

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

TSB-A-05(35)S
Sales Tax
September 27, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S041008A

On October 8, 2004, the Department of Taxation and Finance received a Petition for Advisory Opinion from Conti Enterprises, Inc., One Crugwood Road, South Plainfield, New Jersey, 07080.

The issue raised by Petitioner, Conti Enterprises, Inc., is whether its purchases of materials used or consumed in the installation of a high voltage cable from a power plant to a substation are subject to New York State and local sales tax.

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

Petitioner is a contractor who performs installations of underground high voltage electric cables for a utility company. Petitioner purchases materials used to install the high voltage cables. The cable originates at a remote power plant, is installed within public and private rights-of-way located within New York State, and terminates at the utility company's substation located within New York City. The cable's purpose is to carry high voltage power from the remote power plant to the local substation, where the power is processed through various electrical switchgear and transformers to produce lower voltage electricity. This electricity is distributed to the utility's commercial and residential customers served by the local substation.

The materials required for the installation of the underground high voltage electric cables include the following:

- (1) Oil-filled high voltage cables;
- (2) Conduits through which oil-filled high-voltage cables are pulled and which permanently house these cables;
- (3) Low strength concrete encasement placed around the conduits which serves to dissipate heat produced by the cable and to provide structural protection for the high voltage cables;
- (4) Fiber optic telecommunications cables for use in system monitoring and data collection;
- (5) Conduits through which the fiber optic cables are pulled and which house these cables;

- (6) Temperature sensors and other system controls and devices;
- (7) Heat dissipating oil, oil reservoir tanks, pumps, gauges, and pipelines that are required for cooling the high-voltage cable;
- (8) Underground manhole structures used to access the high voltage cable for purposes of anchoring and splicing the cable;
- (9) Underground manhole structures used to house the coolant oil reservoirs;
- (10) Fire suppression systems for the manhole structures;
- (11) Electrical switchgear, controls, and circuit breakers;
- (12) Soil backfill material to be placed above the low strength concrete encasement for trench restoration; and,
- (13) Concrete and asphalt pavement restoration materials used to restore the roadways and landscape disturbed by the above installations.

The utility company possesses a right-of-way consisting of a franchise or easement on which its transmission or distribution equipment is installed. Such franchise or easement gives the utility company certain rights to use the underlying real property for its installation. In a typical installation, items 1 through 11 will remain the property of the utility and become a part of the utility's easement or franchise. Items 12 and 13 are generally transferred to the owner of the underlying real property and become a part of such real property.

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:

* * *

(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

* * *

(9) Capital improvement. (i) 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 1105 of the Tax Law provides, in part:

On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax . . . upon:

(a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

* * *

(c) The receipts from every sale, except for resale, of the following services:

* * *

(3) Installing tangible personal property, excluding a mobile home, or maintaining, servicing or repairing tangible personal property, including a mobile home, not held for sale in the regular course of business, whether or not the services are performed directly or by means of coin-operated equipment or by any other means, and

whether or not any tangible personal property is transferred in conjunction therewith, except:

* * *

(iii) for installing property which, when installed, will constitute an addition or capital improvement to real property, property or land, as the terms real property, property or land are defined in the real property tax law as such term capital improvement is defined in paragraph nine of subdivision (b) of section eleven hundred one of this chapter

* * *

(5) Maintaining, servicing or repairing real property, property or land, as such terms are defined in the real property tax law, whether the services are performed in or outside of a building, as distinguished from adding to or improving such real property, property or land, by a capital improvement as such term capital improvement is defined in paragraph nine of subdivision (b) of section eleven hundred one of this article

Section 1115(a) of the Tax Law provides, in part:

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

* * *

(15) Tangible personal property sold to a contractor, subcontractor or repairman for use in (i) erecting a structure or building (A) of an organization described in subdivision (a) of section eleven hundred sixteen . . . or (ii) adding to, altering or improving real property, property or land (A) of such an organization . . . as the terms real property, property or land are defined in the real property tax law; provided, however, no exemption shall exist under this paragraph unless such tangible personal property is to become an integral component part of such structure, building or real property.

