

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-05(10)S
Sales Tax
April 4, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S001018A

On October 18, 2000, the Department of Taxation and Finance received a Petition for Advisory Opinion from RSM McGladrey, Inc., 800 Liberty Building, Buffalo, NY 14202-3508. Petitioner, RSM McGladrey, Inc., provided additional information pertaining to the Petition on November 10, 2003.

The issues raised by Petitioner are:

1. Whether the electric utilities consumed by Company B, a manufacturer tenant leasing a building from Company A, and those consumed by Company C, a manufacturer tenant subleasing a portion of the building from Company B, qualify for exemption from sales tax.
2. Whether Company B, as tenant of the property owner Company A and sub-lessor to tenants Company C and Company D, may purchase electricity without the payment of sales tax for resale to its tenants.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Company A, which is not registered for sales tax purposes, owns real property that it leases to Company B. Company B uses a portion of the leased property in its business activities. Company B in turn sub-leases a portion of the space to Company C and Company D. The real property leased is a 125,000 square foot building. Companies B and C are both manufacturers and Company D is a medical equipment supplier. A single meter from the utility company measures the total electrical consumption by all of the tenants at such facility. A sub-meter was installed which measures the electrical consumption by Company C.

The utility bill for the entire building is in the name of Company A and sales tax is charged by the utility company on the full electrical consumption of the entire leased space. Company B pays the amount of the entire electric bill, including the amount of sales tax as charged by the utility company to Company A, without mark up. Company B bills Company C for its utility usage as determined by the separate sub-meter. After deducting the sub-metered usage of Company C, Company B bills Company D for its estimated utility consumption based upon the square footage of Company D's rented space.

The terms of the lease agreement between Company B and Company D provide that the rent for the space Company D is occupying shall be a monetary amount plus the proportionate share of Company D's cost of insurance, maintenance and utilities related to ownership, operation and leasing of the demised premises.

Applicable law and regulations

Section 1105 of the Tax Law provides, in part:

On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax . . . upon:

(a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

(b) (1) The receipts from every sale, other than sales for resale, of the following:
(A) gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature

Section 1115(c)(1) of the Tax Law provides:

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, gas, electricity, refrigeration or steam, for sale, by manufacturing, processing, assembling, generating, refining, mining or 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 of this article.

Section 1132(c)(1) of the Tax Law provides, in part:

For the purpose of the proper administration of this article and to prevent evasion of the tax hereby imposed, it shall be presumed that all receipts for property or services of any type mentioned in subdivisions (a), (b), (c) and (d) of section eleven hundred five . . . are subject to tax until the contrary is established, and the burden of proving that any receipt is . . . not taxable hereunder shall be upon the person required to collect tax or the customer. Except as provided in subdivision (h) or (k) of this section, unless (i) a vendor, not later than ninety days after delivery of the property or the rendition of the service, shall have taken from the purchaser a resale or exemption certificate in such form as the commissioner may prescribe . . . or (ii) the purchaser, not later than ninety days after delivery of the property or the rendition of the service, furnishes to the vendor: any affidavit, statement or additional evidence, documentary or otherwise, which the commissioner may require demonstrating that the purchaser is an exempt organization described in section eleven hundred sixteen, the sale shall be deemed a taxable sale at retail. . . . Where such a resale or exemption certificate or such an affidavit, statement or additional evidence has been furnished to the vendor, the burden of proving that the receipt, amusement charge or rent is not taxable hereunder shall be solely upon the customer. . . .

Section 526.8 of the Sales and Use Tax Regulations provides, in part:

Tangible personal property. (a) Definition. The term *tangible personal property* means corporeal personal property of any nature having a material existence and perceptibility to the human senses. . . .

* * *

(b) Gas, electricity, refrigeration and steam are not considered tangible personal property for the purpose of the tax imposed on utility services. . . .

(c) Tangible personal property does not include:

(1) real property; . . .

Section 528.22 of the Sales and Use Tax Regulations provides, in part:

(a) Exemption. (1) Fuel, gas, electricity, refrigeration and steam and gas, electric, refrigeration and steam service of whatever nature is exempt from the sales and compensating use tax when used directly and exclusively in the production, for sale, of tangible personal property, gas, electricity, refrigeration or steam by one of the following endeavors:

(i) manufacturing;

(ii) processing;

(iii) assembling;

(iv) generating;

(v) refining;

(vi) mining; or

(vii) extracting.

