

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

TSB-A-93 (50)S
Sales Tax
October 4, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S930310A

On March 10, 1993, a Petition for Advisory Opinion was received from Raycon Research and Development, Inc., 91 Blake Road, Brookline, MA 02146.

The issues raised by Petitioner, Raycon Research and Development, Inc., are:

1. Whether Petitioner's purchases of tangible personal property are exempt from sales and use taxes since they are used in connection with experimental or laboratory research and development.
2. Whether Petitioner's purchases of tangible personal property are exempt from sales and use taxes since the project is being done for both the New York State and Federal Governments, and title to all such tangible personal property will belong to the Federal Government.
3. Whether Petitioner's purchases of tangible personal property are exempt from sales and use taxes as machinery or equipment used in the production of tangible personal property, gas, electricity, refrigeration or steam for sale.
4. Whether Petitioner's purchases of tangible personal property are exempt from sales and use taxes since the structure and some installation associated with the structure constructed by Petitioner in connection with the project are intended to be retained as a capital improvement when the testing has been completed and the equipment has been dismantled and removed.

Petitioner has invented a novel Flue Gas Desulfurization Process. This process is of interest to both the New York State and Federal Governments. At the request of both the New York State and Federal Governments, Petitioner has been asked to further develop the process so that it can be used by the general public.

The project is being funded by the United States Department of Energy (hereinafter the "DOE"), the New York State Energy Research and Development Authority (the "NYSERDA"), the Empire State Electrical Energy Research Corporation (the "ESEERCO"), Niagara Mohawk Power Corporation, and by Petitioner.

With government funds, Petitioner is building an experimental pilot plant at Niagara Mohawk Power Corporation's Dunkirk Power Station at Dunkirk, New York which removes the sulfur dioxide from the gas generated in the production of electricity for sale. It is strictly a pollution

control process. DOE defines the project as a proof-of-concept demonstration program. As a research and development project, the demonstration can be a resounding success or a failure.

Petitioner has a cost reimbursement subcontract with the United Engineer and Contractors of Denver, Colorado (the "UE&C") to design and install the pilot plant and subsequently, execute the test program. UE&C has a subcontract with Quackenbush Corporation of Buffalo, New York to complete the structure and install the equipment.

Accordingly to the contract between Petitioner and DOE, the title of all property purchased by the contractor for which the contractor is entitled to be reimbursed as a direct item of cost under the contract shall pass to and vest with the Federal government upon the vendor's delivery of such property.

The experimental equipment will be installed underneath an existing electrical precipitator which provides the ceiling. Side walls, with doors, will be newly installed. These walls, together with ceiling provided by the precipitator will result in a large room providing shelter for installed equipment. Lights, space heating and safety showers will also be installed. It is contemplated that this room and its related improvements will be retained permanently by the Niagara Mohawk Power Corporation since dismantling the room will cause material damage to the existing structure. However, upon completion of the test, experimental equipment will be dismantled and removed.

Petitioner, as part of its Petition for Advisory Opinion, has furnished copies of all the contracts it has with agencies and organizations providing funding.

Section 1105(c) of the Tax Law imposes sales tax on 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, and ...

Section 1101(b)(9)(i) of the Tax Law provides as follows:

(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 1115 of the Tax Law provides, in part, as follows:

Section 1115. 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:

* * *

(10) Tangible personal property purchased for use or consumption directly and predominantly in research and development in the experimental or laboratory sense. Such research and development shall not be deemed to include the ordinary testing or inspection of materials or products for quality control, efficiency surveys, management studies, consumer surveys, advertising, promotions or research in connection with literary, historical or similar projects.

* * *

(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...This exemption shall include all pipe, pipeline, drilling rigs, service rigs, vehicles and associated equipment used in the drilling, production and operation of oil, gas, and solution mining activities to the point of sale to the first commercial purchaser.

Section 528.11 of the Sales and Use Tax Regulations provides, in part, as follows:

Reg. Sec. 528.11 Research and development .-- (Tax Law, Sec.1115(a)(10) and Sec. 1115(b)(ii)). (a) Exemptions (1) The sale

of tangible personal property purchased for use or consumption directly and predominantly in research and development in the experimental or laboratory sense is exempt from the sales and use tax.

(2) The exemption does not extend to installation and repair services for such property.

* * *

(b) Research and development, (1) Research and development in the experimental or laboratory sense means research which has as its ultimate goal:

ii) basic research in a scientific or technical field of endeavor;

(ii) advancing the technology in a scientific or technical field of endeavor;

(iii) the development of new products;

(iv) the improvement of existing products;

(v) the development of new uses for existing products.

* * *

Example 4: An aircraft manufacturer assembles two airplanes, which it uses for function and reliability tests prior to manufacturing this type of airplane for sale. The parts, equipment instrumentation and fuel used on the airplanes during the testing phase are exempt as they are used directly and predominantly in research and development.

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

Reg. Sec. 528.13. Machinery and equipment used in production; telephone and telegraph equipment; parts, tools and supplies - - (Tax Law, Sec. 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. (This exemption includes all pipe, pipeline, drilling rigs, service rigs, vehicles and associated equipment used in the drilling, production and operation of oil, gas and solution mining activities to the point of sale to the first commercial purchaser.

