

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions	:	
of	:	
ROCHESTER GAS AND ELECTRIC CORPORATION	:	DETERMINATION
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period December 1, 1979	:	
through November 30, 1985.	:	

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Petitioner, Rochester Gas and Electric Corporation, 89 East Avenue, Rochester, New York 14649, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1979 through November 30, 1985 (File Nos. 800909 and 803875).

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 259 Monroe Avenue, Rochester, New York, on March 30, 1989 at 1:15 P.M., with all briefs to be submitted by September 15, 1989. Petitioner appeared by Nixon, Hargrave, Devans and Doyle (John R. McQueen, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq., (James Della Porta, Esq., of counsel).

ISSUES

I. Whether payments made by petitioner to a non-profit research and development organization are taxable under section 1105(c)(1) of the Tax Law as purchases of information services.

II. Whether payments made by petitioner to consultants for the service of studying problems discovered in certain nuclear power plants and providing written analyses of the results of their studies constituted purchases of information services taxable under section 1105(c)(1) of the Tax Law.

III. Whether the service of refueling at the Ginna nuclear power plant, when purchased in conjunction with the nuclear fuel, constituted the maintenance, service or repair of real property subject to sales tax under section 1105(c)(3) of the Tax Law.

IV. Whether petitioner established that it had reasonable cause for its failure to report and pay over local sales tax due on its purchase of services to repair equipment used primarily in production.

FINDINGS OF FACT

On November 4, 1983, the Division of Taxation ("Division") issued to petitioner, Rochester Gas and Electric Corporation ("RG&E"), a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1979 through November 30,

1982, assessing tax due of \$670,457.43 plus interest.

On June 20, 1986, the Division issued to RG&E two notices of determination and demands for payment of sales and use taxes due for the period December 1, 1982 through November 30, 1985. The first notice assessed tax due of \$801,444.51 plus interest, and the second notice assessed a penalty of \$61,116.12 plus interest.

For both of the periods in issue here, RG&E executed consent forms extending the period of limitation for the assessment of sales and use taxes, and as a consequence the statutory notices described were timely issued.

RG&E is a gas, electric and steam utility. It is in the business of generating and distributing electricity and steam and distributing natural gas. The energy it needs to generate electricity and steam is derived from water power, fossil fuels and nuclear fuels. During the audit periods, RG&E operated the Ginna nuclear power plant and several conventional power plants.

The notices which are the subject of this proceeding were issued as a result of two separate field audits of RG&E's business operations. The first audit was conducted in 1983 for the period December 1, 1979 through November 30, 1982. The second audit was conducted in 1986 for the period December 1, 1982 through November 30, 1985.

#### The 1983 Audit

(a) The Division did not conduct an audit of RG&E's sales. Since two prior audits revealed that RG&E properly collected and paid over all sales taxes due on its sales of utility services and RG&E continued to employ the same accounting methods for collecting tax, an audit in this area was considered unnecessary. An audit was conducted of RG&E's own purchases of services and property.

(b) Virtually all of RG&E's purchases were made under its direct payment permit; therefore, it paid no sales tax at the time of purchase and maintained accrual accounts for sales tax owed on purchases. A clerical staff person in the corporation's tax department reviewed each voucher to determine whether the transaction was taxable. Each voucher was then coded to ensure that tax was accrued at the proper state and local rate on each taxable transaction.

(c) The auditor conducted a two-step examination of petitioner's purchase records. A statistical sampling was made of all vouchers totalling less than \$20,000.00. A detailed audit was made of all vouchers totalling \$20,000.00 or more. The auditor also reviewed all capital expenditures. This method resulted in additional tax due of \$1,225,937.47. Of this amount, RG&E conceded tax due of \$554,980.04. It disputed the remainder of \$670,957.43.

(d) Of the disputed portion of the audit, \$66,481.44 represents a projection of the results of the statistical sample, and the remaining \$604,475.99 represents a detailed audit of vouchers over \$20,000.00. RG&E did not object to the audit methods employed including the projection of the statistical sample over the entire audit period. It disagreed with the Division's determination that the following transactions were subject to sales tax:

1. Payments to the Electric Power Research Institute ("EPRI") and the Empire State Electric Energy Research Corporation ("ESEERCO");
2. Payments to Westinghouse Electric Company and other consultants for services described by RG&E as "analysis services";

3. Payments to the Nuclear Regulatory Commission ("NRC") for government inspections;
4. Fly ash transportation services;
5. Nuclear refueling services; and
6. Payments to consultants to perform maintenance tests and inspection services.

