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ATTORNEY GENERAL OPINION NO. 84- 93

Honorable Paul "Bud" Burke, Chairman
Senate Assessment and Taxation Committee
8229 Cherokee Circle
Leawood, Kansas 66206

Honorable Jim D. Braden, Chairman
House Assessment and Taxation Committee
P.O. Box 58
Clay Center, Kansas 67432

Re: Taxation--Property Exempt from Taxation--Personal Property Moving in Interstate Commerce (Freeport Exemption)

Synopsis: The classification of natural gas in storage prescribed by the Federal Energy Regulatory Commission for regulatory purposes does not address nor resolve the issue of whether stored natural gas may be subjected to a nondiscriminatory state property tax at the location where such gas has come to rest. Correspondingly, the FERC classification of natural gas stored in underground storage areas as "current gas" is not determinative of whether such stored natural gas is subject to property taxation in the state of Kansas. Such natural gas may or may not be subject to such taxation based upon the occasion and purpose of its storage. If such storage is for the benefit, business purposes and convenience of its owners, and not due to transportation, safety or natural-cause reasons, the Commerce Clause of Article I, §8 of the U.S. Constitution does not prohibit its taxation in the state of Kansas. Cited herein: K.S.A. 1983 Supp. 79-201f, as amended by L. 1984, ch. 350, §1; U.S. Const., Art. I, §8, cl. 3.

* * *

Dear Senator Burke and Representative Braden:

As Chairmen of the Senate and House Assessment and Taxation Committees, you seek an opinion concerning the exclusion of natural gas stored in underground storage areas in Kansas from the property tax exemption prescribed in K.S.A. 1983 Supp. 79-201f, as amended by L. 1984, ch. 350, §1. It has been argued that the gas in question is moving in interstate commerce and, thus, cannot be taxed in any event due to the provisions of the Commerce Clause of the United States Constitution.

This question arises in regard to natural gas owned by interstate natural gas pipeline companies. These companies produce or purchase natural gas and inject it into their pipeline systems. Some of the natural gas produced or purchased is moved along the pipeline systems to underground storage areas located in Kansas. Natural gas is stored in these areas during periods of low demand, then moved through the systems during periods of peak demand.

You explain that, for purposes of establishing a uniform system of accounting for natural gas companies, the Federal Energy Regulatory Commission (FERC) classifies natural gas in such storage areas into three categories, as follows: (1) "Noncurrent, cushion gas," which is a volume of natural gas which must remain in the storage area in order for natural gas to move properly through the pipeline system; (2) "Noncurrent, recoverable gas," which is a volume of natural gas which is not necessary to maintain the flow of gas through the system, but which is not estimated to be removed from the storage area for sale to customers within a period of 24 months or less; and (3) "Current gas," which is a volume of natural gas which the company estimates will be removed from storage for sale to customers within a period of 24 months or less. The FERC requires each interstate natural gas pipeline company to value each classification of natural gas according to rules established by FERC and enter those valuations in the accounting records maintained by each such company. Such accounting records are then subject to audit by the FERC for the purpose of determining compliance with federal statutes and rules regulating the wholesale pricing of natural gas flowing in interstate commerce.

Since the FERC accounting system designates "current gas" as that which is removed from storage and moved along an interstate pipeline system within a period of two years or less, arguably such gas is a commodity moving in interstate commerce and, under

the Commerce Clause of the U.S. Constitution [Art. I, §8, cl. 3], is not subject to property taxation in the state of Kansas. You seek our opinion on the merits of this argument.

Article I, section 8, clause 3 of the United States Constitution in part provides: "Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . . ." (Emphasis added.) These provisions of the federal constitution have been interpreted to prohibit a state from imposing local property taxes upon property which is actually in transit in interstate commerce. See, e.g., Carson Petroleum Co. v. Vial, 279 U.S. 95, 49 S.Ct. 292, 73 L.Ed. 626 (1929); Champlain Realty Co. v. Brattleboro, 260 U.S. 366, 43 S.Ct. 146, 67 L.Ed. 309 (1922); Bacon v. Illinois, 227 U.S. 504, 33 S.Ct. 299, 57 L.Ed. 615 (1913); Kelley v. Rhoads, 188 U.S. 1, 23 S.Ct. 259, 47 L.Ed. 359 (1903); and Coe v. Errol, 116 U.S. 517, 6 S.Ct. 475, 29 L.Ed. 715 (1886). However, the U.S. Supreme Court also has determined that, by reason of a break in the interstate transit of property, such property may become subject to the power of a state to impose a nondiscriminatory property tax upon such property. See, e.g., Brantiff Airways, Inc. v. Nebraska State Board of Equalization, 347 U.S. 590, 74 S.Ct. 757, 98 L.Ed. 967 (1954); Independent Warehouses, Inc. v. Scheele, 331 U.S. 70, 67 S.Ct. 1062, 91 L.Ed. 1346 (1947); Minnesota v. Blasius, 290 U.S. 1, 54 S.Ct. 34, 78 L.Ed. 131 (1933); and Kelley v. Rhoads, supra.

The fact property comes to rest in a state in the course of its interstate transportion may or may not render the property subject to property taxation within that state. Whether such property is subject to local taxation depends on whether the delay or storage is due to transportation, safety or natural-cause reasons or is due to an intentional detention for the benefit, business purposes and convenience of the property's owner. Thus, in each case concerning property whose movement in interstate commerce has been broken, the crucial factor in determining whether the property is subject to local taxation at the point where it has come to rest is not what ultimately happens to the property or where it goes, but the occasion and purpose of the interruption. See: Independent Warehouses, Inc. v. Scheele, supra, 331 U.S. at 83 and Minnesota v. Blasius, supra, 290 U.S. at 10.

As explained in Gulf Refining Co. v. Phillips, 11 F.2d 967 (5th Cir. 1926), cert. denied 273 U.S. 697, 47 S.Ct. 93, 71 L. Ed. 845 (1926):

> "The opinion in the case of Champlain [Realty] Co. v. Brattleboro, 260 U.S. 366, 43 S.Ct. 146, 67 L.Ed. 309, 25 A.L.R. 1195, clearly states the distinction between the arresting of the movement of a commodity in interstate commerce for its safety and protection from dangers due to natural causes to which it is exposed in its journey, and the intentional detention of it for the beneficial purposes of the owner, who did not from the beginning expect it to have an uninterrupted movement to its ultimate destination, but arranged for the halting of it until its further movement could be made to suit his convenience. Such an intentional detention for the purposes just mentioned renders the commodity subject to be taxed at the place where it is stopped." (Emphasis added.) 11 F.2d at 969.

See, also, Independent Warehouses, Inc. v. Scheele, supra; Minnesota v. Blasius, supra; and Kelley v. Rhoads, supra.

The Phillips decision is directly analogous to the situation presented here. In Phillips, the question presented concerned whether oil, brought to Gulf Oil's storage tanks in Dubberly, Louisiana from fields in Arkansas and Louisiana and stored for shipment at a later date to a refinery in Port Arthur, Texas, was property in transit in interstate commerce and thus not subject to property taxation in Louisiana. Gulf maintained 17 huge steel tanks at Dubberly to receive oil from the oil fields in an operation known as a "tank farm." The Court found:

> "The tank farm served the purposes of enabling the appellant [Gulf Oil] to take care of the excess of oil received over what could be moved, and to select the oil to be first moved . . . . Throughout the years . . . [in question] large quantities of oil were constantly kept in the tanks at Dubberly, in some cases the same oil being so kept there for several months. From two to four tanks would suffice for the amount of oil that could be moved through the line going to Texas. The average quantity of oil constantly on hand in the

> tanks at Dubberly was many times more than the quantity that could be delivered to the pipe going to Texas. The tanks at Dubberly were used to store oil until it could be sold or moved through the line going towards its intended final destination." 11 F.2d at 968-969.

Under the circumstances presented, the Court concluded:

> "We think that the continuity of the interstate journey of such oil was so broken, and it so came to rest, as to be subject to local taxation." 11 F.2d at 969.

The fact the FERC classifies natural gas stored in underground storage areas into different categories for the purpose of determining compliance with federal natural gas rate regulations does not address the purpose for which the gas is stored. The FERC's uniform accounting system does not distinguish between natural gas which is stored because of transportation, safety or natural-cause reasons and gas which is stored for the business purposes and convenience of its owner. Rather, the FERC classifications depend solely upon the expected length of time the gas will remain in storage. Thus, in our judgment, the classification of natural gas in storage prescribed by the FERC for its purposes does not address and certainly does not resolve the issue of whether stored natural gas may be subjected to a nondiscriminatory property tax at the location where such gas has come to rest.

Correspondingly, we conclude the FERC classification of natural gas stored in underground storage areas as "current gas" is not determinative of whether such stored natural gas is subject to property taxation in the state of Kansas. Such natural gas may or may not be subject to such taxation based upon the occasion and purpose of its storage. If such storage is for the benefit, business purposes and convenience of its owners, and not due to transportation, safety or natural-cause reasons, the Commerce Clause of Article I, §8 of the U.S. Constitution does not prohibit its taxation in the state of Kansas.

Very truly yours,

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