STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ZAPCO ENERGY TACTICS CORPORATION	:	DETERMINATION DTA NO. 815824
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Years 1994 through 1996.	:	

Petitioner, Zapco Energy Tactics Corporation, 124 Sills Road, Yaphank, New York 11980, filed a 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 years 1994 through 1996.

A hearing was held before Winifred M. Maloney, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on January 14, 1998 at 10:45 A.M., with all briefs to be submitted by June 18, 1998, which date began the six-month period for the issuance of this determination. Petitioner appeared by Daniel P. Duthie, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Brian J. McCann, Esq., of counsel).

ISSUE

Whether charges incurred pursuant to Long Island Lighting Company's PSC tariff are exempt from sales and use taxes because they were imposed on equipment or services directly used in the production of electricity.

FINDINGS OF FACT

1. Petitioner, Zapco Energy Tactics Corporation, owns and operates three landfill gas to electric energy facilities on Long Island. The facilities are located in Oceanside, Smithtown and Oyster Bay, New York. All of these projects use the methane gas produced as a by-product from decomposing refuse to power generators that produce electricity. The methane is used as a fuel source for internal combustion engines which turn the electrical generators at the landfills. Petitioner is an alternative power producer or an independent power producer ("IPP"). The industry also refers to an IPP as a qualifying facility or as an on-site generator.

2. As an IPP, petitioner does not sell its electricity at retail. Rather, all electricity which petitioner produces is sold to Long Island Lighting Company ("LILCO"), which then distributes it to its retail customers. If petitioner distributed its electricity to retail customers it could lose its status as a qualifying facility which could jeopardize its long-term contracts with LILCO. In order to sell electricity to LILCO, petitioner's equipment must be electrically interconnected in parallel with LILCO's system.

3. Both state and federal energy policies encourage alternative power production to conserve finite and expensive energy resources.

4. The New York State Public Service Commission ("PSC") exercises jurisdiction over the rates and operations of electric utilities in New York State. For PSC purposes, LILCO is considered an electric utility while petitioner is not. LILCO groups its customers by service classification and sets its rates accordingly. It submits tariffs for each service classification to the PSC for approval. The record includes copies of the tariffs and revisions approved by the PSC, specifically PSC No. 7 - Electricity Service Classification 11 tariff ("SC-11 tariff" or "tariff"), which sets the rates at which LILCO will purchase electrical service from an on-site generator

such as petitioner. The tariff also sets forth the charges which LILCO may impose on an on-site generator for LILCO-provided energy service.

5. Beginning in January 1994, LILCO began collecting sales tax on the SC-11 tariff charges which it collected from petitioner for the three facilities listed in Finding of Fact "1". Each facility's monthly LILCO statement pertaining to the SC-11 tariff charges is part of the record. Review of the statements reveals that LILCO collected sales tax on the following charges: the service charge; the SC-11 net demand charge; the fixed interconnection charge; and the New York Telephone lease line rental charge. From February 1996 through May 1996, LILCO did not assess the SC-11 net demand charge to the Oceanside facility per "LILCO/Zapco negotiations."

6. During the period in issue, LILCO collected a total of $63,752.42 in sales tax on the SC-11 tariff charges for all three facilities. The breakdown by site is as follows: Oceanside - $36,012.56; Smithtown - $10,961.32 and Oyster Bay - $16,778.54.

7. On or about June 21, 1996, petitioner filed an Application for Credit or Refund of Sales and Use Taxes for the period January 1994 through May 1996 in the amount of $63,752.42. The application sought a refund of sales taxes collected by LILCO on the charges collected from petitioner pursuant to the SC-11 tariff. The refund application was based upon petitioner's position that, inasmuch as the interconnection facilities are vital to the production of electricity and should, therefore, be considered production equipment which is exempt from sales tax, the maintenance charges for the interconnection facilities should also be exempt from sales tax.

8. Prior to filing the refund application, Dominic Antignano, on behalf of petitioner, made verbal and written requests to the Division for guidance about the taxability of the SC-11 tariff charges and whether the interconnect equipment is production machinery.