#### The 1986 Audit

(e) The 1986 audit was conducted as the 1983 audit had been. Total additional tax due, after application of a credit due of \$382,823.96, was determined to be \$1,127,017.76. RG&E conceded tax due of \$325,573.25, leaving an amount in dispute of \$801,444.51. The disputed amount represents tax due on these transactions: payments to EPRI and ESEERCO, fly ash transportation, and nuclear refueling services.

(f) Included in the tax conceded by RG&E was \$270,714.05, representing local sales taxes imposed on RG&E's purchase of contractual services for the maintenance and repair of equipment used in production (referred to in the record as "contract labor"). The Division had found tax due on such purchases on the 1983 audit as well. While RG&E conceded the tax due, it protested the Division's imposition of penalty and interest above the minimum for RG&E's failure to pay the tax due on these transactions.

By the time of hearing, some of the disagreed portions of both audits had been conceded or settled. The only items presently disputed are (1) the payments to ESEERCO, (2) payments to Westinghouse and other consultants for analysis services, (3) nuclear refueling services, and (4) the imposition of penalty.

#### Payments to ESEERCO

RG&E is a member of two research and development consortiums, EPRI and ESEERCO. On audit, the Division treated all payments made by RG&E to EPRI and ESEERCO as the purchase of information services taxable under section 1105(c)(1) of the Tax Law. At hearing, RG&E established that EPRI is a not-for-profit corporation exempt from Federal taxation under section 501(c)(3) of the Internal Revenue Code. As a consequence, the Division conceded after the hearing that any purchases RG&E made from EPRI were exempt from sales tax under section 1116(a)(4) of the Tax Law. It continues to assert that payments made to ESEERCO are taxable as purchases of an information service.

RG&E is a regulated public utility subject to the jurisdiction of the New York State Public Service Commission ("PSC"). Through its ratemaking procedures, the PSC encourages RG&E to expend approximately one percent of its revenues on research and development. Its budget is reviewed by the PSC staff to ensure that monies allocated for research and development are properly expended. Many of the internal company research projects undertaken by RG&E address short-term considerations and the research findings which result can be implemented quickly. RG&E's internal projects also provide support for basic research. Other research problems encountered by RG&E are long-term or large-scale in nature. To address these problems, RG&E pools its resources with a number of other organizations. During the years at issue, RG&E, with the approval of the PSC, expended approximately 51 percent of its research and development budget on internal company programs, 22 percent on contributions to EPRI, 20 percent on contributions to ESEERCO and 7 percent on contributions

to the New York State Energy Research and Development Authority.

Although payments to EPRI are no longer in issue, some discussion of EPRI's history and purposes will aid in understanding the parties' positions as they relate to ESEERCO. EPRI was founded in 1972 as a not-for-profit corporation. Its purposes, as set forth in greater detail in its articles of incorporation and by-laws, are to promote and conduct research and development in the area of electric power generation, to create through study and research the methods and means to provide electric power which is both economically efficient and environmentally safe, to provide a medium for the exchange of information among organizations and individuals concerned with electric power research and development, and to disseminate information about research and development activities in the field of electric power.

EPRI membership is open to individuals and organizations who have evinced an intention to support a national program for research and development in the production, transmission, distribution and utilization of electric power. The membership is divided into five classes: (1) agencies of the Federal government; (2) cooperative corporations engaged in the production and transmission of electric power; (3) electric utilities operated by state and local governments; (4) investor owned utility companies; and (5) non-voting members, consisting of any other individuals or organizations eligible for membership. EPRI had approximately 500 members during the audit periods, and RG&E has been a member since EPRI's inception.

EPRI is funded by member contributions. After the board of directors approves the annual program plan and budget, the necessary revenues are raised through assessment of the membership. During the audit periods, EPRI's operating budget was approximately \$300 million per year. The annual amount of each member's contribution was calculated by a formula based on two factors, gross revenues derived from electric power sold and number of kilowatt hours sold to ultimate customers. RG&E contributed about \$1.1 million per year to EPRI which amounted to approximately .04 percent of EPRI's annual budget.

