

**New York State Department of Taxation and Finance
Office of Counsel**

TSB-A-16(25)S
Sales Tax
August 29, 2016

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. S130221A

The Department of Taxation and Finance received a Petition for Advisory Opinion from [REDACTED]. “Petitioner” asks whether charges for natural gas used and converted by a fuel cell to electricity are eligible for the sales tax exemption for gas and electricity used directly and exclusively in production. We conclude that Petitioner’s purchase of fuel and utilities to power a fuel cell will be exempt from sales tax if used directly and exclusively in the production process.

Facts

Petitioner operates a chain of retail supermarkets. Petitioner leases a fuel cell for use at one of its stores. This building is powered mainly by fuel cell technology using natural gas. Petitioner states that there are three sources of energy at this particular store: a natural gas account; the fuel cell account (400 kilowatt hours); and electricity supplied by a third-party supplier.

Petitioner purchases natural gas from a third party supplier; the natural gas is then converted by the fuel cell to kilowatt hours of electricity. The 400 KWH produced through the fuel cell is incorporated with electricity separately obtained through a third-party supplier. Petitioner states that it is almost impossible to determine whether a particular fuel source is powering particular equipment in the building.

Analysis

Petitioner is engaged in certain production activities at its store where the fuel cell is in use (e.g., baking, cutting and packaging meat, slicing deli meats and cheeses to order, etc.). Petitioner sells these items to its customers. Accordingly, Petitioner is engaged in the production of tangible personal property for sale.

In order to qualify for exemption, Petitioner’s fuel cell and the parts, tools and supplies used in conjunction with such fuel cell must be used “directly and predominantly” in the production of tangible personal property for sale. “Directly” means that the equipment, during the production phase of a process, must: “(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 of the product to be sold; or (iv) be used to place the product to be sold into the package in which it will enter the stream of commerce.” 20 NYCRR § 528.13(c)(1). Machinery and equipment to create energy used in the production process also can qualify as “directly” used in production. See *Matter of Niagara Mohawk Power Corp. v. Wanamaker*, 286 AD 446 (4th Dep’t 1955); *Matter of Deco Builders, Inc.*, Tax Appeals Tribunal, May 9, 1991. Petitioner’s fuel cell would meet the “directly” requirement if the fuel cell creates the energy used to power equipment used in production.

“Predominantly” means more than 50%. *See* 20 NYCRR § 528.13. In order to satisfy the “predominantly” requirement, the machinery or equipment must be used more than 50% during the production process. If machinery or equipment that is used in the production process is also used 50% or more in the administrative or distribution phase, it would not qualify for the production exemption. *See* 20 NYCRR § 528.13(c)(4). Petitioner’s fuel cell would meet the “predominantly” requirement if more than 50% of the use of the fuel cell provides the energy used to power production equipment.

Tax Law § 1115(c) also exempts from sales tax gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service used “directly and exclusively in the production of tangible personal property, gas, electricity, refrigeration or steam, for sale, by manufacturing, processing, assembling, generating, refining, mining, extracting, farming, agriculture, horticulture or floriculture....” “Directly” means that such energy sources and services “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.” 20 NYCRR § 528.22(c). “Exclusively” means that all of such energy sources or services must be used in the production process. *See id.*

Because energy sources and services are typically received in bulk, which would make the exemption inapplicable if any of such energy sources or services were used for non-production purposes (e.g., providing electricity for lightning), a purchaser that uses a portion of such energy sources and services in production is permitted to claim a refund or credit for the portion of those energy sources or service used directly and exclusively in production. *See* 20 NYCRR § 528.22(c)(3). However, the purchaser must maintain adequate records with respect to the allocation of energy sources and services used for production and non-production purposes and must submit an engineering survey or the formulae used to arrive at such allocation. *See id.*

As noted above, Petitioner is engaged in certain production activities at its store that uses a fuel cell. Therefore, purchases of natural gas that are converted by the fuel cell to electricity will be exempt from sales tax to the extent they are used directly and exclusively in the production process. Petitioner is required to employ a method (e.g. engineering study) to allocate the portion of energy used in production processes. That method will be subject to review by the Department. *See* Publication 852 *Sales Tax Information For: Manufacturers, Processors, Generators, Assemblers, Refiners, Miners and Extractors, and Other Producers of Goods and Merchandise*; TSB-M-82 (25)(S) -- Determining Electricity Used in the Production of Tangible Personal Property for Sale. The portion of Petitioner’s utility purchases that are not used or consumed in an exempt manner are subject to sales tax.

DATED: August 29, 2016

/S/
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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately

describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.