

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-05(31)S
Sales Tax
August 16, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S050203A

On February 3, 2005, the Department of Taxation and Finance received a Petition for Advisory Opinion from Northeast Fire Protection Systems, Inc., 318 Charlton Road, Ballston, New York, 12020. Petitioner, Northeast Fire Protection Systems, Inc., provided additional information pertaining to the Petition on April 22, 2005.

The issue raised by Petitioner is whether it is liable for sales tax on the portion of the charge for fire protection system components attributable to the value added by the seller, a related corporation, that fabricates the components.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner and Burnt Hills Fabricators, Inc. (BHF) are two corporations. Both corporations are owned by the same two shareholders, James Fantauzzi and Michael Phinney. Both shareholders have the same percentage of ownership in each company. The same people serve on the board of directors and as officers of both corporations. Mr. Fantauzzi is the president, and Mr. Phinney is the vice president of both corporations. In his capacity as president of both corporations, Mr. Fantauzzi hires, fires and directs the work of the employees of both corporations. Each corporation has its own Federal employer's identification number and Certificate of Authority for New York State sales tax purposes. Each corporation has its own employees and separate payrolls. Each corporation maintains its own set of books and records.

Petitioner contracts with its customers to install fire protection systems. BHF purchases pipe and other materials, which it fabricates into fire protection system components pursuant to the specifications provided by Petitioner. Petitioner uses the components provided and fabricated by BHF in its installations of fire protection systems. Sales tax is charged by BHF to Petitioner on materials used but not on the value of the labor supplied by BHF. BHF pays its own employees, but does so with a transfer of funds from Petitioner. BHF does not perform installations of fire protection systems.

BHF is operated so as to not make a profit. Petitioner provides payroll services for BHF in the form of issuing BHF paychecks to BHF employees and other typical payroll services. BHF employees may use vehicles owned by Petitioner to transport the fabricated materials to Petitioner's jobs.

Throughout the entire process, Mr. Fantauzzi directs both companies as if they were one entity. Such entity's primary function is the installation of fire protection systems for its customers. Employees of Petitioner and BHF work at the same location. Company meetings and social functions are attended by the employees of both companies.

Applicable law and regulations

Section 1101(b) of the Tax Law provides, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c) and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

* * *

(3) Receipt. The amount of the sale price of any property and the charge for any service taxable under this article . . . valued in money, whether received in money or otherwise, including any amount for which credit is allowed by the vendor to the purchaser, without any deduction for expenses

* * *

(4) Retail sale. (i) A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property, or (B) for use by that person in performing the services subject to tax under paragraphs (1), (2), (3), (5), (7) and (8) of subdivision (c) of section eleven hundred five where the property so sold becomes a physical component part of the property upon which the services are performed or where the property so sold is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax. Notwithstanding the preceding provisions of this subparagraph, a sale of any tangible personal property to a contractor, subcontractor or repairman for use or consumption in erecting structures or buildings, or building on, or otherwise adding to, altering, improving, maintaining, servicing or repairing real property, property or land, as the terms real property, property or land are defined in the real property tax law, is deemed to be a retail sale regardless of whether the tangible personal property is to be resold as such before it is so used or consumed

* * *

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume . . . conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

* * *

Section 1101(b)(9)(i) of the Tax Law defines the term *capital improvement* as:

An addition or alteration to real property which:

(A) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and

(B) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and

(C) Is intended to become a permanent installation.

Section 1115 of the Tax Law provides, in part:

(a) Receipts from the following shall be exempt from the tax on retail sales imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten:

* * *

(12) Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property, gas, electricity, refrigeration or steam for sale, by manufacturing, processing, generating, assembling, refining, mining or extracting. . . .

Section 1119(c) of the Tax Law provides:

(c) A refund or credit equal to the amount of sales or compensating use tax imposed by this article and pursuant to the authority of article twenty-nine, and paid on the sale or use of tangible personal property, shall be allowed the purchaser where such property is later used by the purchaser in performing a service subject to tax under paragraph (1), (2), (3), (5), (7) or (8) of subdivision (c) of section eleven hundred five or under section eleven hundred ten and such property has become a physical component part of the property upon which the service is performed or has been transferred to the purchaser of the service in conjunction with the performance of the service subject to tax or if a contractor, subcontractor or repairman purchases tangible personal property and later makes a retail sale of such tangible personal property, the acquisition of which would not have been a sale at retail to him but for the second to last sentence of subparagraph (i) of paragraph (4) of subdivision (b) of section eleven hundred one. An application for the refund or credit provided for herein must be filed with the commissioner of taxation and finance within the time provided by subdivision (a) of section eleven hundred thirty-nine. Such application shall be in such form as the commissioner may prescribe. Where an application for credit has been filed, the applicant may immediately take such credit on the return which is due coincident with or

immediately subsequent to the time that he files his application for credit. However, the taking of the credit on the return shall be deemed to be part of the application for credit. The procedure for granting or denying such applications for refund or credit and review of such determinations shall be as provided in subdivision (e) of section eleven hundred thirty-nine.

Section 541.2 of the Sales and Use Tax Regulations provides, in part:

Definitions. The words, terms and phrases used in this Part have the following definitions except when the context clearly indicates a different meaning:

(a) Construction contract. (1) A *construction contract* means a contract to erect, construct, alter, repair or maintain any building or other structure, project, development or other improvement on or to real property, property or land.

