

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-93 (7) S
Sales Tax
January 7, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S920206C

On February 6, 1992 a Petition for Advisory Opinion was received from Stewart & Stevenson Operations, Inc., P.O. Box 1637 - Tax Dept., Houston, Texas 77251-1637.

The issue raised by Petitioner, Stewart & Stevenson Operations, Inc., is whether the operation and maintenance of cogeneration plants which were built with funds from industrial development agencies are exempt from State and local sales and use taxes.

Petitioner, Stewart & Stevenson Operations, Inc. has contracted with Kamine/Besicorp Carthage L.P. and Kamine/Besicorp South Glens Falls L.P., agents of the industrial development agencies, to furnish personnel to operate and maintain two cogeneration energy plants in New York State consisting of buildings and equipment owned by the Jefferson County Industrial Development Agency and the County of Saratoga Industrial Development Agency. These plants produce steam and electricity, which Kamine/Besicorp Carthage L.P. and Kamine/Besicorp South Glens Falls L.P. (hereinafter "Kamines") sell to James River Paper Co. and Niagara Mohawk.

Petitioner has quoted a monthly fixed sum operation and maintenance fee to Kamines. The maintenance labor costs consist of four man hours daily for outside plant maintenance such as landscaping or snow shoveling, and a few hours daily for inside maintenance. The remainder of the labor costs are to operate the energy plants. Petitioner also purchases office supplies, chemicals for cleaning, tools and spare parts, lubricants, operator equipment and other items normally used and supplied for a cogeneration facility.

Section 1101(b)(5) of the Tax Law defines "sale, selling or purchase" as: "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 1105 of the Tax Law provides, in relevant part:

Imposition of sales tax. - . . . there is hereby imposed and there shall be paid a tax of four percent upon:

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

(b) The receipts from every sale, other than sales for resale of . . .electricity, . . .and steam, and. . .electric. . .and steam service of whatever nature

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

(3) Installing tangible personal property. .. or maintaining, servicing or repairing tangible personal property. . .not held for sale in the regular course of business, whether or not the services are performed directly. . .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 as such term. . .is defined in paragraph 9 of subdivision (b) of section eleven hundred one of this chapter. . . .

Section 1115 of the Tax Law states, in part:

Exemptions from sales and use taxes. -- (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 . . .electricity , . . . or steam for sale, by . . . generating, . . . but not including parts with a useful life of one year or less or tools or supplies used in connection with such machinery, equipment or apparatus.

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

Machinery and equipment used in production; telephone and telegraph equipment; parts, tools and supplies. [Tax Law, S1115(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 . . . electricity, . . . or steam, by . . . generating, . . .

(iii) (a) Parts with a useful life of one year or less, tools or supplies for use or consumption directly and predominantly in the production of . . . electricity, . . . or steam for sale by . . . generating, . . .

. . .

(iv) The services of installing, repairing, maintaining or servicing the exempt machinery, equipment, apparatus, parts, tools or supplies identified in subparagraph (i), . . . or (iii) of this paragraph.

(2) Exemption from taxes imposed by localities other than New York City.

(i) There is an exemption from all local sales and use taxes, other than the taxes imposed in New York City, for all sales and uses of:

(a) tangible personal property used or consumed directly and predominantly in the production for sale of . . . electricity, . . . or steam by . . . generating, . . .

(ii) There is no exemption from the sales and use taxes imposed by localities on the sale of the services of installing, repairing, maintaining or servicing any of the exempt tangible personal property identified in subparagraph (i) of this paragraph. However, a charge for the installation of tangible personal property which becomes a capital improvement to real property is not subject to tax.

. . .

(4) An exempt use certificate is used to claim the exemptions from the State and local sales taxes described in this subdivision.

. . .

(b) Production. (1) The activities listed in paragraph (a)(1) 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

(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 . . . 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.

. . . .

(5) Machinery or equipment used in production by someone other than its owner is exempt under the same conditions as other machinery and equipment.

. . . .

(e) Parts, tools and supplies.

(1) The term part means a replacement for any portion of a machine or piece of equipment, and any device attached to the machinery or equipment and used in connection with the performance of its function. A part cannot accomplish the work for which it was designed independent of the machine for which it is intended to be a component.

(2) The term tool means a manually operated implement for performing a task.

(3) The term supply means an item of tangible personal property used in the maintenance of machinery or equipment and an item of tangible personal property used or consumed in production, whose use is incidental to such production, or which is expendable.

Example 9: Oil, grease or coolant for the efficient operation of machines that are used directly and predominantly in the production of tangible personal property for sale are supplies exempt from State and local taxes except for the taxes imposed in New York City under section 1107 of the Tax Law.