(2) Fuel, gas, electricity, refrigeration and steam and like services used or consumed in the heating, cooling or lighting of buildings or in the preparation of food and drink subject to tax imposed by section 1105(d) of the Tax Law or in the storage of tangible personal property, are subject to the sales tax.

* * *

(4) An exempt use certificate (Form ST-121) is used to make purchases eligible for this exemption, without payment of sales tax. (See section 532.4(e) of this Title.)

* * *

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

- (i) operate exempt production 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.

Example 1: A welding shop produces stainless steel railings. In order to carry out the production, the railings must be welded in an inert atmosphere. The welding shop purchases an inert gas which is used to create the inert atmosphere. The gas is used directly in production.

(3) (i) *Exclusively* means that the fuel, gas, electricity, refrigeration and steam and like services are used in total (100%) in the production process.

(ii) Because fuel, gas, electricity, refrigeration and steam when purchased by the user are normally received in bulk or in a continuous flow and a portion thereof is used for purposes which would make the exemption inapplicable to such purchases, the user may claim a refund or credit for the tax paid only on that portion used or consumed directly and exclusively in production.

(iii) In the alternative, an exempt use certificate (Form ST-121) may be used, providing full liability is assumed for any State and local tax due on any part of purchases used for other than the exempt purposes described in subdivision (a) of this section. The taxable portion of these purchases is to be reported as a "purchase subject to use tax" on a sales and use tax return required to be filed with the Department of Taxation and Finance.

(iv) The user must maintain adequate records with respect to the allocation of fuel, gas, electricity, refrigeration and steam used directly and exclusively in production and for nonexempt purposes.

(v) For the purpose of substantiating the allocation of fuel, gas, electricity, refrigeration and steam and like services used directly and exclusively in production from that used for nonexempt purposes, the user must, when claiming a refund or credit, submit an engineering survey or the formulae used in arriving at the amounts used in an exempt manner.

Example 2: A producer of electricity purchases fuel oil in bulk. The oil is used both to create steam to operate turbines which produce electricity and to heat buildings. The oil used for steam to operate the turbines is used directly in production while the oil used to heat buildings is not used in production.

Example 3: A manufacturing plant purchases electricity to power its production machinery and also to light its buildings. Only the electricity used to power the production machinery is used directly in production.

Example 4: A food processor packages and ships t.v. dinners to a flash freezing plant to process the dinners. The flash freezing of the dinners is refrigeration used in production. The frozen dinners are then moved to a refrigerated warehouse for storage to await sale and delivery. The refrigerated storage is not refrigeration used in production.

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The utility bill is in the name of Company A and it includes sales tax on the full electrical consumption of the entire leased space. Company B pays the entire electric bill, including sales tax. A sub-meter is installed which measures the electrical consumption by Company C. Company B bills Company C for the actual utilities consumed by Company C as measured by the separate meter. Company B bills Company D for its estimated utility consumption based on the square footage of the rented space.

Section 1105(b) of the Tax Law imposes the sales tax on utility services when furnished as a separate identifiable sales transaction. If individual tenants have their utility consumption accurately measured through the use of sub-meters so that the landlord's charges to the tenants for utility consumption reflect the tenant's actual usage, the landlord is making a separate sale of such utility service, and the landlord must register as a vendor for sales tax purposes. Unless the sale of the utility service is otherwise exempt, the landlord must collect and remit tax on its charges to the tenants for the utility services billed to such tenant. See *Mutual Redevelopment Houses, Inc. v Roth*, 307 AD 2d 422 [2003].

If the electrical consumption by individual tenants is not separately metered or otherwise accurately measured and the landlord bills the tenants for their share of the electricity usage based upon the square footage rented or some other method for determining the tenants' pro rata share of the utility costs, such charges are in the nature of additional rent. The landlord is

considered to be providing the utility service as an incident to the lease of real property and there is no separate sale of such service to the tenant. In such case, the charges to the tenant are not subject to sales tax as the sale of a utility service and the landlord is responsible for paying sales tax on its purchases of the utility service. See *Ascension Sheet & Metal Fabrication, Inc.*, Adv Op Comm T & F, September 28, 2004, TSB-A-04(24)S.

Under the facts set forth in this Advisory Opinion, a single meter determines the total amount of electric service provided to the entire building by the utility company. Company B's payment of the total bill (including sales tax) for the electric service provided to the building by the utility company is clearly a separate purchase of electric services subject to the sales tax imposed by section 1105(b) of the Tax Law. If Company B is paying such amount to Company A directly or is paying Company A's bill directly to the utility company (which payment releases Company A from its debt to the utility company), the payments represent a purchase by Company B of the electric services from Company A.

