Georgia State University

POLICY brief

FISCAL RESEARCH PROGRAM

SCHOOL OF POLICY STUDIES

NATURAL GAS DEREGULATION AND STATE SALES TAX COLLECTIONS IN GEORGIA

Introduction

Deregulation in the natural gas industry has come to mean separating the purchase of the gas itself from the purchase of the transportation of the gas. Under this separation, consumers will pay the traditional local supplier for transportation, but will be free to purchase natural gas from a number of national marketers. This "unbundling" of natural gas can affect state and local sales tax collections in two ways. First, the tax status of natural gas purchases may change under deregulation, which will effect the ability of the state to collect sales tax on natural gas. Second, if the price of natural gas falls and total spending on natural gas falls as a result, then total sales tax revenue will decrease.

The sales tax revenue impact of natural gas deregulation in Georgia is highly uncertain. The timetable for allowing consumer choice is not certain at this point, nor is the tax status of gas purchases under deregulation. The state currently collects about $80 million in sales and use tax on the sale of natural gas, but one cannot be sure exactly how much of this total is in jeopardy. This policy brief discusses the issues that will ultimately determine the impact on sales tax revenue in Georgia resulting from deregulation of the Natural Gas Industry.

Natural Gas Deregulation in Georgia

In 1997, the Georgia General Assembly passed Senate Bill 215, a deregulation act intended to reduce the price of natural gas to households in Georgia. Under the bill, customers of the Atlanta Gas Light Corporation (AGL) and the United Cities Gas Company (UCG) could be allowed to purchase natural gas from a number of suppliers. There will, however, be only one pipeline system to transport the gas; consumers will pay the current provider for transportation of the gas.

This type of natural gas competition is not entirely new to Georgia. For each of the past six years, between 60 and 68 percent of all Georgia industrial natural gas consumption has been purchased from someone other than the local provider (U.S. Department of Energy (1997)). In fact, price reductions for industrial customers have been cited as one of the motivators for opening residential gas markets to competition (Quinn (1997)).

As of December, 1997, only AGL had applied to the Public Service Commission (PSC) to unbundle its services, charging every current customer for transportation of natural gas but allowing other firms to sell gas through AGL pipes. With the time requirements for application analysis and the certification of any new natural gas suppliers, the PSC does not anticipate residential consumer choice being allowed until at least late 1998.

February, 1998

Sales Taxation Issues

1. The Sales Tax Base under a Deregulated Natural Gas Industry

Several important sales tax base issues have emerged from this deregulation act. If a customer purchases natural gas from an out-of-state supplier and the transportation of natural gas from an in-state supplier, there are two main areas of uncertainty regarding the tax status of the new purchase structure under current Georgia law. The first concerns the ability to collect sales taxes from out-of-state suppliers, while the second concerns the ability to tax transportation charges.

First, if out-of-state suppliers do not have tax nexus in Georgia, the suppliers cannot be required to collect Georgia sales taxes.[1] This nexus issue currently exists for mail-order companies -- many of the larger companies do not have tax nexus in Georgia and currently do not collect Georgia sales taxes. However, tax nexus has not been a problem with industrial purchases of natural gas from out-of-state suppliers. In Georgia, firms that are registered sales tax collectors are subject to use tax compliance audits. Therefore, if an out-of-state vendor sells natural gas to a Georgia industrial client and does not collect sales taxes, the Georgia firm is required to remit use tax.[2]

In theory, Georgia households will now be responsible for use tax on natural gas purchases if all state and local sales taxes have not been collected. In practice, however, Georgia follows a typical use-tax enforcement policy (Due and Mikesell (1994)). The state only enforces the use tax on firms who are registered collectors of the Georgia sales tax and on anyone who purchases an automobile out of state and registers the automobile in Georgia. In the absence of a change in enforcement policy, the state could lose uncollected sales taxes.

[1] The U.S. Supreme Court has ruled that states cannot require a firm to collect sales taxes when the firm does not have a legal presence in the state. The two landmark cases are *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* and *Quill Corporation v. North Dakota*.

[2] Georgia is on very firm legal ground in collecting use tax on natural gas. When the Ohio Department of Taxation decided to assess use tax on an industrial user instead of the state sales tax on an out-of-state marketer, the U.S. Supreme Court upheld the tax despite the fact that natural gas sales by regulated utilities in Ohio were exempt (Hellerstein (1998)).

The tax nexus issue is complicated by the PSC's requirement that each natural gas supplier be certified by the Commission. It is uncertain whether this requirement is sufficient to establish legal tax nexus for every natural gas supplier. If it does not, the state could still try to require out-of-state suppliers to collect Georgia taxes as a condition for being certified. But the legality of a state attempt to require a company to pay a tax that it otherwise does not have to pay is questionable; requiring a firm to establish nexus in order to conduct business in Georgia could violate federal law, which prohibits restrictions on interstate commerce.

Second, the tax status of natural gas transportation charges in a deregulated environment is also not certain. When transportation costs are a component in a tangible property sale in Georgia, they are generally taxable. However, this tax status depends on where the transaction is considered to occur (i.e., at the point of shipping or the point of destination) and what type of agency agreement exists between the seller, the customer and the shipper. It is unclear whether natural-gas transportation charges could be structured so as to avoid sales taxation in Georgia. For example, it appears that if a customer buys gas from an out-of-state supplier and is billed separately for the transportation, the customer cannot be charged sales tax on the transportation charges.

Many natural gas users in Georgia either are not currently served by AGL (or UCG) or will continue to purchase natural gas from AGL. These customers will be unaffected in terms of their sales tax by the deregulation regardless of the outcomes of the tax-status questions. However, customers served by AGL (which is the only firm that currently has requested that its services be unbundled) can be affected under AGL unbundling if its customers choose an out-of-state supplier. A representative of the PSC believes AGL serves approximately 75 percent of Georgia, including some of the largest Georgia metropolitan areas — Atlanta, Athens, Augusta, Brunswick, Macon, Rome, and Savannah.

Many current AGL customers will continue to purchase natural gas from a Georgia firm. In a survey of local natural gas providers, the U.S. Department of Energy (1997) found that 24 percent of industrial customers purchased bundled sales delivery of natural gas in 1995 (down from 47 percent in 1987) while approximately 100 percent of residential customers purchased the traditional natural gas bundle. Customers who do not switch gas companies will continue to pay a sales tax on both the gas and transportation services. Customers who choose an out-of-state provider, on the other hand, may pay a sales tax on all, some, or none of their natural gas bill depending on how the tax situs issues are resolved.

2. Sales Tax Collections with a Decrease in the Price of Natural Gas

Deregulation will almost certainly mean cheaper natural gas in Georgia. Consumers will benefit from this reduction but, in all likelihood, total spending on natural gas will decrease. The decline in spending will mean a decline in taxable sales.

Purchases from public utilities are thought to be unresponsive to price changes; meaning users will consume about the same quantity of gas if prices change. Therefore, one cannot expect a reduction in price to be offset by an increase in use.[3] Evidence on the magnitude of the response to a price decline for natural gas in Georgia is scarce. Hawkins (1997) found the price elasticity of services provided by utilities for residential consumers to be negligible; meaning a 10 percent decline in prices should lead to a 10 percent decline in spending. But, this estimate covered all utility spending and covered spending for households only. According to the U.S. Department of Energy (1997), commercial users and industrial users accounted for about 17 and 54 percent (respectively) of all natural gas consumed in Georgia.[4] Industrial users are not at issue, since these users already purchase natural gas on the open market. The price elasticity of natural gas purchases by commercial users is an issue that does not appear to have been addressed.

Current Georgia Revenue Yield from the Sale of Natural Gas

Georgia is one of 39 states which tax commercial natural gas purchases and one of 24 states which tax residential purchases (Federation of Tax Administrators (1997)). The fact that Georgia does not exempt the purchase of natural gas when that gas is, in turn, used to produce, say, taxable electricity is inconsistent with the tax maxim that intermediate goods should not be taxed since it leads to double taxation.

Natural gas purchases in Georgia were $1.8 billion dollars in calendar 1996 (U.S. Department of Energy (1997)). Therefore, 1996 state sales tax collections were on the order of $80.5 million, or about 2 percent of state sales tax revenue. According to the U.S. Department of Energy (1997), more than 125 billion cubic feet of natural gas was transported to Georgia commercial and industrial users in 1996; since these firms are likely to be subject to sales tax audits, we assume these users submit the appropriate use tax if the vendor does not collect sales taxes.

Local sales tax collections will be effected in the same way as state sales taxes. However, the calculations do not include local sales tax revenues.

The percentage of current sales tax revenue that is in jeopardy under deregulation, and the fiscal year when any revenue loss would occur, is impossible to determine with confidence. If households and commercial users who are not registered sales tax collectors in Georgia are able to purchase from tax-exempt suppliers and to separately pay a tax-exempt transportation charge, the percentage reduction will be large. If, on the other hand, the PSC policies reach all eligible suppliers through their agreement to create tax nexus in Georgia, and if transportation charges do not qualify for a sales-tax exemption, revenue should fall slightly as the price of natural gas decreases.

If the state collects sales tax from all industrial purchases of natural gas, then at most about 46 percent of the state sales tax on gas is in jeopardy. However, many residential purchasers will not shift to out-of-state suppliers, and thus effectively less than 46 percent is in jeopardy. Further, some portion of the sales tax on commercial purchases, which account for about 17 percent of natural gas purchases, can be captured through the state's audit of registered sales tax collectors. Assuming that even half of the commercial and residential purchases are made from out-of-state suppliers, then only about one fourth of the current sales tax on natural gas, approximately $20 million, is in jeopardy.

Is the potential revenue loss from natural gas deregulation a cause for concern? The Georgia sales tax exemption of food-for-home consumption is reducing annual revenue by more than $500 million (Bahl and Hawkins (1997)). Compared to that reduction, the possible loss in sales tax revenue from natural gas deregulation is quite small. However, it can be argued that natural gas revenue is just one portion of a much larger sales tax base that may disappear in the near future. Electricity deregulation should follow the natural gas initiative and raise the same

[3] If the demand for a commodity is price elastic, an increase in the tax rate would actually yield a lower revenue total. Most economists believe that the demand for utilities is not price elastic.

[4] This estimate does not include natural gas consumed by utilities.

sales tax questions, but with far more dollars at stake. Wider use of the Internet and other telecommunication services could also result in a loss of sales tax revenue as Georgians increase their purchases from firms with no nexus in Georgia. If the sales tax is to be a major Georgia revenue source in the next century, it is important to find a legally defensible way to keep the natural gas deregulation process from diminishing our tax base. This is a legal issue that deserves state attention.

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ABOUT THE AUTHOR

Richard R. Hawkins is Principal Consultant with the Fiscal Research Program and Assistant Professor of Economics at the University of West Florida. He did his undergraduate work at Emory University and received his Ph.D. in economics from Georgia State University. While at GSU he was a Research Associate in the Fiscal Research Program. His research interests include public finance, particularly the sales tax.

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Fiscal Research Program
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