The Division's Sales Tax Instructions and Interpretations Unit sent a letter dated April 15, 1996 to petitioner, which stated, in pertinent part, as follows:

> In the correspondence you question whether the SC-11 charge from LILCO is subject to sales tax. The correspondence states that the SC-11 charge is for the maintenance of the interconnect equipment. In addition, you question whether the interconnect equipment is production machinery. Pursuant to our telephone conversation on April 12, 1996, it was determined that the interconnect equipment is the electrical wiring that connects your electrical generating facilities to the electrical grid of LILCO.
>
> It would appear from the available information that the interconnect equipment does not qualify as production machinery or equipment, since the electricity has already been produced. The interconnect equipment is used to deliver the electricity to LILCO, who in turns sells the electricity to its customers via its electrical grid.
>
> Based upon the information contained in the correspondence and our telephone conversation, the SC-11 charge is for the maintenance of tangible personal property or real property.
>
> The New York State Sales and Use Tax Law provides that the maintaining or servicing of tangible personal property or real property is subject to tax unless purchased for resale. Therefore, the charge for the maintenance of the interconnect equipment is subject to sales tax.

9. On July 19, 1996, the Division issued a Notice of Disallowance to petitioner denying its claim for refund of sales tax on the basis "that the interconnect equipment does not qualify as production machinery or equipment and is, therefore, taxable."

10. The electrical service covered by the SC-11 tariff must generally have the following characteristics: "Single or three phase alternating current, approximately 60 hertz, at one standard delivery voltage with service metered at, or compensated to, that delivery voltage;" secondary service at 120/208, 120/240 or 277/480 volts; primary service at 2400/4160 or 7620/13,200 volts; sub-transmission service at 23,000, 33,000 or 69,000 volts; and transmission

at 138,000 volts or higher. The tariff allows LILCO to determine site specific service characteristics.

11. LILCO requires all interconnected facilities operating in parallel with the LILCO system to meet certain generation criteria including, among other things, voltage production, variations and dips, over and under frequency situations and total harmonic voltage. It also requires that if the voltages cannot be maintained within specified tolerances, the interconnected facility will automatically disconnect the generating equipment from the LILCO system within one second of a drop below the voltage tolerance. Petitioner's three facilities are required to produce and deliver voltages of approximately 13,000 volts.

LILCO requires specific protective devices, i.e., breakers, relays and switches, to protect its system from that of an interconnected IPP. Among the devices is a Supervisory Control and Data Acquisition ("SCADA") system remote terminal unit ("RTU") located at each generating site. The RTU, through the use of telemetering, provides LILCO with supervisory trip control of the interconnection breakers. A dedicated telephone line connects the RTU with LILCO's mainframe supervisory computer located at the substation. LILCO orders the telephone lease line; however, the IPP is required to pay for installation, maintenance and subsequent monthly charges for the line. Each of petitioner's facilities has the required dedicated telephone line.

12. At the hearing, petitioner focused its presentation on the Oceanside facility, using testimony, diagrams and photographs. The facilities at Smithtown and Oyster Bay use equipment, without significant difference, to produce and deliver electricity to LILCO in a manner similar to that employed at Oceanside. Petitioner's president, George Jansen, generally described both the Oceanside interconnection facility and its operation. His description can be summarized as follows:

Six 720 KW induction generators, producing electricity at about 5,000 volts, are connected to a 5kV overhead generator bus. The generator bus is connected to a 5MVA 5kV to 13kV step up/isolation transformer which steps up the voltage to approximately 13,000 volts. The step up/isolation transformer is connected to a 13kV intertie breaker, consisting of protective devices, including metering potential transformers, current transformers, an oil circuit breaker and the RTU which allow petitioner's system to be disconnected. The intertie breaker is connected to 350 MCM AL underground cable which runs to a metering box[1] mounted on stanchions connected by wires to a primary metering pole at the Oceanside Landfill property line on Long Beach Road. One section of 336 AL overhead wire connects the primary metering pole to LILCO's 13kV dedicated feeder line originating at LBS#2395. LILCO's dedicated feeder line consists of approximately 2,500 feet of 350 MCM AL aerial cable running along a pole line to the substation exit riser pole. LILCO's Barrett 13kV substation breaker 2WB-585 is connected to the exit riser pole via 1,000 MCM AL underground cable. Although not specifically described above, there are protective devices located on LILCO's side of the interconnect which allow LILCO to disconnect petitioner's facility from the LILCO system for system repairs or other reasons.

13. Mr. Jansen also offered a brief explanation of some of the charges imposed by LILCO pursuant to the tariff. He stated that petitioner could not avoid paying LILCO the service charge as it is a charge required by the tariff. He further explained that the telephone lease line charge relates to the required separate stand-alone telephone line necessary for "telemetering of power produced by the project to be sent automatically" to LILCO (tr., p. 61).