* * *

(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.

(3) The determination of when production begins is dependent upon the procedure used in a plant. If on receiving raw materials, the purchaser weighs, inspects, measures, or tests the material prior to placement into storage, production begins with placement into storage, and the prior activities are administrative. If the materials are unloaded and placed in storage for production without such activities, the unloading is the beginning of production.

* * *

(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 casual 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.

Section 1116(a) of the Tax Law provides, in part, as follows:

Sec. 1116. Exempt organizations - - (a) Except as otherwise provided in this section, any sale or amusement charge by or to any of the following or any use or occupancy by any of the following shall not be subject to the sales and compensating use taxes imposed under this article:

(1) The state of New York, or any of its agencies, instrumentalities, public corporations (including a public corporation created pursuant to agreement or compact with another state or Canada) or political subdivision 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;

(2) The United States of America, and any of its agencies and instrumentalities, insofar as it is immune from taxation where it is the purchaser, user or consumer, or where it sells services or property of a kind not ordinarily sold by private persons; ...

In the Matter of MGK Constructors, Dec Tax App Trib, March 5, 1992, the Tribunal held that when acting as a purchaser, user or consumer, the City of New York is not subject to sales tax pursuant to Section 1116(a)(1) of the Tax Law. Moreover, a contractor acting as an agent of the City would likewise not be subject to sales tax in accordance with Sections 541.2(c) and 529.2(b) of the Sales and Use Tax Regulations.

The Tribunal further held that the criteria set out in Section 541.3(d)(4) of the Sales and Use Tax Regulations for establishing whether an agency relationship exists is applicable only to exempt organizations identified under Sections 1116(a)(3) - (6) of the Tax Law, and as New York City is an exempt organization pursuant to Section 1116(a)(1) of the Tax Law, it was not subject to such criteria.

Thus, the Tribunal held that since no regulation sets forth a criteria for establishing whether an agency relationship exists an exempt organization identified in Sections 1116(a)(1) and (2) of the Law, that the general principle of agency as cited in the Matter of Hooper Holmes, Inc. v. Wetzler, 152 AD2d 871, 544 NYS2d 233, 235, lv denied 75 NY2d 706, 552 NYS2d 929, must be applied. In Hooper Holmes, Inc. v. Wetzler, supra, the court stated: "To establish an agency or representative relationship must be a manifestation that petitioners consented to act on behalf of clients, subject to the latter's control and that the clients authorized fiduciary relationship."

In the instant case, Petitioner's study and development of a process to remove sulfur dioxide from gas generated in the production of electricity for sale falls within the meaning of research and development in the experimental or laboratory sense as defined in Section 528.11 of the Sales and Use Tax Regulations. Therefore, pursuant to Section 1115(a)(10) of the Tax Law, Petitioner's purchases of tangible personal property purchased for use or consumption directly and predominantly in the research and development project are not subject to sales and use taxes. It is noted, however, that pursuant to Section 528.11 of the Sales and Use Tax Regulations that such exemption does not extend to installation and repair services of such tangible personal property.

Moreover, pursuant to Sections 1101(b)(9) and 1105(c)(3) of the Tax Law, the installation of tangible personal property which when installed will constitute an addition or capital improvement to the real property will be exempt from sales and use taxes. Therefore, if a contractor hired by Petitioner is making the purchases of the tangible personal property used in the construction of the structure, its purchases of such tangible personal property would be subject to sales and use taxes. However, the contractor's charges to Petitioner for performing the capital improvement would be exempt from sales and use taxes. If Petitioner purchases the tangible personal property used in the construction of the structure, Petitioner's purchase would be subject to sales and use taxes. However, the charges for installing the structure and any other equipment which is intended to be a permanent installation would be exempt from sales and use taxes.

Further, pursuant to Section 1115(a)(12) of Tax Law and Section 528.13 of the Sales and Use Tax Regulations machinery and equipment purchased for use in the production for sale of tangible personal property, gas, electricity, refrigeration or steam qualify for exemption from and use taxes imposed by Section 1105 of the Tax Law. Since Petitioner is not producing gas, electricity, refrigeration or steam for sale, the purchases by Petitioner of such machinery and equipment does not qualify for exemption under Section 1115(a)(12) of the Tax Law and Section 528.13 of the Sales and Use Tax Regulations.

In addition, contracts and agreements furnished by Petitioner do not establish that an agency relationship exists between Petitioner and the Federal and New York State governments. Therefore, since it cannot be manifested that Petitioner is acting on behalf of the Federal and New York State governments, subject to their control and that the Federal and New York State government have authorized this fiduciary relationship, pursuant to MGK Constructors, supra, Petitioner does not

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qualify for exemption from sales and use taxes on purchases of tangible personal property on the basis that it is acting as an agent for an entity exempt under Sections 1116(a)(1) or (2) of the Tax Law.

It should be noted that an Exempt Use Certificate (Form ST-121) is used to make purchases of tangible personal property for use or consumption directly or predominately in research and development without the payment of sales tax. A Certificate of Capital Improvement (Form ST-124) must be executed where the installation of tangible personal property will result in the performance of a capital improvement.

DATED: October 4, 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.