

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
PENN YORK ENERGY CORPORATION	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Periods March 1, 1980	:	
through November 30, 1981 and September 1, 1982	:	
through November 30, 1982.	:	DECISION

In the Matter of the Petitions	:	DTA Nos. 801098,
of	:	801227, 807595,
NATIONAL FUEL GAS SUPPLY CORPORATION	:	806344 & 806850
for Redetermination of Deficiencies or for	:	
Refund of Corporation Tax under Article 9 of	:	
the Tax Law for the Years 1980 through 1986.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on March 14, 1991 with respect to petitions filed by Penn York Energy Corporation, 10 Lafayette Square, Buffalo, New York 14203 for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the periods March 1, 1980 through November 30, 1981 and September 1, 1982 through November 30, 1982.

Petitioner National Fuel Gas Supply Corporation, 10 Lafayette Square, Buffalo, New York 14203 filed an exception to the determination of the Administrative Law Judge issued on March 14, 1991 with respect to its petitions for redetermination of deficiencies or for refund of corporation tax under Article 9 of the Tax Law for the years 1980 through 1986. Petitioners appeared by Phillips, Lytle, Hitchcock, Blaine & Huber, Esqs. (James A. Locke, Esq. and Martha L. Salzman, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel).

Both parties filed briefs on the respective exceptions. Oral argument, at the request of both parties, was held on April 16, 1992.

After reviewing of the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioner Penn York Energy Corporation's out-of-state purchases of natural gas, used in-state as "base gas," were properly subject to compensating use tax under Tax Law § 1110.

II. Whether gross receipts from petitioner National Fuel Gas Supply Corporation's sales of "base gas" to Penn York Energy Corporation were properly included in Supply's "gross operating income" for purposes of the tax on utility services imposed under Tax Law § 186-a.

III. Whether the Division of Taxation properly included a portion of the gross receipts from petitioner National Fuel Gas Supply Corporation's sales of natural gas to National Fuel Gas Distribution Corporation in Supply's "gross operating income" for purposes of Tax Law § 186-a.

IV. Whether petitioner National Fuel Gas Supply Corporation has shown reasonable cause and an absence of willful neglect such that penalties assessed herein should be abated.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Prior to commencement of the hearings in these matters, the duly authorized representatives of the parties entered into three stipulations of facts. These stipulations, referenced to the appropriate file numbers, and modified only so as to omit specific references to various exhibits included therewith, and to include the respective dates of the relevant statutory notices, are set forth hereinafter.

MATTER OF PENN YORK ENERGY CORPORATION

STIPULATED FACTS IN RESPECT OF FILE NOS. 801098 AND 801227

Petitioner Penn York Energy Corporation ("Penn York") is a New York corporation engaged in a natural gas storage business, with its principal office and place of business at 10 Lafayette Square, Buffalo, New York 14203.

During the period March 1, 1980 through November 30, 1981 (the "audit period"), petitioner was engaged in the business of storing natural gas in New York State for gas utility companies.

As a result of an audit of petitioner's books and records, the Division of Taxation (hereinafter the "Division") issued notices of determination and demands for payment of sales and use taxes due ("notices"), asserting, by notice dated February 20, 1984, additional sales tax due of \$1,045,652.58 for the period March 1, 1980 through February 28, 1981 and, by notice dated May 30, 1984, \$1,571,563.00 for the period March 1, 1981 through November 30, 1981, plus interest accrued to the date of the notices. Petitioner timely filed petitions for redetermination of the asserted deficiencies. A pre-hearing conference was held in May 1985.

Petitioner operates three storage facilities in New York State, the East and West Independence and Beech Hill storage sites, all of which are located in the county of Allegheny, New York. At the facilities, petitioner stores natural gas for approximately 20 gas utility companies which operate in the northeast section of the United States.

During the audit period, petitioner purchased natural gas from National Fuel Gas Supply Corporation ("Supply") and other natural gas supply companies for use as "base gas" at the East and West Independence facilities.

In 1976, Supply and National Fuel Gas Storage Corporation ("Storage"), petitioner's predecessor in interest, applied to the Federal Power Commission ("FPC") to obtain FPC's approval of the development of the East and West Independence storage facilities and the construction of 17.7 miles of pipeline in Allegheny County, New York and Potter County, Pennsylvania to connect the storage facilities to interstate gas transmission facilities near Supply's

Ellisburg Compressor Station located near Ellisburg, Pennsylvania in Potter County, Pennsylvania.