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[1]The metering box contains two meters, one which records the flow of energy to LILCO's system and the other which records the flow of energy from LILCO's system to petitioner's system.

14. As noted above, LILCO is the only utility to which petitioner's facilities supply electricity. If the interconnect is interrupted, the production of electricity ceases immediately. One of petitioner's expert witnesses, Douglas L. Phethean, proffered the following explanation as to why that occurs:

> [b]ecause there is no load connected to the generation of the facility. There is no means by which production can occur. It's sort of like your electric wall switch here that stands ready and has electricity in it, and capable of production, yet there's no lamps or equipment attached to it. There is no load. It sees no reason to produce. So that acts like an extension cord or a cord, if you will, and connects the lightbulbs that are out on the light company system and whatnot to this generation, and allows it to produce. Absent that, there is no production and yet it stands ready; but there is no effective production of power. (Tr., p. 120.)

If petitioner's facilities were connected to other utilities in addition to LILCO, the interrupted interconnection would not necessarily interrupt the generation of power to the other utilities.

15. Petitioner is one of LILCO's service customers. LILCO provides electric service to each of petitioner's facilities whenever the power production from a particular facility is inadequate to meet its own requirements or a facility is not operating.

16. LILCO and petitioner's predecessor[2] entered into a parallel generation agreement ("PGA") for each facility. The record includes copies of all three PGAs. In accordance with prudent electric utility practice, each PGA sets forth the terms and conditions under which the parties agree to be bound with respect to the interconnection facility's construction, production and delivery of electricity. The terms, among other things, require that petitioner deliver electricity of a type known as three - phase alternating current, having certain characteristics, at the point of interconnection of its facility and LILCO's system. LILCO is to be responsible for the measurement of electricity to and from each party which is to be made on petitioner's side of

[2]Petitioner's predecessor was Energy Tactics, Inc.. The record is silent as to when and under what circumstances petitioner became known as Zapco Energy Tactics Corporation.

the disconnect switches. Both petitioner and LILCO, through the use of switches, are required to be able to disconnect the facility from LILCO's system in the event of de-energization by either party. The terms also require that petitioner pay for its electric generation facility, the electric fault protection equipment and LILCO's interconnection equipment, including any necessary system reinforcements. The PGAs further provide that petitioner will pay for the electric service it receives from LILCO based on the rate schedules on file with the PSC and will also "pay the other rates and charges required by" the SC-11 tariff.

17. Petitioner paid about $500,000 to $600,000 for Oceanside's interconnect equipment. The record is silent as to the exact amount which petitioner paid for the other facilities' interconnection equipment.

18. As noted above, LILCO is responsible for measuring the number of kilowatt hours it receives from a particular facility and the number of kilowatt hours it sends to that facility. In addition, it is responsible for calculating the amount due petitioner based on the number of kilowatt hours produced at a particular facility. Petitioner receives a net amount which is calculated in the following manner: LILCO multiplies the number of kilowatt hours a facility produces by the per kilowatt hour tariff rate, then subtracts the total SC-11 tariff charges plus applicable sales tax and forwards the difference to petitioner.

19. The SC-11 tariff section entitled "Rate II - To be paid by the On-Site Generator" contains paragraphs which set forth the various monthly charges to be paid by an on-site generator, such as petitioner, based upon the type of electric service it receives from LILCO, i.e., whether it receives electric service from LILCO solely under SC-11 or under another service classification in addition to SC-11. The service charge, SC-11 net demand charge and the fixed interconnection charge upon which LILCO collected and petitioner paid sales tax are all defined

in this section. At all three facilities, petitioner received service from LILCO under another service classification in addition to SC-11.

The service charge is a charge which petitioner pays for required "additional metering devices" necessary under SC-11 in addition to the metering devices required to be installed under the other service classification. Because petitioner's facilities are served at the "distribution voltage level" it pays a demand charge based on "each kW of the contract capacity provided hereunder in excess of any maximum demand charge taken under the other Service Classification." According to the paragraph entitled "Determination of Contract Capacity," the initial contract capacity was specified in the on-site generator's application for service and is "automatically increased to the highest average kilowatts measured in a 15-minute interval during any month. The demand shall be taken to the nearest one-tenth kilowatt." The "fixed interconnection charge" which LILCO charges petitioner is defined in the "Special Provisions" paragraph as follows:

> Interconnection charges are for the costs not covered elsewhere that are in excess of the ordinary costs which the Company would have incurred to supply the On-Site Generator's electrical requirements under the applicable Service Classification. Interconnection costs are payable in full to the Company by the On-Site Generator at the time these costs are incurred. Interconnection plant installed on Company's property will be maintained by the Company, in return for which the On-Site Generator or its successor will pay an 11.4 percent annual charge based on the total investment in such interconnection plant.

