

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

TSB-A-93 (70) S
Sales Tax
August 2, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S930208B

On February 8, 1993 a Petition for Advisory Opinion was received from Morgan Stanley Group Inc., 1251 Avenue of the Americas, New York, New York.

The issues raised by Petitioner, Morgan Stanley Group Inc., are:

1. Whether the purchase, lease, installation and entering into of contracts for the maintenance, servicing and repair of the Leasehold Improvements and Project Facilities by MS Financing, as agent for and on behalf of the IDA, are exempt from Sales and Use Taxes by virtue of the IDA's statutory exemption from tax.

2. Whether payments under the leases of the Leasehold Improvements and Project Facilities from the IDA to MS Financing, from MS Financing back to the IDA, and from the IDA to MS & Co. and the Eligible Affiliates are not subject to Sales and Use Taxes by virtue of the IDA's statutory exemption from tax.

Petitioner has requested this Advisory Opinion on behalf of its wholly-owned subsidiaries, Morgan Stanley & Co. Incorporated (hereafter MS & Co.), MS Financing Inc. (hereafter MS Financing), and Morgan Stanley Trust Company, Morgan Stanley Realty Incorporated and Morgan Stanley Asset Management Inc. (hereafter the Eligible Affiliates) with respect to the application of New York State and New York City Sales and Compensating Use Taxes to the purchase, lease, installation and/or maintenance of certain eligible property under the circumstances described below.

To induce MS & Co. to maintain its offices in the City of New York (the "City"), the City has proposed to extend, and the City and Petitioner have entered into an understanding with regard to, certain benefits including Sales and Compensating Use Tax benefits (as more fully described herein, the "Project"). This ruling request, as noted above, relates only to the Sales and Compensating Use Tax benefits offered by the City.

MS & Co. leases office space at 1251 Avenue of the Americas (the "Exxon Building"). MS & Co. also leases space at various other locations throughout the City (collectively, the "Other Locations").

For regulatory reasons, MS Financing (rather than MS & Co. or the Eligible Affiliates) purchases, leases, installs, and will enter into maintenance, service and repair contracts with respect to, as applicable, (i) leasehold improvements in the Exxon Building, and (ii) machinery, equipment, furnishings and other items of personal property for use by MS & Co. and the Eligible Affiliates both in the Exxon Building and at Other Locations. Currently, MS Financing leases the leasehold improvements and the personalty to MS & Co. and the Eligible Affiliates pursuant to the terms of an operating lease or leases.

In order to make available the benefits offered by the City, the City and the New York City Industrial Development Agency ("IDA") have proposed the following structure:

- o The owner of the Exxon Building (the "Landlord") will condominiumize the Exxon Building and will convey to the IDA title to the condominium units leased to MS & Co. (the "Leased Space").

- o The IDA will lease the Leased Space back to the Landlord for a nominal rental, and the Landlord will sublease the Leased Space to MS & Co. pursuant to the terms of the existing space lease between Landlord and MS & Co.

- o MS & Co. will lease the Leased Space to the IDA, and the IDA will lease the Leased Space back to MS Financing (this lease from the IDA to MS Financing is hereinafter referred to as the "Financing Lease").

- o The IDA will issue bonds from time to time, presently contemplated to be purchased by Petitioner or by an affiliate of Petitioner, to finance purchases and leases of leasehold improvements and equipment and other personalty, as well as the costs of installing the same. MS Financing will purchase and install, and will enter into maintenance contracts with respect to, leasehold improvements in the Exxon Building as agent for the IDA (such leasehold improvements, together with replacements, enhancements and additions thereto, collectively, the "Leasehold Improvements"). MS Financing will also purchase, lease, and enter into service, repair and maintenance contracts with respect to, machinery, equipment, personal property and other items as agent for the IDA (such personal property, whether used in the Exxon Building or in any of the Other Locations, and together with any replacements, enhancements and additions thereto, collectively, the "Project Facilities"). The IDA will hold title to, or a leasehold or license interest in, the Leasehold Improvements and the Project Facilities and will lease the same to MS Financing pursuant to the terms of the Financing Lease. Rents paid by MS Financing to the IDA under the Financing Lease will be in an amount equal to principal and interest on the bonds, i.e., in an amount sufficient to repay the bonds.

- o MS Financing will lease the Leased Space, the Leasehold Improvements and the Project Facilities to the IDA, and, lastly, the IDA will sublease the Leased Space, the Leasehold Improvements and the Project Facilities to MS & Co. and the Eligible Affiliates pursuant to an operating lease. The Eligible Affiliates may be substituted or added to as parties to the operating lease. Rents paid by MS & Co. and the Eligible Affiliates to the IDA under the operating lease will be assigned by the IDA to MS Financing.

- o A project agreement and guaranty ("Project Agreement") among the IDA, MS & Co., Petitioner and MS Financing will provide that MS Financing will purchase or lease the Leasehold Improvements and Project Facilities as agent for the IDA. The Project Agreement will also provide that, during the ten (10) years of the Project, the IDA will be the owner of the Leased Space, Leasehold Improvements and Project Facilities and that MS Financing, as agent for the IDA, may enter into contracts for maintenance, repair and service functions with respect to the Leasehold Improvements and Project Facilities.

o At the conclusion of the Project (in ten (10) years), the bonds will mature and be paid off, the Financing Lease (and the other IDA leases) will terminate, title to the Project Facilities and the Leasehold Improvements will be reconveyed to MS Financing, and title to the Leased Space will revert to the Landlord.