In connection with seeking FPC approval of the development of the East and West Independence storage facilities and construction of the pipeline, Supply entered into Precedent Agreements with Central Hudson Gas & Electric Corporation, Delmarva Power & Light Company, Elizabethtown Gas Company, Lowell Gas Company, Orange & Rockland Utilities, Inc. and UGI Corporation (collectively, the "Buyers"). Pursuant to the agreements, Supply agreed to seek FPC authorization of the development of the storage facilities. Pursuant to its Precedent Agreement with Supply, each Buyer agreed to sell and deliver base gas to Supply. The Precedent Agreements include a statement that:

"[b]uyer shall be responsible for concluding the necessary arrangements for the transportation of the storage gas between Buyer's distribution system and Seller's [Supply's] Ellisburg Station, Potter County, Pennsylvania."

The Precedent Agreements also contemplate that each Buyer and Supply would enter into an Underground Storage Service Agreement upon Supply's receiving FPC approval of the development of the storage facilities and construction of the pipeline. A "Form of Underground Storage Service Agreement" was included as an exhibit to Supply and Storage's application for FPC approval. Article IV (Delivery Point and Pressures) of the Form of Underground Storage Agreement states that:

"[t]he point of delivery for gas received for Buyer's account by Seller and re-delivered to Buyer for Buyer's account shall be at the pipeline interconnection of Seller's pipeline near the Ellisburg Station of National Fuel Gas Supply Corporation in Potter County, Pennsylvania with the interstate transmission facilities of _____ ('_____')."

In February 1980, Supply filed an abbreviated application with the Federal Energy Regulatory Commission ("FERC") for certificates of public convenience and necessity authorizing the limited term sale of natural gas for resale, limited term use of transportation facilities for direct sale, and related pre-granted abandonments. One of the exhibits to the abbreviated application is

a Base Gas Sales Agreement between Supply (Seller) and Storage (Buyer). Article V (Delivery Point and Pressures) of the Base Gas Sales Agreement states that:

"[t]he Point of Delivery for gas sold and delivered to or for Buyer's account shall be at the pipeline interconnection of Seller's pipeline with the pipeline facilities of Buyer near Ellisburg, Pennsylvania."

On September 15, 1980, FERC issued an order approving the sale and operation of the storage facilities. The order states that:

"[t]he direct sale will be made through Supply Corporation's existing transportation facilities for delivery at the interconnection with Storage Corporation's facilities near Ellisburg, Pennsylvania."

The total tax at issue for the audit period, \$2,617,215.58, is with respect to petitioner's purchases of base gas.

STIPULATED FACTS IN RESPECT OF FILE NO. 807595

Petitioner Penn York is a New York corporation engaged in a natural gas storage business, with its principal office and place of business at 10 Lafayette Square, Buffalo, New York 14203.

During the period September 1, 1982 through November 30, 1982 (the "audit period"), petitioner was engaged in the business of storing natural gas in New York State for gas utility companies.

As a result of an audit of petitioner's books and records, the Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated June 15, 1988, asserting additional sales and use tax due of \$328,730.71 for the period September 1, 1982 through November 30, 1982, plus interest accrued to the date of the notice. Petitioner timely filed a request for conciliation conference which was held on March 9, 1989. The conciliation order dated August 25, 1989 sustained the notice. Petitioner timely filed a petition for redetermination with the Division of Tax Appeals.

On December 6, 1989, a hearing was held before Administrative Law Judge Timothy J. Alston of the Division of Tax Appeals. The hearing concerned petitioner's petition for a redetermination of sales and use tax for the period March 1, 1980 through November 30, 1981 (designated as File Numbers 801098 and 801227) (the "prior case") as well as the petition of

National Fuel Gas Supply Corporation for a redetermination of its corporation franchise tax for the years 1980 through 1986 (designated as File Numbers 806344 and 806850).

The sole issue in this matter (File Number 807595) is the same as the sole issue in the prior case, that is, whether petitioner's purchase and storage of base gas are subject to New York State sales and use tax. In addition, the essential facts in this matter are the same as in the prior case.

Petitioner and the New York State Department of Taxation and Finance hereby agree that the determination of Administrative Law Judge Timothy J. Alston in the prior case shall also be considered the Division of Tax Appeals Administrative Law Judge's determination in File Number 807595. File Number 807595 will be joined in any appeal of the prior case to the Tax Appeals Tribunal, the Third Department of the Appellate Division of the New York State Supreme Court or the New York Court of Appeals.

ADDITIONAL FACT IN THE MATTER OF PENN YORK ENERGY CORPORATION

As previously noted herein, Penn York purchased natural gas in Pennsylvania and, following such purchases, transported such gas out of Pennsylvania and into New York for use as "base gas" at its storage facilities in Allegheny County, New York. "Base gas" is injected into a storage field during its development to build up the pressure necessary to remove other gas, often referred to as "top gas," during a withdrawal cycle.

