7-27-2017

Southern Cal. Edison v. State Dep't of Taxation, 133 Nev. Adv. Op. 49 (Jul. 27, 2017)

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TAX LAW: USE TAX & THE DORMANT COMMERCE CLAUSE

Summary:

The Court considered whether an electrical utility company was entitled to a tax refund after it had paid taxes under an alleged discriminatory taxation scheme. The Court held that the company was not entitled to a tax refund because the company's statutory construction argument regarding NRS 372.270 in conjunction with NRS 372.185 would create absurd results. Moreover, the company did not provide sufficient evidence demonstrating substantially situated competitors who benefited from the unconstitutional taxation scheme. Finally, the Court found that the company was not entitled to a tax credit for the money it paid to an out-of-state tax because the tax was not a sales tax.

Background:

The Court considered whether Southern California Edison ("Edison") was due a use tax refund given Edison's allegation that because it alleged to make the requisite showing of favored competitors. Alternatively, the Court considered whether Edison is owed a tax credit in an amount equal to the transaction privilege tax (TPT) levied by Arizona. Prior to this case, the Court recognized that "[v]iolations of the dormant Commerce Clause are remedied by compensating for the negative impact to the claimant as measured by the unfair advantage provided to the claimant's competitors."[2]

Edison is an electrical utility company that owned a majority interest in the Mohave Generation Station – a power plant that bought coal exclusively from Peabody Western Coal Company ("Peabody"). Peabody extracted the coal in Arizona. Respondent State of Nevada Department of Taxation ("Department") levied a use tax on the coal Edison purchased from Peabody, pursuant to NRS 372.185. Between March 1998 and December 2000, during Edison and Peabody's course of business, Edison paid $23,986,668 in Nevada use tax and $9,703,087.52 due to the Arizona (TPT).

Edison filed a claim against the Department and the Nevada Tax Commission for a refund and/or tax credit – both of which were denied. As a result, Edison filed a claim in the district court, which stayed Edison's proceedings while awaiting the decision from *Sierra Pacific*. After *Sierra Pacific* was decided, the district court concluded that NRS 372.270 was unconstitutional, however, Edison was not entitled to a refund because it did not have any favored competitors that benefited from the discriminatory taxation scheme.

Discussion:

On appeal, Edison advanced three arguments:

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[1] By Karson Bright

[2] *See* Sierra Pacific Power Co. v. State Dep't of Taxation, 130 Nev. Adv. Op. 93, 338 P.3d 1244, 1246 (2014).

> (1) NRS 372.185 (use tax) and NRS 372.270 (use tax exemption) can be harmonized to bring NRS 372.270 within constitutional parameters, and, under this construction, Edison is entitled to a refund because the use tax does not apply to coal purchases; (2) if the Court did not apply Edison's proposed statutory construction, NRS 372.270 is impermissibly discriminatory under the dormant Commerce Clause and Edison made a showing of advantaged competitors caused by NRS 372.270, thereby entitling Edison to a refund pursuant to *Sierra Pacific*; and (3) if [the] Court decides that Edison is not owed a refund, Edison is entitled to a tax credit for the TPT Arizona levied on the coal's production.[3]

NRS 372.270 cannot be harmonized with NRS 372.185 to bring it within constitutional parameters

Edison argued that NRS 372.270 is capable of being constitutional if it is harmonized with NRS 372.185. With this construction, Edison's coal purchases would qualify for the exemption in NRS 372.270. In response to Edison's statutory construction argument, the Court reviewed Edison's question de novo.[4] The Court next looked to Nevada's use and sales tax statutory scheme, which is structured as follows:

> Under Nevada law, sales and use taxes are complementary, yet mutually exclusive. Sales tax applies to the sale of tangible personal property within the state. NRS 372.105. Conversely, use tax applies to the use, storage, and consumption of tangible personal property within the state. NRS 372.185 … The use tax complements the sales tax so that all tangible personal property sold or utilized in Nevada is subject to taxation. Use taxation is also a way for Nevada to tax transactions outside the state that would otherwise escape sales taxation. The incidence of Nevada's use tax falls directly upon the party that makes the out-of-state purchase and uses property within the state.[5]

The Court found that NRS 372.185 imposes a tax on the use, storage, or consumption purchased out-of-state that would have been a taxable sale if it occurred in Nevada, whereas NRS 372.270 exempted from sales and use tax the gross receipts from the sale, storage, use, or consumption in Nevada. As a result, the Court found that NRS 372.270's effect is to favor in-state mines over out-of-state mines.

Edison Contended that NRS 372.270 could be read in a way that avoids interstate discrimination citing the Court's prior rulings regarding statutory interpretation, which state: "[w]hen the language of a statute admits of two constructions, one of which would render it constitutional and valid and the other unconstitutional and void, that construction should be adopted which will save the statute."[6]

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[3] Southern Cal. Edison v. State Dep't of Taxation, 133 Nev. Adv. Op. 49, 5 (Jul. 27, 2017).
[4] *See* I. Cox Constr. Co. v. CH2 Invs., LLC, 129 Nev. 139, 142, 296 P.3d 1202, 1203 (2013).
[5] *See* State Dep't of Taxation v. Kelly-Ryan, Inc., 110 Nev. 276, 280, 871 P.2d 331, 334–35 (1994).
[6] *See* Ford v. State, 127 Nev. 608, 619, 262 P.3d 1123, 1130 (2011) (quoting Virginia & Truckee R.R. Co. v. Henry, 8 Nev. 165, 174 (1873)).