20. Petitioner's expert witnesses included Frank W. Radigan, whose professional career has included a 15-year tenure with the PSC in both the rates and system planning sections. Mr. Radigan was asked to generally explain the service charge and the fixed interconnection charge. According to Mr. Radigan, the fixed interconnection charge is a carrying charge which is meant "to recover on an average basis, expenditures that the utility makes in [the] performance of

its business." (Tr., p. 104.) The expense items which would be included in the interconnection charge would include the expense of sending a LILCO employee out to repair a broken piece of the interconnect equipment, as well as an allocation of administrative and general expenses. Mr. Radigan explained that the service charge is the way the utility recovers money for meter reading, and includes an allocation of administrative and general costs.

SUMMARY OF THE PARTIES' POSITIONS

21. Citing Tax Law § 1115(a)(12), 20 NYCRR 528.13 and the decision in ***Matter of Niagara Mohawk Power Corporation v. Wanamaker*** (286 App Div 446, 144 NYS2d 458, ***affd*** 2 NY2d 764, 157 NYS2d 972), petitioner argues that the sales tax charged by LILCO should be refunded because the tax is collected on the charges for maintenance of interconnection equipment used directly and exclusively in the production of electricity.

22. The Division asserts that only the generators produce electricity while the remaining pieces of machinery comprising the interconnection are used in the transmission and distribution of electricity. It maintains that the issue of whether transmission lines, transformers and similar equipment of an electric utility qualify for the production exemption has already been addressed in the ***Matter of Niagara Mohawk Power Corporation v. Wanamaker*** (***supra***), wherein the court ruled that such equipment was not used directly in production but rather was used in transmission and distribution of electricity. The Division argues that the ***Wanamaker*** decision is binding precedent on the issue of whether or not equipment which comprises the interconnection is used in the production process. It contends that inasmuch as the interconnection equipment is used to distribute electricity, not produce it, the fixed interconnection charges for maintenance of that equipment would not qualify for exemption from tax. As for the service charges and telephone lease line charges, the Division asserts that these charges "appear from the record to

cover the cost of LILCO providing telephone equipment or metering devices to Zapco, and cannot be classified in any way as equipment used directly in production." (Division's brief, p.19.) Lastly, the Division maintains that the maintenance services at issue are subject to local sales tax even if the interconnection equipment at issue is considered production equipment.

23. In its reply brief, petitioner argues that it has shown through both expert testimony and documentary evidence that the fixed interconnection charge is levied for the maintenance of equipment vital to the production function. It also contends that even though the service and telephone lease line charges are relatively small amounts, they are "part of or directly attributed to the interconnection and, hence, part of the production function" (Petitioner's reply brief, p. 15). Petitioner concedes that the Division is correct that there is no exemption for the local portion of the sales tax on the maintenance of production equipment.

CONCLUSIONS OF LAW

A. Tax Law § 1105(b) imposes a sales tax upon

> [t]he receipts from every sale, other than sales for resale, of gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature, and from every sale, other than sales for resale, of telephony and telegraphy and telephone and telegraph service of whatever nature except interstate and international telephony and telegraphy and telephone and telegraph service.

Tax Law § 1105(c)(3) imposes a sales tax upon the receipts of every sale, except for resale from "maintaining, servicing or repairing tangible personal property . . . not held for sale in the regular course of business. . . ."

Tax Law § 1105-B(b) exempts the receipts from every sale of the services of installing, repairing, maintaining or servicing tangible personal property described in Tax Law § 1115(a)(12) from the tax imposed under Tax Law § 1105(c), "but not for the purposes of the

taxes imposed by section eleven hundred seven or eleven hundred eight or authorized pursuant to the authority of article twenty-nine of this chapter."

Tax Law § 1115(a)(12) provides an exemption from sales and use tax for "[m]achinery or equipment for use or consumption directly and predominantly in the production of tangible personal property, gas, electricity, refrigeration or steam for sale . . . ."

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, gas, electricity, refrigeration or steam, for sale, by manufacturing, processing, assembling, generating . . . 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.

