

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

TSB-A-04(24)S
Sales Tax
September 28, 2004

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S010612E

On June 12, 2001, the Department of Taxation and Finance received a Petition for Advisory Opinion from Ascension Sheet & Metal Fabrication, Inc., 1254 Erie Avenue, North Tonawanda, New York, 14120.

The issue raised by Petitioner, Ascension Sheet & Metal Fabrication, Inc., is whether, under the circumstances described below, the purchase of utilities by a landlord is exempt from sales tax where such utilities are used by the tenant exclusively in the production of tangible personal property for sale.

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

Petitioner operates two related manufacturing companies under common ownership (Company A and Company B). Company A and Company B occupy the same facility consisting of two buildings in both of which they share space. Pursuant to a subsidized energy program in which Company A and Company B participate, a single modem-based electric meter was installed in the facility to measure electrical usage for the entire facility. Company A and Company B share electricity purchases for which this single meter is used.

Company A acts as the facility's landlord and charges rent to Company B. Company A is billed by the utility company for the electric usage of the entire facility each month because the existing metering system is in Company A's name. Company A bills Company B for rent and real estate taxes on a monthly basis. The rental agreement states, in part:

1. Tenant has inspected the premises, including all of the structures, equipment, facilities, walls, services, lights, overhead cranes and jib cranes, heating, plumbing, sewers, electrical services, wiring, water, gas, sprinklers and all other facilities, equipment, fixtures and functions, and accepts the same in the present condition, except that Landlord will, with all reasonable dispatch, install a separate meter for electrical service, or, at its election, sub-meter electrical services and demand loads, and bill Tenant for said electrical usage and demand.

2. Tenant, as additional rent, shall pay for gas, electricity, water, sewers, garbage, rubbish, trash, scrap, dumpster, and a proportionate share of common area maintenance costs, and all other utilities and services including usage, load and demand charges, as well

as proportionate and equitable increases in real property taxes and assessments levied against the leased premises over the 1989 base year.

Although the rent agreement provided that Company A would install separate meters to separately measure Company B's utility usage, such meters have not been installed. While each building in the facility had electric sub-meters in place, they were not used to monitor electric usage by the companies since each company shared space in the two buildings. Separate charges for electricity and gas appear on Company A's monthly bill to Company B. Company A bills Company B for 80% to 91% of the total electric charge it pays each month based on Company B's floor space utilization as this was considered a fair approximation of Company B's overall electric usage. Company A submitted a copy of a monthly bill to Company B showing separate amounts for gas, electric, real estate taxes, rent, legal, water, insurance and sales tax. Both entities are manufacturing entities and utilize the bulk of the electricity purchased in manufacturing processes to operate welding machines, large machinery, and the like.

Applicable law and regulations

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.

(b) (1) The receipts from every sale, other than sales for resale, of the following: (A) gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature; . . .

Section 1115(c)(1) of the Tax Law provides:

Fuel, gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature for use or consumption directly and *exclusively* in the production of tangible personal property, gas, electricity, refrigeration or steam, for sale, by manufacturing, processing, assembling, generating, refining, mining or extracting shall be exempt from the taxes imposed under subdivisions (a) and (b) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten of this article. (Emphasis added.)

Section 1132(c)(1) of the Tax Law provides, in part:

For the purpose of the proper administration of this article and to prevent evasion of the tax hereby imposed, it shall be presumed that all receipts for property or services of any type mentioned in subdivisions (a), (b), (c) and (d) of section eleven hundred five . . . are subject to tax until the contrary is established, and the burden of proving that any receipt . . . is not taxable hereunder shall be upon the person required to collect tax or the customer. . . unless (i) a vendor, not later than ninety days after delivery of the property or the rendition of the service, shall have taken from the purchaser a resale or exemption certificate in such form as the commissioner may prescribe . . . or (ii) the purchaser, not later than ninety days after delivery of the property or the rendition of the service, furnishes to the vendor: any affidavit, statement or additional evidence, documentary or otherwise, which the commissioner may require demonstrating that the purchaser is an exempt organization described in section eleven hundred sixteen, the sale shall be deemed a taxable sale at retail. . . . Where such a resale or exemption certificate or such an affidavit, statement or additional evidence has been furnished to the vendor, the burden of proving that the receipt . . . is not taxable hereunder shall be solely upon the customer. . . .

