

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
O. W. HUBBELL & SONS, INC. : DECISION
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period June 1, 1981 :
through February 29, 1984. :

Petitioner, O. W. Hubbell & Sons, Inc., 100 Main Street, New York Mills, New York 13417, filed an exception to the determination of the Administrative Law Judge issued on May 25, 1989 with respect to its petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1981 through February 29, 1984 (File No. 801913). Petitioner appeared by Samuel D. Hester, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Mark Volk, Esq., of counsel).

Petitioner filed a brief on exception. The Division filed a letter in lieu of a brief.

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

ISSUE

Whether the Division of Taxation properly determined that certain utilities purchased by petitioner were not consumed in the production of tangible personal property for sale and were therefore not exempt from tax pursuant to Tax Law § 1115(c).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

On December 20, 1984, following an audit, the Division of Taxation issued to petitioner, O. W. Hubbell & Sons, Inc., a Notice of Determination and Demand for Payment of Sales and

Use Taxes Due for the period June 1, 1981 through February 29, 1984 which assessed \$21,925.71 in tax due, plus interest.

Petitioner is a manufacturer and contractor involved in the manufacture, sale and installation of guard rails. With respect to the manufacturing aspect of its business, petitioner acquires steel from its supplier and galvanizes this material pursuant to certain specifications. Galvanizing is a process by which a zinc coating is bonded to iron or carbon steel, thereby forming an impermeable barrier against corrosion. Once petitioner has galvanized the steel, it is a finished product and is placed in inventory. A portion of petitioner's product is sold outright. The remainder of the guard rails are installed by petitioner as contractor pursuant to installation contracts. The installation of the guard rails results in a capital improvement to real property. The galvanizing process performed by petitioner is part of the guard rail manufacturing process.

The deficiency at issue results from a Division determination that 78.19% of utilities consumed in the operation of equipment used in petitioner's galvanizing process were properly subject to sales tax. On audit, the Division reviewed and totaled petitioner's utility bills associated with the gas and electric meters measuring the consumption of gas and electricity in petitioner's galvanizing plant. The Division assumed that all of the gas and electricity consumed in the galvanizing plant was consumed directly in the operation of the galvanizing equipment and was therefore consumed directly in the production of guard rails. Next the Division examined petitioner's 1983 sales records. The Division determined that \$2,628,672.00 of petitioner's total sales of \$12,053,251.00 (or 21.81%) were "direct sales"; that is, outright sales not involving the installation of the guard rails. The Division determined that these direct sales were properly exempt from sales tax and further determined that the gas and electricity consumed in the galvanizing process with respect to this 21.81% of petitioner's 1983 sales, the direct sales, was properly exempt from tax. The Division further determined that the remaining 78.19% of petitioner's 1983 sales did not constitute sales of guard rails, but were sales pursuant

to installation contracts which resulted in capital improvements. Consequently, the Division determined that the utilities consumed in the galvanizing process with respect to these contract sales were properly subject to tax.

The Division then applied the 1983 direct sales/contract sales revenue percentages to petitioner's galvanizing plant's utility bills throughout the entire period of audit. The Division thus assumed that the direct sales/contract sales ratio remained constant throughout the audit period. The Division further assumed that the percentage of utilities consumed in the galvanizing of guard rails for direct sales and installation contracts was identical to the direct sales/contract sales revenue. Thus, since the Division determined that contract sales amounted to 78.19% of total sales in 1983, the Division concluded that 78.19% of the galvanizing plant's utility bills throughout the audit period were properly subject to tax. The application of this taxable percentage to the galvanizing plant's utility bills resulted in the assessment herein.

Petitioner contracted exclusively with state and local governments to install guard rails. In 1983, petitioner performed work under installation contracts with New York State which generated revenue of \$6,808,273.00. Contract work for Pennsylvania brought in \$637,261.00. In its computation of petitioner's 1983 contract sales, the Division included \$1,978,967.00 in outright sales of guard rails to corporations affiliated with petitioner. Direct sales of \$1,437,795.00 were made to four affiliated corporations which installed the guard rails purchased from petitioner pursuant to installation contracts. The remaining \$541,172.00 of these sales were to an affiliated corporation which resold the guard rails to contractors.

At hearing petitioner introduced the results of a survey of its galvanizing equipment's gas and electric consumption. This survey was conducted by an electrical contractor. In contrast to the Division's presumption that all of the utilities consumed in the galvanizing plant were used directly in production, petitioner's survey indicated that 27% of the electricity and 93% of the gas consumed in petitioner's galvanizing plant was consumed directly in the galvanizing process. Based on this survey, petitioner conceded its liability for \$6,009.32 in sales tax on purchases of utilities during the period at issue.

OPINION

In the determination below the Administrative Law Judge decided that petitioner's process of galvanizing guard rails for use on its road improvement projects, along with the utilities directly consumed in connection therewith, did not constitute the production of tangible personal property for sale within the meaning of Tax Law § 1115(c) and that the utility purchases at issue were properly subject to sales tax. In addition, petitioner's contention that the utility purchases at issue were exempt from sales tax pursuant to Tax Law § 1115(a)(15) was rejected on the grounds that "tangible personal property" as used in Tax Law § 1115(a)(15) specifically excludes gas and electricity. The Administrative Law Judge did, however, modify the assessment of the Division as he concluded that the Division erred to the extent that it determined to be taxable those utilities which were consumed in the galvanizing of guard rails sold by petitioner to affiliated corporations.