MATTER OF NATIONAL FUEL GAS SUPPLY CORPORATION

STIPULATED FACTS

Petitioner National Fuel Gas Supply Corporation is a Pennsylvania corporation engaged in a natural gas supply business, with its principal office and place of business at 10 Lafayette Square, Buffalo, New York 14203.

During the period January 1, 1980 through December 31, 1986 (the "audit period"), petitioner was engaged in the business of supplying natural gas to natural gas distributors in western New York State.

As a result of an audit of petitioner's books and records, the Division issued to petitioner notices of deficiency of corporation taxes under Article 9 (section 186-a) of the Tax Law

("notices"), each dated October 15, 1986, for the periods ending December 31, 1980 through December 31, 1983, asserting additional corporation tax due of \$478,003.00, plus penalties and interest accrued to the date of the notices. Petitioner timely filed a petition for redetermination of the asserted deficiencies. A conciliation conference was held on April 20, 1988.

As a result of an audit of petitioner's books and records, the Division issued to petitioner notices for the periods ending December 31, 1984 through December 31, 1986, each dated January 27, 1989, asserting additional corporation tax due of \$54,722.00, plus penalties and interest accrued to the date of the notices. Petitioner timely filed a petition for redetermination of the asserted deficiencies.

During the audit periods, petitioner sold natural gas to National Fuel Gas Distribution Corporation ("Distribution"), a New York corporation. Distribution is engaged in the business of distributing and selling natural gas in western New York State. The total corporation tax at issue with respect to petitioner's "gross operating income" from sales of natural gas to Distribution is \$118,974.00. Of that amount, \$64,252.00 is for the periods ending December 31, 1980 through December 31, 1983 and \$54,722.00 is for the periods ending December 31, 1984 through December 31, 1986.

During the periods ending December 31, 1980 through December 31, 1983, petitioner sold over \$2,400,000,000.00 worth of natural gas to Distribution. During the periods ending December 31, 1984 through December 31, 1986, petitioner sold over \$1,800,000,000.00 worth of natural gas to Distribution.

During the periods ending December 31, 1980 through December 31, 1983, petitioner sold natural gas to Penn York, a New York corporation. Penn York operates three storage facilities in New York State, the East and West Independence and Beech Hill storage sites, all of which are located in Allegheny County, New York. At the facilities, Penn York stores natural gas for approximately 20 gas utility companies which operate in the northeast section of the United States.

During the periods ending December 31, 1980 through December 31, 1983, Penn York purchased natural gas from petitioner and other natural gas supply companies for use as "base gas" at the East and West Independence facilities.

In 1976, petitioner and National Fuel Gas Storage Corporation ("Storage"), Penn York's predecessor in interest, applied to the Federal Power Commission ("FPC") to obtain FPC's approval of the development of the East and West Independence storage facilities and the construction of 17.7 miles of pipeline in Allegheny County, New York and Potter County, Pennsylvania to connect the storage facilities to interstate gas transmission facilities near petitioner's Ellisburg Compressor Station located near Ellisburg, Pennsylvania in Potter County, Pennsylvania.

In connection with seeking FPC approval of the development of the East and West Independence storage facilities and construction of the pipeline, petitioner entered into the Precedent Agreements with Central Hudson Gas & Electric Corporation, Delmarva Power & Light Company, Elizabethtown Gas Company, Lowell Gas Company, Orange & Rockland Utilities, Inc. and UGI Corporation (collectively, the "Buyers"). Pursuant to the agreements, petitioner agreed to seek FPC authorization of the development of the storage facilities. Pursuant to its Precedent Agreement with petitioner, each Buyer agreed to sell and deliver base gas to petitioner. The Precedent Agreements include a statement that:

"[b]uyer shall be responsible for concluding the necessary arrangements for the transportation of the storage gas between Buyer's distribution system and Seller's [Supply's] Ellisburg Station, Potter County, Pennsylvania."

The Precedent Agreements also contemplate that each Buyer and petitioner would enter into an Underground Storage Service Agreement upon petitioner's receiving FPC approval of the development of the storage facilities and construction of the pipeline. A "Form of Underground Storage Service Agreement" was included as an exhibit to petitioner and Storage's application for FPC approval. Article IV (Delivery Point and Pressures) of the Form of Underground Storage Agreement states that:

"[t]he point of delivery for gas received for Buyer's account by Seller and re-delivered to Buyer for Buyer's account shall be at the pipeline interconnection of Seller's pipeline near the Ellisburg Station of National Fuel Gas Supply Corporation in Potter County, Pennsylvania with the interstate transmission facilities of _____ ('_____')."

