

**New York State Department of Taxation and Finance
Office of Counsel**

TSB-A-15(53)S
Sales Tax
December 31, 2015

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S130910C

The Department of Taxation and Finance received a Petition for Advisory Opinion from [REDACTED], and [REDACTED] (together, Petitioner). Petitioner asks five questions: (1) whether its sales to customers of access to a bundle of fiber optic cables that allows the customer's equipment to establish a connection to its business partners through its Cross Connect service are subject to sales tax as telegraphy or telephony under Tax Law § 1105(b); (2) whether its rentals of Cages or Suites are subject to tax as a storage service under § 1105(c)(4); (3) whether its charges to maintain or operate its customer's equipment are subject to sales tax; (4) whether its sales of Fixed Electrical Power service are subject to tax as electric service under § 1105(b); and (5) whether future sales of Metered Electrical Power service would be subject to tax as electric service under § 1105(b).

We conclude, based on the facts presented, that: (1) Petitioner's charges to its customers for the use of its "dark" fiber optic cables that provide a means for the customers' equipment to connect to their business partners through its Cross Connect service are not subject to sales tax as telegraphy or telephony under Tax Law § 1105(b); (2) its charges for renting its cages or suites are not subject to tax as a storage service under § 1105(c)(4); (3) its charges to maintain its customers' equipment are subject to sales tax; (4) its sales of Fixed Electrical Power service are not subject to tax under § 1105(b) because Petitioner does not meter the electricity provided to its customers; and (5) its future sales of Metered Electrical Power service would be subject to tax as electric service under § 1105(b).

Facts

Petitioner is in the business of providing co-location services, interconnection, and managed IT infrastructure services at data centers in buildings in New York that it leases from others, as discussed below. Petitioner provides options for a customer to choose a product (i.e. Cross Connect, Cloud Exchange, Internet Exchange) to enable interconnection between the customer and its business partners. These solutions are provided through its carrier-neutral co-location centers, called International Business Exchanges ("IBXs"), located in the buildings it leases. Petitioner offers customers direct interconnection to an aggregation of bandwidth providers, including the world's top carriers, Internet Service Providers ("ISPs"), broadband access networks (DSL/cable) and international carriers. Customers locate their equipment in the IBXs in order to utilize the technology available in the IBX to connect with business partners, service providers and networks.

(1) Cross Connect Service –

Under the Cross Connect service, Petitioner provides customers access to a bundle of fiber optic cables that allows a customer's equipment to establish a connection to its business partners. The customer's equipment must be located in Petitioner's IBX in order to gain access to Petitioner's fiber optic cable. Petitioner installed the cables that it uses to provide its services in the buildings where its IBXs are located. Within the IBX, the cable sits in trays above the customers' equipment. Outside the IBX, the fiber is contained in a conduit that may be buried anywhere from three to six feet underground. Customers are unable to gain access to the cable at any location outside the IBX. Petitioner's leases with its landlords for its data centers provide that leasehold improvements that Petitioner makes, such as its installation of fiber optic cables, may not be removed at the end of the lease term and become the landlord's property.

Petitioner does not transmit data, sounds, or signals through the cables. In this capacity, the cable is commonly referred to as "dark fiber." The fiber remains "dark" until the customer "lights" the cable by establishing service with a third party provider. Only when the fiber is "lit" by the third party provider is the customer able to transmit data from, and receive data at, its equipment in the IBX.

The Cross Connect service is provided to customers in addition to other services rendered within the IBX or from a remote location (i.e., another IBX). Petitioner separately states its charges for its Cross Connect service on invoices and contracts with its customers.

(2) Cage/Suite Rentals -

Petitioner enters into a contract with a customer to lease a "cage" or "suite" of space at its IBX to the customer. Petitioner charges its customers a fixed fee for the space on a recurring monthly basis. Petitioner separately states the charge for the space on invoices to its customers. A cage is configured with cabinets, cable distribution systems, and access to electrical power. A suite is configured with the same elements in a fully enclosed and secure space. The contract specifies the amount of space leased or "licensed" by the customer, ranging from 75 square feet to as many as 2,000 square feet or more. Under the agreement, the customer has control of, access to and possession of the space 24 hours a day, seven days a week, although the customer may provide Petitioner a key to the space. Petitioner is able to access the cage or suite, but generally does not do so other than to respond to emergency or life safety issues. A customer locates its equipment in the cage or suite in order to use the Cross Connect Service and other services to connect with business partners, service providers, and networks. The customer is permitted to supply racks, cabinets, and other facilities for its use in the space. The customer does not relinquish possession or control of its equipment to Petitioner.

(3) Maintenance and Operation of Customer's Equipment –

A customer will maintain and operate its own equipment located in its cage or suite. However, a customer may elect to have Petitioner maintain the customer's equipment, in which case Petitioner will separately charge the customer for maintaining the equipment. Most customers choose to maintain their own equipment. Likewise, a customer may elect to have Petitioner operate the customer's equipment for a separate charge.