Virtually all of EPRI's budget was spent on research and development activities. As of 1985, EPRI had started approximately 2,500 research projects and completed approximately 1,500 of these. The primary activities associated with the conduct of a project were performed by outside contractors. Approximately 80 percent of EPRI's budget was used to fund these contracts, and the remaining 20 percent was used to manage and oversee the contracts, to disseminate information and to pay EPRI's operational expenses.

An example of a project undertaken by EPRI during the audit years is the gasification-combined cycle plant built at Southern California Edison Company's Cool Water generating station. The plant was built through a partnership of EPRI, industrial suppliers, contractors, process developers, and domestic and foreign utilities. The technology developed on this project chemically converts coal to gas which is cooled, cleaned of pollutants, and then fired in a combustion turbine to produce electricity. It is generally regarded as a demonstration of the most advanced methods of turning coal into electric power with the least impact on the environment. The total cost of the project was more than \$300 million.

An important part of EPRI's program is the transfer of technology to its members. This is done through seminars and conferences and the loan of EPRI employees, among others. One of the most important ways of transmitting information is through the publication of technical reports. A contractor working for EPRI typically prepares a technical report summarizing the results of its work. EPRI edits these reports, formats them in accordance with EPRI's publishing standards and makes them available to its members. Members receive reports in several ways. Members are asked to list research areas or projects in which they are specifically interested; EPRI then forwards automatically any report within the utility's listed areas of interest. EPRI also publishes periodic guides to published reports, and members may order

reports at any time. EPRI does not charge members for reports provided to them. These same reports are available to the public at a nominal cost.

RG&E is also a member of ESEERCO, a New York research and development consortium similar in many ways to EPRI. ESEERCO was founded in 1960 as the Empire State Atomic and Development Associates ("ESADA") to conduct research and development in the field of nuclear energy. In 1973, the organization was reconstituted as ESEERCO and its activities were expanded to include all fields of electric energy research and development. ESEERCO supports a research and development program directed to the particular needs of its members which are the major investor-owned New York State electric utilities.

ESEERCO employs a staff of 12 individuals, 8 of whom are scientists, engineers or administrators specializing in the field of electric power generation. The staff supports the work of five technical committees which are composed of employees of ESEERCO's member utilities. The committees meet six to eight times per year to identify common problems, to develop projects in a research area, and to monitor on-going projects. When necessary, subcommittees and task forces are formed, reporting to the main committees. In carrying out its work, ESEERCO makes use of the personnel and facilities of its member utilities. ESEERCO staff members testify before regulatory agencies and participate in conferences, seminars and symposiums with other research organizations, on behalf of its member utilities. As is the case with EPRI, the primary activities associated with the conduct of a research project are performed by outside contractors.

Each ESEERCO member appoints two representatives to the ESEERCO Board of Directors each year. The board is ultimately responsible for approving all research and development projects undertaken by ESEERCO. Research projects are divided into two classes, minor projects with an anticipated cost over the term of the project of less than \$250,000.00 and major projects with an anticipated cost over the term of the project of more than \$250,000.00. ESEERCO's Administrative Committee has the power to approve minor projects within certain limitations established by the board. Major projects require a unanimous vote of the board, voting at a meeting at which a quorum is present.

Each year ESEERCO puts out a call for funds to pay the operating expenses of ESEERCO and to pay the costs to be incurred by ESEERCO as a result of ESEERCO's entering into contracts to implement research and development projects. Budget expenses are allocated to members using a formula based on the member's reported annual energy requirements, essentially kilowatt hours of electricity generated. Thus, the greater a member's electric generation, the larger its contributions will be relative to other members. Upon request by the treasurer, each ESEERCO member pays its allocated share of three major expenses: (1) the operating expenses of ESEERCO; (2) costs incurred by ESEERCO as a result of its entering into contracts for minor projects; and (3) costs incurred by ESEERCO as a result of its entering into contracts for major projects. A member is obligated to pay costs in the third category only if it had a representative present when the unanimous vote of the board was taken or if it later agreed to bear its allocated share of the board approved project. An individual member may opt out of a particular project by dissenting from a board vote approving a major project or, if not present at the time the vote is taken, refusing to share the cost of the project. If the board decides to go forward with the project despite the lack of unanimity, the remaining members then bear the cost of the project. Once a member votes to approve a project, its obligation to fund that project continues even if it later terminates its membership in ESEERCO. This has occurred in the case of Long Island Lighting Company which was forced to drop its ESEERCO membership because of financial hardship. ESEERCO has never undertaken a major project which did not have the unanimous approval of its members.