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.

* * *

(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 ...

(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 such real property, property or land, by a capital improvement as such term ... is defined in paragraph 9 of subdivision (b) of section eleven hundred one of this chapter

Section 1107 of the Tax Law provides, in relevant part:

(a) General. On the first day of the first month following the month in which a municipal assistance corporation is created under article ten of the public authorities law for a city of one million or more, in addition to the taxes imposed by sections eleven hundred five and eleven hundred ten, there is hereby imposed ..., within the territorial limits of such city, and there shall be paid, additional taxes, at the rate of four percent, which except as provided in subdivision (b) of this section, shall be identical to the taxes imposed by sections eleven hundred five and eleven hundred ten. Such sections and the other sections of this article, including the definition and exemption provisions, shall apply for purposes of the taxes imposed by this section in the same manner and with the same force and effect as if the language of those sections had been incorporated in full into this section and had expressly referred to the taxes imposed by this section.

Section 1109 of the Tax Law provides, in relevant part:

(a) General. In addition to the taxes imposed by sections eleven hundred five and eleven hundred ten of this article, there is hereby imposed within ... the metropolitan commuter transportation district ... and there shall be paid, additional taxes, at the rate of one-quarter of one percent, which shall be identical to the taxes imposed by sections eleven hundred five and eleven hundred ten of this article

Section 1110 of the Tax Law provides, in relevant part:

Except to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state ..., (A) of any tangible personal property purchased at retail, (B) of any tangible personal property manufactured, processed or assembled by the user, (i) if items of the same kind of tangible personal property are offered for sale by him in the regular course of business or (ii) if items are used as such or incorporated into a structure, building or real property by a contractor, subcontractor, or repairman in erecting structures or buildings, or building on, or otherwise adding to, altering, improving, maintaining, servicing, or repairing real property, property or land, as the terms real property, property or land are defined in the real property tax law, if items of the same kind are not offered for sale as such by such contractor, subcontractor or repairman or other user in the regular course of business, (C) of any of the services described in paragraph (1) of subdivision (c) of section eleven hundred five, and (D) of any tangible personal property ... not acquired for purposes of resale, upon which any of the services described under paragraphs (2) and (3) of subdivision (c) of section eleven hundred five have been ,performed

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 imposed 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 1116(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 the General Municipal Law provides, in relevant part:

Tax exemptions

(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.

Section 917-a of the General Municipal Law establishes the New York City Industrial Development Agency as an industrial development agency in general having the powers of industrial development agencies under Article 18-A of the General Municipal Law.

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 agencies 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, lv to app den 67 NY2d 606, the section 874 tax exemption was held to be broader than the exemption provided by Section 1116 of the Tax Law.

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

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 expenses 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

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.

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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.

In accordance with the sections of law and regulations cited above and the decisions in Wegmans Food Markets, Inc. v. Department of Taxation and Finance (126 Misc 2d 144, aff'd 115 AD2d 962, iv to app den 67 NY2d 606) and Wegmans Food Markets, Inc. v. The Department of Taxation and Finance of the State of N.Y., (Sup Ct, Monroe County, Jan. 10, 1992, Galloway, J.) supra, and provided that all the terms and conditions of the relevant documents are complied with, in the instant matter receipts from purchases made by MS Financing as agent for and on behalf of the IDA whether made as a purchase or lease of tangible property or a purchase of a service of maintaining, repairing or servicing the Leasehold Improvements and Project Facilities will be exempt from the taxes imposed under Sections 1105, 1107, 1109 and 1110 of the Tax Law, provided that the IDA is the owner, lessor or lessee of the property and that the purchase invoices, statements and contracts with vendors and suppliers provide that the IDA is the purchaser, lessor or lessee and that MS Financing is the disclosed agent of the IDA. However, in any instance where the maintenance, repair or servicing results in the replacement of parts, materials or supplies that are consumed in the daily ongoing operation of equipment, etc., where such parts, materials or supplies must be replaced whenever consumed, the portion of the charges applicable to such parts, materials or supplies will be subject to the tax imposed under Sections 1105, 1107, 1109 and 1110 of the Tax Law as indicated 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.) supra. Prudential Securities, Incorporated. Adv Op Comm T&F, April 28, 1993.

However, it is noted that in any transaction where the charges are for maintenance services, in addition to exempt maintenance services, the total charges will be subject to the tax imposed under Sections 1105(c)(3) or (5) of the Tax Law unless the charges applicable to the exempt maintenance services are separately stated from the other charges or otherwise reasonably allocated. Prudential Securities, Incorporated. Adv Op Comm T&F, April 28, 1993.

Payments under the leases of the Leasehold Improvements and Project Facilities from the IDA to MS Financing, from MS Financing back to the IDA, and from the IDA to MS & Co. and the Eligible Affiliates are not subject to sales or compensating use tax by virtue of the IDA's statutory exemption from tax.

DATED: August 2, 1993

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