(4) Fixed Electric Power –

Petitioner purchases electric power from New York electric utilities and pays applicable fees and taxes, including sales tax, to the utilities. Petitioner provides its customer access to and use of a live power circuit to power the customer's equipment located in the IBX and charges them a fixed monthly amount based on the number of kilowatt hours dedicated to the customer. A customer specifies the number of kilowatt hours it will need per month (based on the number of servers located in its cage or suite, or similar factors) for the term of the contract, within a range set by Petitioner. Petitioner's charge for Fixed Electrical Power is not based on consumption. Petitioner charges the customer the fixed amount whether or not the customer uses all of the kilowatt hours contractually allotted to it. Petitioner uses a power monitoring system on power circuits delivered to customers that automatically captures and stores quarter-hourly current readings. Petitioner's system estimates electrical usage/demand at a moment in time for a cage or suite and compares it to the contractual draw cap. The power monitoring system can trend the draw readings it stores to show a history of customer usage. If a customer's usage exceeds the amount allotted to it, the customer is asked to pay an additional power charge or decrease its usage. If a customer continually goes over its 'fixed amount,' it will be asked to increase its fee structure.

(4) Metered Electrical Power -

Petitioner does not currently provide Metered Power Service to customers in New York, but it may do so in the future. Under the Metered Electrical Power service, Petitioner would charge a customer a variable amount each month based on the number of kilowatt hours the customer consumes, plus a negotiated monthly administrative fee that is intended to cover Petitioner's cost to administer, monitor, and read the meter. Petitioner would separately state its charges for Metered Electrical Power on contracts and invoices to the customer. In customer contracts, the Metered Electrical Power would typically contain a "minimum commitment" clause that would state the number of kilowatt hours the customer agrees to pay for each month in the event the customer consumes less power than the agreed-upon "minimum." The Fixed Electrical Power and Metered Electrical Power services would be mutually exclusive (except as described above regarding minimum commitments on the Metered Electrical Power service offering).

Analysis

(1) Cross Connect Service –

Tax Law § 1105(b) imposes sales tax on receipts from sales, other than for resale, of telephony and telegraphy and telephone and telegraph service of whatever nature, except interstate and international telephony and telegraphy and telephone and telegraph service. Section 1105(b) imposes tax on receipts from intrastate communication by means of devices employing the principles of telephony and telegraphy. Telephony and telegraphy include use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals. *See* 20 NYCRR § 527.2(d).

Petitioner does not itself transmit sound or other signals via its Cross Connect service. Rather, Petitioner provides its fiber optic cables to its customers to allow them to connect their own equipment to the cables and, once they obtain connectivity from a third party or ISP, to the Internet. Because the customers use their own equipment to connect to Petitioner's cables, and the third party or ISP then carries the customers' data or other signals to their destination, Petitioner is deemed to be providing "dark cables" and not providing telephony or telegraphy service. If Petitioner does not provide the equipment or energy source necessary to light the fiber optic cable for the transmission of communications when selling the use of its "dark" cables, Petitioner's charges to customers for their use of "dark" cable are not receipts from the sale of telephone or telegraph services. *See* TSB-A-05(32)S.

Petitioner's charges for its Cross Connect Service also do not constitute charges for the sale or use of the cables as tangible personal property, because the cables as installed constitute a capital improvement to real property, the sales, lease, or use of which is not subject to sales tax. "Capital improvement" means an addition or alteration to real property which (1) substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; (2) 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 (3) is intended to become a permanent installation. Tax Law § 1101(b)(9)(i). First, it is reasonable to conclude that the cables substantially add to the value of the real property. Second, the fiber optic cables are installed in a manner that they become part of the real property or are permanently affixed to the real property so that removal would cause material damage to the real property or to the cables. *See Sales and Use Tax Classifications of Capital Improvements and Repairs to Real Property*, Publication 862 (4/01). Where the cables, wires, conduits, and other equipment used in conjunction with the cables are installed in a manner similar to the building's electrical system wires, conduits, and related equipment so that they become a part of the real property, their installation would meet the second requirement of Tax Law § 1101(b)(9)(i). *See* TSB-A-09(10)S. Finally, the installation of the cables meets the third requirement because the cables become the property of the landlord and Petitioner may not remove them at the end of the lease term. *See Sales and Use Tax Classifications of Capital Improvements and Repairs to Real Property*, Publication 862 (4/01).