In February 1980, petitioner filed an abbreviated application with the Federal Energy Regulatory Commission ("FERC") for certificates of public convenience and necessity authorizing the limited term sale of natural gas for resale, limited term use of transportation facilities for direct sale, and related pre-granted abandonments. One of the exhibits to the abbreviated application is a Base Gas Sales Agreement between petitioner (Seller) and Storage (Buyer). Article V (Delivery Point and Pressures) of the Base Gas Sales Agreement states that:

"[t]he Point of Delivery for gas sold and delivered to or for Buyer's account shall be at the pipeline interconnection of Seller's pipeline with the pipeline facilities of Buyer near Ellisburg, Pennsylvania."

On September 15, 1980, FERC issued an order approving the sale and operation of the storage facilities. The order states that:

"[t]he direct sale will be made through Supply Corporation's existing transportation facilities for delivery at the interconnection with Storage Corporation's facilities near Ellisburg, Pennsylvania."

The corporation tax at issue with respect to petitioner's "gross operating income" from sales of base gas to Penn York during the periods ending December 31, 1980 through December 31, 1983 is \$413,751.00.

***ADDITIONAL FACTS IN THE MATTER OF
NATIONAL FUEL GAS SUPPLY CORPORATION***

The portion of the Supply assessment derived from sales of base gas to Penn York and resulting in a corporation tax deficiency totaling \$413,751.00 was based upon sales from petitioner to Penn York in the following amounts:

<u>Year</u>	<u>Amount of Gas Sold</u>
1980	\$ 1,986,424.00
1981	7,109,115.00
1982	<u>4,696,153.00</u>
	\$13,791,692.00

The amount of these sales is not in dispute.

Consistent with certain regulatory accounting guidelines, Penn York did not treat the base gas purchased from petitioner as an inventory asset. In the event that Penn York determined to resell the base gas, this classification would not impede such a resale.

Penn York has used the natural gas purchased from Supply for use as base gas in its storage operations (see, above) since the time of purchase. Penn York intends to continue to use the gas in this manner for an indefinite period. At some future time, Penn York may close down its storage operations in Allegheny County. At that, as yet, indefinite point in time, Penn York may sell the base gas to consumers for their consumption.

The portion of the Supply assessment derived from sales of gas to Distribution and resulting in a tax deficiency totaling \$118,974.00 was based upon Distribution's self-consumption of gas in New York in amounts as follows:

<u>Year</u>	<u>Gas Self-Consumed by Distribution</u>
1980	\$ 496,270.00
1981	704,424.00
1982	521,112.00
1983	419,947.00
1984	676,388.00
1985	761,412.00
1986	<u>386,270.00</u>
	\$3,965,823.00

The amounts for gas self-consumed by Distribution were taken from Distribution's records. Specifically, these amounts were determined from review of certain annual reports made by Distribution to the New York Public Service Commission, and also from certain allocations made by Distribution with respect to gas consumed by Distribution in New York and in Pennsylvania. The accuracy of the self-consumption amounts is not in dispute.

Distribution purchased natural gas from more than one supplier. The precise number of suppliers is not in the record. Throughout the 1980-1986 period, Distribution purchased approximately 95% of its natural gas from Supply. For the years 1984 through 1986, Distribution's annual reports filed with the New York Public Service Commission indicate an aggregate total purchased gas amount of \$1,862,432,064.00. As has been stipulated (see, above),

during this same period Supply sold over \$1,800,000,000.00 worth of gas to Distribution. During the years 1984 through 1986, then, Distribution purchased over 96.6% of its natural gas from Supply.

On audit, the Division determined that 100% of the gas self- consumed by Distribution was properly includible in Supply's "gross operating income" for purposes of Tax Law § 186-a.

Throughout the 1980-1986 period, Distribution consumed only about .1% of all of the natural gas it purchased from Supply and other gas suppliers. The remaining 99.9% of the gas purchased by Distribution was distributed and resold to consumers.

During the 1980-1986 period, Supply did not file a return with respect to the tax imposed by Tax Law § 186-a. Distribution did annually file such a return.

Petitioners Penn York and Distribution are affiliated corporations. Each is a wholly-owned subsidiary of National Fuel Gas Corporation.

OPINION

The Administrative Law Judge determined that the storage of the base gas at Penn York's natural gas storage facilities in New York was not subject to use tax under Tax Law § 1110 because gas is not defined in the Tax Law as tangible personal property for purposes of section 1110 of the Tax Law.

The Administrative Law Judge also determined that the gross receipts from Supply's sales of base gas to Penn York are includible in Supply's "gross operating income" for the purposes of section 186-a of the Tax Law because even though the sale of the gas occurred outside the State, the definition of "gross operating income" includes receipts from:

"sales of gas or gas service for ultimate consumption or use within New York. Thus, it is the sale for consumption or use in New York which is includible in the definition of gross operating income under Tax Law § 186-a" (Determination, conclusion of law "N," emphasis added).

