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

TSB-A-90(40)S
Sales Tax
TSB-A-90(16)C
Corporation Tax
TSB-A-90(1)M
Miscellaneous Tax
August 21, 1990

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. Z900312D

On March 12, 1990 a Petition for Advisory Opinion was received from The Brooklyn Union Gas Company, 195 Montague Street, Brooklyn, New York 11201.

The issue raised by Petitioner, The Brooklyn Union Gas Company, is the taxability of certain transactions involving the marketing of natural gas as a motor fuel.

Petitioner is a regulated public utility engaged primarily in the distribution at retail of natural gas for heating, hot water and range use via underground pipes to residential, commercial, and governmental customers in New York City.

Petitioner plans to develop a market for natural gas as a motor fuel. Vehicles currently operating on gasoline will be adapted to also run on Compressed Natural Gas (CNG) as a motor fuel. The CNG will be stored in cylinders installed in the trunk or affixed to the chassis of the vehicle. These cylinders will be filled at a compressor station which is hooked up to Petitioner's gas lines.

In order to induce vehicle owners to adapt their vehicles to run on CNG, Petitioner will sell and install a conversion kit for less than its actual cost to Petitioner. Petitioner intends to recover the difference through profits from the sales of CNG. It is anticipated that the CNG will be sold at a much lower price than an equivalent gallon of gasoline. Petitioner intends to engage in the following transactions:

1. Petitioner will purchase CNG conversion kits.
2. Petitioner will sell and install the CNG kits.
3. Petitioner will sell the CNG as a motor fuel at its own filling stations.
4. Petitioner will sell natural gas to fleet owners who will have their own compressors and filling stations.
5. Petitioner will sell natural gas to retail filling stations who will subsequently compress and resell the CNG to vehicle owners.

Sections 284, 284.a and 284.b of Article 12-A of the tax law impose, in the aggregate, an excise tax of 8 cents per gallon on motor fuel imported or caused to be imported into the state by a distributor for use, distribution, storage or sale in the state or upon motor fuel which is produced, refined, manufactured or compounded by a distributor in the state, or if the tax has not been imposed prior to its sale in this state when such product is sold by a distributor.

"Motor fuel" is defined in section 410.2(a)(1) of the Motor Fuel and Diesel Motor Fuel Regulations as:

> "gasoline, benzol or other product, which is suitable for use in the operation of a motor vehicle engine . . . . Motor fuel includes but is not limited to gasoline, liquified petroleum gas, compressed natural gas or propane gas or any combination,. . .which is suitable for use in the operation of a motor vehicle engine. However, for purposes of the taxes imposed by article 12-A and the prepaid tax imposed by Article 28 of the Tax Law, . . .compressed natural gas. . .[is] not deemed to be motor fuel until pumped into the fuel tank of a motor vehicle for use in the operation thereof on the public highways of New York State, or, of a pleasure or recreational motor boat for use in the operation thereof on the waterways of New York State including any waterways bordering on the state.

"Distributor" is defined in regulation section 410.2(b) as "any person, firm, association or corporation. . . . producing, refining, manufacturing or compounding any motor fuel within the state."

Section 283 of the tax law requires the registration of motor fuel distributors and provides, in part, that "No person, unless so registered,. .shall produce, refine, manufacture or compound motor fuel within the state." It further provides that "No distributor, unless so registered, shall make any sale, transfer, use or other disposition of motor fuel within the state. ."

Based on the foregoing, Petitioner's sales of CNG will constitute the production of motor fuel within the state at the point it is pumped into the fuel tank of a motor vehicle. As a result of this activity, Petitioner will be required to register with the Department of Taxation and Finance as a distributor of motor fuel and will be required to remit the 8 cent per gallon motor fuel excise tax on such sales of CNG. In addition, Petitioner will be required to remit the appropriate sales tax on the sale of such fuel.

Petitioner's sales of natural gas to other service stations or to fleet owners will not be considered sales of motor fuel since it will not be pumping CNG in to the fuel tank of a motor vehicle. Accordingly, such sales will not be subject to the taxes imposed under article 12-A of the Tax Law.

Section 1101 of the Tax Law states, in part:

Definitions.--

(b) 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:

(1) Purchase at retail. A purchase by any person for any purpose other than those set forth in clauses (A) and (B) of subparagraph (i) of paragraph (4) of this subdivision.

* * *

(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) and (5) 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 service subject to tax ....

Section 526.3 of the Sales and Use Tax Regulations states:

Purchase at retail. [Tax Law, Section ll01(b)(1)]

The term purchase at retail means a purchase by any person of tangible personal property or services, for any purpose other than:

(a) for resale of the property or services as such or when the property is purchased for resale as a physical component part of tangible personal property; or

(b) for use by the purchaser in performing services subject to the tax under section 1105(c)(1), (2), (3) or (5) of the Tax Law where the property becomes a physical component part of the property upon which the services are performed or is later actually transferred to his customer in conjunction with the taxable services performed.

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

Retail sale. [Tax Law, Section l101(b)(4)]

(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.

