein.

The exemption allowed under L. 1988, ch. 386, §3(mm) applies to machinery and equipment used "directly and primarily for the purposes of manufacturing . . . processing . . . or distributing articles of tangible personal property. . . ." The legislature has indicated an intent to classify electricity as tangible personal property in K.S.A. 1987 Supp. 79-3602(m)(B), as amended. Thus, purchase of the property in question would at least arguably be exempt from sales tax pursuant to L. 1988, ch. 386, §3(mm) which takes effect January 1, 1989.

Finally, K.S.A. 1987 Supp. 79-3606(ee), as amended, exempts from sales tax the following:

"All sales of tangible personal property or services purchased for the purpose of and in conjunction with constructing, reconstructing, enlarging or remodeling a qualified business facility located within an enterprise zone, which will qualify for an income tax credit under K.S.A. 79-32,153 and amendments thereto, and the sale and installation of machinery and equipment purchased for installation at such a facility. . . ."

Pursuant to the job expansion and investment credit act of 1976, K.S.A. 1987 Supp. 79-32,153 et seq., a taxpayer investing in a "qualified business facility", as defined by K.S.A. 1987 Supp. 79-32,154(b), as amended by L. 1988, ch. 99, §60, is entitled to a state income tax credit. This credit, and thus the K.S.A. 1987 Supp. 79-3606(ee) sales tax exemption, may be available to an electric utility company meeting the criteria established in K.S.A. 1987 Supp. 79-32,154, as amended.

In summary, the purchase of machinery and equipment used by a utility in the production of electricity is subject to taxation under the Kansas retailers' sales tax act unless it is exempted pursuant to L. 1988, ch. 386, §3(mm) or is purchased for installation at a qualified business facility located within an enterprise zone and which qualifies for an income tax credit pursuant to K.S.A. 1987 Supp. 79-32,153, as

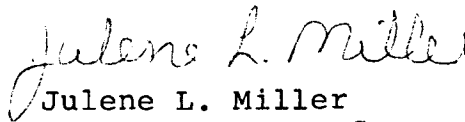
amended. The service of installing such machinery and equipment is taxable under the sales tax act unless purchased for installation at a qualified business facility as described above, or unless it is installed in connection with the original construction of a facility as defined by K.S.A. 1987 Supp. 79-3603(p) (3), as amended.

You inquire further whether machinery and equipment used by a utility in the production of electricity would be subject to property taxes. K.S.A. 79-101 provides that all property in this state, whether real or personal, shall be subject to property tax unless expressly exempted therefrom. K.S.A. 1987 Supp. 79-201a Second provides an exemption from property tax for all property "used exclusively by the state or any municipality or political subdivision of the state." See also Kan. Const., Art. 11, §1(b)(2). The Kansas Supreme court has held that this exemption applies to property used in the operation of a municipally-owned electric power plant. State v. Smith, 144 Kan. 570, 571, 572 (1936). However, machinery and equipment used in the operation of a privately owned electric utility company is not expressly exempted from property taxation and indeed is subject to the taxing provisions found at K.S.A. 79-5a01 et seq. Thus it is our opinion that the machinery and equipment used exclusively by a municipality in the operation of an electric utility is exempt from property tax, while the machinery and equipment of a privately owned and operated electric utility is subject to such taxation, unless it is included in an exemption granted pursuant to article 11, section 13 of the Kansas Constitution, or is otherwise exempted due to extenuating circumstances.

Very truly yours,



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