Georgia Letter Ruling Number: LR SUT-2018-09
Topic: Manufacturing, Energy
Dated: July 31, 2018

This letter is in response to your request for reconsideration of the Department's guidance on the application of Georgia sales and use tax to energy necessary and integral to manufacturing.

Facts Presented by Taxpayer

[Redacted], ("Taxpayer") purchases and uses biomass fuel, tire derived fuel, electricity, natural gas, and coal to produce steam. The steam is produced for two purposes: for selling steam to the adjacent, affiliated paper mill[1] and for using the remaining steam to generate electricity to be sold to a power company.

On February 11, 2016, Taxpayer submitted a request for a letter ruling determining if Taxpayer is "primarily engaged in producing electricity for resale" as used in the definition of the term "energy" in O.C.G.A. § 48-8-3.2(a)(3). The following facts were presented to the Department:

> Taxpayer supplies the majority of the paper mill's steam, although the mill's needs are greater than Taxpayer can provide.[2] While Taxpayer controls the amount of steam produced, the paper mill's consumption is controlled by the mill rather than Taxpayer. In other words, Taxpayer does not limit the paper mill's consumption of steam (except as limited by the capacity of the operations). This sale of steam is an arm's length transaction, but there is no penalty for non-delivery of steam. Additionally, Taxpayer does not have the ability to sell steam to any other entities.
>
> Based on the twenty-year power purchase agreement between Taxpayer and the power company, Taxpayer has a contracted limit for electricity to be sold to the power company but not a contracted base amount. Despite the flexibility provided in the contract, it is financially advantageous for Taxpayer to deliver almost all of its declared capacity because of its participation in a capacity payment system.
>
> Taxpayer's steam turbine generator has limited condensing capacity. This design configuration depends on large amounts of steam being extracted for paper mill use: Taxpayer cannot generate the current declared capacity of 29 MW without steam extracted. Thus, it is necessary to maintain mill steam sales to achieve power production at or near capacity, and Taxpayer would not be financially viable without steam sales. In practice, Taxpayer normally provides the maximum steam possible to the mill and, consequently, maintains its current power sales rate near production capacity.
>
> In addition to the process description above, Taxpayer provided the following:
>
> - The value of the capital assets and investments used to produce steam far exceed those used to produce electricity for resale.
> - Approximately 59% of the energy derived from the combustion of solid fuels within the boiler is used to produce steam for purchase by the mill. The remainder of this energy goes to condensing steam or other processes in power production.
> - On average, 45% of Taxpayer's gross revenue results from the sale of steam and 55% Taxpayer's gross revenue results from the sale of electricity. By contract with the power company, power revenue fees are set for 20 years with a 2.5% annual adjustment. The steam fees are adjusted annually based on a neutral index, with a cap of 2.5% per year.

[1] The paper mill, which shares some common ownership with Taxpayer, provides to Taxpayer biomass which is used as one of the fuel types in Taxpayer's boiler.

[2] The paper mill owns a gas fired package boiler and a gas turbine-generator with a heat recovery steam generator. When the steam provided by Taxpayer is insufficient to maintain desired production levels, the mill produces the necessary steam with these units.

- It takes approximately 1.25 hours to produce electricity with the same heat value as the amount of steam produced in one hour. It takes approximately 47.8 minutes to produce electricity with the same resale value as the amount of steam produced in one hour.
- Taxpayer considers its facility to be classified under the 2012 North American Industrial Classification System (NAICS) code 221117 (Biomass electric power generation). This industry comprises establishments primarily engaged in operating biomass electric power generation facilities. These facilities use biomass to produce electric energy. The electric energy produced in these establishments is provided to electric power transmission systems or to electric power distribution systems.[3]

Much of the biomass fuel purchased by Taxpayer meets the definition of "biomass material" under the sales and use tax exemption contained in O.C.G.A. § 48-8-3(83)(A). However, in addition to biomass material, Taxpayer also purchases other fuels to burn to produce steam.

On February 24, 2017, the Department issued a letter ruling (the "First Ruling") with the Department's position that Taxpayer is primarily engaged in producing electricity for resale. On September 5, 2017, Taxpayer requested that the Department reconsider the First Ruling based on additional information: (i) Taxpayer considers its facility to be classified under a different NAICS code and (ii) Taxpayer meets a Federal Energy Regulatory Commission (FERC) fundamental use standard regarding energy sold to an electric utility.

NAICS Code

Taxpayer provides that the company selected NAICS code 221117 (Biomass Electric Power Generation), as described above, but only in error because the engineers saw "biomass" in the description and did not realize there was a code more closely aligned with the facility's actual operations. Taxpayer claimed that this was the NAICS code entered on the sales tax registration application Taxpayer filed with the Department in 2014 but that the code was subsequently changed to a different code, NAICS code 314999 (All Other Miscellaneous Textile Product Mills), as reflected on Taxpayer's Georgia Sales Tax Certificate of Registration effective August 2014.[4] In July 2017, after the issuance of the First Ruling, Taxpayer updated the Department's records to be classified using NAICS code 221330 (Steam and Air Conditioning Supply), which includes steam production and distribution.

FERC certification

Taxpayer's agreement to sell electricity to the power company is conditioned on Taxpayer being certified by FERC as a Qualifying Facility (QF). Pursuant to federal law and regulations, a QF must qualify as a (i) small power production facility or (ii) a cogeneration facility.[5] Although Taxpayer is self-certified as a QF solely based on qualifying small power production facility status, Taxpayer claims that the facility qualifies as a small power production facility as well as a cogeneration facility.[6]

---

[3] "North American Industry Classification System: 221117 Biomass Electric Power Generation." *United States Census Bureau*. http://www.census.gov/cgi-bin/sssd/naics/naicsrch?code=221117&search=2012 (August 23, 2016). This code is comprised of part of the facilities in 2007 NAICS code 221119 (Other electric power generation), and it is a subset of 22111 (Electric Power Generation).

[4] The Department's records reflect that Taxpayer claimed the NAICS code 314999 (All Other Miscellaneous Textile Product Mills) at the time of the company's sales tax registration application. As a result, this code is included on Taxpayer's Georgia Sales Tax Certificate of Registration. In August 2016, as part of a response to Department questions about the first letter ruling request, Taxpayer asserted 221117 (Biomass Electric Power Generation) is the NAICS code with the closest description available.

[5] 16 U.S.C. § 792, *et seq*.; 18 C.F.R. Part 292.

[6] Taxpayer explained that the company completed the forms a small power production facility because it is a far simpler and less expensive process than to qualify as a cogeneration facility. Taxpayer further provided that, for the initial certification, limited data at the time meant that it was much more expedient to file as a small power production facility. However, the records available through the FERC Online eLibrary (*elibrary.ferc.gov*) show that Taxpayer

To qualify as a cogeneration facility after 2006, the electrical, thermal, chemical, and mechanical output of a cogeneration facility must be used fundamentally for industrial, commercial, residential or institutional purposes and must not be intended fundamentally for sale to an electric utility, taking into account technological, efficiency, economic, and variable thermal energy requirements, as well as state laws. Federal regulations explicitly provide that, for the purpose of satisfying this requirement, the electrical, thermal, chemical and mechanical output of the cogeneration facility will be considered used fundamentally for industrial, commercial, or institutional purposes, and not intended fundamentally for sale to an electric utility if at least 50 percent of the aggregate of such output, on an annual basis, is used for industrial, commercial, residential or institutional purposes.[7]

Taxpayer contends that the facility meets these operating and efficiency standards for top-cycling cogeneration facilities.[8] The steam produced by Taxpayer and used by the paper mill is a productive use of steam (thermal energy). The average output used for industrial purposes (i.e., use by the paper mill) is 77% of the output.[9] Accordingly, because over 50% of the facility's energy output is sold to the related paper mill and not an electric utility, Taxpayer asserts that the facility meets the fundamental use requirement for qualifying cogeneration facilities. As such, since Taxpayer would satisfy that requirement, Taxpayer believes that the production methods and output support that Taxpayer is primarily engaged in industrial purposes rather than for sale to an electric utility.

Issue

Is Taxpayer "primarily engaged in producing electricity for resale" as used in the definition of the term "energy" in O.C.G.A. § 48-8-3.2(a)(3)?