The Administrative Law Judge rejected Supply's assertion that the sales were exempt as sales for resale. He determined that Supply sold base gas to Penn York for use by Penn York in

its storage operations as base gas and that Penn York has used and will continue to use the base gas so purchased in its operations for an indeterminate period.

The Administrative Law Judge also determined that a portion of Supply's sales of natural gas to Distribution are includible in "gross operating income" for purposes of section 186-a of the Tax Law since Distribution used a portion of the gas purchased for its own use in New York.

Finally, the Administrative Law Judge determined that penalty was properly imposed against Supply for failure to file a return and pay the tax imposed by section 186-a of the Tax Law with respect to sales of natural gas to Distribution. The Administrative Law Judge determined that Supply showed reasonable cause and an absence of willful neglect with regard to its sales to Penn York and that penalty should, therefore, be cancelled.

The Division, in its exception to the Administrative Law Judge's determination, reiterates its position at hearing that the base gas purchased by Penn York is tangible personal property for purposes of section 1110 and is subject to the use tax.

Supply, in its exception, asserts that since the sales to Penn York occurred in Pennsylvania, and Supply did not deliver the gas into New York State, the receipts are not includible in its "gross operating income" under section 186-a. Supply relies on the statement of legislative findings in L 1991, ch 166, § 149 which imposes a tax on gas importers in support of its position. In any event, Supply argues that the gas was not purchased by Penn York for its ultimate use or consumption in New York but was purchased for resale and, thus, is not includible in "gross operating income." Supply also contends that the extension of the tax to out-of-state sales violates applicable constitutional standards governing state power to tax interstate commerce since there is "no nexus" between the sale and the state upon which to base the imposition of the tax. Even if there were nexus, Supply asserts that the application of the tax to the receipts from Supply's sales of gas to Penn York is not apportioned to in-state activity and, thus, would tax the out-of-state sales in violation of the constitutional principles governing the State's power to tax interstate commerce. Supply also argues that its sales to Distribution are not includible in "gross

operating income" because Distribution is a reseller of gas and the sales to it were sales for resale. Finally, Supply argues that penalty should not be imposed with regard to its sales to Distribution.

We deal first with whether Penn York's storage of base gas in its New York facilities was subject to the use tax in section 1110 of the Tax Law.

We affirm the determination of the Administrative Law Judge on this issue for the reasons stated in his determination in conclusions of law "A" through "H."

We deal next with whether Supply's sales of base gas in Pennsylvania to Penn York were properly included as "gross operating income" for purposes of section 186-a.

We reverse the determination of the Administrative Law Judge on this issue.

Section 186-a of the Tax Law imposes a tax upon the "gross income" of every utility doing business in New York State which is subject to the supervision of the State Department of Public Service and upon the "gross operating income" of "every other utility" doing business in New York. A "utility" includes every person subject to the supervision of the Department of Public Service and also "every other person (whether or not such person is subject to such supervision) who sells gas . . . delivered through mains, pipes . . . or [who] furnishes gas . . . service, by means of mains, pipes . . ." (Tax Law § 186-a[2][a][i], emphasis added).

20 NYCRR 500.2(a) and (b) define the two types of utilities described in section 186-a as utilities of the first class (those under the supervision of the Department of Public Service) and second class, respectively.

"(2) Utilities in the second class are mainly those which, generally speaking, would not be classed as utilities but which are made utilities by statute for the purpose of this tax. Ordinarily, although there are exceptions, such as omnibuses, utilities in this group resell utility services which are purchased from utilities in the first class" (20 NYCRR 500.2[b][2], emphasis added).¹

¹The questions and answers in 20 NYCRR 500.2(b)(3) provide examples of the utilities in this class:

"Question 1: Is the owner or lessee of a hotel, apartment house or office building, who purchases gas, electricity, steam, water, refrigeration or telephony and resells any part of all of the same to tenants, subject to tax?

Answer: Yes.

"Question 2: A tenant in a hotel apartment house or office building pays a

The stated intent of the Legislature in including "second class utilities" in section 186-a was to tax "persons and corporations which were directly in competition with ordinary utilities" (L 1941, ch 137, § 11, cited in Quotron Sys. v. Gallman, 39 NY2d 428, 384 NYS2d 147, 148).