* * *

(c) Resale exclusion. (1) Where a person, in the course of his business operations, purchases tangible personal property or services which he intends to sell, either in the form in which purchased, or as a component part of other property or services, the property or services which he has purchased will be considered as purchased for resale, and therefore not subject to tax until he has transferred the property to his customer.
(2) A sale for resale will be recognized only if the vendor receives a properly completed resale certificate...

(3) Receipts from the sale of property purchased under a resale certificate are not subject to tax at the time of purchase by the person who will resell the property. The receipts are subject to tax at the time of the retail sale.

* * *

(5) The purchase by a vendor of an item of tangible personal property which is sold by him as a physical component part of tangible personal property to a customer is a purchase for resale and therefore is not subject to tax...

(6) Tangible personal property purchased for use in performing services which are taxable under section 1105(c)(1), (2), (3) and (5) of the Tax Law is purchased for resale and not subject to tax at the time of the purchase, where the property so sold (i) becomes a physical component part of the property upon which the services are performed, or (ii) is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax.

Section 1105 of the Tax Law states, in part:

Imposition of sales tax.--

. . .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, 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. .

Section 527.1 of the Sales and Use Tax Regulations states, in part:

Sale of tangible personal property. (Tax Law, section l105[a]) (a) Imposition. The sales tax is imposed on the receipts from every retail sale of tangible personal property ....

Section 527.5 of the Sales and Use Tax Regulations states, in part:

Installing. repairing, servicing and maintaining tangible personal property. Section 1105[c][3])

(a) Imposition. (1) The tax is imposed on receipts from every sale of the services of installing, maintaining, servicing or repairing tangible personal property, by any means. . ., whether or not any tangible personal property is transferred in conjunction with the services.

(2) Installing means setting up tangible personal property or putting it in place for use.

Since Petitioner will sell and install the conversion kits, Petitioner's purchases of such kits will be considered as purchases for resale and will fall within the resale exclusion from sales tax under Section 1104(b)(4) of the Tax Law and Section 526.6(c) of the Sales and Use Tax Regulations. Accordingly, Petitioner may purchase the conversion kits tax exempt provided Petitioner furnishes the supplier of the kits a properly completed form ST-120, Resale Certificate. Because the installation of the conversion kits will be considered as the service of installing tangible personal property, the receipts from Petitioner's total charges to customers will be subject to State and local sales tax as imposed under Section 1105(c)(3) of the Tax Law and Section 527.5 of the Sales and *Use* Tax Regulations. However, if the conversion kits are purchased for promotional or advertising purposes and sold for a minimal charge which does not reflect their true cost, then they will be considered to be retail purchases by Petitioner and not sales to the recipients of the kits in accordance with Section 526.6(c)(4) of the Sales and Use Tax Regulations.

Section ll01(b)(4)(ii) of the Tax Law states, in part:

(ii) Notwithstanding the provisions of subparagraph (i) of this paragraph, no motor fuel. . .shall be sold or used in this state without payment, and inclusion in the sales price of such motor fuel, of the tax on motor fuel required to be prepaid pursuant to the provisions of section eleven hundred two of this article except where a provision of this article relating to

motor fuel. . .specifically provides otherwise and except in the case of a sale or use subject to tax under section eleven hundred five or eleven hundred ten, respectively, of this article.

Section 561.2 of the Sales and Use Tax Regulations states, in part:

Definitions. [Tax Law, Sections 1101(b)(4)(ii), 1111(e)(6)]

(a) Automotive fuel. For the purpose of the prepaid sales tax on motor fuel, automotive fuel means motor fuel as defined in section 282.2 of the Tax Law and section 410.0 of this Title.

(1) Motor fuel means gasoline, benzol or other product. . .which is suitable for use in operation of any motor vehicle engine. Motor fuel includes but is not limited to,...compressed natural gas. . . .

(d) Distributor. For the purposes of this part, in general, the term distributor has the same meaning as it has for purposes of the motor fuel taxes imposed by and pursuant to the authority of article 12-A of the Tax Law. Where the tangible personal property being sold is motor fuel, a distributor means:

(1)(i) Any person. . .who produces, refines, manufactures or compounds any motor fuel within the State.

Since natural gas is not included within the definition of motor fuel under Section 561.2(a)(1) of the Sales and Use Tax Regulations nor under Section 410.2(a)(1) of the Motor Fuel Tax Regulations, Petitioner's sales of natural gas to fleet owners and to operators of retail filling stations will not be considered as sales of motor fuel. Such sales of natural gas will be subject to the appropriate state and local sales or use taxes imposed under Sections l105(b), l105-A, 1107, 1109, and 1110 of the Tax Law unless the fleet owner or the retail filling station operator is purchasing the natural gas for resale purposes and furnishes a properly completed form ST-120, Resale Certificate to Petitioner.

In accordance with the provisions of Section 410.2(a)(1) of the Motor Fuel Tax Regulations, CNG is not deemed to be a motor fuel until pumped into the fuel tank of a motor vehicle, or a pleasure or recreational motor boat for use on public highways or on waterways of New York State, respectively. When Petitioner pumps CNG into the fuel tank of such a motor vehicle or motor boat at its filling station, Petitioner will be making a retail sale of motor fuel. Petitioner will be liable for collecting the appropriate state and local sales tax on the actual selling price per gallon at the rate applicable in the locality where such sales occur, pursuant to section 1105(a) of the Tax Law.

Production of CNG occurs at the time of conversion from natural gas to CNG. Petitioner will be producing CNG thru use of compression equipment located at Petitioner's filling stations. As Petitioner will sell the CNG as a motor fuel at its filling stations, Petitioner will be considered to be producing motor fuel when pumping the CNG into the fuel tank of a qualifying motor vehicle or motor boat. Since Petitioner will be producing motor fuel within the state, Petitioner will fall within the definition of distributor under Section 561.2(d)(1)(i) of the Sales and Use Tax Regulations. Petitioner will be required to register as a distributor under the provisions of Section 283 of the Tax Law.

Section 186 of the Tax Law imposes a franchise tax upon every corporation, joint-stock company or association formed for or principally engaged in the business of supplying water, steam or gas "for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this state". The tax imposed consists of two parts, a gross earnings tax and an excess dividends tax. Only the earnings tax is pertinent to the issue raised herein. In its original form, section 186 provided for a franchise tax upon various types of utility companies measured by their "gross earnings from all sources within this state." In interpreting the statute, the Appellate Division held in 1906 that in order to arrive at gross earnings, the cost of raw materials used in producing the utility service had to be deducted from the company's gross receipts (People ex rel Brooklyn Union Gas Co v Morgan, 114 App Div 266). In 1907, the legislature amended section 186 by adding the following definition: "The term 'gross earnings' as used in this section means all receipts from the employment of capital without any deduction" (L 1907, ch 734, # 3). Shortly thereafter, the Court of Appeals, construing the new amendment, found that its purpose was "to enlarge the scope of the franchise tax by including all moneys that were received as products of all uses of corporate capital, 'without any deduction'" (People ex rel Westchester Light Co v Gaus, 199 NY 147, 149). Almost sixty years later, the Court held that the amendment did not contemplate a substitution of "gross receipts" for "gross earnings" as the basis for taxation; rather it "merely sought to include [in gross earnings]. . .that portion of 'gross earnings' which represents the 'employment of capital' to manufacture, distribute and sell various public utility services" (Matter of Consolidated Edison v Tax Commn, 24 NY2d 114, 119).

Section 186 specifically states that gross earnings means "all receipts from the employment of capital without any deduction" (emphasis added). There are no regulations promulgated under section 186. However, it is clear from the legislation and the decisions of the courts that it was not the intent to allow a deduction for the cost of purchasing items such as the CNG conversion kits.

Accordingly, Petitioner's gross earnings, under section 186, will include the receipts from selling and installing the CNG kits, selling CNG as a motor fuel at Petitioner's own filling station, selling natural gas to a fleet owner, and selling natural gas to a retail filling station.

Section 186-a of the Tax Law, provides a tax on the furnishing of utility services that is equal to three percent of the gross income of a utility that is subject to the supervision of the New York State Department of Public Service. Gross income as defined in section 186-a 2(c) consists of the following elements:

1. receipts from any sale made or service rendered for ultimate consumption or use by the purchaser in New York State;

2. profits from the sale of securities;

3. profits from the sale of real property;

4. profit from the sale of personal property (other than inventory);

5. receipts from interest, dividends, and royalties, derived from sources within New York State; and

6. profits from any transaction (except sales for resale and rentals) within New York State whatsoever.

When computing receipts from any sale made or service rendered for ultimate consumption or use by the purchaser in this state, no deduction is allowed on account of the cost of goods sold, the cost of materials used, labor or services or other costs, interest or discount paid, or any other expense whatsoever.

Accordingly, Petitioner's gross income under section 186-a, will include the receipts from sales made or services rendered for ultimate consumption or use by the purchaser in New York State which consist of receipts from selling and installing the CNG kits, selling CNG as a motor fuel at Petitioner's own filling station and selling natural gas to a fleet owner. Petitioner is not allowed a deduction for the cost of purchasing CNG conversion kits. Petitioner's gross income will not include the receipt or profit from selling natural gas to a retail filling station who subsequently compresses and resells the CNG to vehicle owners as a motor fuel because this transaction would be a sale for resale.

Section 188 of the Tax Law imposes a tax surcharge at the rate of 15 percent, in the case of years ending on December 31, 1990 and December 31, 1991, and at the rate of 10 percent, in the case of years ending on December 31, 1992, of the tax imposed under section 186 and 186-a of the Tax Law, after the deduction of any credits against tax otherwise allowable under Article 9 of the Tax Law.

For purposes of Article 13-A of the Tax Law, natural gas is an exempt product. Therefore, Petitioner's activities described herein, will not be subject to tax under such Article.

DATED: August 21, 1990

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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