In 1982, ESEERCO's budget was somewhat over \$16 million, of which about \$1 million

was budgeted for operating expenses, and the remainder was budgeted for contracts entered into for research and development projects. During the audit periods, RG&E contributed slightly less than \$1 million per year to ESEERCO.

ESEERCO is primarily concerned with short-term and mid-term projects designed to improve electric service. Approximately 30% of the projects entered into by ESEERCO have been co-sponsored with EPRI. For example, ESEERCO contributed approximately \$7.5 million to the coal-gasification combined cycle plant described in Finding of Fact "13". ESEERCO has also undertaken projects addressing issues of special concern to New York State. To address problems caused by acid rain, ESEERCO has entered into a long-range research project in cooperation with the New York State Department of Environmental Conservation. Essentially, this project entails gathering information on over 1,200 lakes and ponds in the Adirondacks in order to determine the acidic content and presence of fish and wildlife in those bodies of water. RG&E's witness described it as taking a snapshot of the Adirondacks in order to have a point of comparison. As of December 1985, ESEERCO had completed approximately 250 research projects and was in the process of conducting an additional 150 projects.

All research conducted by ESEERCO is contracted out to organizations with the expertise to actually carry out the research activities. Each contractor is required to submit a report summarizing its findings. These technical reports are published under ESEERCO's name. Its members automatically receive copies of all such reports. The reports are available to the public at no charge if extra copies are available, and if they are not, copies are provided for the cost of reproducing the report.

By letter dated May 17, 1961, the Internal Revenue Service found that contributions made by a member to ESADA (ESEERCO's former name) constituted research and experimental expenditures within the meaning of section 174 of the Internal Revenue Code.

RG&E treated its contributions to ESEERCO as research and development expenses for all relevant purposes, including internal accounting, Federal and State taxation and ratemaking proceedings before the PSC.

### Analysis Services

During the first audit period, a number of nuclear generating facilities throughout the nation experienced problems associated with equipment or procedures common to many nuclear plants. When such problems arise, the Nuclear Regulatory Commission ("NRC") requires utilities to undertake a study for the purpose of determining the problem's cause and suggesting ways of correcting it. All affected utilities are required to make such studies, but in the interests of efficiency, the utilities often form owners groups which will engage a manufacturer or consultant to conduct the required tests at one of the plants and to share its findings and recommendations with the NRC and all affected utilities. RG&E belonged to three such owners groups during the first audit period. The first was the reactor vessel motion group, a group of eight utilities addressing the issue of reactor vessel motion following an accident involving loss of coolant. The second was the Three Mile Island Group, a group of 26 utilities which joined together to address a range of problems arising from the nuclear accident at Three Mile Island. The third was a group of 10 utilities addressing the problem of feed water cracking tubes. The experiences of the third group were described with some detail by RG&E.

In May 1979, wall cracks were detected in the pipe elbows of a steam generator operating in a nuclear power plant in the Mid-West and manufactured by Westinghouse Electric Corporation. On June 25, 1979, the NRC issued a directive to all pressurized water reactor

facilities with similar generators ordering the inspection of all their feedwater lines. This resulted in the other plants detecting cracks in the same general areas. In order to provide a uniform and systematic approach to the assessment of this problem, a utilities Feedwater Line Cracking Owners Group was formed with Westinghouse as its technical agent. At this time, the factors causing the cracking were suspected but not positively identified. The owners group identified eight tasks necessary to evaluate the thermal, hydraulic, structural and environmental conditions which could individually or collectively contribute to cracking of feedwater lines. As the program progressed, revisions and additions were made to the program. In sum, the objective of the overall program was to provide an approach for all utilities in evaluating the cause of feedwater line cracking, and to identify modification options available to minimize or eliminate its continuance. Westinghouse's total charge for its services was \$538,534.50. Approximately \$400,000.00 of this was for engineering services, and \$140,000.00 was for computer services. Westinghouse produced a final report which was delivered to each member of the Owners Group and the NRC. It included the results of its studies and recommendations regarding options available to the utilities in addressing the feedwater cracking problem in their individual plants. The complete report was not made available to the public.

