

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
National Fuel Gas Supply Corporation :
and :
National Fuel Gas Distribution Corporation :
as Successors to Iroquois Gas Corporation :
:
for Revision of a Determination or for Refund of :
Sales and Use Taxes under Articles 28 and 29 of :
the Tax Law for the Period June 1, 1973 through :
August 31, 1974. :

AFFIDAVIT OF MAILING

In the Matter of the Petition :
of :
National Fuel Gas Distribution Corporation :
:
for Revision of a Determination or for Refund of :
Sales and Use Taxes under Articles 28 and 29 of :
the Tax Law for the Period September 1, 1974 :
through February 28, 1978. :
:

State of New York }

ss.:

County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of April, 1984, he served the within notice of Decision by certified mail upon National Fuel Gas Distribution Corporation, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

National Fuel Gas Distribution Corporation
10 Lafayette Square
Buffalo, NY 14202

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

Page 2
Affidavit of Mailing

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
6th day of April, 1984.

Daniel Baruchack

Barbara A. [Signature]
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

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through February 28, 1978. :

State of New York }

ss.:

County of Albany }

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National Fuel Gas Supply Corporation
and National Fuel Gas Distribution Corporation
as Successors to Iroquois Gas Corp.
10 Lafayette Square
Buffalo, NY 14202

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6th day of April, 1984.

Daniel Parschuch

James A. [Signature]
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

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National Fuel Gas Supply Corporation :
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Sales and Use Taxes under Articles 28 and 29 of :
the Tax Law for the Period September 1, 1974 :
through February 28, 1978. :
:

State of New York }

ss.:

County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of April, 1984, he served the within notice of Decision by certified mail upon Thomas M. Barney, the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Thomas M. Barney
Phillips, Lytle, Hitchcock, Blaine & Huber
3400 Marine Midland Center
Buffalo, NY 14203

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

Page 2
Affidavit of Mailing

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
6th day of April, 1984.

Daniel Panchuck

James P. H. H. H.

Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

April 6, 1984

National Fuel Gas Distribution Corporation
10 Lafayette Square
Buffalo, NY 14202

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1138 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Thomas M. Barney
Phillips, Lytle, Hitchcock, Blaine & Huber
3400 Marine Midland Center
Buffalo, NY 14203
Taxing Bureau's Representative

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

April 6, 1984

National Fuel Gas Supply Corporation
and National Fuel Gas Distribution Corporation
as Successors to Iroquois Gas Corp.
10 Lafayette Square
Buffalo, NY 14202

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Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Thomas M. Barney
Phillips, Lytle, Hitchcock, Blaine & Huber
3400 Marine Midland Center
Buffalo, NY 14203
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
NATIONAL FUEL GAS SUPPLY CORPORATION :
and :
NATIONAL FUEL GAS DISTRIBUTION CORPORATION :
As Successors to IROQUOIS GAS CORPORATION :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period June 1, 1973 :
through August 31, 1974. :

DECISION

In the Matter of the Petition :
of :
NATIONAL FUEL GAS DISTRIBUTION CORPORATION :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1974 :
through February 28, 1978. :

Petitioners, National Fuel Gas Supply Corporation and National Fuel Gas Distribution Corporation, as successors to Iroquois Gas Corporation, and National Fuel Gas Distribution Corporation, 10 Lafayette Square, Buffalo, New York 14202, filed petitions for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the periods June 1, 1973 through August 31, 1974 and September 1, 1974 through February 28, 1978 (File Nos. 28978 and 30536).

A formal hearing was held before Daniel J. Ranalli, Hearing Officer, at the offices of the State Tax Commission, 65 Court Street, Buffalo, New York, on March 8, 1983 at 9:15 A.M. with all briefs to be submitted by July 15, 1983.

Petitioners appeared by Phillips, Lytle, Hitchcock, Blaine & Huber (James A. Locke, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Patricia L. Brumbaugh, Esq., of counsel).

ISSUE

Whether delivery of gas by petitioner, free of cost, to certain of its customers was a sale subject to tax within the meaning and intent of section 1101(b)(5) of the Tax Law.

FINDINGS OF FACT

1. On December 18, 1978, as the result of a field audit, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against Iroquois Gas Corporation in the amount of \$68,411.39 plus interest of \$25,913.36 for a total due of \$94,324.75 for the period June 1, 1973 through August 31, 1974. On the same date, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner National Fuel Gas Distribution Corp. in the amount of \$545,641.37 plus interest of \$102,808.10 for a total due of \$648,449.55 for the period September 1, 1974 through February 28, 1978. Petitioners, National Fuel Gas Supply Corporation and National Fuel Gas Distribution Corporation are the successors to Iroquois Gas Corporation.

2. Petitioners had executed consents extending the period of limitation for assessment of sales and use taxes for the taxable periods June 1, 1973 through June 30, 1974 and September 1, 1974 through August 31, 1977 to December 20, 1978.

3. At a prehearing conference held on July 21, 1981, the Audit Division agreed to the cancellation of \$38,330.42 tax due for the period June 1, 1973 through August 31, 1974 and \$193,199.45 tax due for the period September 1,

1974 through February 28, 1978. Petitioners executed partial withdrawals of petition and discontinuance of case as to \$24,975.66 tax due for the period June 1, 1973 through August 31, 1974 and \$300,508.35 for the period September 1, 1974 through February 28, 1978. The amount remaining in issue was \$5,105.31 plus minimum interest for the period June 1, 1973 through August 31, 1974 and \$46,259.36 plus interest for the period September 1, 1974 through February 28, 1978 for a total amount in issue of \$51,364.67 plus interest.

4. Petitioners are engaged in the development of natural gas resources and the retail sale of natural gas. In order to assure an adequate supply of natural gas for their customers, petitioners have attempted to develop natural gas resources in Western New York. To accomplish this, petitioners have entered into gas leases with many real property owners in the region.

5. At the hearing, petitioners submitted several typical gas leases into evidence. Each lease recited that in consideration of the payment of One Dollar and the respective covenants and agreements set forth therein, the lessors granted the premises to petitioners, as lessees, for the sole purpose and with the exclusive rights to the lessee of drilling and operating for oil and gas. The leases provided for a specified rental until a producing well was developed and then applied a different amount "in lieu of the rental" or as a "royalty" or simply required payment of a specified amount depending on the gas removed from each well.

6. Each of the leases contained various "free gas" clauses in the event gas was discovered in paying quantities and was marketed. The free gas clauses stated either that "there is reserved" to the lessor sufficient gas from producing wells on the premises "to light and heat one dwelling house on the premises" or that the lessor "may have" gas from producing wells on the premises

"free of cost to light and heat one dwelling house on the premises only". Some leases had no limit on the volume of the free gas that could be used to light and heat one dwelling while others set a maximum quantity and provided that the lessor would pay petitioners for excess consumption at the "rate charged to domestic consumers". Petitioners maintain customer free gas verification records which list the consumption by month for each individual account.

7. It is the free gas provided by petitioners which is in issue in this matter. At the hearing, petitioners produced evidence indicating that some of the free gas in issue was provided to members of the Seneca Indian Nation on the Seneca Reservation and also to municipalities on lands owned by the municipalities. The Audit Division conceded that, in any event, the free gas provided to individual members of the Seneca Nation residing on the Reservation would not be subject to tax and that the delivery of free gas to municipalities is within the exemption provided by section 1116(a)(1) of the Tax Law. The aforesaid exemptions amounted to \$3,594.20 for the Indian Reservation and \$2,513.35 for the municipalities which reduces the amount in issue to \$4,404.97 plus interest for the period June 1, 1973 through August 31, 1974 and \$40,851.73 plus interest for the period September 1, 1974 through February 28, 1978.

8. Each gas lease further provides that the lessor must make the connection at the well and lay the pipe to carry the free gas from the well to his residence at his own expense. Some lessors who have producing wells on their property receive no retail gas service from petitioners' distribution system. Such lessors obtain their gas directly from the well and such gas is transported to their residences. If a lessor is already receiving retail gas service, his free gas will normally be delivered through petitioners' transmission system. This arrangement is necessary because petitioners have determined that it is

inherently unsafe for any structure to have gas entering it from two separate sources. It also saves the lessor the expense of laying his own pipeline. If a lessor wishes to use his own pipeline to transport his free gas from the well to his residence and his residence is already connected to petitioners' transmission system, petitioners will generally withdraw its retail service from the residence. Petitioners maintain records (not placed in evidence) which indicate the type of connection for each well. Since most wells are drilled in remote areas, petitioners' Land Department Manager estimated that there are more leases where a lessor takes his free gas directly from the well than those cases where the gas is delivered through petitioners' transmission system. If a lessor does not have a dwelling house on the leased property where the producing well is drilled, he is not entitled to any free gas under the terms of the lease.

9. It is the Audit Division's position that the delivery of free gas to lessors by petitioners was a transfer of possession for a consideration and thus was a sale subject to tax under section 1101(b)(5) of the Tax Law. Petitioners maintain that, as to the delivery of gas to lessors through their own pipeline, there is no transfer of title or possession since the lessors receive their own property through their own pipeline and, thus, there is no sale. As to the lessors who receive free gas through petitioners' transmission system, petitioners argue that they (petitioners) are acting as bailees of a fungible commodity and only serve to deliver the lessors' property in petitioners' pipeline.

10. Petitioners submitted proposed findings of fact all of which have been substantially adopted by the Tax Commission in its decision herein.

CONCLUSIONS OF LAW

A. That section 1101(b)(5) of the Tax Law defines the term sale, in part, to mean any transfer of title or possession or both in any manner or by any means whatsoever for a consideration.

B. That, although in some states the view is taken that an oil and gas lease transfers oil and gas in place to the lessee (see Stephens County v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 29 A.L.R. 566; 38 Am. Jur.2d, Gas and Oil, §67), the New York view has been that oil and gas, while in place, are not the subject of an absolute, but only of a qualified, ownership until reduced to possession and that there can be no transfer of title to them before they have been so reduced (see Wagner v. Mallory, 169 N.Y. 501; Shepherd v. Mc Calmont Oil Co., 38 Hun. 37; 37 N.Y. Jur., Mines and Minerals, §9).

C. That the lessors of the property in issue herein never had title to or possession of the gas in place under their land since they did not bring it to the surface and reduce it to their possession. Rather petitioners took title to and possession of the natural gas in issue at the time the gas was brought to the surface. Therefore, when petitioners delivered the gas in issue to the lessors, either through the lessors' pipeline or petitioners' pipeline, there was a transfer of title and possession from petitioners to the lessors. The consideration for the transfer was the granting by the lessors to petitioners of the right to go on the lessors' land and drill for gas and the granting of the exclusive rights to any gas found thereon. Thus, there was a transfer of title or possession for a consideration which was a sale subject to tax within the meaning and intent of section 1101(b)(5) of the Tax Law.

Petitioner's reliance on Pittsburgh & West Virginia Gas Co. v. Nicholson, 97 W. Va. 540, 12 A.L.R. 1392, is misplaced insofar as the holding in that

case, to the effect that a lessee is entitled to receive no gas from the wells until after it has provided for the lessor's entitlements, is not concerned with title and possession of the gas but rather with rights and obligations under the lease. In the present case the critical issue is not whether the lessors were entitled to free gas from the wells but, rather, who had title to or possession of the gas at the wellhead in order to determine whether there was a transfer of such title or possession.

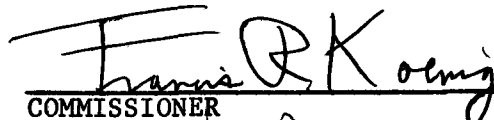
D. That the petitions of National Fuel Gas Supply Corporation and National Fuel Gas Distribution Corporation, as successors to Iroquois Gas Corporation, and National Fuel Gas Distribution Corporation, are granted to the extent indicated in Findings of Fact "3" and "7"; that the Audit Division is directed to modify the notices of determination and demand for payment of sales and use taxes due issued December 18, 1978 accordingly; and that, except as so granted, the petitions are in all other respects denied.

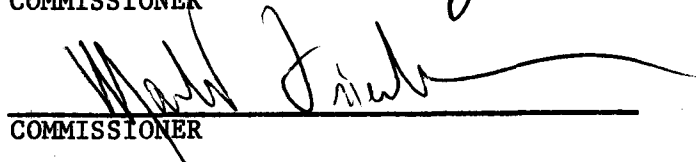
DATED: Albany, New York

STATE TAX COMMISSION

APR 06 1984


PRESIDENT


COMMISSIONER


COMMISSIONER

P 440 976 819

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to	
Thomas M. Barney	
Street and No.	
3400 Marine Midland	
P.O., State and ZIP Code	
Buffalo, NY 14203	
Postage	\$
Certified Fee	
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	
Return Receipt Showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	\$
Postmark or Date	

PS Form 3800, Feb. 1982

P 440 976 820

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