Section 526.8 of the Sales and Use Tax Regulations provides, in part:

Tangible personal property. (Tax Law, §1101(b)(6)) (a) Definition. The term *tangible personal property* means corporeal personal property of any nature having a material existence and perceptibility to the human senses. Tangible personal property includes, without limitation:

- (1) raw materials, such as wood, metal, rubber and minerals;
- (2) manufactured items, such as gasoline, oil, chemicals, jewelry, furniture, machinery, clothing, vehicles, appliances, lighting fixtures, building materials;
- (3) artistic items, such as sketches, paintings, photographs, moving picture films and recordings;
- (4) animals, trees, shrubs, plants and seeds;
- (5) water;
- (6) coins and other numismatic items, when purchased for purposes other than for use as a medium of exchange;
- (7) postage stamps, when purchased for purposes other than mailing; and

(8) precious metals in the form of bullion, ingots, wafers and other forms.

(b) Gas, electricity, refrigeration and steam are not considered tangible personal property for the purpose of the tax imposed on utility services. . . .

(c) Tangible personal property does not include:

(1) real property; . . .

Section 528.22 of the Sales and Use Tax Regulations provides, in part:

(a) *Exemption.* (1) Fuel, gas, electricity, refrigeration and steam and gas, electric, refrigeration and steam service of whatever nature is exempt from the sales and compensating use tax when used directly and exclusively in the production, for sale, of tangible personal property, gas, electricity, refrigeration or steam by one of the following endeavors:

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| (i) manufacturing; | (vii) extracting; |
| (ii) processing; | (viii) farming; |
| (iii) assembling; | (ix) agriculture; |
| (iv) generating; | (x) horticulture; or |
| (v) refining; | (xi) floriculture. |
| (vi) mining; | |

(2) Fuel, gas, electricity, refrigeration and steam and like services used or consumed in the heating, cooling or lighting of buildings or in the preparation of food and drink subject to tax imposed by section 1105(d) of the Tax Law or in the storage of tangible personal property, are subject to the sales tax.

* * *

(4) An exempt use certificate (Form ST-121) is used to make purchases eligible for this exemption, without payment of sales tax. (See section 532.4(e) of this Title.)

* * *

(c) *Directly and exclusively.* (1) *Directly* means the fuel, gas, electricity, refrigeration and steam and like services, and must during the production phase of a process, either:

- (i) operate exempt production machinery or equipment; or
- (ii) create conditions necessary for production; or
- (iii) perform an actual part of the production process.

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

Example 1: A welding shop produces stainless steel railings. In order to carry out the production, the railings must be welded in an inert atmosphere. The welding shop purchases an inert gas which is used to create the inert atmosphere. The gas is used directly in production.

(3) (i) Exclusively means that the fuel, gas, electricity, refrigeration and steam and like services are used in total (100%) in the production process.

(ii) Because fuel, gas, electricity, refrigeration and steam when purchased by the user are normally received in bulk or in a continuous flow and a portion thereof is used for purposes which would make the exemption inapplicable to such purchases, the user may claim a refund or credit for the tax paid only on that portion used or consumed directly and exclusively in production.

(iii) In the alternative, an exempt use certificate (Form ST-121) may be used, providing full liability is assumed for any State and local tax due on any part of purchases used for other than the exempt purposes described in subdivision (a) of this section. The taxable portion of these purchases is to be reported as a "purchase subject to use tax" on a sales and use tax return required to be filed with the Department of Taxation and Finance.

(iv) The user must maintain adequate records with respect to the allocation of fuel, gas, electricity, refrigeration and steam used directly and exclusively in production and for nonexempt purposes.

(v) For the purpose of substantiating the allocation of fuel, gas, electricity, refrigeration and steam and like services used directly and exclusively in production from that used for nonexempt purposes, the user must, when claiming a refund or credit, submit an engineering survey or the formulae used in arriving at the amounts used in an exempt manner.

* * *

Example 4: A manufacturing plant purchases electricity to power its production machinery and also to light its buildings. Only the electricity used to power the production machinery is used directly in production.

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Company A purchases electric service from a utility company. Company A bills Company B for rent and real estate taxes on a monthly basis. The agreement between Company A and Company B provides that the charge for electric and gas usage by Company B is collected by Company A as additional rent. Although separate charges for electricity and gas appear on Company A's monthly invoice for rent to Company B, such charge is based upon Company A's estimate of Company B's utility consumption. The estimate that Company B is consuming from 80% to 91% of the total electric charge Company A pays each month is based on Company B's percentage of utilization of the total floor space of the facilities. Both entities are manufacturing entities and utilize the bulk of the electricity purchased in manufacturing to operate welding machines, large machinery, and the like.