Section 1116 of the Tax Law provides, in relevant part:

(a) . . . any sale . . . by or to any of the following or any use . . . by any of the following shall not be subject to the sales and compensating use taxes under this article:

(1) The State of New York, or any of its agencies, instrumentalities, public corporations . . . or political subdivisions where it is the purchaser, user or consumer, or where it is a vendor of services or property of a kind not ordinarily sold by private persons.

Section 529.2(a) of the New York State Sales and Use Tax Regulations provides, in relevant part:

(2) A public corporation as used in this section means any corporation created by an act of the Legislature for a public purpose . . .

Example: . . . Industrial Development Agencies are public corporations and may purchase tangible personal property exempt from the sales and use taxes.

Section 541.3(a) of the Sales and Use Tax Regulations provides, in relevant part:

" . . . When a contractor's customer is a governmental entity described in section 116(a)(1) . . . of the Tax Law, the contract signed by the government representative and the prime contractor is sufficient proof of the exempt status of purchases made for such contract.

(1) Such governmental entities include:

(i) . . . (c) industrial development authorities"

Section 874 of Article 18-A of the General Municipal Law (GML) concerning the tax exemptions for industrial development agencies provides as follows:

(1) It is hereby determined that the creation of the agency and the carrying out of its corporate purposes is in all respects for the benefit of the people of the state of New York and is a public purpose, and the agency shall be regarded as performing a governmental function in the exercise of the powers conferred upon it by this title and shall be required to pay no taxes or assessments upon any of the property acquired by it or under its jurisdiction or control or supervision or upon its activities.

(2) Any bonds or notes issued pursuant to this title, together with the income therefrom, as well as the property of the agency, shall be exempt from taxation, except for transfer and estate taxes.

In Wegmans Food Market, Inc. v The Department of Taxation and Finance of the State of N.Y., (Sup Ct, Monroe County, Jan. 10, 1992, Galloway, J.) the issues presented concerned generally the scope and applicability of the tax exemption established by section 874 of the General Municipal Law and more specifically, whether that tax exemption applied to operational expenses incurred by plaintiff in the day-to-day operation of several projects in western New York State developed as its supermarkets. Those markets were constructed and equipped under agreements made with various municipal industrial development authorities pursuant to Article 18-A of the General Municipal Law, and accordingly their construction was financed by industrial development bonds (IDBs) issued by the various local industrial development agencies. The projects were technically owned by the respective agencies as security for the bonds, but were under "lease back" arrangements with the plaintiff. In an earlier action, Wegmans Food Markets v Department of Tax & Finance of the State of N.Y., 126 Misc 2d 144, affd 115 AD2d 962, iv to app den 67 NY2d 606, the section 874 tax exemption was held to apply to all tangible personal property installed or utilized in connection with the construction and equipping of several of plaintiff's IDA projects.

The court in its January 10, 1992 opinion stated in part:

The nature of the typical IDA project, as discussed in Erie County Indus. Dev Agency v Roberts (94 AD2d 532, 539-540, affd 63 NY2d 810), does not involve "a genuine allocation of ownership in the agency" Erie County, supra, p 539), and, thus,

it is "not a public work" (Erie County, supra, p 540). The typical IDA is a private facility "operated by a private corporation for the sole benefit of its shareholders and will not be for public use" (emphasis added, p 539); and although "the agency performs a governmental function and operates as a governmental agency and instrumentality, its involvement is limited to providing tax exempt bonds as an investment incentive" (Erie County, supra, p 539); and the "conveyance of legal title to the agency with the simultaneous lease back to the company is structured merely as a mechanism to facilitate financing" (Erie County, supra, p 539). "Neither the fact that the agency holds formal title to the project, nor the fact that certain tax exemptions are accorded to the project, transform that which is, in essence, a private venture" (Erie County, supra, p 540). "The public involvement concerns only the creation of the economic conditions and incentives which will encourage and foster this type of private development" (Erie County, supra, 540).

The nature of an IDA, as described above, suggests a distinction between the public involvement necessary to establish the project, and the subsequent private (i.e., non-public) operation of the established project.

B.

Also, in Fagliarone (supra), the Third Department (at p 769) distinguishes operating expenses from the type of property-acquisition and development expenses involved in the prior Wegmans case (supra) and observes that operating expenses--unlike property-acquisition expenses -- "would not alter the amount of financing necessary to develop the project" and "by their very nature are such that they are incapable of becoming SIDA's personal property." Thus, Fagliarone does not support a holding that operating expenses are tax exempt, and in fact, even suggests they are not exempt.

C.

