STATE OF NEW YORK

DIVISION OF TAX APPEALS

| | | |
|---|---|---|
| In the Matter of the Petition<br>of<br>**BRITISH AIRWAYS, P.L.C.**<br><br>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 March 1, 1994 through February 28, 1997. | : | |
| In the Matter of the Petition<br>of<br>**TERMINAL ONE GROUP ASSOCIATES, LLP**<br><br>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, 1998 through September 30, 1999. | : | DETERMINATION<br>DTA NOS. 818259 and 818429 |

Petitioner British Airways, P.L.C., Attn: Maureen Brady, Manager, 75-20 Astoria Boulevard, Jackson Heights, New York 11370, 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 period March 1, 1994 through February 28, 1997.

Petitioner Terminal One Group Associates, LLP, Terminal One, JFK International Airport, Jamaica, New York 11430, 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 period June 1, 1998 through September 30, 1999.

A consolidated hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on January 9, 2002 at 10:30 A.M., with all briefs to be submitted by August 12, 2002, which date began the six-month period for the issuance of this determination. Petitioners appeared by McDermott, Will & Emery (Peter L. Faber, Esq., and Arthur R. Rosen, Esq., of counsel) and by Lynn Edward Kenner, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (John E. Matthews, Esq., of counsel at the hearing and John E. Matthews, Esq., James Connolly, Esq. and Christopher Kelly, Esq., of counsel on the brief).

## *ISSUES*

I. Whether petitioners' purchases of heated and chilled water from the Port Authority of New York and New Jersey ("Port Authority") were purchases of refrigeration and steam services which are subject to tax pursuant to Tax Law § 1105(b)(1).

II.. Whether petitioners' purchases of heated and chilled water are exempted from sales tax by Tax Law § 1116(a)(1).

III. Whether charges by the Port Authority to petitioners for heated and chilled water were identifiable sales transactions subject to sales tax pursuant to Tax Law § 1105(b)(1) or were part of petitioners' rent and thereby not subject to tax.

## *FINDINGS OF FACT*

Each petitioner entered into a written stipulation of facts (each stipulation included exhibits attached thereto) with the Division of Taxation ("Division"), the contents of which have been substantially incorporated into the following findings of fact.

1. Petitioner British Airways, P.L.C. ("British Airways") is a corporation organized under the laws of England which was, at all times relevant hereto, engaged in the business of operating an airport terminal at John F. Kennedy International Airport ("JFK") in Queens, New York.

Petitioner Terminal One Group Associates, LLP ("Terminal One") is a limited liability partnership organized under the laws of the State of New York which was, at all times relevant hereto, engaged in the business of operating an airport terminal at JFK in Queens, New York.

2. The terminals operated by petitioners are leased from the Port Authority. Under the terms of each lease, British Airways and Terminal One are required to purchase hot water and chilled water from the Port Authority to be used in the heating and cooling of the interior space of petitioners' terminals.

3. Section 18 of the lease agreement between the Port Authority and British Airways[1] is entitled "Additional Rent and Charges" and provides as follows:

> If the Port Authority is required or elects to pay the sum or sums or incurs any obligations or expense by reason of the failure, neglect or refusal of the Lessee to perform or fulfill any one or more of the conditions, covenants or agreements contained in this Agreement or as a result of an act or omission of the Lessee contrary to the said conditions, covenants and agreements, the Lessee agrees to pay the sum or sums so paid or the expense so incurred including all the interest, costs, damages and penalties, and the same may be added to any installment of rent thereafter due hereunder, and each every [sic] part of the same shall be and become additional rent, recoverable by the Port Authority in the same manner and with like remedies as if it were originally a part of the rent as set forth in Section 3.

Section 56(b)(iii) of the lease agreement between the Port Authority and Terminal One[2] provides as follows:

---

[1] A nearly identical provision is found in section 22 of the lease agreement between the Port Authority and Terminal One.

[2] A nearly identical provision is found in section 52(b)(iii) of Supplement No. 1 (dated May 4, 1993) of the lease agreement between the Port Authority and British Airways

> It is agreed that during or subsequent to the expiration of this Agreement no charge to or payment by the Lessee with respect to hot Water, Chilled Water or Chilled Water distribution gallonage shall be included in, affect, or change in any way the calculation and determination of Port Authority costs or charges under any other agreement between the Lessee and the Port Authority at the Airport and any such Port Authority cost or charge shall be calculated and determined as if no charge to or payment by the Lessee with respect to Hot Water or Chilled Water had been incurred.