Charges to a tenant for an Electricity Rent Inclusion Factor have been determined to be charges for an electric service provided only as an incident to the rental of the commercial premises and not as a "separate transaction having as its primary purpose the furnishing of utilities or utility services." Such charges are therefore not considered subject to tax as receipts from the sale of utility services under section 1105(b) of the Tax Law. See *Empire State Building Co. v New York State Dept. of Taxation and Finance*, 81 NY2d 1002. Essentially, this means that such rent inclusion charges paid by tenants consuming nonmetered electric service are not receipts from the sale of a utility service by the landlord and thus are not charges which are subject to sales tax.

It has been determined that where individual tenants have meters by which a landlord can determine the monthly use of electricity and the landlord bills the tenants for the electricity used, such receipts constitute the sale of a utility service. The landlord must register as a vendor for sales tax purposes and must collect sales tax on charges for the electric service billed to the tenant. See *Mutual Redevelopment Houses, Inc. v Roth*, 307 AD2d 422 (3rd Dept 2003).

In the present case, however, there was not a separate or individual metering of the utility usage of the tenant. Although separate sub-meters existed which might have been used to measure utility usage at Petitioner's facility, since Company A and Company B jointly share the use of the space in such facility, the sub-meters do not separately measure the landlord's (Company A) or the tenant's (Company B) individual usage. The monthly charges to Company B for its pro rata share of utility service based upon Company B's proportionate square footage of leased space occupied, are considered incident to Company B's lease of the real property. The charges are in the nature of additional rent and do not constitute a receipt for the separate sale of a taxable service. See

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Debevoise & Plimpton v New York State Taxation & Finance, 80 NY2d 657, 661; *Empire State Building Co. v New York Dept. of Taxation & Finance*, *supra*.

Accordingly, the charges by Company A to Company B, pursuant to their lease agreement, for reimbursement by Company B of its estimated portion of the monthly electrical usage of the facility are considered nontaxable charges for rent rather than charges for electricity subject to tax under section 1105(b) of the Tax Law. Company A's purchases of electricity from a utility company, therefore, are not purchases for resale to Company B. Company A's purchases of electricity are subject to sales tax under section 1105(b) of the Tax Law unless otherwise exempt.

Section 1115(c) of the Tax Law provides only that those utilities used directly and exclusively in the production process will qualify for exemption from sales tax. Section 528.22(c)(1) of the Sales and Use Tax Regulations provides that utilities are used directly in production when used during the production process to operate exempt production machinery. Section 528.22(c)(3) of the Sales and Use Tax Regulations defines the term *exclusively* to mean that the fuel, gas, electricity, refrigeration and steam and like services are used in total (100%) in the production process. Section 528.22 further provides that the user must maintain adequate records with respect to the allocation of fuel, gas, electricity, refrigeration and steam used directly and exclusively in production and for nonexempt purposes. Where utilities billed from a single meter are used for mixed taxable purposes (e.g., light, heat, etc.) and exempt purposes, the purchases of utilities are subject to sales tax, and a refund or credit may be claimed for the tax paid on utilities used directly and exclusively in production. The purchaser is permitted to show the amounts used for such taxable and exempt purposes using alternative methods other than direct separate metering. For the purpose of substantiating the allocation of fuel, gas, electricity, refrigeration and steam and like services used directly and exclusively in production the user may, in claiming a refund or credit, submit an engineering survey or other formulae used in arriving at the amounts used in an exempt manner. See *Sales Tax Information For: Manufacturers, Processors, Generators, Assemblers, Refiners, Miners and Extractors, and Other Producers of Goods and Merchandise*, Publication 852 (12/97), *Appendix A*, for guidance in determining the amount of electricity used exclusively in production where the production usage is not separately metered.

Company A, a manufacturer, has purchased electricity which it has itself consumed in its business as a manufacturer of property for sale. In addition, a portion of the electricity purchased by Company A and consumed by Company B, although not a purchase of electricity which will be resold by Company A to Company B, will nonetheless be similarly partially consumed by Company B in the production of tangible personal property for sale by Company B. Section 1115(c) of the Tax Law provides for an exemption from sales tax on purchases of electricity of whatever nature which is used or consumed directly and exclusively in the production of tangible personal property for sale by manufacturing. Provided that Company A can, as required by section 1132(c)(1) of the Tax Law and section 528.22(c)(3)(iv) of the Sales and Use Tax Regulations, produce records substantiating the usage of utility services, the tax paid by Company A on charges by the utility

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company for electricity used directly and exclusively in the production of tangible personal property for sale by Company A and/or Company B is eligible for refund or credit.

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