(16) Tangible personal property sold to a contractor, subcontractor or repairman for use in maintaining, servicing or repairing real property, property or land (i) of an organization described in subdivision (a) of section eleven hundred sixteen . . . as the terms real property, property or land are defined in the real property tax law; provided, however, no exemption shall exist under this paragraph unless such tangible personal property is to become an integral component part of such structure, building or real property.

(17) Tangible personal property sold by a contractor, subcontractor or repairman to a person other than an organization described in subdivision (a) of section eleven hundred sixteen, for whom he is adding to, or improving real property, property or land by a capital improvement, or for whom he is about to do any of the foregoing, if such tangible personal property is to become an integral component part of such structure, building or real property; provided, however, that if such sale is made pursuant to a contract irrevocably entered into before September first, nineteen hundred sixty-nine, no exemption shall exist under this paragraph.

Section 1116(a) of the Tax Law provides for exemption from the sales and compensating use taxes with respect to New York State governmental entities, United States governmental entities, certain nonprofit organizations and other entities who have received New York State exempt organization status.

Section 1119(c) of the Tax Law provides:

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 1139(a) of the Tax Law provides, in part:

In the manner provided in this section the tax commission shall refund or credit any tax, penalty or interest erroneously, illegally or unconstitutionally collected or paid if application therefor shall be filed with the tax commission (i) in the case of tax paid by the applicant to a person required to collect tax, within three years after the date when the tax was payable by such person to the tax commission

Section 526.6 of the Sales and Use Tax Regulations provides, in part:

Retail sale. (a) The term *retail sale* or *sale at retail* means the sale of tangible personal property to any person for any purpose, except as specifically excluded.

(b) Special rule--sales specifically included as retail sales. (1) A sale of any tangible personal property to a contractor, subcontractor or repairman for use or consumption in erecting structures or buildings or adding to, altering, improving, maintaining, servicing or repairing real property, property or land, is deemed to be a retail sale, regardless of whether the tangible personal property is to be resold as such before it is used or consumed. . . .

Section 528.13 of the Sales and Use Tax Regulations provides, in part:

Machinery and equipment used in production; telephone and telegraph equipment; parts, tools and supplies. [Tax Law, §1115(a)(12)]

(a) *Exemption.* (1) "Exemption from statewide tax." An exemption is allowed from the tax imposed under subdivisions (a) and (c) of section 1105 of the Tax Law, and from the compensating use tax imposed under section 1110 of the Tax Law, for receipts from sales of the following:

(i) Machinery or equipment (including parts with a useful life of more than one year) used or consumed directly and predominantly in the production for sale of tangible personal property, gas, electricity, refrigeration or steam, by manufacturing, processing, generating, assembling, refining, mining or extracting

* * *

(b) *Production.* (1) The activities listed in paragraph (1) of subdivision (a) of this section are classified as administration, production or distribution.

(i) *Administration* includes activities such as sales promotion, general office work, credit and collection, purchasing, maintenance, transporting, receiving and testing of raw materials and clerical work in production such as preparation of work, production and time records.

(ii) *Production* includes the production line of the plant starting with the handling and storage of raw materials at the plant site and continuing through the last step of production where the product is finished and packaged for sale.

(iii) *Distribution* includes all operations subsequent to production, such as storing, displaying, selling, loading and shipping finished products.

(2) The exemption applies only to machinery and equipment used directly and predominantly in the production phase. Machinery and equipment partly used in the administration and distribution phases does not qualify for the exemption, unless it is used directly and predominantly in the production phase.

* * *

(c) *Directly and predominantly.* (1) *Directly* means the machinery or equipment must, during the production phase of a process:

(i) act upon or effect a change in material to form the product to be sold, or

(ii) have an active causal relationship in the production of the product to be sold, or

(iii) be used in the handling, storage, or conveyance of materials or the product to be sold, or

(iv) be used to place the product to be sold in the package in which it will enter the stream of commerce.

(2) Usage in activities collateral to the actual production process is not deemed to be used directly in production.

* * *

(4) Machinery or equipment is used predominantly in production, if over 50 percent of its use is directly in the production phase of a process.