On exception petitioner contends that the mere fact that the contracts included the installation of the galvanized rail does not change the fact that there is a transfer of title or possession qualifying as a sale pursuant to Tax Law § 1101(b)(5). Petitioner also argues that since gas and electricity are included in the definition of "tangible personal property" for purposes of the imposition of sales tax under Tax Law § 1105(b), which is the imposition at issue, it follows that the same definition should apply for purposes of the exemption from sales tax. Thus, petitioner submits that the utility purchases at issue should be exempt from sales tax pursuant to § 1115(a)(15) as sales of tangible personal property sold to a contractor for use in constructing a capital improvement for an exempt organization.

In response, the Division relies upon the determination of the Administrative Law Judge in support of its position that petitioner's utility purchases should not be exempt from sales tax.

We affirm the determination of the Administrative Law Judge.

Tax Law § 1115(c) provides that:

"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 ... for sale, by manufacturing ... 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." (Emphasis added.)

As emphasized, the foregoing section requires that the utilities at issue be used or consumed in the production of tangible personal property "for sale". In making a determination as to whether the utilities at issue qualify for the exemption claimed it must be ascertained whether the galvanized guard rail was manufactured for sale within the meaning of Tax Law § 1115(c).

The test which the courts of New York have developed with respect to the exemption at hand is that utilities will not be considered as used in the production of tangible personal property "for sale" for purposes of the manufacturing exemption when the facts indicate that the product is being manufactured primarily for use in services provided by the producer (see, Matter of Midland Asphalt v. Chu, 136 AD2d 851, 523 NYS2d 697, 699; see also, Matter of Southern Tier Iron Works v. Tully, 66 AD2d 921, 410 NYS2d 711, 713; Matter of Burger King, Inc. v. State Tax Commn., 51 NY2d 614, 435 NYS2d 689 [where the same standard was applied to purchases of machinery claimed to fall within the manufacturing exemption provided by Tax Law § 1115(a)(12)]). We conclude that petitioner is not entitled to the exemption provided by Tax Law § 1115(c).

A review of the record indicates that petitioner installs more than 60 percent of the guard rails which it galvanizes. Petitioner's attempts to dismiss this fact are not persuasive. Specifically, petitioner contends that it should qualify for the exemption at issue as it meets the definition of sale as set forth in Tax Law § 1101(b)(5). This section defines "sale" as "[any] transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume, conditional or otherwise, in any manner or by any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor." Petitioner argues that it falls within this definition of sale since title or possession of the guard rails is transferred by petitioner to a governmental agency which has contracted to purchase it.

The fact that the contracts provide for the passage of title or possession prior to the installation of the guard rails does not negate the underlying purpose of petitioner's operation as indicated by the facts (see, Matter of Willets Point Contracting, Tax Appeals Tribunal, September 14, 1989). It is the substance rather than the form of petitioner's operations that controls the characterization of its business for purposes of qualifying for the subject exemption (see, Matter of Midland Asphalt v. Chu, *supra*; Matter of Southern Tier Iron Works v. Tully, *supra*; Matter of Willets Point Contracting, *supra*). Further, the burden is upon petitioner to prove its entitlement to the exemption which it claims (Matter of Grace v. State Tax Commn., 37 NY2d 193, 371 NYS2d 715). Here the evidence indicates that at the time of the subject purchases petitioner was installing over 60 percent of the guard rails which it galvanized.

In determining how a taxpayer's business should be characterized, the decisions of the courts have concentrated on viewing the business of the taxpayer as a whole (Matter of Midland Asphalt v. Chu, *supra*; Matter of Southern Tier Iron Works v. Tully, *supra*; Matter of Willets Point Contracting, *supra*). For example, this method was applied by the court in Southern Tier wherein it was determined that the taxpayer, a fabricator of structural steel which both supplied and erected the steel beams it fabricated, was not entitled to the manufacturing exemption as the "whole package" provided by the taxpayer indicated that it was fabricating steel for its own purposes and not "for sale". The basis for the court's decision in Southern Tier was that the fabrication and subsequent erection of the steel beams by the taxpayer indicated that each was a component of the overall package provided by the taxpayer. A reading of the statute as petitioner would have us construe it would only stand if the interpretation provided by the courts is disregarded. As a result, we conclude that petitioner was galvanizing the guard rails for its own use and was not primarily in the business of selling the panels separately from the services which it provided (see, Matter of Midland Asphalt v. Chu, *supra*, 523 NYS2d 697, 699; Matter of Southern Tier Iron Works v. Tully, *supra*, 410 NYS2d 711, 713). Thus, that portion of petitioner's utility purchases which were consumed in the galvanizing of the guard rails

which were later installed by petitioner pursuant to its installation contracts were properly subject to tax.

In addition, we agree with the Administrative Law Judge that petitioner's contention that the purchases of utilities at issue were exempt from sales tax pursuant to Tax Law § 1115(a)(15) is without merit. Tax Law § 1115(a)(15) provides for an exemption from the tax imposed by Tax Law § 1105(a) when certain conditions have been met. Since the tax which is at issue is imposed pursuant to Tax Law § 1105(b) petitioner's claim that its utility purchases are exempt from the imposition of Tax Law § 1105(a) is not relevant. Even if the tax imposed pursuant to Tax Law § 1105(a) had been at issue petitioner has done nothing to establish that the utilities at issue became "an integral component part" of the galvanized guard rails as required by the Tax Law § 1115(a)(15) exemption. Thus, the exemption offered by Tax Law § 1115(a)(15) is not available for petitioner's utility purchases.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner, O. W. Hubbell & Sons, Inc., is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of O. W. Hubbell & Sons, Inc. is granted to the extent indicated in conclusions of law "C" and "E" of the Administrative Law Judge's determination but the petition is otherwise denied; and

4. The Notice of Determination and Demand dated December 20, 1984, is modified to the extent indicated in paragraph "3" above, but is in all other respects sustained.

DATED: Troy, New York
March 22, 1990

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner