ALERT
NOVEMBER 17, 2009

TAX
News Concerning Recent Tax Issues

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ELECTRICITY DELIVERY AND STRANDED COST CHARGES ARE TAXABLE

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The Pennsylvania Supreme Court held that after deregulation of the electricity industry, charges by a distribution company for the transmission of electricity and for stranded costs are taxable for Sales and Use Tax purposes. *Spectrum Arena Limited Partnership v. Commonwealth,* No. 42 MAP 2008 (Pa. Nov. 5, 2009). This was a hard case, and it made bad law.

After deregulation of the electricity industry in 1996 through the Electricity Generation Consumer Choice and Competition Act ("Competition Act"), a consumer can purchase electricity from any generator. The electricity is delivered by the local electricity distribution company, which may not be the generator and vendor of the electricity. Pennsylvania Sales Tax is imposed on the retail sale of nonresidential electricity. The tax base has always included charges by a vendor for delivery, but it has never taxed transportation services by a third party. Accordingly, before the Competition Act, delivery charges for electricity were taxable because they were bundled with charges by the generator for the sale of electricity. After the Competition Act was enacted, the Department of Revenue published a statement of policy that states that delivery charges of electricity remain taxable whether or not the delivery services are provided and billed by the electricity generator. 61 Pa. Code § 60.23(d). A statement of policy is not subject to the same review and does not have the binding effect of a regulation. 61 Pa. Code §3.2(b). A regulation has stated for decades that charges for delivery provided and billed by a party other than the vendor are not taxable. 61 Pa. Code § 54.1(c).

In support of its conclusion that delivery charges by an electricity distribution company are taxable, the Supreme Court stated that electricity is not a consumer good unless it is transmitted or delivered to the consumer along power lines, and that without delivery there can be no sale. That is directly contrary to the statute and has never been true for Sales and Use Tax purposes. A retail sale is defined as a transfer of *ownership, custody* ***or*** *possession* of tangible personal property. 72 P.S. § 7201(m). Therefore, a transfer of ownership is a taxable event, whether or not there has been delivery. The Court further stated that by including distribution charges as sales of electricity for Gross Receipts Tax purposes, the General Assembly indicated its intention that previously unfunded distribution charges remain taxable for Sales Tax purposes. The opposite is true. Since the General Assembly changed the definition of sales of electricity for Gross Receipts Tax purposes, and not for Sales Tax purposes, the implication is that it did not intend a Sales Tax change.

The Supreme Court did not mention the strongest factor in favor of its decision. As part of the Competition Act, the Commonwealth imposes a Revenue-Neutral Reconciliation Tax ("RNR Tax") as part of the Gross Receipts Tax. The RNR Tax insures that revenue from the electricity industry will neither increase nor decrease as a result of deregulation. The Competition Act states that the RNR Tax is not intended to cause a shift in proportional tax obligations among customer classes. 66 Pa. C.S. § 2810(a). Just such a shift would occur if delivery charges by a distributor are not subject to Sales and Use Tax, which is generally not imposed on individual commercial customers, and the shortfall is picked up by the Gross Receipts Tax, the economic burden of which is borne by all consumers of electricity, residential and commercial. However, the statement of intention is in sharp contrast with what the General Assembly actually enacted in the Competition Act. The Supreme Court ignored the conflict.

The Supreme Court is probably correct with respect to competitive transition ("CT") charges and intangible transition ("IT") charges. The statute permits an electric distribution

company to recover these charges, which are defined as charges for *net electric generation-related costs.* 66 Pa. C.S. § 2803. In effect, the General Assembly is imposing a current charge on retail customers of a distribution company for the unrecovered cost of generating electricity. That can fairly be characterized as a statutory mandated charge for the generation of electricity, which is clearly taxable. The Supreme Court opinion does not discuss the point. Rather, the Supreme Court undercuts the argument by characterizing the CT charges as compensation for distribution, which is contrary to the statutory definition.

Apparently, the General Assembly made a mistake in the Competition Act. Notwithstanding its general intention not to shift the burdens among classes of users, it failed to amend the definition of electricity for Sales and Use Tax purposes to include in the tax base charges by a distributor, while it did include them for Gross Receipts Tax purposes in the RNR Tax. In rescuing the General Assembly from its error, the Supreme Court made strikingly incorrect statements about tax law which, if taken seriously, will come back to haunt taxpayers, the government, and the courts alike.

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