The several sections constituting GML, Article 18-A, also suggest the distinction between property-acquisition expenses necessary to establish the project and subsequent operating expenses. The exemptions under section 874 apply to taxes upon the "property" acquired by IDAs and the authorized "activities" of an IDA or its agent. Section 858 which defines the purposes and powers of IDAs in great detail, does not include the "operation" of a project. That section does state, however, that the purposes of IDAs shall be to promote and assist in "acquiring, constructing, reconstructing, improving, maintaining, equipping and furnishing commercial facilities" The maintaining of "facilities" (not the maintaining of businesses) would include expenditures necessary to maintain (i.e., preserve) the condition of the "facilities" or the "project", which is, according to section 854(4), "any land, any building or other improvement, and all real and personal properties

. . . including, but not limited to, machinery, equipment and other facilities." This would not include "maintenance" expenses necessary to the operation of the business, as distinguished from "maintenance" expenses necessary to preserve the property.

The IDAs are not authorized to engage in supermarket businesses, or any other businesses per se. Their functions are limited to the acquisition, construction, reconstruction, leasing, improving, maintaining, equipping, and furnishing of projects as security for the repayment of industrial development bonds, in the nature of a mortgage. Although there is a project lease arrangement between an IDA and the private developer it is a financing lease with the "rent" paid thereunder consisting only of amortized costs and expenses related to the project financing and the IDBs. The IDAs do not pay the costs of utilities or other operational expenses; nor do the leases suggest that the "rent" has been adjusted so as to account for the developer's payment of operational expenses. The lease is simply a financing tool, designed to secure tax-exempt IDBs, which are part of an overall plan benefitting, financially, the private developer and IDB purchasers. Of course, if IDAs are not authorized to operate a business then it would have no authority to designate agents to do that which they could not do themselves.

Although some of the numerous expenses listed by plaintiff in their complaint may be exempt (such as expenses necessary to preserve or repair project property), not all of the claimed expense would be exempt. Many of these expenses bear no relationship to the purchase, repair or replacement of project property per se but instead represent costs of supermarket business operations. For example, a very large part of the claimed utilities expenses represents purchases of non-tangible electrical power used in operating foodfreezing equipment to preserve and display food for sale to customers. Although such utility service runs through power conduits located on IDA properties, the ongoing utility costs incurred are not for the conduits but for the power, and therefore do not sufficiently relate to the authorized functions of the IDAs with respect to such property.

Because all the expenses involved in this action do not have the same relationship to the IDA's ownership of the project and authorized functions under the financing scheme, the expenses must be individually examined to determine what, if any, relationship each bears to the authorized and lawful functions of an IDA, particularly the "maintenance" function. The exemption shall be applicable only to those expenses properly within such function and authority. In this regard, it should be noted that tax-exempt maintenance would be that needed to maintain the structural integrity of the structures constructed or rehabilitated to house the various supermarkets, or to repair equipment used as part of the project.

The use of utilities and washing of windows and other such operating expenses have nothing to do with the underlying financing scheme and should not be tax-exempt under the law. If one business is able to operate indefinitely without paying taxes on its operating expenses simply because at one time its structures were financed with IDBs, that business would have an apparently unintended, open-ended economic advantage over competitors, thereby flying in the face of the fundamental purpose of the law -- i.e., the development of economically sound commerce. GML, Article 18-A, need not be construed so as to defeat its stated purpose or to enhance its already significant economic benefits. To do so is not required by the letter of the law and would defeat its purpose and spirit.

This decision is not inconsistent with Wegmans (supra), where the tax exemption of section 874 was held applicable to the purchase of tangible personal property acquired and owned by the IDA, as security for the IDBs. Ownership of property, real and personal - - as distinguished from operation of the business - - was clearly within the express, contemplated function and authority of IDAs under the GML. The property at issue was being acquired by or for the IDA, and the cost of acquiring such property would be affected by the addition of sales tax. That is an essential component of the entire IDA financing scheme.

Because industrial development agencies are not authorized to engage in any businesses per se (See Wegmans Food Market, Inc. v The Department of Taxation and Finance of the State of New York, supra,) neither of the industrial development agencies in the instant matter will be considered to be operating either of the cogeneration plants. Accordingly, Petitioner's operation of the cogeneration plants does not fall within the tax exemptions provided under Section 874 of the General Municipal Law, Section 1116(a)(1) of the Tax Law or Section 529.2(a) of the Sales and Use Tax Regulations. However, it is noted that Section 1105(c) of the Tax Law imposes tax on receipts from the sale, except for resale of, specifically enumerated services. Petitioner's operation of the cogeneration plants on behalf of Kamines for the purpose of producing electricity and steam for sale by Kamines is not one of the services specifically enumerated under Section 1105(c) of the Tax Law. Generally, Petitioner's receipts for operating the cogeneration plants would not be subject to State or local sales tax provided such charges were separately stated when billed to Kamines. However, since Petitioner's current method of billing Kamines pursuant to the contract between the parties is to issue an invoice for a monthly fixed sum operation and maintenance fee, without differentiating taxable charges versus nontaxable charges, Petitioner is liable for collecting State and local tax on the total monthly fee billed to Kamines. (See 20 NYCRR 527.1(b); La Cascade, Inc. v State Tax Commission, 91 AD2d 784).

It is noted that pursuant to Section 1105(b) of the Tax Law sales tax is to be collected on receipts from every sale, other than for resale, of electricity and steam, and of electricity and steam services by the owners of the plants.

As the stated purposes of industrial development agencies is to promote and assist in "acquiring, constructing, reconstructing, improving, maintaining, equipping and furnishing commercial facilities, the maintaining of "facilities" (not the maintaining of businesses) would include expenditures necessary to maintain (i.e., preserve) the condition of the "facilities" or the "project", which is, . . . , "any land, any building or other improvement and all real and personal properties. . . ." and would not include "maintenance" expenses necessary to the operation of the business, as distinguished from "maintenance" expenses necessary to preserve the structural integrity of the property. (See Wegmans Food Market Inc. v The Department of Taxation and Finance of the State of New York, supra)

In the instant matter, Petitioner's receipts from their client for maintenance necessary to the daily ongoing operation of the cogeneration plants will be subject to the sales tax imposed under Section 1105(c)(5) of the Tax Law regardless of whether Petitioner's clients are or are not acting as agent for an industrial development agency. Normal and routine maintenance, whether interior or exterior, necessary to the daily ongoing operation of the cogeneration plants includes (but is not limited to) ordinary janitorial services such as dusting furniture, fixtures, windowsills and ledges; washing windows, vacuuming floors and carpets; cleaning, disinfecting and deodorizing bathrooms and bathroom fixtures; oiling door hinges; replacing light bulbs; replacing washers in faucets; adjusting thermostats; cleaning or changing filters; reading gauges and lubricating equipment; and other services such as snow shoveling and moving grass.

When Petitioner performs maintenance or repair services to real property necessary to preserve the structural integrity of the IDA's facilities or to the IDA's production machinery in the cogeneration plants necessary to preserve such machinery, such maintenance or repair services will be considered as maintenance or repairs necessary to preserve the structural integrity of the property rather than as normal and routine maintenance or repairs necessary to the operation of the business. Petitioner's receipts from its clients for these maintenance or repair services will generally be exempt from sales tax under the provisions of Section 874(2) of the General Municipal Law provided the clients are purchasing the maintenance services as agent for the industrial development agency and provided the charges are separately stated from the charges for the normal and routine maintenance or repair services which are necessary for the daily ongoing operation of the cogeneration facilities and from the charges billed to the client by Petitioner for the specific operation of the cogeneration facilities. However, it is again noted that because Petitioner's current method of billing Kamines pursuant to the contract between the parties is to issue an invoice for a monthly fixed sum operation and maintenance fee, without differentiating taxable charges versus nontaxable charges, Petitioner is liable for collecting State and local tax on the total monthly fee billed to Kamines. (See 20 NYCRR 527.1(b); La Cascade, Inc. v State Tax Commission, 91 AD2d 784).

Petitioner's purchases of consumable office supplies, such as paper, constitute purchases of administrative supplies which are not used directly and predominantly in a production process but which are used to perform administration activities as discussed in Section 528.13(b)(1)(i) of the

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Sales and Use Tax Regulations. Accordingly, Petitioner's purchases of these items will be subject to the tax imposed on sales of tangible personal property under Section 1105(a) of the Tax Law.

Petitioner's purchases of chemicals for cleaning, lubricants, tools and spare parts which are intended for use in performing janitorial and other maintenance duties will not be used directly and predominantly in a production process and accordingly, will be subject to the tax imposed on sales of tangible personal property under Section 1105(a) of the Tax Law. However, if any of these items are used in the maintenance of machinery or equipment used directly and predominantly in production, the purchase of such items will not be subject to State and local taxes under the provisions of Section 1115(a)(12) or Section 1105-B of the Tax Law and Section 528.13 of the Sales and Use Tax Regulations.

Petitioner's purchases of operator equipment and other items which are intended for use in a manner other than directly and predominantly in a production process will be subject to the tax imposed on sales of tangible personal property under Section 1105(a) of the Tax Law. However, if Petitioner can substantiate that such items are used in the production process in a manner which would qualify for exemption under Section 1115(a)(12) or 1105-B of the Tax Law and Section 528.13 of the Sales and use Tax Regulations such purchases will be exempt from the tax imposed under Section 1105(a) of the Tax Law.

Whenever Petitioner makes purchases which will be exempt from tax under the provisions of Section 1115(a)(12), 1105-B and Section 528.13 of the Sales and Use Tax Law, Petitioner must present the supplier a properly completed form ST-121, Exempt Use Certificate.

DATED: January 7, 1993

/s/
PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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