STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. S950522A

On May 22, 1995, a Petition for Advisory Opinion was received from Atlantic Pipeline Corporation, 10 Penn Center, 1801 Market Street, Philadelphia, PA 19103-1699.

The issue raised by Petitioner, Atlantic Pipeline Corporation, is whether electricity consumed by Petitioner in the transport of intermediate petroleum products between refining sites and locations at which additional stages of processing are accomplished is consumed directly in the production of tangible personal property for purposes of the exemption provided by Section 1115(c) of the Tax Law.

Petitioner presents the following facts. Petitioner, a subsidiary of the Sun Company, Inc. ("Sun"), operates an interstate network of pipelines, regulated by the Federal Energy Regulatory Commission (FERC), located partially within the State of New York. The network transports petroleum fuel products which have been refined from crude oil.

The products carried in the section of the network located in New York (the "NY network") over the course of a year include:

(a) Gasoline (85%)
(b) Kerosene (11%)
(c) Fuel Oil/Diesel Fuel (4%)

The NY network originates in Pennsylvania. Approximately 75% to 85% of the products transported in the NY network have been produced from crude oil by Sun Company, Inc. (R&M) ("Sun R&M") in its local refining operation. Sun R&M purchases the crude oil used in its refining operation from third parties who have extracted the crude oil.

Approximately 58% of the products in the NY network are owned by Sun R&M. These products as well as the remaining 42% of the products carried in the network are transported on a common carrier basis subject to FERC regulation.

The two major branches of the NY network terminate in Rochester and Buffalo. The majority of the Sun R&M owned products are delivered in these cities to two terminals owned and operated by Sun R&M.

The Sun R&M owned products are temporarily held at the terminals and then loaded into tanker trucks primarily for delivery to retail sites (gasoline stations etc.). With the exception of a negligible portion of the products which might be trucked into Canada, the products are then delivered by the tankers to retail sites located within New York.

All of the Sun R&M owned and manufactured gasoline products (or approximately 49% of the total products handled in the network over the course of a year) are in pre-retail form when they are delivered from the NY network to the terminals. The products will be subject to at least one additional stage of processing at the point of delivery to the tanker trucks with the blending of detergent additives to produce "name brand" grades of retail gasoline. This same process of addition and blending is accomplished at the point of delivery to an additional indeterminate portion, equal to at least one or two percent of the total products in the NY network, of the gasoline products.

In addition, a significant, though indeterminate, portion of the gasoline products are also subject to an additional stage of processing (in this case inter-mixture) at the point of retail sale in order to produce additional intermediate retail grades of gasoline. There are four grades of gasoline products in the NY Network (86, 87, 93 and 94 octane). The Sun R&M owned products have been refined to 86 and 94 octane grades and will be sold at retail in 86, 87, 89, 92, 93 and 94 grades. The intermediate grades are produced by blending the 86 and 94 octane products at the pump.

Some portion of the remaining products (diesel fuel and kerosene) are subject to similar intermixture at the point of delivery to the tanker trucks in order to produce retail winter grades of diesel fuel. Some portion of the kerosene in the NY network is blended with a portion of the product intended for use as diesel fuel at the point of delivery to lower the freezing point in order to produce winter grade. Traditional fuel oil and diesel fuel are chemically identical fractional products of crude oil. Red dye is added to that portion of the product intended for use as fuel oil prior to its leaving the refinery.

The NY network is serviced by four pumping stations located in New York (at Corfu, Caledonia, Cohocton and Corning) which, in concert with stations located on the Pennsylvania portion of the network, power the movement of the products from the refining sites to the terminals where approximately forty-nine percent (49%) of the contents are subject to one or more additional stages of processing prior to transfer or sale to another.

These pumping stations are all remote, unmanned facilities, and one hundred percent of the electricity consumed in their operation is devoted to movement of the products.

Approximately forty-nine percent of the network's operations are devoted to the transport of manufactured gasoline products creating conditions necessary to the production of "name-brand", retail grades of gasoline. The network transports the products after the initial stage of production has begun but prior to the completion of the final preparation of the products for sale.

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:

* * *

(12) Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property,...by manufacturing, processing,...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.

* * *

(c) 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,...for sale, by manufacturing, processing,...refining, mining, 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.

Section 528.13(c) of the Sales and Use Tax Regulations which pertains to exempt machinery and equipment provides, in part, as follows:

(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 causal 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 528.22(c) of the Sales and Use Tax Regulations which pertains to exempt fuel, gas, electricity, refrigeration and steam provides, in part, as follows:

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

(i) operate exempt 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.

In this case, Petitioner is a Federal Energy Regulatory Commission (FERC) regulated interstate network of pipelines which, as noted in the statement of facts, transports product on a common carrier basis subject to FERC regulation. Approximately 58% of the product transported is owned by Petitioner's parent (Sun R & M) and the remaining portion by others. The primary function of Petitioner's pipeline and pumping stations is to transport product. The transportation of Sun R & M owned product to Sun R & M terminals by Petitioner's pipeline is ancillary to and not a continuation of the production process. This conclusion is supported by the decision in Matter of St. Joe Resources Co. v. New York State Tax Comm. 72 NY2d 943, revg on the dissenting opn below 132 AD2d 98, where the court upheld the taxability of trucks used to transport ore from a mine to a mill over public roads, on the grounds that the transportation was not part of production. See also Envirogas, Inc. v. Chu, 114 AD2d 38, affd 69 NY2d 632 and Matter of Tenneco Inc., State Tax Commission, January 17, 1986, (TSB-H-86(86)S), which hold that pipeline transmission of natural gas is ancillary to production.

The last sentence of section 1115(a)(12) of the Tax Law exempts pipeline and other 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." (Emphasis added) This provision does not apply to the NY network. Sun R&M purchases the crude oil used in its refining operation from third parties who have extracted the crude oil. The extracted crude oil, therefore, has been sold before Sun R&M's refined petroleum fuel products enter the NY network. Accordingly, for purposes of the last sentence of section 1115(a)(12), the NY network is not used directly and predominantly in production.

Since the transportation of fuel products in Petitioner's pipeline is ancillary to the production process, the pumping stations which power the movement of the products through the pipeline are not used directly in production. See 20 NYCRR 528.13(c)(2). Thus, the electricity used to power the pumping stations is not used directly and exclusively in the production of tangible personal property for sale and, therefore, does not fall within the scope of the exemption under section

1115(c) of the Tax Law. Accordingly, Petitioner's purchases of electricity to operate the four pumping stations located within New York State are subject to sales and use taxes.

DATED: February 5, 1996

/s/
DORIS S. BAUMAN
Director
Technical Services Bureau

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