On audit, the Division determined that payments made to consultants such as Westinghouse for their services and final reports were subject to sales tax as the purchase of an information service.

### Nuclear Refueling

The nuclear fuel system at the Ginna station consists of fuel assemblies. Each assembly is made up of pencil-thin rods containing uranium pellets. RG&E replaces approximately one-third of the assemblies each year. Because the fuel is radioactive, the refueling process is complex and requires a high level of knowledge and skill to accomplish. The spent fuel rods are removed from the reactor core, transferred to an adjacent building and deposited in the spent fuel pool. New fuel assemblies are placed in the core, and all of the fuel assemblies are rearranged to achieve the optimal mix of new and old assemblies. The entire procedure is carried out under 40 feet of water. The nuclear power plant is placed out of service while the refueling occurs.

The Division determined that the nuclear refueling constituted the taxable service of maintaining, servicing or repairing real property under section 1105(c)(5) of the Tax Law. RG&E contests the imposition of tax on these charges only for the years 1984 and 1985.

During the years 1979 through 1983, the refueling service was performed by specialists other than the suppliers of the fuel. Beginning in 1984, RG&E contracted with Westinghouse to supply both the nuclear fuel and refueling services. RG&E entered into a contract with Westinghouse which covered "the fabrication of nuclear fuel and associated services". RG&E purchase orders show separate billing for the fabrication of the nuclear fuel and the refueling services. One invoice dated January 27, 1984 shows the price for "full-scope refueling services" for one outage period to be \$228,230.00.

### Penalty

The Division assessed a penalty for the period December 1, 1982 through November 30, 1985 under Tax Law § 1145(a) on that portion of audited tax due relating to contract labor. RG&E conceded the underlying tax but contests the penalty.

RG&E hires outside contractors to repair and maintain its generating facilities. These

services are exempt from State sales and use taxes under Tax Law § 1105-B(b), but subject to local sales and use taxes. On the 1983 field audit, the Division found that RG&E had failed to accrue and pay tax due on these contract labor transactions. Following that audit, RG&E did not change its accounting procedures to capture the local tax; consequently, tax was found due on the same transactions on the 1986 audit.

During both audit periods, all RG&E vouchers were routed through one individual who was responsible for determining whether sales and use taxes were due. This individual followed written guidelines and had in-house tax experts available for advice as needed. Approximately 200 vouchers per day were reviewed and coded for tax purposes. The coding is a complex task because RG&E operates in 10 different taxing jurisdictions and its purchase transactions are subject to a wide range of sales tax provisions some of which are complex and subject to varying interpretations.

In order to code the contract labor vouchers and accurately capture the local tax on each individual transaction, RG&E would have had to substantially change its existing accounting and computer systems. At the time the audits were being conducted, RG&E was in the process of evaluating and redesigning these systems; therefore, it delayed making any immediate changes and instead addressed the tax on contract labor within the context of a major redesign of the accounting and computer systems. As of mid-June 1986, the necessary changes were implemented.

#### Stipulation

Following the administrative hearing, RG&E and the Division entered into a stipulation which is adopted here as Findings of Fact "34" through "39".

During the period December 1, 1979 through November 30, 1982, petitioner paid to the State Department of Taxation and Finance the amount of \$286,784.91 in use taxes for the use of its own electricity and gas.

Use taxes for the self-use of petitioner's electricity and gas were paid in the period December 1, 1979 through November 30, 1982, based upon representations made to petitioner by auditors from the Department of Taxation and Finance. Those auditors stated that petitioner was required to pay use tax on its use of its own electricity and gas.

In a subsequent audit, representatives of the Department of Taxation and Finance stated that the New York Tax Law does not impose any use tax on self-use of utility services. Accordingly, credit was allowed for all such use taxes paid in the period from December 1, 1982 through November 30, 1985.