B. In the instant matter, petitioner paid sales tax on four separate charges which were mandated under either LILCO's SC-11 tariffs or the LILCO - petitioner parallel generation agreements. Petitioner claims that these charges are exempt from taxation because they are charges incurred for the maintenance of exempt production equipment, to wit, the interconnection equipment described in Finding of Fact "12". The Division maintains that neither the interconnection equipment, nor the various charges qualify for exemption from taxation.

In order to determine whether, in this case, any of the charges are exempt from taxation, it is necessary to first determine what function the various pieces of equipment which constitute the Zapco - LILCO interconnection facilities play.

C. The Division's regulations provide that the statewide tax exemption applies to:

> [m]achinery or equipment (including parts with a useful life of more than one year) used or consumed directly and predominantly in the production for sale of tangible personal property, gas, electricity, refrigeration or steam, by

> manufacturing, processing, generating, assembling, refining, mining or extracting. (This exemption includes all pipe, pipeline, drilling rigs, service rigs, vehicles and associated equipment used in the drilling, production and operation of oil, gas and solution mining activities to the point of sale to the first commercial purchaser.) (20 NYCRR 528.13[a][1][i].)

According to the regulation, "production" begins with "the handling and storage of raw materials at the plant site and continu[es] through the last step of production where the product is finished and packaged for sale" (20 NYCRR 528.13[b][1][ii]).

20 NYCRR 528.13(c) defines *directly and predominantly,* in pertinent part, as follows:

> (1) *Directly* means the machinery or equipment must, during the production phase of a process:
>
> (i) act upon or effect a change in material to form the product to be sold, or
>
> (ii) have an active causal relationship in the production of the product to be sold, or
>
> (iii) be used in the handling, storage, or conveyance of materials or the product to be sold, or
>
> (iv) be used to place the product to be sold in the package in which it will enter the stream of commerce.
>
> * * *
>
> (4) Machinery or equipment is used predominantly in production, if over 50 percent of its use is directly in the production phase of a process. . . .

In ***Matter of Niagra Mohawk Power Corporation v. Wanamaker*** (***supra***), the court dealt with the application of a county sales and use tax exemption for tangible personalty used or consumed "directly and exclusively" in the production of tangible personal property for sale. In that case, as in this case, the petitioner produced electricity. The parties in dispute conceded that the coal, boiler, turbine and generator were used "directly and exclusively" in the production of electricity but disagreed as to whether the exemption applied to various ash and coal handling

equipment that included conveyor belts moving coal toward the boiler; slag lines, pumps and narrow gauge railway which carried the ash from the boiler; various structures including concrete caissons and foundations which supported the machinery; and the building which housed the entire plant. In making its decision, the court noted that there is no simple test to apply, but considered the following basic questions:

> (1) Is the disputed item necessary to production?
>
> (2) How close, physically and causally, is the disputed item to the finished product?
>
> (3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system? (***id***., 144 NYS2d at 461).

The court held that the ash and coal handling system was not taxable because it worked together with the boiler to make up a system which supplied the power from which the electricity was produced. The court noted that it was not practical to divide a generating plant into "distinct" stages and that the "words 'directly and exclusively' should not be construed to require the division into theoretically distinct stages of what is in fact continuous and indivisible." The court similarly determined that the various structures and supports used to steady the machinery were necessary to the machinery's proper functioning and thus, were not taxable. The court noted:

> As a whole, the plant is a producing unit. The structures do not play as active a role as, for example, the turbine. But activity is not the test of directness. The walls of the boiler have a 'passive' function in one sense. The important thing is that all parts of the plant contribute, continuously and vitally, to production, and they are all integrated and harmonized (***id***., 144 NYS2d at 462).

Additional disputed items included the transformers at the Huntley steam station, and an elaborate system of substations, transformers, towers and poles, conductors, voltage regulators, circuit breakers and similar equipment which distributed electricity to the petitioner's residential and commercial customers. After applying the three questions to the disputed items, the court

determined that they were used in the transmission or the distribution and not in the production of electricity.

