

UTILITIES - PROBLEM AREAS, ANALYSES AND DETERMINATIONS

The following questions, resulting from a recent field audit, are presented below with accompanying analyses and determinations.

1. Where does production start in a coal-fed boiler to generate electricity?

Production, according to section 528.13 of the Sales and Use Tax Regulations, starts with the handling and storage of raw materials at the plant site. Raw materials, are materials from which a final product is made. Therefore, coal, normally regarded as a fuel, is the raw energy material from which electricity is produced, and production starts with the handling and storing of this raw material.

This is consistent with the court determination in *The Matter of Niagara Mohawk Corporation vs. George W. Wanamaker* wherein Erie County under their pre-1965 Tax Law said sales tax was due on non-productive coal and ash handling equipment such as the crane and car dumper which unload incoming coal; the conveyor belts which move it along toward the boiler; the crushers, sprayers, metal detectors which process the coal as it moves along the belts; and the slag lines and pumps and narrow gauge railway which carry the ash and slag from the boiler. The Appellate Division of the Supreme Court in their decision for the taxpayer stated:

"There is no simple test of what constitutes 'consumption directly and exclusively*' in the production' of electricity. The basic questions are the following: (1) Is the disputed item necessary to production? (2) How close, physically and casually, is the disputed item to the finished product? (3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?"

"After much study of the matter, we have concluded that the purchase or use of the coal and ash handling equipment is not taxable. That equipment is as essential to production as the generator itself. A serious breakdown in it would quickly stop or impair the output of electricity. We are further impressed with the synchronization and integration of the boiler and coal and ash equipment. The one could not operate without the other. Working together they make up a system which supplies the power from which electricity is produced It is not practical to divide a generating plant into 'distinct' stages. It was not built that way, and it does not operate that way. The words 'directly and exclusively'* should not be construed to require the division into theoretically distinct stages of what is in fact continuous and indivisible.... "

A review of the blue print submitted during audit indicated all incoming coal is weighed at either a truck weighing station or a railroad car weighing station. It is after this point that production would be regarded as starting, since weighing of coal prior to placement into storage is considered to be an administrative activity (part 528.13(b)(3)). If the materials had been unloaded and placed in storage for production without weighing, then the unloading would have been the beginning of production.

*Effective September 1, 1974, Section 1115(a)(12), commonly known as the manufacturer's exemption, was amended by changing the word "exclusively" to "predominantly" with regard to the use of machinery, equipment, parts and tools.

Fuels and utilities were not included in this change and remain taxable unless used directly and exclusively in production.

2. In pollution control equipment, are monitors or analysers of water or air considered to be used directly and exclusively in production?

Waste treatment equipment to prevent water or air pollution is considered to be used directly and predominantly in production (Sales and Use Tax Regulation 528.13(d)). Waste treatment equipment would include the monitors or analysers that are built into a system designed for the prevention of water or air pollution and that are essential to the operation of the waste treatment equipment.

3. Are contractors and municipalities performing a service which results in a capital improvement to real property when cutting holes and later replacing the pavement in streets, roads and sidewalks?

The status of the work performed by the contractors and municipalities is dependent upon the service being performed which necessitated the cutting of the holes, in the first place. If this work is deemed a capital improvement (such as the relocation of gas mains or a new gas service installation), so is the work of the contractor or municipality. If the work is deemed a maintenance or repair (such as the installation of inserts, valves, meters, regulators, drips, straps, seals and protective devices in existing gas services), so is the work of the contractor or municipality.