The company has not yet been refunded any of the use taxes for self-use of utility services paid in the period December 1, 1979 through November 30, 1982.

The company was not required to pay use tax on the self-use of utility services.

The \$286,784.91 in taxes incorrectly paid in the audit period December 1, 1979 through November 30, 1982 may be and will be applied and set off against any amounts of unpaid or underpaid taxes found to be owing in the instant matter for the audit period December 1, 1979 through November 30, 1982.

#### CONCLUSIONS OF LAW



A. The first issue to be addressed involves RG&E's payments to ESEERCO. It is RG&E's contention that the substance of the transaction between itself and ESEERCO was the funding of research and development activities and that such transactions do not fall within the purview of the sales tax law. The Division's position is that ESEERCO was furnishing information services subject to tax under Tax Law § 1105(c)(1). Tax Law § 1105(c)(1) imposes a tax upon:

"(c) The receipts from every sale, except for resale, of the following services:

(1) The furnishing of information by printed, mimeographed or multigraphed matter or by duplicating or by duplicating written or printed matter in any other manner, including the services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons...."

The statute contains three elements: the tax is imposed upon (1) receipts from the sale of a service (2) of furnishing information (3) by some medium other than the spoken word. The Division's position is that ESEERCO is in the business of gathering, compiling and furnishing information to its clients (the seven utility companies) who receive such information in the form of technical reports for which they pay an annual fee; thus, the three elements of the statute are satisfied and all payments to ESEERCO are subject to tax. RG&E maintains that it was not purchasing information services from ESEERCO, but rather funding research and development. In weighing the arguments of the parties it is helpful to keep two principles in mind. First, where the issue to be determined is whether a certain event or transaction is subject to tax at all, the taxing statute is to be construed most strongly in favor of the taxpayer (Matter of Grace v. New York State Tax Commission, 37 NY2d 193, 196, 371 NYS2d 715, 718). Second, in the absence of contrary legislative intent, "[a] tax law should be interpreted as the ordinary person reading it would interpret it" (Matter of Holmes Electric Protective Co. v. McGoldrick, 262 App Div 514, 518, 30 NYS2d 589, 594, affd 288 NY 635).

The three elements of the statute will be discussed here somewhat out of order. First, it is apparent that ESEERCO does furnish information to RG&E through the technical reports which it provides to all of its members. RG&E argues that the language of section 1105(c)(1) refers exclusively to the processing of existing information and does not apply to the furnishing of "newly discovered" information. The Division counters that the term "furnishing of information" contains no limitation on the nature or complexity of the information furnished. In its view, the service provided to RG&E by ESEERCO is essentially indistinguishable from commonly recognized information services such as credit reports, tax or stock market advisory and analysis reports and product and marketing surveys (20 NYCRR 527.3[a][3]). In Matter of Allstate Insurance Co. v. State Tax Commission (115 AD2d 831, affd 67 NY2d 999), the court held "[t]he words in the phrase 'including the services of collecting, compiling or analyzing information' are not used as words of limitation". Applied here, the court's holding suggests that the statute does not distinguish between existing information and newly discovered information. Furthermore, an attempt to distinguish between information services and research and development on this basis inevitably deteriorates into a fruitless epistemological debate.

Since ESEERCO furnishes information to RG&E by way of printed matter, it is clear that the third element of the statute is met.

To satisfy the first element of the statute, there must be a taxable exchange. The statute imposes a tax on "receipts from the sale of furnishing information" (Tax Law § 1105[c][1]). In Matter of Audell Petroleum Corporation v. State Tax Commission (69 NY2d 818, 513 NYS2d 962), the Court of Appeals narrowed the operation of section 1105(c)(1) to information

provided by an entity whose business it is to provide information services. The Court stated:

"it is the sale of the service of furnishing information by a business whose function it is to collect and disseminate information which is taxable under Tax Law § 1105(c)(1) and not the mere sale of information" (Matter of Audell Petroleum Corporation, supra at 820).