Analysis

Georgia levies and imposes a tax (subject to certain specific exemptions) on the retail purchase, retail sale, storage, use, or consumption of tangible personal property, certain enumerated services, and utilities.[10]

The sale and use of energy are exempt from sales and use tax (except certain sales and use taxes for educational purposes) if the energy is necessary and integral to the manufacture of tangible personal property and sold, used, stored, or consumed at a manufacturing plant in Georgia.[11] "Energy" means natural or artificial gas, oil, gasoline, electricity, solid fuel, wood, waste, ice, steam, water, and other materials necessary and integral for heat, light, power, refrigeration, climate control, processing, or any other use in any phase of the manufacture of tangible personal

---

first submitted to FERC Form 556 (the notice of self-certification of QF status) in May 2013. At that time, Taxpayer selected "qualifying cogeneration facility status" rather than "qualifying small power production facility status." In 2014, Taxpayer submitted Form 556 to change the previously certified facility and sought "qualifying small power production facility status" rather than "qualifying cogeneration facility status." The same status was the sole status selected on forms filed in 2015 and 2017.

[7] 18 C.F.R. § 292.205 (facilities that do not meet this standard may present other evidence to FERC that the facility should nevertheless be certified). Facility output is reported as energy measured in MWh.

[8] Topping-cycle cogeneration facility means a cogeneration facility (equipment used to produce electric energy and forms of useful thermal energy - such as heat or steam - used for industrial, commercial, heating, or cooling purposes, through the sequential use of energy) in which the energy input to the facility is first used to produce useful power output, and at least some of the reject heat from the power production process is then used to provide useful thermal energy. 18 C.F.R. § 292.202.

[9] Taxpayer provided a chart with monthly useful electrical power output in Btu/Hr compared to useful steam thermal energy output in Btu/Hr. Taxpayer later clarified that the overall energy measured in Btu – as opposed to power in Btu/Hr – that Taxpayer sells is, on average over a two-year period, 77% steam and 23% electricity.

[10] O.C.G.A. §§ 48-8-1, 48-8-2(31)(A), and 48-8-30(a).

[11] O.C.G.A. § 48-8-3.2; Ga. Comp. R. & Regs. r. 560-12-2-.64.

property. However, the term "energy," as used in the exemption at issue, excludes energy purchased by a manufacturer that is primarily engaged in producing electricity for resale.[12]

Here, Taxpayer is purchasing materials to burn for heat, which is necessary to produce steam and electricity. Therefore, it seems that the purchased materials would be considered energy unless Taxpayer, the manufacturer, is primarily engaged in producing electricity for resale.

Exemptions from taxation are strictly construed, and an exemption will not be granted unless the relevant statute clearly and distinctly shows that such was the plain and unambiguous intention of the General Assembly.[13] The phrase "primarily engaged in producing electricity for resale" is not defined, so the Department assumes that the words are used in their ordinary senses. "Primarily" means "for the most part" or "in the first place."[14] "Engaged" means "involved in activity," "being used," or "busy with some activity."[15]

The First Ruling stated that, in light of Taxpayer's relationship with its steam purchaser, business model, self-classification, and production methods, the facts presented indicate that Taxpayer is primarily engaged in producing electricity for resale. The additional assertions in Taxpayer's September 5, 2017 request for reconsideration do not change the Department's understanding of the determinative factors underlying the First Ruling.[16]

Ruling

In view of the totality of Taxpayer's description of its current operations, Taxpayer is "primarily engaged in producing electricity for resale" as used in the definition of the term "energy" in O.C.G.A. § 48-8-3.2(a)(3).

The opinions expressed in this ruling are based upon the information contained in your request and limited to the specific transactions, facts, circumstances and taxpayer in question. The facts herein are those presented by the taxpayer and the Department accepts them as true for this ruling. If the facts presented herein change, are not true, are different, or material facts have been omitted, the conclusions reached in this ruling may change. In addition, subsequent statutory or administrative rule changes or judicial interpretations of the statutes or rules upon which this advice is based may subject similar future transactions to a different tax treatment than that expressed in this ruling.

[12] O.C.G.A. § 48-8-3.2; Ga. Comp. R. & Regs. r. 560-12-2-.64.
[13] Ga. Comp. R. & Regs. r. 560-12-1-.18.
[14] "Primarily," *Merriam-Webster.com*. http://www.merriam-webster.com/dictionary/primarily (April 18, 2018).
[15] "Engaged," *Merriam-Webster.com*. http://www.merriam-webster.com/dictionary/engaged (April 18, 2018).
[16] Taxpayer's request states that, should it be necessary, Taxpayer will amend its FERC qualification status from small power production facility to cogeneration facility. Because the cogeneration facility requirements set forth in 18 C.F.R. § 292.205 do not correspond with the relevant portion of the definition of "energy" codified in O.C.G.A. § 48-8-3.2, such a change to Taxpayer's federal self-certification status would not, without more, alter the conclusions in this ruling.