As relevant here, "gross operating income" of a second class utility means "receipts received in or by reason of any sale . . . made for ultimate consumption or use by the purchaser of gas . . . or in or by reason of the furnishing for such consumption or use of gas . . . service in this state (Tax Law § 186-a[2][d]).²

The fundamental question here is whether, for purposes of the out-of-state sales to Penn York at issue, Supply is a second class utility subject to the imposition of the tax. Resolution of this issue is not found by focusing solely on the definition of "gross operating income," as do the parties herein. Nor can it be resolved by focusing solely on the definition of "utility." Rather, the

lump sum as monthly rental, which includes gas, electric, steam, water and telephone services or any one or more of such services. Is the landlord subject to the tax? **Answer:** No. The landlord becomes taxable only if he sells one or more of such utility services at identifiable, flat or metered rates.

"Question 3: Is a mutual telephone company, not subject to public service regulation, subject to tax? **Answer:** Yes.

"Question 4: Is a hotel subject to tax where it supplies telephone services to its guests and makes a charge therefor? **Answer:** Yes.

"Question 5: A stock quotation company sells telegraph ticker service to brokers in various localities, using wires leased from a telegraph company. Is it engaged in the sale of telegraphy so as to be subject to the tax? **Answer:** Yes.

"Question 6: Is a cold storage plant, which stores perishable foods or other articles for others, but does not deliver refrigeration to others through mains or pipes, subject to tax? **Answer:** No.

"Question 7: Is a concern that supplies refrigeration to others by transmitting refrigeration fluid from a central point to the premises of such other individuals, corporations or entities subject to tax? **Answer:** Yes.

"Question 8: A gas tank is installed on the premises of a householder and connected with household outlets by a pipe, through which gas is sold to him, either at metered rates or otherwise. The tank is refilled from time to time. Is the householder's seller taxable? **Answer:** No" (20 NYCRR 500.2[b][3]).

²"Gross income," the basis for tax for utilities under the jurisdiction of the Department of Public Service, i.e., first class utilities, includes, in addition to gross receipts from sales, profits from certain other activities such as interest, dividends and royalties.

statute must be reviewed in its entirety. The issue is one of statutory interpretation and we are guided by the principle that "any well-founded doubt as to the meaning [of a tax statute] defeats the tax, and the statute should be construed against the taxing authority" (Syracuse Univ. v. Murphy, 10 AD2d 468, 200 NYS2d 807, 809; see also, Quotron Sys. v. Gallman, supra). Based on the facts in this case, we conclude Supply is not a second class utility. We rely principally on the fact that the tax is imposed on those persons (utilities) which sell gas "delivered through mains [or] pipes or [who] furnish gas . . . service, by means of mains [or] pipes" (Tax Law § 186-a[2][a][i]). It seems clear, at least with respect to out-of-state sales, that the "delivery" of the gas or the "furnishing" of the service into the State by the seller is integral to determining whether a seller is a second class utility for purposes of the tax and, thus, whether receipts from sales of gas are includible in "gross operating income." Stated differently, the "delivery" or "furnishing" of the gas or gas service provides the necessary connection between "sale" (out-of-state) and "ultimate use or consumption" of the gas or the gas service in New York State for purposes of defining what receipts are includible in "gross operating income." Thus, with regard to out-of-state sales of gas or gas service, the tax is imposed on receipts from sales where the seller delivers the gas or gas service into the State through mains or pipes for ultimate use or consumption by the purchaser in the State. Conversely, where the sale of the gas occurs out-of-state, and the gas is brought into the State by someone other than the seller, the receipts are not includible in "gross operating income" of the seller.

This interpretation is consistent with the findings of the Legislature in enacting section 189 of the Tax Law, which imposes a tax on every person who imports, or causes to be imported into this State, gas services which have been purchased outside the State for such person's use or consumption in this State.³ The Legislature stated that:

³We note that the same result was reached by the Division in an Advisory Opinion issued in April 1991 (petitioner # C900806A; 1 TSB-A-91[11]C; 1991 WL 95623 [New York State Dept. of Taxation & Fin.]).

This interpretation is also consistent with the Division's regulations which define "gross income" to include receipts from "sales made and services rendered for the ultimate consumption or use in this State by the purchaser" (20 NYCRR 501.4). Question 9 of the regulation amplifies the meaning of this language as follows:

"the main goal of [section 189] is to attempt to equalize the tax burden in relation to consumers of gas service. Presently, consumers of gas services may avoid the burden of the taxes imposed by sections 186 and 186-a of the tax law by purchasing the service out-of-state and hiring transportation to carry that service to the consumer's premises in this state. The legal incidence of the taxes imposed by sections 186 and 186-a of the tax law are on the utility making sales of gas services in this state. However, both of these taxes are presently passed through by the utility separately, and in their entirety, to consumers purchasing gas services from such utility in this state pursuant to rate regulation of the charge for such services by the public service commission. Thus, consumers of gas services purchased in this state from utilities bear the direct pass-through of both such taxes. [This bill is] an attempt to impose on those consumers who purchase gas services outside this state a comparable fair tax burden. Accordingly, to insure continuing comparability, pursuant to regulation by the public service commission, utilities shall be required to continue to pass through the total amount of such taxes to in-state consumers so that such consumers will continue to bear the economic burden of such taxes. In this manner a continuing comparable economic burden is imposed by . . . this act on these consumers who purchase gas service out-of-state for use or consumption in this state as compared to consumers who purchase gas services in this state from utilities" (L 1991, ch 166, § 149).