Accordingly, the determinative issue here is whether ESEERCO is a "business whose function it is to collect and disseminate information". To address this issue, it is reasonable to focus on the services provided by ESEERCO to RG&E and RG&E's intentions in funding ESEERCO (cf., Matter of New York State Cable Tel. Assn. v. Tax Commn., 88 Misc 2d 601, 388 NYS2d 560, affd 59 AD2d 81, 397 NYS2d 205 [where the lower court found that in determining whether a cable television company was engaged in the service of telephony and telegraphy one must focus on the nature of the service provided and not merely whether the service was provided by means of a telephonic or telegraphic service]).

ESEERCO is directly engaged in conducting research and development. It is recognized by the PSC and the IRS as an entity whose primary function is research and development. The composition of ESEERCO includes not only its own employees, but also the technical committees, subcommittees and task forces staffed by representatives of the utility members. ESEERCO's activities include identifying problems in electric generation, developing projects in a research area, contracting for the completion of projects, and monitoring on-going projects. It disseminates information through conferences, seminars and symposiums and the active participation of its utility members on its various committees, as well as through the distribution of technical reports. Placing undue emphasis on the technical reports distorts the nature of the services ESEERCO offers its members. The technical reports are certainly an important product of the overall research and development activities conducted, but the reports are not the focal point of ESEERCO's efforts. That is, ESEERCO's primary function is to conduct research and development, not merely to produce the information reports which are, at most, epilogues to ESEERCO's research and development activities.

RG&E became a member of ESEERCO to supplement its own research and development by pooling its resources with other utilities. In this way, RG&E could use its research and development expenditures to address long-term and large-scale problems which it could not address by itself. The Division notes that through its membership on the ESEERCO board and its ability to opt out of any major project RG&E was able to exert a great deal of influence on projects undertaken by ESEERCO. However, this is not the equivalent of ordering an information service to produce an information report on a particular topic. Certainly, a benefit of RG&E's membership in ESEERCO is its ability to participate in all of ESEERCO's activities. RG&E's receipt of the technical reports was also an important benefit of membership. But RG&E funds ESEERCO to ensure that certain research and development activities are conducted, not to obtain the information contained in the technical reports.

Finally, some attention should be given to the nature of the payments RG&E makes to ESEERCO. RG&E's contributions to ESEERCO of almost \$1 million per year are used to fund ESEERCO's operations and to fund research and development contracts. These payments are taxable under Tax Law § 1105(c)(1) only if they are receipts from the sale of information services. The Division maintains that the payments represent such receipts pursuant to 20 NYCRR 527.3(a)(4)(iii) which states:

"An annual fee for subscribing to a service is taxable if it entitles the subscriber to a certain number of free reports, or to reduced charges on reports, unless the subscriber is entitled only to oral reports."

In my view, the ordinary person reading the language of Tax Law § 1105(c)(1) and the cited regulation would not conclude that RG&E's payments to ESEERCO constituted an annual fee for subscribing to an information service (cf., Matter of New York State Cable Tel. Assn. v. State Tax Commn., *supra*, 397 NYS2d 205, 206 [containing a similar discussion as it relates to telephony and telegraphy services taxable under Tax Law § 1105(b)]). Clearly, RG&E did not fund ESEERCO in order to obtain technical reports at no cost. The reports would have been available to RG&E at a nominal charge in any case. The Division argues that the price charged by an information service for its product includes the costs of gathering, compiling and analyzing information and hence the price RG&E paid to ESEERCO was a reasonable price for the information service provided. This argument might be persuasive if it was concluded that ESEERCO is in the business of providing an information service. Based on the preceding discussion, it is concluded that ESEERCO is not "a business whose function it is to collect and disseminate information" (Matter of Audell Petroleum Corporation v. State Tax Commission, *supra*). Rather, ESEERCO's business is to conduct research and development, and RG&E makes payments to ESEERCO to fund and participate in that research and development. Such activities do not fall within the operation of the sales tax law.

B. The second issue to be addressed is whether RG&E's payments to consultants for "analysis services" are subject to tax under Tax Law § 1105(c)(1). As described in the Findings of Fact, RG&E along with other utilities hired consultants to conduct certain studies required by the NRC. Invoices submitted by RG&E for the Feedwater Owners Group show that it was billed for engineering services and computer analysis and not for the final reports which documented the results of the studies. It is RG&E's position that it purchased engineering and other professional analysis services not subject to sales tax. The Division argues that RG&E purchased information services.