As a seller of electric services subject to tax, the landlord (Company A) should be registered as a vendor pursuant to section 1134 of the Tax Law and is required to collect the sales tax due on its sales of electric service to Company B. Assuming that all of the electricity purchased by Company A is resold to Company B, Company A may purchase such electricity from the utility company exempt from sales tax as a purchase for resale. Company A should furnish the utility company with a properly completed *Resale Certificate* (Form ST-120) when making exempt purchases for resale.

Company B's purchases of electricity from Company A are subject to sales tax except to the extent that such electricity is used or consumed in the production of tangible personal property for sale or resold, as discussed below.

Company B accurately determines Company C's individual usage of electricity by the use of the separate sub-meter. Company B bills Company C for such usage based upon the sub-metered consumption. This constitutes a sale of electric service by Company B to Company C and such sale is subject to sales tax. Company B is, therefore, if not already registered for sales tax purposes by virtue of its sales of tangible personal property as a manufacturer, required to be registered to make sales of electricity to Company C.

The terms of the lease agreement between Company B and Company D provides that the rent for the space occupied by Company D is a fixed monetary amount plus a proportionate share of the cost of insurance, maintenance and utilities related to ownership, operation and leasing of the demised premises. Company D's electric consumption is not accurately determined by meter or otherwise, and Company D is not billed for its electric usage. Accordingly, the charges by Company B as sub-lessor to its sub-lessee, Company D, are not subject to sales tax. The pro rata share of electric service based upon Company D's proportionate square footage of leased space which is billed to Company D is considered to be incident to Company D's lease of real property and is not a separately identifiable sale of electric service. Those charges are in the nature of

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additional rent and are not charges for the separate sale of a taxable service. See *Debevoise & Plimpton v New York State Taxation & Finance*, 80 NY2d 657, 661; *Empire State Building Co. v New York Dept. of Taxation & Finance* 81 NY2d 1002 affg 185 AD2d 201. Therefore, the electric services provided by Company B to Company D are not purchased by Company B for resale.

Section 1115(c) of the Tax Law provides for an exemption from sales and use tax on purchases of electricity of whatever nature for use or consumption directly and exclusively in the production of tangible personal property for sale by manufacturing. Company B has purchased electricity some of which is consumed by Company B in the production of tangible personal property for sale by Company B. To the extent that Company B can produce records substantiating that it purchased electricity which was used by it directly and exclusively in the production of tangible personal property for sale, Company B is eligible for the exemption from sales and use tax with respect to such usage. Similarly, Company C as a manufacturer may be eligible to claim an exemption with respect to the portion of the electricity purchased by it from Company B to the extent such electricity is consumed directly and exclusively by Company C in the production of tangible personal property for sale. See section 528.22 of the Sales and Use Tax Regulations.

Company D, as a supplier of medical equipment, does not appear to be engaged in the production of tangible personal property for sale. Thus, the purchase of electricity by Company B for consumption by its sub-lessee, Company D, will not qualify for the exemption provided in section 1115(c) of the Tax Law for utilities consumed in the production of tangible personal property for sale.

Electricity consumed by Company B, Company C and Company D in the general heating, lighting, ventilation and operation of the building is not considered to be consumed directly and exclusively in the production of tangible personal property for sale and the purchase of electricity consumed in this manner is not eligible for exemption from tax. See *MOD-PAC Corp.*, Adv Op St Tax Comm, June 12, 1985, TSB-A-85(20)S; *Weber-Knapp Company*, Adv Op St Tax Comm, May 29, 1985, TSB-A-85(15)S; *Fancher Chair Co., Inc.*, Adv Op St Tax Comm, March 15, 1983, TSB-A-83(11)S. Charges by Company B to Company C for electricity so consumed, and charges paid by Company B to Company A for such electricity, are subject to sales tax.

Since Company B consumes a portion of the electricity supplied to the building and does not resell the portion of the electricity supplied to and consumed by Company D, Company B may not purchase the electricity supplied to the building tax exempt as a purchase for resale. However, Company B does in fact resell a portion of the electricity to Company C and uses a sub-meter to separately determine Company C's usage. Company B, in filing its sales and use tax return, may take a credit for sales tax it paid to Company A with respect to the electricity sub-metered and resold by it to Company C, and may also take a credit for sales tax paid on

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electricity which it uses directly and exclusively in the production of tangible personal property for sale.

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