The facts here are that Supply sold the base gas to Penn York in Pennsylvania. Penn York delivered the gas to its facilities in New York State through its own pipelines. Accordingly, since Supply did not deliver the gas by pipe or main into New York, it is not a utility of the second class with regard to those sales and the receipts from the sale of such gas are not includible in Supply's "gross operating income" for purposes of section 186-a.

In view of this conclusion, it is not necessary for us to deal with the issue of whether the sales to Penn York were sales for resale as distinguished from sales for ultimate use or consumption and, thus, not includible in "gross operating income" (Brooklyn Union Gas Co. v.

"Question 9: What is meant by sales made and services rendered?

"Answer: In general, it means sales of gas . . . when delivered through mains, pipes or wires, sales of merchandise which are part of stock in trade, charges for transportation of passengers and goods, toll charges, and service charges such as charges for installation and moving of telephones and for the delivery of messages" (20 NYCRR 501.4, emphasis added).

This rationale is equally applicable to "gross operating income" which includes receipts from sales made and services rendered for ultimate consumption in New York.

McGoldrick, 270 AD 186, 59 NYS2d 243, affd 298 NY 536; 20 NYCRR 501.9). Nor is it necessary for us to deal with the constitutional issues raised by petitioner concerning the application of the section 186-a tax to out-of-state sales.

We deal next with whether Supply should be required to include as "gross operating income" receipts from sales to Distribution.

The Administrative Law Judge determined that:

"it was clearly not reasonable for [Supply] to assume that all of the gas it sold to Distribution was resold to consumers simply because Distribution was in the business of selling gas to consumers. Petitioner was aware (or, at the very least, should have been aware) that Distribution, its sister corporation . . . self-consumed in New York approximately .1% of the natural gas it purchased from its suppliers. This self consumption was documented by annual reports filed by Distribution with the New York State Public Service Commission" (Determination, conclusion of law "O").

The Administrative Law Judge acknowledged the inability of Supply "to be able to identify the specific molecules or quantity of gas self-consumed by Distribution as having been supplied by [Supply]." However, he found such identification was not necessary since:

"[t]ax law section 1081(a) authorizes the Division to estimate a taxpayer's corporation tax liability from any information in its possession where a taxpayer fails to file a return as required under Article 9" (Determination, conclusion of law "O").

The Administrative Law Judge found the Division's conclusion that all of the gas self-consumed by Distribution was gas purchased from Supply to be reasonable.

Supply reiterates its assertions at hearing, i.e., that it does not sell gas to consumers but to gas distribution companies which resell the gas to consumers; that while Distribution purchased approximately 95% of its gas from Supply (approximately \$4.2 billion worth of gas), it also purchased gas from other sellers; that it used a small amount of the gas it purchased for self-use, i.e., .1% (one tenth of a percent); and that it was impossible to determine which of the gas it purchased from which seller was used for self-consumption. Supply's conclusion is that:

"[i]n the context of a sale to a customer [Distribution] which is in the business of selling gas to consumers . . . it is reasonable [for Supply] to assume that the customer resells the gas to consumers" (Supply's brief in support of exception, p. 19, emphasis added).

We reverse the determination of the Administrative Law Judge.

It has not been asserted here that Supply delivered the gas to Distribution outside of New York. Moreover, it is clear that Distribution used a portion of the gas it purchased from its suppliers, including Supply, and resold the rest. Accordingly, Supply was a utility of the second class and was required to file a tax return under section 186-a concerning its sales to Distribution. The fact that Supply did not file such a return allowed the Division to estimate Supply's New York tax liability "from any information in its possession" (Tax Law § 1081[a]). The crux of the matter is whether petitioner has satisfied its burden of proving by clear and convincing evidence that both the method used to arrive at the assessment and the assessment itself are erroneous (see, Matter of R & J Automotive, Tax Appeals Tribunal, June 15, 1989). We conclude that petitioner has met its burden since no one, including the Division's auditor, has been able to explain how Supply could identify with specificity the amount of gas it sold to Distribution which was self-consumed by Distribution. In reaching this conclusion, we focus on the relative responsibilities of Supply, as seller, and its purchasers to insure that tax is paid on the receipts from sales of gas when the gas is self-consumed. We look to the Division's regulations for guidance.

