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Energy in the Law

Purchases of Gas Gathering Pipeline in an Enterprise Zone – Exempt from Colorado Sales Tax

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In the early 2000's, the Colorado Department of Revenue ("DOR") granted Pioneer a sales tax exemption for its purchases of well machinery, its compressor stations machinery, and its gas gathering pipeline and fittings that connected its wells with its compressor stations at its Raton Basin facility, because they were used in manufacturing tangible personal property for sale or profit. Pioneer's Raton Basin facility is in an Enterprise Zone, which expands the definition of manufacturing to include the extraction of natural resources.

However, starting in 2003, a different DOR Tax Conferee took a contrary position and denied Pioneer the same sales tax exemption for its gas gathering line purchases in 2003-2004 (and all subsequent tax years); claiming the gathering line was merely used for gathering and transportation of the CBM gas from the wells to the compressor stations and was not directly and predominantly used in the manufacturing of a new product, as required under the general statewide exemption. Pioneer appealed this sales tax refund denial to the Director, DOR. After a hearing, the Director, in a Final Determination (DD-620), upheld DOR's denial of Pioneer's requested sales tax refund for its gas gathering pipeline and fittings.

Pioneer appealed the Final Determination of the DOR to the Denver District Court. Judge McGahey agreed with Pioneer and ordered the DOR to refund the sales taxes which Pioneer paid under protest in 2003-2004 on its purchases of gas gathering pipeline and fittings used in manufacturing CBM gas in an Enterprise Zone. The DOR appealed this judgment to the Court of Appeals.

In a published opinion of August 14, 2014, *Pioneer Natural Resources USA, Inc., Plaintiff-Appellee, v. Colorado Department of Revenue, Defendant-Appellant*, 2014 COA 101, the Colorado Court of Appeals affirmed the Denver District Court's grant of summary judgment in Pioneer's favor that its purchases of gas gathering pipeline and fittings used in its Raton Basin (Enterprise Zone) facility qualify as machinery used in the manufacturing of

tangible personal property (CBM gas) such that the purchases are exempt from sales tax pursuant to C.R.S. §§ 39-26-709 (general statewide manufacturing sales tax exemption) and 39-30-106 (specific Enterprise Zone sales tax exemption).

In the Raton Basin, Pioneer operates over 2,000 wells and 10 compressor stations all connected by gas gathering pipeline. The pipeline pressure is managed daily by pressure transducers that are accurate to 0.1 lbs/psig to assist in extracting the gas from the coal and by the company's continuous pigging operations. These pressures and the size of the pipeline reduce the pressure at the wellhead which in turn increases production of the CBM gas.

In an Enterprise Zone, the definition of manufacturing is expanded to also include: "refining, blasting, exploring, processing and beneficiation, or otherwise extracting from the earth . . . natural resources." C.R.S. § 39-30-106(1)(b)(emphasis added). Under the general statewide sales tax statute, "[m]achinery used during the manufacturing process to move material from one direct production step to another in a continuous flow . . . during the manufacturing process is deemed directly used in manufacturing." C.R.S. § 39-26-709(1)(d).

The Court of Appeals agreed that Pioneer's gas gathering pipeline and fittings were directly used to extract gas from the earth and move the gas from "one direct production step to another in a continuous flow." Thus, the Court of Appeals affirmed the district court's ruling that Pioneer's gas gathering pipeline and fittings qualified for the Enterprise Zone sales tax exemption as machinery directly used in manufacturing tangible personal property (CBM gas) for sale or profit. In doing so, the Court of Appeals logically construed the expanded definition of manufacturing under the Enterprise Zone exemption together with the definition of what constitutes machinery used in manufacturing under the statewide exemption in reaching its conclusion.

Colorado operators, including Pioneer, have waited since 2003 for the Department of Revenue to refund sales taxes paid under protest on purchases of gas gathering pipeline and fittings in an Enterprise Zone. Since this decision is unanimous and Chief Judge Loeb concurred, the Department of Revenue will have to think long and hard about filing a petition for certiorari to the Supreme Court. If they do so, the petition must be filed no later than 42 days after the date of the Court of Appeals Opinion.

Please contact [Karen Spaulding](#) of Beatty & Wozniak, P.C. if you have any questions.