D. Based on this case law and the extensive evidence presented in this matter, I find that the generators, generator bus, step-up transformer, the intertie breaker, the underground cable, the metering box and its wires, and the metering pole, all of which are located at petitioner's facilities and on its side of the interconnect, are integral and essential parts of the production process. It is clear that this machinery works together in a "continuous and indivisible" manner "to make an integrated and synchronized system" (***see***, ***Matter of Niagara Mohawk Power Corporation v. Wanamaker***, ***supra***). The generator produces electricity at 5,000 volts which is stepped-up to 13,000 volts by the transformer. The transformer is connected to the intertie breaker, consisting of protective devices, which monitors voltage fluctuations. The intertie breaker will shut down the system if voltages drop below accepted tolerances. The intertie breaker is connected to the underground cable. The electricity flows through the underground cable to the metering box, where the amount of electricity passing into the LILCO system is measured. Right after measurement, the finished product is ready for delivery and, in fact, is delivered to LILCO. The finished product, in this case, is electricity metered at 13,000 volts. LILCO will not accept service from petitioner at lower voltages and will immediately disconnect its system from petitioner's system when there are voltage fluctuations.

The remainder of the interconnection equipment, consisting of petitioner's overhead wire which connects the metering pole to LILCO's 13 kV dedicated feeder line, LILCO's feeder line, the substation exit riser pole, the underground cable and the substation breaker, transmits and distributes the electricity to and through LILCO's system. LILCO's interconnection equipment is

used in the transmission and the distribution of electricity. Therefore, LILCO's interconnection equipment does not qualify for the production exemption found in Tax Law § 1115(a)(12).

E. The issue in this matter is whether LILCO properly collected sales tax from petitioner on the service charge, the SC-11 net demand charge, the fixed interconnection charge and the New York Telephone lease line charge. As noted in Finding of Fact "19", the SC-11 tariff defines the service and net demand charges, as well as the fixed interconnection charge. I will first address the taxability of the fixed interconnection charge. According to the tariff, the fixed interconnection charge is for maintenance of LILCO's interconnection equipment. Since it has been determined that LILCO's interconnection equipment is used in the distribution of electricity, maintenance services on that equipment are properly subject to tax (***see***, Tax Law § 1105[c][3]).

Turning next to the service charge and the SC-11 net demand charge, it is clear from the tariff that both of these charges relate to electric service which LILCO provides to each of petitioner's facilities. LILCO provides this service whenever the power production from a particular facility is inadequate to meet its own requirements or a facility is not operating. The issue then becomes whether or not this electric service is used in the production of electricity. The record clearly establishes that the sole function of each of petitioner's facilities is the production of electricity for sale to LILCO. Moreover, I have determined that all of the equipment, except petitioner's overhead wire connecting the metering pole to LILCO's feeder line, located at each of petitioner's facilities is used directly and predominantly in the production of electricity (***see***, Conclusion of Law "D"). Since the net demand charge is based on contract capacity provided under the SC-11 classification in excess of any maximum demand under the other service classification, this electric service is used directly and exclusively by petitioner in

its production of electricity and is exempt from taxation pursuant to Tax Law § 1115(c) (***see***, 20 NYCRR 528.22[c][1], [3][i], [ii]). As for the service charge, it relates to a metering device which I have determined to be a piece of exempt production equipment; therefore, it is exempt from taxation pursuant to Tax Law § 1105-B(b).

The last charge on which petitioner paid sales tax is the New York Telephone lease line charge. Petitioner contends that this is a charge necessary to the operation of the interconnection, and therefore should not be subject to tax. Petitioner has failed to prove that it is not purchasing telephone service from LILCO. The provisions of Tax Law § 1105(b) with respect to telephony and telegraphy and telephone and telegraph service impose a tax on receipts from intrastate communication by means of devices employing the principles of telephony and telegraphy. According to 20 NYCRR 527.2(d)(2), "[t]he term 'telephony and telegraphy' includes use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals." The record clearly establishes that this lease line charge is for the required dedicated telephone line which is used for telemetering of information to LILCO's supervisory computer. Therefore, the telephone lease line charge is properly subject to tax .

F. The record includes the LILCO monthly statements on which the contested sales tax was imposed. LILCO collected sales tax on the four charges discussed above. It calculated the monthly sales tax due for each facility by multiplying the sum of the four charges by the sum of the applicable state and local tax rates. Petitioner is seeking a refund of the sales tax it paid on the four charges. It has conceded that only the statewide portion of the collected sales tax may be refunded. In Conclusion of Law "E", I determined that both the service charge and the SC-11 net demand charge qualify for exemption from taxation. Therefore, taking that determination into

consideration, the Division is directed to recompute the sales tax due in this matter and issue a refund accordingly.

G. The petition of Zapco Energy Tactics Corporation is granted in accordance with Conclusions of Law "E"and "F" and in all other respects the Division's denial of petitioner's claim for refund is sustained.

DATED: Troy, New York
December 10, 1998

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE