

This Week in State Tax (TWIST)

December 2, 2024



Maryland: Appeals Court Rules Certain Electric Transmission and Delivery Equipment Qualify for Production Exemption

The Maryland Court of Appeals recently ruled that certain of Potomac Edison's electricity transmission equipment qualified for a sales and use tax exemption as equipment used directly and predominantly in a production activity. Potomac Edison purchased electricity from a generating plant outside Maryland and used its transmission and distribution system (T&D system) to carry the electricity to its Maryland customers. As the electricity traveled from the generating plant to the customers, Potomac Edison adjusted the voltage up and down to enable efficient travel and make the electricity usable for customers of various types.

Potomac Edison claimed its activities qualified for an exemption in Maryland for tangible personal property purchased for use directly and predominantly in a production activity. However, on audit, the Comptroller assessed sales and use tax, based on the finding that Potomac Edison was not entitled to the exemption. Potomac Edison appealed, and after a series of legal proceedings, the matter arrived at the Court of Appeals for a second time, with the primary substantive issue before it being whether the Maryland Tax Court had erred in finding on remand that substantial portions of Potomac Edison's T&D system was used in a production activity and was therefore exempt from sales and use tax.

In a prelude to the current matter, the case arrived on its first trip to the Court of Appeals after the state Tax Court had denied Potomac Edison's claim. In that case, the Tax Court focused on definitions that categorized the transmission, distribution, and delivery of electricity as a taxable service, determining that Potomac Edison was not engaged in processing or manufacturing, and thus did not qualify for the exemption. The appellate court reversed and remanded the initial Tax Court decision, finding that there was definitely processing involved in the transmission and delivery of the electricity and that the Tax Court had erred in finding that none of the equipment qualified for exemption.

On remand at the Tax Court, an expert witness categorized the assets purchased by Potomac Edison into five groups as to whether they were used directly and predominantly in changing the form or characteristics of energy. After reviewing each category, the Tax Court concluded that conductor wires and cables continually processed electricity by organizing and directing the movement of electrons. Absent this, the electricity in the form used and consumed by customers could not have been produced, thus qualifying it for exemption. The Tax Court also found that transformer and substation equipment were exempt because they constantly processed the voltage of electricity that customers purchased and consumed. Conversely, the distribution and foundation

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support equipment were not exempt, as they primarily consisted of electric meters used to measure customer usage rather than to process electricity. In the instant decision, the appellate court held that the Tax Court's decision on remand was supported by substantial evidence in the record and denied the Comptroller's arguments. For more information on [*In the Matter of the Comptroller of Maryland*](#), contact [Justin Mikol](#).

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