(2) Cage/Suite Rentals –

Tax Law § 1105(c)(4) imposes sales tax on receipts from sales, other than for resale, of the service of storing tangible personal property not held for sale in the regular course of business. While the tax is imposed on the service of providing storage space, it is not imposed on the lease of real property for storage. The following are indicators of a rental or lease of real property: (1) the tenant contracts for a certain amount of footage in a specific location; (2) the tenant has unlimited control of access to the space and exclusive possession of the space; (3) the tenant's possession and control of the space must be to the exclusion of the proprietor (as described below); (4) the tenant is allowed to supply racks, cabinets, and other facilities for the tenant's own use in the leased space; and (5) the proprietor does not provide additional services that require the tenant to give up possession and control of his or her property to the proprietor (such as receiving, handling, storing, or forwarding of the tenant's personal property). A real property tenant's exclusive possession of the space may be established by means of a lock under the control of the tenant, and will still be recognized if the proprietor has a duplicate or master

key, but the written lease agreement specifically provides that the proprietor has no right of access to the space during the term of the rental except to collect rent, make necessary repairs, or in an emergency.

A lease can be distinguished from the provision of storage space, in that under a lease, the tenant contracts for a certain amount of footage in a specific location, the tenant has unlimited control of access to the space, and may supply his or her own racks, cabinets and other physical facilities. *See* 20 NYCRR § 527.6(b)(2). The lease of storage space will be exempt from sales tax only if it does not actually constitute a storage service. A key element in providing a storage service is the relinquishment of possession and control of the stored goods by the tenant to the proprietor. If the proprietor provides additional services (such as receiving, handling, storing, or forwarding of the tenant's personal property) that require the tenant to give up possession and control of the stored goods to the proprietor, a lease may be deemed to constitute a taxable storage service. *See* New York Sales Tax Bulletin No. TB-ST-340, *Household Movers and Warehouse*s.

Customers locate their equipment in Petitioner's IBXs "cages" or "suites" in order to utilize "third party" technology available in the IBX to connect with business partners, service providers, and networks. The amount of space leased by the customer is defined in the customer contract. The customer has exclusive possession of the space for the term of the agreement (but may at its option provide Petitioner a copy of the key to the space). The customer is permitted to supply racks, cabinets, and other facilities for their own use in the leased space. Petitioner's customers do not relinquish control of the equipment they place in their space at the IBX. Customers are permitted access to their IBX cages or suites 24 hours a day, seven days a week. Accordingly, Petitioner's rentals of cages or suites to its customers do not constitute the taxable storing services under § 1105(c)(4). Instead, they are leases of real property and are not subject to sales tax.

(3) Maintenance and Operation of Customer's Equipment –

Tax Law § 1105(c)(3) imposes sales tax on sales, other than for resale, of the services of installing, maintaining, servicing, or repairing tangible personal property, not held for sale in the regular course of business, whether or not any tangible personal property is transferred in conjunction therewith. If a customer elects to have Petitioner install, maintain, service, or repair the customer's equipment, Petitioner's charges for such services would be subject to sales tax. If Petitioner makes a single charge for the maintenance and operation of customer equipment, the entire charge would be subject to tax. Petitioner did not provide any information about the types of customer equipment it might operate. Thus, we cannot opine about whether a separately-stated charge to operate that equipment would be subject to sales tax.

(4 & 5) Electrical Power

Tax Law § 1105(b) imposes sales tax on sales, other than for resale, of electricity and electric service of whatever nature. However, a commercial lessor's provision of non-metered electricity that is paid for by tenants through rent inclusion charges is a redistribution of electricity rather than a sale or resale, for purposes of imposition of sales tax. Since the formula

applied by a lessor for computing the charge for redistribution of electricity does not represent actual economic cost of the service supplied, the charges are incidental to the commercial tenants' rent charges, and do not constitute "sales" or "resales" of electricity for purposes of § 1105 (b). *Empire State Building Company v New York State Dept. of Taxation & Fin.*, 81 NY2d 1002 (1993). *See also Debevoise & Plimpton v New York State Dept. of Taxation & Fin.*, 80 NY2d 657 (1993). In essence, 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 subject to sales tax. *See, e.g.*, TSB-A-04(24)S.

Petitioner purchases electrical power from, and pays applicable charges and taxes to, its electric power suppliers, including sales tax. Petitioner purchases electrical power in order to provide its overall service to its customers. The amount that Petitioner charges a customer for the Fixed Electrical Power is not based on consumption. Instead, it is based on the amount of power that the customer requests to have allocated to it (which depends on the number of servers it locates in its cage or suite, or similar factors). Customers locate their equipment at the IBX in order to gain access to the Cross Connect service and other services that are available at the IBX. As such, Petitioner's charges for Fixed Electrical Power do not represent the actual economic cost of the electricity supplied and are incidental to the customer's rental of the cage or suite. Thus, its charges for Fixed Electric Power are not subject to sales tax.

However, a landlord's sales of metered electricity to its tenants are subject to sales tax as sales other than for resale. If the individual tenants have meters by which the 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. Thus, if Petitioner meters the electricity it provides to its customers and charges them for the electricity, it must collect tax on such sales. *See Mutual Redevelopment Houses, Inc. v Roth*, 307 AD2d 422 (3rd Dept, 2003). *See* TSB-A-04(24)S The existence of the fixed minimum charge does not produce a different result. However, if the electricity is metered, Petitioner can purchase the electricity for resale.

DATED: December 31, 2015

/S/

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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.