Clearly, Westinghouse and the other consultants billing RG&E were not in the business of collecting and disseminating information. The final reports they provided to the owners groups were incidental to the provision of professional services and not subject to sales tax (*see*, Matter of Rochester Gas and Electric Corporation, State Tax Commission, March 6, 1985).

C. The third issue to be addressed is whether RG&E's purchase of nuclear refueling services is subject to sales tax. In Matter of Rochester Gas and Electric v. State Tax Commission (128 AD2d 238, 516 NYS2d 341, *affd* 71 NY2d 931) the court upheld the State Tax Commission's finding that the installation of nuclear fuel was a separate transaction from the purchase of nuclear fuel and that the installation of fuel was a maintenance service to real property subject to tax under Tax Law § 1105(c)(5). RG&E argues here, as it did before the Appellate Division, that installation of the nuclear fuel was an integral part of the purchase of the fuel which is itself exempt under Tax Law § 1115(c).

RG&E argues that there is a factual difference which distinguishes the transaction found subject to tax in the earlier case from the transactions at issue here, namely that before 1984 the nuclear fuel and refueling services were provided by two separate vendors, whereas in 1984 and 1985 both the fuel and the refueling were provided by Westinghouse. The distinction is not determinative of the issue.

The Appellate Division found that the installation of nuclear fuel was a highly-skilled task which required the services of specialists, and as a consequence, it held that the installation of the fuel was sufficiently independent of the purchase of the fuel to be considered a separate transaction (Matter of Rochester Gas and Electric v. State Tax Commission, *supra*). The same is true here. The separateness of the installation task is evidenced by testimony establishing that the service could be purchased separate from the nuclear fuel, invoices showing that Westinghouse separately billed for refueling services and the nuclear fuel, and the magnitude of the charge for refueling.

D. Finally, RG&E contends that it had reasonable cause for its failure to report tax due on contract labor charges for the 1982 through 1985 audit period.

Tax Law § 1145(a), as effective for the period in issue, provides that a penalty will be imposed unless the taxpayer affirmatively shows that its failure to comply with the Tax Law was due to reasonable cause and not due to willful neglect. RG&E cites 20 NYCRR 536.5(b) to support its contention that its substantial compliance with the tax laws "is sufficient 'reasonable cause' to abate penalties and interest charges above the...minimum." This regulation states:

"In determining whether reasonable cause exists, in addition to an evaluation of [the facts offered to show reasonable cause], the taxpayer's previous compliance record with respect to all of the taxes imposed pursuant to the Tax Law may be taken into account."

Regulations in effect for the audit period contain a substantially similar statement (20 NYCRR former 536.1[b]). It follows then that substantial compliance with the Tax Law is not in itself sufficient to show reasonable cause but must be weighed with other evidence.

The evidence establishes that after the 1983 audit RG&E was aware that its routine purchases of contract labor services were subject to local sales and use taxes and that its existing accounting and computer systems were not able to capture the tax owed. Because these systems were in the process of being redesigned, RG&E decided not to report tax due on contract labor transactions until the appropriate modifications could be made within the context of revamping its entire computer system. The difficulties RG&E encountered in modifying its accounting and computer systems do not constitute reasonable cause even when considered in light of its overall compliance with the Tax Law. Even if RG&E lacked the accounting resources necessary to accurately account for the tax due on the contract labor transactions, it might have made some effort to estimate its tax liability in this area. Instead, RG&E made a calculated decision not to report tax due on these purchases. The fact that RG&E accurately collected and reported taxes on its sales of utility services and paid tax on almost all categories of its purchases cannot excuse a willful decision not to report or pay tax on a discrete class of transactions.

E. As stated in Finding of Fact "39", RG&E and the Division agree that RG&E is entitled to a refund of \$286,784.91 to be applied towards taxes, penalty and interest found to be due and owing as a result of this determination.

F. The petitions of Rochester Gas and Electric Corporation are granted to the extent indicated in Conclusions of Law "A", "B" and "E"; the notices of determination and demands for payment of sales and use taxes due issued on November 4, 1983 and June 20, 1986 shall be modified accordingly; and, in all other respects, the petitions are denied.

DATED: Troy, New York  
December 21, 1989

/s/ Jean Corigliano  
ADMINISTRATIVE LAW JUDGE