

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

TSB-A-95 (9) C
Corporation Tax
May 19, 1995

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C950104A

On January 4, 1995, a Petition for Advisory Opinion was received from Long Island Lighting Company, 175 East Old Country Road, Hicksville, New York 11801.

The issues raised by Petitioner, Long Island Lighting Company, are whether the sales proceeds received from a specified sale leaseback transaction (1) are taxable under section 186 of the Tax Law and (2) are taxable under section 186-a of the Tax Law only to the extent that such proceeds exceed Petitioner's undepreciated cost.

Petitioner is a publicly-held utility corporation subject to the supervision of the New York State Department of Public Service (the "PSC"). As such, Petitioner is required to pay taxes on its gross earnings and gross income pursuant to sections 186 and 186-a of the Tax Law, respectively.

Petitioner is considering entering into one or more sale-leaseback transactions whereby it would sell certain equipment (the "Equipment") to a group of investors (the "Purchaser-Lessors"), who would then lease the Equipment back to Petitioner for a stated period. Although the benefit to Petitioner is essentially a reduction in financing costs (*i.e.*, the proceeds from the sale of the Equipment), the transaction would be intended to qualify as a "true lease" for Federal income tax purposes.

The equipment under consideration for possible sale-leaseback transactions includes various items of machinery and equipment used in the production, transmission and distribution of electricity and natural gas. For example, such equipment might include an undivided interest in one of Petitioner's electricity generating plants. Alternatively, such equipment might include certain diesel generators manufactured by Colt Industries, together with associated spare parts, accessories and related equipment and structures and would likely include other items that have not yet been identified. Some of the equipment under consideration is affixed to structures or to the ground and thus constitutes real property for New York State Real Property Tax purposes but is depreciable as personal property for Federal income tax purposes.

It is contemplated that Petitioner would sell the Equipment to the Purchaser-Lessors. The Purchaser-Lessors would lease the Equipment back to Petitioner for a term of years, after which the right to possess and use the Equipment would revert to the Purchaser-Lessors. (The terms of the transaction may give Petitioner the right to purchase the Equipment at the end of the lease term or to extend the term of the lease.) Petitioner would pay monthly or quarterly rent during the lease term.

For Federal income tax purposes, Petitioner would recognize gain or loss on the sale equal to the difference between its cost for each item of property sold, adjusted for depreciation and other adjustments to basis, and the sales price. Petitioner would deduct the rental payments as made. The Purchaser-Lessors, as the owners of the Equipment, would be entitled to depreciation deductions with respect to the Equipment.

Section 186 of the Tax Law imposes a franchise tax upon every corporation, joint-stock company or association formed for or principally engaged in the business of supplying water, steam or gas, when delivered through mains or pipes, or electricity, "for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this state"

When section 186 of the Tax Law was enacted, it provided for a franchise tax measured by "gross earnings from all sources within this state" In 1907, the Legislature amended section 186 by providing a statutory definition of gross earnings. "Gross earnings" is defined as "all receipts from the employment of capital without any deduction".

The definition of gross earnings was added to overcome the effect of a 1906 New York State Appellate Division decision holding that in order to arrive at taxable "gross earnings", the cost of raw materials used in producing the utility service had to be deducted from the company's gross receipts. (See People ex rel Brooklyn Union Gas Co. v Morgan, 114 App Div 266, affd 195 NY 616). "The statute provides for taxing 'gross earnings from all sources' and adds that that means 'all receipts from the employment of capital without deduction' we must regard the law as classifying with earnings all receipts from the use of capital." (People ex rel Westchester Lighting Co. v Gaus, 199 NY 147, 150)

In 1969, the New York State Court of Appeals stated that "the 1907 amendment [of section 186] did not contemplate a substitution of 'capital', or 'gross receipts' for 'gross earnings' as the basis for taxation. It merely sought to include that portion of capital which the Brooklyn Union Gas Co. case [supra] required to be deducted from 'gross earnings' to arrive at the proper basis. This is only that portion of 'gross earnings' which represents the 'employment of capital' to manufacture, distribute and sell various public utility services." (Matter of Consolidated Edison Co. of NY v State Tax Commission, 24 NY2d 114, 119). In the Consolidated Edison Co. case, the court determined that (assuming there was no gain on the transactions) the proceeds received by the company for property damage and insurance claims and from the sale of capital assets no longer employed in its business, consisting of real property, scrap and used machinery, are amounts realized from the destruction or confiscation of capital, not from the employment of capital.

Based on legislation and the decisions of the courts, the gain, rather than the entire proceeds, on the sale of real or tangible personal property that is used in a taxpayer's business but is not held for sale to the taxpayer's customers is a receipt from the employment of capital, and as such, the gain constitutes gross earnings under section 186 of the Tax Law. The statute states that no deductions from gross earnings are allowed. Therefore, for purposes of section 186 of the Tax Law, the basis for computing the gain on the sale of such real or tangible personal property is the original cost of such property, without the deduction of depreciation or expenses incurred in making the sale that is

attributable to such property. The gain is determined by subtracting from the receipts from the sale of the property, the original cost of the property. In addition, when the sale of such real or tangible personal property results in a loss, rather than a gain, such loss may not be deducted from the taxpayer's other gross earnings.

Herein, the gain, rather than the entire proceeds, on the sale of Equipment (machinery and equipment used in the production, transmission and distribution of electricity and natural gas, such as an undivided interest in one of Petitioner's electricity generating plants, or certain diesel generators manufactured by Colt Industries, together with associated spare parts, accessories and related equipment and structures) is a receipt from the employment of capital and as such, the gain constitutes gross earnings under section 186 of the Tax Law. When determining whether there is a gain from the sale of such Equipment for purposes of section 186 of the Tax Law, depreciation and other expenses attributable to such Equipment is not deducted from the original cost. The gain is determined by subtracting from the receipts from the sale of the equipment, the original cost of the equipment. If the sale of such Equipment results in a loss, such loss may not be deducted from Petitioner's other gross earnings.

Section 186-a of the Tax Law provides for a tax on the furnishing of utility services that is equal to three and one-half percent of the gross income of a utility that is subject to the supervision of the PSC. Gross income, as defined in section 186-a.2(c) of the Tax Law, consists of the following elements:

1. receipts from any sale made or service rendered for ultimate consumption or use by the purchaser in New York State;
2. profits from the sale of securities;
3. profits from the sale of real property;
4. profits from the sale of personal property (other than inventory);
5. receipts from interest, dividends, and royalties, derived from sources within New York State; and
6. profits from any transaction (except sales for resale and rentals) within New York State whatsoever.

Accordingly, under section 186-a of the Tax Law, a utility subject to the supervision of the PSC includes in gross income the profits from the sale of real property and the profits from the sale of personal property, other than inventory. For purposes of section 186-a of the Tax Law, the basis for computing the profit on the sale of real or personal property, other than inventory, is the original cost of such property, without the deduction of depreciation that is attributable to such property. The gain is determined by subtracting from the receipts from the sale of the property, the original cost of the property along with the expenses incurred in making the sale. If the sale of such real or personal property results in a loss, rather than a profit, such loss may not be deducted from the taxpayer's other gross income.

TSB-A-95 (9) C
Corporation Tax
May 19, 1995

Herein, the profit from the sale of Petitioner's Equipment is required to be included in gross income for purposes of section 186-a of the Tax Law. When determining whether there is a profit on the sale of such Equipment for purposes of section 186-a of the Tax Law, depreciation attributable to such Equipment is not deducted from the original cost. The gain is determined by subtracting from the receipts from the sale of the equipment, the original cost of the equipment along with the expenses incurred in making the sale. If the sale of such Equipment results in a loss, such loss may not be deducted from Petitioner's other gross income.

DATED: May 19, 1995

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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