**Opinion Letter**

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| **Letter Number:** | **O-2004-006** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Refund claims.** |
| **Keywords:** |  |
| **Approval Date:** | **07/16/2004** |

**Body:**

Office of Policy & Research  
  
  
July 16, 2004

XXXXX  
XXXXX  
XXXXX

RE: Your letter dated April 19, 2004

Dear XXXX:  
  
Thank you for your recent letter. You work for a construction contractor that does a variety of work, including laying foundations. Your letter to the department was accompanied by a copy of a letter to you from Allen, Gibbs & Houlik, L.C. ("AGH"). The AGH letter states:

Dear Sir or Madam:  
  
Allen, Gibbs & Houlik, L.C. has been retained by XXXX ("the Customer") for the purpose of conducting a review of sales, use and other types of excises taxes paid to vendors. Based on our analysis of their records, it appears that the Customer paid the sales tax listed on your invoices in error.  
  
I have enclosed a listing of invoices where your company invoiced sales tax. Also enclosed is an exemption certificate that pertains to the purchases identified by these invoices, unless this is a claim for non-taxable services (no exemption certificate required). Please exempt XXXX from sales tax on future purchases of these items from you company.  
  
If you agree that the Customer's refund claim is valid, please issue a refund or credit memorandum for **$2111.90** made payable to XXXX and forward it to me in the enclosed business reply envelope within 60 days from the date of this letter. I am tracking all of the refund requests for XXXX and will forward the funds to them. Please complete Part A of Form ST-21 and sign and date where indicated; then send a copy of this form along with a copy of your check or credit memo to the Kansas Department of Revenue so that they can credit you account. Please be advised that if you issue a refund or credit memorandum, the Department of Revenue may review and/or challenge your decision.  
  
If for any reason you do not wish to accept the exemption certificate and/or to issue a refund, please complete the highlighted portions of Parts A and E of Form ST-21 and return them to us in the enclosed business reply envelope within 60 days from the date of this letter. These documents will allow XXXX to directly request a refund claim from the Kansas Department of Revenue. **IF YOU DO NOT REFUND THIS CLAIM, PLEASE DO NOT FILE A REFUND REQUEST DIRECTLY WITH THE STATE OF KANSAS.**  
  
If you have any questions, you may contact me at Allen, Gibbs & Houlik, L.C. Thank you for your immediate attention to this matter.

Accompanying the AGH letter to you was a completed Integrated Production Machinery and Equipment Exemption Certificate that identifies XXXX Electric Cooperative, Inc. ("XXXX") as the purchaser. It is signed by XXXX's Manager of Accounting and dated February 9, 2004. The certificate claims exemption for a "concrete foundation" that "supports the electrical equipment at the Bison Substation." The AGH work-up submitted with the letter describes the work done on "4/2/2002" as "Labor and materials to build a concrete foundation for the electrical equipment at the Bison substation." During a telephone conversation, your owner indicated that your company had installed concrete foundations at the substation, and paid sales tax on its purchases of concrete from a third party. The company also collected and remitted sales tax on the services that it performed for XXXX.  
  
Please be advised that you should not issue the requested refund nor should you exempt labor services or materials for projects such as this in the future. Labor services and materials used to build substations are taxable. This is clearly stated in Revenue Ruling 19-2003-2:

**(3) No exemption for sales of machinery and equipment located at substations. No exemption for installation, maintenance, and repair services performed at substations.**The legislative history of 1977 S.B. 49 indicates that the original construction exemption for municipal electric utilities and electric cooperatives was limited to their transmission lines. Consequently, sales of material and equipment for use at their substations are taxable, as are all labor services performed at a substation. *KDOR Revenue Ruling 19-2003-2, issued January 8, 2003.*

It should be noted that AGH seeks a refund of the taxes that you paid on materials. A contractor cannot refund taxes that it paid to a third party on its material purchases.  
  
The claim submitted to you is likely based on the Board of Tax Appeals' ("BOTA") order in *In re the Tax Appeal of Western Resources, Inc.*, Docket No. 2001-802-DT (October 15, 2003). The department appealed the ruling and the appeal is pending before the Kansas Appellate Courts. The department believes that the BOTA's decision will be reversed on appeal. Even if it is not reversed, the BOTA's holding in *Western Resources* does not control this refund request because any refund entitlement here must be determined under the Integrated Production Machinery and Equipment statute that took effect on July 1, 2000.  
  
The *Western Resources* decision construed an exemption statute that was repealed on July 1, 2000. The BOTA construed (or misconstrued) this exemption as it applied to purchases that Western Resources made from August 1996 though September 1999. Because the BOTA decision was based on the earlier law, *Western Resources* does not control the refund request at issue here. K.S.A. 2003 Supp. 79-3606(kk) --- the statute that has been in place since July 1, 2000 --- controls whether or not XXXX is entitle to a refund on the purchases made on or after July 1, 2000.  
  
K.S.A. 2003 Supp. 79-3606(kk) contains numerous provisions that show it does not apply to substations operated by electric companies, gas companies, water companies or pipeline companies. These provisions include:  
  
· K.S.A. 2003 Supp. 79-3606(kk)(2)(C), which defines "manufacturing or processing plant or facility" and specifically excludes facilities that are operated to convey or assist in conveying natural gas, electricity, oil or water:

*(C) "manufacturing or processing plant or facility" means a single,* *fixed location owned or controlled by a manufacturing or processing business that consists of one or more structures or buildings in a contiguous* *area where integrated production operations are conducted to manufacture or process tangible personal property to be ultimately sold at retail.* *Such term shall not include any facility primarily operated for the purpose* *of conveying or assisting in the conveyance of natural gas, electricity, oil* *or water. A business may operate one or more manufacturing or processing plants or facilities at different locations to manufacture or process a* *single product of tangible personal property to be ultimately sold at retail;*

· K.S.A. 2003 Supp. 79-3606(kk)(2)(D), which provides examples of industrial manufacturing or processing operations. These examples include water treatment plants, electric generation plants, and petroleum refineries. None of the examples can be read as extending to electric substations, water pressurization stations, or to pipeline pumping stations:

*Industrial manufacturing or processing operations include, by way of illustration but not of limitation, the fabrication* *of automobiles, airplanes, machinery or transportation equipment, the* *fabrication of metal, plastic, wood, or paper products, electricity power* *generation, water treatment, petroleum refining, chemical production,* *wholesale bottling, newspaper printing, ready mixed concrete production,* *and the remanufacturing of used parts for wholesale or retail sale.*

· K.S.A. 2003 Supp. 79-3606(kk)(3), which lists machinery and equipment that is deemed to be an integral or essential part of an integrated production operation. The descriptions provided clearly limit the exemption to machinery or equipment located at a qualifying plant or facility. As noted above, manufacturing or processing plant or facility, by definition, does not include any facility primarily operated for the purpose of conveying or assisting in the conveyance of natural gas, electricity, oil or water:

*(B) to transport, convey, handle or store the property undergoing* *manufacturing or processing at any point from the beginning of the production line through any warehousing or distribution operation of the* *final product that occurs at the plant or facility; . . .*  
  
*(I) to transmit or transport electricity, coke, gas, water, steam or similar substances used in production operations from the point of generation,* *if produced by the manufacturer or processor at the plant site, to that* *manufacturer's production operation; or, if purchased or delivered from* *offsite, from the point where the substance enters the site of the plant or* *facility to that manufacturer's production operations; . . . .*

· K.S.A. 2003 Supp. 79-3606(kk)(5)(C), which provides that machinery and equipment used as an integral or essential part of an integrated production operation "shall not include transportation and distribution equipment . . . located outside the plant or facility":

*(5) "Machinery and equipment used as an integral or essential part* *of an integrated production operation" shall not include: . . .*  
*(C) transportation, transmission and distribution equipment not primarily used in a production, warehousing or material handling operation* *at the plant or facility, including the means of conveyance of natural gas,* *electricity, oil or water, and equipment related thereto, located outside* *the plant or facility;*

These statutory provisions are redundant for a reason. The Kansas legislature did not intend to exempt purchases of materials or services for substations owned by electric distribution companies, gas utilities, telephone companies, water utilities that are not registered under the clean drinking water act, and pipelines. Accordingly, these entities, including XXXX, are not entitled to claim exemption for services, equipment, or materials purchased to build and repair their substations.  
  
There is no basis in law for the refunds or exemption that XXXX is claiming for the periods in question. You should not honor these claims.

Sincerely,  
  
  
  
Thomas E. Hatten  
Attorney/Policy & Research

**Date Composed: 07/19/2004 Date Modified: 07/19/2004**