Strange Bedfellows

by Dennis C. Linken on March 16, 2012

One would think a casino operator and a church would be unlikely to agree on much, but in an opinion only a lawyer could love, they did indeed find common ground. It all arises out of a recent New Jersey Tax Court decision, which held that the distribution of electricity — as distinct from and in addition to the generation and transmission of electricity — is taxable under the New Jersey Sales and Use Tax Act.

In 1999, the Legislature enacted the Electric Discount and Energy Competition Act ("EDECA"), in an effort to introduce competition into the electric public utility market. Prior to EDECA, the local public utility (such as Public Service Electric and Gas Company) had a monopoly on the provision and delivery of electric service to customers. The utility owned the generating equipment and facilities used to produce electric energy, as well as the transmission facilities (high capacity wires and equipment) and the distribution lines used to deliver electricity. The customer had only one option: to purchase electricity from the local utility. In doing so, the customer paid charges which encompassed all of the essential functions — generation, transmission and distribution — involved in the process.

Then along came EDECA, and suddenly the energy world changed; customers now have a choice — at least as to generation and transmission services. The distribution function remains with the local utility company.

It turns out that the New Jersey Sales and Use Tax Act imposes a sales tax upon "utility services," defined as "the transportation or transmission of natural gas or electricity by means of mains, wires, lines or pipes, to users or customers." Thus, the question: Are charges imposed for "distribution" services — taking the electricity already produced by the generator and transported to the local utility, and then delivering it to the customer — properly included as the "transportation or transmission" of electricity, thereby subjecting charges for distribution services to sales tax?

A somewhat unusual combination of taxpayers, the owner of the Showboat Casino in Atlantic City and a medical center in Camden affiliated with Our Lady of Lourdes Church, albeit independently of each other, disagreed with the interpretation of the statute by the Director of the Division of Taxation., They challenged the imposition of the Sales and Use Tax Act on utility charges for distribution of electricity. They argued that, while the Sales and Use Tax Act applies to the generation and transmission functions, the statute's lack of reference to distribution activities made clear the Legislature's intent that charges for distribution should not be so taxed.

The Tax Court, however, disagreed and held that the common meaning of the terms transportation and transmission encompassed distribution service as well.

Also at issue in the case were charges related to costs visited upon the electric utilities by virtue of EDECA, and the introduction of competition into the energy market. So-called market transition charges, transition bond charges, and societal benefits charges, together with other such costs, are permitted to be passed on by the utility companies to their customers. The casino operator and the medical center contended that such costs are really "taxes" — not "receipts" from the sale of utility services — and thus are not subject to the sales tax. Not so, said the Court. Unlike taxes imposed by the State, the charges for such costs are simply collected from customers to compensate the utility companies for the costs incurred by them as a result of deregulation. Such charges are therefore properly subject to sales tax.

The application of the Sales and Use Tax Act to literally a multitude of transactions is an exceedingly complex area of the law. Should you have questions or concerns with regard to the Sales and Use Tax Act, contact our tax attorneys for advice.