The Division's regulation relating to the calculation of "gross operating income" is less than clear when applied here. Read literally, it would require Supply to report all of its "purchases of gas" which form the basis for the tax, regardless of whether it resells such gas. Supply must provide a detailed schedule of the amounts it resold, including places where the sales were made, and the quantities sold; and the quantities consumed by it (20 NYCRR 502.3[b]).⁴

⁴20 NYCRR 502.3(b) provides:

"(b) Utilities in the second class are required to report all purchases of commodities which form the basis for the tax, regardless of whether they resell all that they purchase or only a portion thereof. If they resell any part of the quantity they purchase, they will be required to show in the detailed schedule of the tax return the places where sales were made or services rendered, together with the quantities sold and the amounts received on account of such sales, as well as the quantities consumed by them."

In order for Supply to support its deduction for the amount of gas sold for resale, its purchasers, here Distribution, must report to Supply, the amount resold (20 NYCRR 502.3[c]).⁵ We note, however, that a report of the amount resold is not, as the Division asserts, the same as a report of the amount of gas purchased from Supply by Distribution which was self-consumed. Moreover, as the record in this case indicates, the Division could not state how Distribution could make that calculation. Specifically, at hearing, in response to the question: "How would . . . [Distribution] determine which of the gas you buy from which sources is the gas that's being self-consumed," the witness replied, "[t]o the best of my ability, I can't imagine how they compute it. I have no idea" (Hearing Tr., p. 75).⁶

⁵20 NYCRR 502.3(c) provides:

"(c) In order that the apartment house, office building or other utility, which resells some part or all of the utility service purchased, may support its claim that all such service was not resold and that the utility which made the original sale may support its deduction of the quantity resold by its purchaser, it is necessary for the apartment house, office building or other utility so reselling utility services to report to its vendor, as of the end of its billing period, the quantity resold. In the city of New York, sales tax remission certificates may be accepted as such a report.

"Question 69: A utility sells 15,000 kilowatt hours of electricity to an office building between June 29, 1950, and July 25, 1950, which is billed as follows:

"Demand charge.....	\$100
10,000 K.W.H. at four cents.....	400
5,000 K.W.H. at two cents.....	<u>100</u>
	\$600

"The average price per K.W.H. is, therefore, four cents. The office building, during a period ended in July, 1950, uses 6,000 K.W.H. and resells 8,000 K.W.H. to its tenants for \$400. What amount is taxable as gross operating income of the office building? **Answer:** The office building will be subject to tax on its receipts of \$400."

⁶Reference to the regulation dealing with treatment of sales for resale for purposes of calculating "gross income" by utilities of the first class is also not helpful. It suggests the following method of handling such situations:

"(1) The original seller shall include in its gross income all receipts from such sales but may take a deduction for the amount resold by the purchaser at its (the vendor's) sales price. If the original seller has not, at the time the report for a given period is being rendered, received information from his purchaser of the number of units resold, the deduction may be claimed in a succeeding period when the information is received" (20 NYCRR 501.9[b][1]).

In summary, the regulations do not provide a method by which Supply could reasonably ascertain the amount of gas purchased from it by Distribution which was used or consumed by Distribution in New York, nor can the Division offer any such method.⁷ Under the circumstances, we think it clearly erroneous to attribute the total amount of self-use by Distribution to purchases from Supply. Therefore, this portion of the assessment is cancelled and the penalty issue in connection with the assessment is moot.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;
2. The exception of National Fuel Gas Supply Corporation is granted;
3. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "2" above, but is otherwise sustained;
4. The petition of Penn York Energy Corporation is granted; and

This suggestion would require Supply to include all receipts from all sales and then take a deduction for the amount resold by its purchaser. In this context, Distribution would provide Supply with the amount of gas it purchased and then resold. However, as with the regulation for the calculation of "gross operating income," this information would not indicate the amount of gas purchased by Distribution from Supply which was self-consumed.

⁷The problem, in our view, lies in the fact that Supply is not a "typical" utility of the second class as envisioned by the regulations, in that it is not a reseller of gas purchased from a utility of the first class (20 NYCRR 500.2[b][2]).

5. The petition of National Fuel Gas Supply Corporation is granted.

DATED: Troy, New York
October 1, 1992

/s/John P. Dugan

John P. Dugan
President

/s/Francis R. Koenig

Francis R. Koenig
Commissioner

/s/Maria T. Jones

Maria T. Jones
Commissioner