Section 541.1(b) of the Sales and Use Tax Regulations provides:

The principal distinguishing feature of a sale to a contractor, as compared to a sale to other vendors who purchase tangible personal property for resale, is that the sale of tangible personal property to a contractor for use or consumption in construction is a retail sale and subject to sales and use tax, regardless of whether tangible personal property is to be resold as such or incorporated into real property as a capital improvement or repair. Whenever a contractor uses materials, on which the contractor has paid sales tax, in a repair or maintenance contract (except interior cleaning and maintenance contracts of 30 days or more) subject to the sales tax on services under section 1105(c) of the Tax Law, the contractor may be entitled to a refund or credit of the portion of the tax he paid attributable to the materials transferred to the customer.

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

Contracts with customers other than exempt organizations.

* * *

(b) *Capital improvements contracts.* (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.

(2) Labor and material charges. All charges by a contractor to the customer for adding to or improving real property by a capital improvement are not subject to tax provided the customer supplies the contractor with a properly completed certificate of capital improvement.

(4) Documents; capital improvement contracts.

(i) When a properly completed certificate of capital improvement has been furnished to the contractor, the burden of proving the job or transaction is not taxable and the liability for the tax rests solely upon the customer.

(a) The prime contractor should obtain a certificate of capital improvement from the customer and retain it as part of his records. Copies of such certificate must be furnished to all subcontractors on the job and retained as part of their records.

(b) A certificate of capital improvement may not be issued by a contractor, subcontractor or any other person to a supplier on the purchase of tangible personal property.

(ii) Where a contractor does not receive a capital improvement certificate from a customer, the contract or other records of the transaction will prevail. In such case:

(a) where the contractor does not receive a capital improvement certificate, collects tax on the full invoice price and the job is a capital improvement to real property, the contractor is liable for the tax on the cost of materials incorporated into the job, plus the tax collected from the customer. The customer is entitled to a refund of the tax paid to the contractor; or

(b) where the contractor does not receive a capital improvement certificate, collects no tax on the charges billed to the customer and the job is a capital improvement to real property, the contractor is liable for the tax on the cost of materials incorporated into the job performed.

(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

Purchases of materials by Petitioner for use in performing installations for utility companies can generally be divided into those purchases which remain the property of the utility company after installation and those purchases which become the property of the owner of the underlying realty after installation. The utility company typically retains ownership of the installed oil-filled high voltage cables; the conduit through which the cable runs; low strength concrete encasements; fiber optic telecommunications cables for use in system monitoring and data collection; conduits which house the fiber optic cables; heat dissipating oil, oil reservoir tanks, pumps, gauges, and pipelines that are required for cooling the high-voltage cable; temperature sensors; manhole structures; fire suppression systems for the manhole structures; and electrical switchgear, controls, and circuit breakers (hereinafter “the Equipment”). The property owner typically takes possession of items such as soil backfill materials and concrete and asphalt pavement restoration materials.

The utility company possesses a right-of-way consisting of a franchise or easement on which its transmission or distribution equipment is installed. Such franchise or easement gives the utility company certain rights to use the underlying real property for making installations. If the particular installation meets the requirements set forth in section 1101(b)(9)(i) of the Tax Law for a capital improvement to real property, Petitioner’s charges to the utility company for such installation are not subject to sales tax. See section 1105(c)(3)(iii) of the Tax Law and section 527.7(b) of the Sales and Use Tax Regulations; and *Marcum & Kliegman, LLP*, Adv Op Comm T & F, May 27, 2005, TSB-A-05(20)S. In such case, Petitioner should accept a properly completed Certificate of Capital Improvement (ST-124). See section 1132(c) of the Tax Law and section 532.4 of the Sales and Use Tax Regulations. However, Petitioner’s purchases of materials and equipment which will be installed as part of a capital improvement constitute purchases at retail which are subject to sales or use tax under section 1105(a) or section 1110(a) of the Tax Law, unless otherwise exempt. See section 1101(b)(4)(i) of the Tax Law and section 541.1(b) of the Sales and Use Tax Regulations. Sales or use tax paid by Petitioner on the purchase of materials and equipment which remain the property of the utility company after installation may be included by Petitioner as part of its cost of materials on any bill or invoice given by Petitioner to its customer.

In the *Matter of Niagara Mohawk Power Corporation v George W. Wanamaker*, 286 App Div 446, affd 2 NY2d 764, various substations, transformers, towers, poles, conductors, voltage regulators, circuit breakers and similar equipment located at a steam plant and elsewhere were deemed to be used in transmission or distribution rather than in production of electricity. Production was deemed to stop at the generator, and the increase in voltage by transformers at the plant was simply to facilitate distribution. See *ABB Power Transmission, Inc.*, Adv Op Comm T & F, July 17, 1990, TSB-A-90(34)S. Accordingly, the Equipment described by Petitioner is considered to be used in distribution activities and is not used directly in production for purposes of section 1115(a)(12) of the Tax Law. See section 528.13(b) of the Sales and Use

Tax Regulations. Therefore, purchases of Equipment by Petitioner are not exempt under section 1115(a)(12).

Sections 1115(a)(15) and (16) of the Tax Law state that, "no exemption shall exist under this paragraph unless such tangible personal property is to become an integral component part of such structure, building or real property [of an exempt entity]." With respect to Petitioner's installations of the Equipment on property owned by New York State or one of its political subdivisions, such installation is performed pursuant to the utility's franchise, and title to the conduit is acquired by and remains with the utility. It is not transferred to the owner of the underlying property. The Equipment, therefore, does not become an integral component part of the property of the governmental entity. Petitioner's purchases of Equipment which, when installed, meets the three conditions set forth in section 1101(b)(9)(i) of the Tax Law, are not exempt from sales tax under sections 1115(a)(15) and (16) of the Tax Law but, rather, are subject to sales tax the same as any building material purchased by a contractor, subcontractor or repairman and incorporated into a capital improvement project. Likewise, purchases by Petitioner of the Equipment installed on any private property as described above are subject to sales tax. See *Marcum & Kliegman, LLP, supra*.

Purchases by Petitioner of soil, backfill, concrete and asphalt pavement restoration materials and the like which become the property of the owner of the underlying realty upon installation are also purchases at retail subject to sales or use tax unless otherwise exempt. However, such materials, when incorporated into the real property of an entity exempt pursuant to section 1116(a) of the Tax Law, may be purchased by Petitioner without the payment of sales or use tax. See sections 1115(a)(15) and (16) of the Tax Law. If Petitioner has paid sales tax on its purchases of materials which, upon installation, become the property of and are incorporated into the real property of an exempt entity as described above, Petitioner may apply for a refund within three years of the date the tax was payable to the Tax Department. See section 1139(a) of the Tax Law.

Where fiber optic telecommunications cables, oil, oil reservoir tanks, pumps and gauges and the like are installed so as to be an integral physical component of the high voltage cable system, the installation of these and similar components are considered part of the overall capital improvement.

If some of Petitioner's installations do not qualify as a capital improvement project or as part of a capital improvement project, the installation will be subject to tax pursuant to section 1105(c)(3) or (c)(5) of the Tax Law. For example, if the heat dissipating oil must be periodically replenished or changed, the original installation and replacement of the oil may not be part of the overall capital improvement. Similarly, to the extent that certain items, such as pumps and gauges, sensors, electrical switchgear, etc., are not integral components of the high voltage cable system, Petitioner's charges for the system components and their installation are subject to sales tax pursuant to sections 1105(a) and 1105(c)(3) of the Tax Law. See *Matter of Charles R. Wood*

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Enterprises, Inc. v State Tax Commn., 67 AD2d 1042; *Matter of West Mountain Corp. v Miner*, 85 Misc2d 416; *Matter of Gem Stores, Inc.*, Tax Appeals Tribunal, October 14, 1988, DTA No. 802661; *Cornwell Energy Management, Inc.*, Adv Op Comm T & F, May 8, 2003, TSB-A-03(22)S. The replacement of oil, or pumps and gauges, sensors, etc., in connection with the repair of the high voltage cable system is subject to sales tax under section 1105(c)(5) of the Tax Law.

Where Petitioner installs a component of the high voltage cable system which remains tangible personal property after installation, Petitioner may purchase such component for resale without payment of sales tax. See section 541.5(b)(4)(iii), Example 1 of the Sales and Use Tax Regulations. Where Petitioner has paid sales tax on such tangible personal property used in such installation, Petitioner may apply for a refund or credit of the tax paid. See section 1119(c) of the Tax Law. Petitioner must collect sales tax on the charges for such installation from its customer.

DATED: September 27, 2005

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

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