However, the Court found that Edison's reading of the statutes would produce absurd results and therefore declined to adhere to Edison's proposed construction.[7] Edison's reading was absurd because it would confuse the location of the mine with the location of the sale. Furthermore, Edison's harmonization would also avoid net proceeds tax on its transactions with Peabody and allow companies to completely avoid use, sales, and net proceeds taxation – which was not what the legislature intended. The Court concluded, citing its language from *Sierra Pacific*, that NRS 372.270 was originally enacted only "to avoid taxing the proceeds of mines already subject to the net proceeds tax."[8]

Edison does not have substantially similar favored competitors that benefited from the discriminatory taxation scheme

Next, Edison argues that if NRS 372.270 is not harmonized with NRS 372.185 consistent with its proposed construction, the district court's finding that NRS 372.270 is unconstitutional under the dormant Commerce Clause should stand. Similarly, the Department also did not dispute the district court's determination that NRS 372.270's tax exemption was unconstitutional so the Court only considered Edison's claim for a full refund of the taxes it paid on the coal purchase.

Edison contends that it presented the district court with adequate evidence of favored competitors that would entitle it to a full refund under *Sierra Pacific*. The Court looked to an excerpt of the district court's holding, which stated: "there are no facts in the record to support a finding that [Edison], by paying use tax on its purchase of the coal slurry, is being discriminated against in comparison to a similarly situated tax payer" and that "[Edison] did not pay any higher taxes than did its competitors." For this finding of fact in the trial court, this Court could not reverse "unless the judgment is clearly erroneous and not based on substantial evidence."[9] Moreover, the Court also recognized that "[s]tate courts have the duty of determining the appropriate relief for Commerce Clause violations, and, to satisfy due process requirements, courts must provide some 'meaningful backward-looking relief' to correct taxes paid pursuant to an unconstitutional scheme."[10]

The Court concluded that the proper analysis for determining whether favored competitor to Edison existed would be to first answer the threshold question of whether the competitor was a "substantially similar entity" to Edison before determining whether Edison was entitled to a monetary remedy as a result of a dormant Commerce Clause violation.[11] For a dormant Commerce Clause violation to exist, the claimed discrimination must create a competitive advantage between

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[7] *See* City Plan Dev., Inc. v. Office of Labor Comm'r, 121 Nev. 419, 435, 117 P.3d 182, 192 (2005) ("When interpreting a statute, this court … seek[s] to avoid an interpretation that leads to an absurd result.").

[8] *See Sierra Pac.*, 130 Nev. Adv. Op. 93, 338 P.3d at 1248,

[9] *See* Certified Fire Prot., Inc. v. Precision Constr., Inc., 128 Nev. 371, 377, 283 P.3d 250, 254 (2012) (internal quotes omitted).

[10] *See Sierra Pac.*, 130 Nev. Adv. Op. 93, 338 P.3d at 1248 (quoting McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, Dep't of Bus. Reg. of Fla., 496 U.S. 18, 31 (1990)).

[11] *See Sierra Pac.*, 130 Nev. Adv. Op. 93, 338 P.3d at 1249 n. 7 (citing General Motors Corp. v. Tracy, 519 U.S. 278, 298–99 (1997).

these "substantially similar entities," however the competitive markets are generally narrowly drawn.[12]

Based on this analysis, and similar to the holding in *Sierra Pacific*, the Court found that Edison does not compete against power companies that use coal mined within Nevada because there is not enough coal to justify commercial operations.[13] Therefore, because the Court declined to draw the market in such a way to compare coal producers to producers of natural gas, solar, and other sources of energy, Edison failed to prove there were any similarly situated coal producers who were favored due to the taxation scheme.

Edison is not entitled to a tax credit based on the TPT paid to Arizona

Finally, Edison argues that even if a refund is not warranted, it is entitled to a $9,703,087.52 tax credit because it paid the TPT in Arizona. The Court first looked to the Nevada Administrative Code, which states that the Department will allow a tax credit if the tax (in this case, for the TPT) if the tax is considered to be a sales tax.[14] Determining whether the TPT was a sales tax was a question of law for the Court.[15] Regarding the TPT, the Arizona Supreme Court and the Arizona Department of Revenue have found that the TPT is to be distinguished from a sales tax; the tax is on the privilege of doing business in Arizona and is not a true sales tax.[16]

Based on the findings from the Arizona Supreme Court, this Court found that the TPT was not a true sales tax that would warrant Edison a tax credit. Furthermore, the Court found that even if the TPT was a sales tax, it was Peabody who bore the cost of the tax and Edison was merely reimbursing them.

Conclusion:

Edison is not entitled to any tax refund because NRS 372.270 could not be harmonized with NRS 372.185 and Edison did not show that there were substantially similar competitors that were advantage by the unconstitutional tax. Furthermore, Edison is also not entitled to a tax credit because the TPT is not a sales tax within the meaning of NAC 372.055.

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[12] *See id.* (citing *General Motors Corp.*, 519 U.S. at 301–03).
[13] *See Sierra Pac.*, 130 Adv. Nev. Op. 93, 338 P.3d at 1249 & n.6.
[14] *See* NEV. ADMIN. CODE § 372.055.
[15] *See* Garcia v. Prudential Ins. Co. of Am., 129 Nev. 15, 19, 293 P.3d 869, 872 (2013).
[16] *See* City of Phoenix v. West Publ'g Co., 712 P.2d 944, 946–47 (Ariz. Ct. App. 1985).