* * *

(d) A *construction contractor* means any person who engages in erecting, constructing, adding to, altering, improving, repairing, servicing, maintaining, demolishing or excavating any building or other structure, property, development, or other improvement on or to real property, property or land.

(e) *Contractor* means a construction contractor, subcontractor or repairman.

Section 541.5(b) of the Sales and Use Tax Regulations provides, in part:

(1) Purchases. All purchases of tangible personal property (excluding qualifying production machinery and equipment exempt under section 1115(a)(12) of the Tax Law) which are incorporated into and become part of the realty or are used or consumed in performing the contract are subject to tax at the time of purchase by the contractor or any other purchaser. A certificate of capital improvement may not be validly given by any person or accepted by a supplier to exempt the purchase of these materials.

* * *

(4)(iii) If a contract includes the sale of tangible personal property which remains tangible personal property after installation, the contractor must collect the appropriate New York State and local taxes from the customer on the selling price, including any charge for installation, of the tangible personal property unless a properly completed exemption certificate is issued by the customer. The contractor may apply for a credit or refund of taxes he has paid on purchases of the tangible personal property that remain tangible personal property after installation.

Example 1: A contractor sells a building he has constructed and, as a part of the sale agreement, installs free standing water fountains which remain tangible personal property when installed. The contractor's billing to his customer must separately state all charges for tangible personal property included in the sales agreement. The New York State and applicable local tax rate must be collected on the total charges for the water fountains including any installation charges. In this instance, the contractor may purchase the water fountains tax-free using a contractor exempt purchase certificate. If he pays the tax to his supplier, he is entitled to a refund or credit of the tax paid on the purchase of the water fountains.

Opinion

Petitioner is in the business of installing fire protection systems and is therefore a construction contractor for sales tax purposes. See section 541.2(d) and (e) of the Sales and Use Tax Regulations. Petitioner's sister corporation, BHF, purchases the raw materials and fabricates the components of these systems.

BHF's sole function is to fabricate parts for the fire protection systems installed by Petitioner. Petitioner reimburses BHF for its cost of materials used in these fabrications and also reimburses BHF for its labor costs by a transfer of funds. Such transfers constitute payments by Petitioner to BHF for the labor portion of the fabricated components purchased by Petitioner from BHF. See *Matter of Hygrade Casket Corporation v Commissioner of Taxation and Finance, et al*, 212 AD2d 843 (3d Dept 1995).

Accordingly, Petitioner's cost of materials which it incorporates into the real property of its customers consists of all the consideration paid by Petitioner to BHF for the fabricated materials, whether or not such consideration appears on any bill or invoice rendered by BHF to Petitioner. Petitioner is liable for and BHF is required to collect sales tax computed on the total amount of consideration paid for the fire protection system components, including the amount attributable to labor provided by BHF. See section 1101(b)(3) of the Tax Law; *Matter of Hygrade Casket Corporation v Commissioner of Taxation and Finance, et al, supra*. A contractor's purchases of tangible personal property for use or consumption in performing a capital improvement contract are purchases at retail which are subject sales or use tax. See section 1101(b)(4)(i) of the Tax Law and section 541.5(b) of the Sales and Use Tax Regulations. The contractor performs a capital improvement to real property when all three conditions in section 1101(b)(9)(i) of the Tax Law are met. The contractor's purchase of components which, when installed, do not constitute a capital improvement but remain tangible personal property may be made without payment of sales tax. The contractor is eligible for a credit or refund of tax paid on its purchases of the components used in taxable projects (i.e., other than capital improvements) where it resells the components. See section 1119(c) of the Tax Law and section 541.5(b)(4)(iii), Example 1 of the Sales and Use Tax Regulations.

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It should be noted that BHF purchases the materials on which it performs fabrication services and subsequently sells the fabricated components to Petitioner. BHF is, therefore, a manufacturer as contemplated in section 1115(a)(12) of the Tax Law and, as such, is entitled to the sales tax exemptions granted under sections 1115(a)(12) and 1105-B of the Tax Law. See Publication 852 entitled *Sales Tax Information For: Manufacturers, Processors, Generators, Assemblers, Refiners, Miners and Extractors, and Other Producers of Goods and Merchandise* (12/97) for additional information.

Petitioner suggests that the employees of its sister corporation, BHF, should be treated as if they were employees of Petitioner. In *Matter of Motion Marketing Associates, Inc. T/A On Target*, Dec Tax App Trib, July 23, 1992, DTA No. 805977, the Tax Appeals Tribunal noted that “notwithstanding the informal interaction and commingling of funds which occurred between the two corporations on a regular basis” the companies were to be treated as two distinct legal entities. Thus, in *Motion Marketing* the exclusion from the sales tax for taxable services performed by employees in their capacity as employees did not apply to the services performed for the one company by the employees of its related entity.

In the case at hand, each company had its own employees and separate payrolls; separate books and records; and individual sales tax registrations and separate FEINs. The companies made payments and reimbursements amongst themselves in exchange for the property and services they each provided to the other. Thus, though there was informal interaction between the companies, Petitioner may not disregard their distinct separate identities for sales tax purposes.

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/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.