4. The Port Authority is a governmental body that is described in section 1116(a)(1) of the Tax Law of the State of New York.

5. The Port Authority and KIAC Partners ("KIAC"), a New York general partnership, entered into a series of three agreements consisting of an Energy Purchase Agreement, a Construction and Operations Agreement and an Agreement of Lease (each of the agreements was dated April 28, 1993) for the construction, installation and operation of a cogeneration facility at JFK.

6. The partners of KIAC are Airport Cogen Corp., a Delaware corporation, Aviation Funding Corp., a Delaware corporation and CEA KIA, Inc., a New York corporation. After the execution of the agreements with the Port Authority, KIAC was purchased by Calpine Corp. However, the partnership and the three agreements have never been terminated and are, therefore, still in effect.

7. The hot water used in the heating systems and the chilled water used in the cooling systems at the terminals operated by petitioners are supplied by KIAC to the Port Authority which, in turn, supplies it to petitioners. The chilled water and the hot water are produced from the waste heat that results when electricity is produced by the KIAC facility. Cogeneration captures the waste heat that results when electricity is produced by gas-fired turbines. That

waste heat is used to generate hot water that is used to heat and chilled water that is used to cool the passenger terminals located in the Central Terminal Area at JFK.

8. Each petitioner can regulate the temperature of the air in its terminal but it cannot regulate the temperature of the hot water and chilled water that it receives from KIAC.

9. KIAC controls and maintains the pipes from the KIAC plant to and from and including the heat exchangers located in the mechanical equipment rooms in the airport terminals. The hot water is delivered in excess of 240 degrees Fahrenheit and at a pressure of 250 pounds per square inch ("psi"). British Airways and Terminal One control and maintain the hot water distribution and air handling systems on the terminal side of the heat exchangers. KIAC's hot water never gets commingled with the hot water of British Airways or Terminal One. KIAC maintains its portion of the system at no additional charge. Each petitioner maintains the pipes and other equipment in its terminal at its own expense. The Port Authority has no maintenance responsiblity.

10. The heat exchanger is a large insulated box, as big as a large room, with compartments. The KIAC hot water enters the heat exchanger and flows through alternate compartments, flowing out of the heat exchanger after passing through each alternate compartment. The British Airways and Terminal One water, at a lower temperature, flows through a second set of alternate compartments through which the KIAC hot water in the adjacent compartments does not flow. Consequently, some of the heat, i.e., thermal energy from the KIAC hot water, is transferred to the British Airways and Terminal One water. This raises the temperature of the British Airways and Terminal One water. Ultimately, the KIAC water, at a lowered temperature, exits the heat exchangers and is returned to the KIAC facility. The

British Airways and Terminal One water circulates around its terminal and returns to the heat exchanger at a lowered temperature.

11. When cooling of the terminal is required, KIAC delivers chilled water to the mechanical equipment room of the terminal in pipes controlled and maintained by KIAC. That water then flows into pipes controlled and maintained by British Airways or Terminal One for distribution to air handling equipment throughout its terminal. The water, at a raised temperature, is then returned to the mechanical equipment room in pipes controlled and maintained by the lessee (British Airways or Terminal One) for return to the KIAC plant through pipes controlled and maintained by KIAC. KIAC maintains its portion of the system at no additional charge. The terminal operator maintains its equipment at its own expense. On exiting the terminal for return to the KIAC facility, the temperature of the water is thus elevated. The Port Authority has no maintenance responsibility.

12. The lessee's (British Airways and Terminal One) chilled water and hot water requirements are supplied by the Port Authority. Both the chilled water and hot water charges by the Port Authority to British Airways and Terminal One are based on the thermal energy used as calculated by the increase in temperature and the volume of chilled water used or, alternatively, by the decrease in temperature and the volume of hot water used. The thermal energy used is converted into British Thermal Units ("BTUs"). The charge for this water by the Port Authority is a unit charge, different for hot and chilled water, multiplied by the number of BTUs. The Port Authority also charged British Airways and Terminal One for any loss of system water inside the terminal. Petitioners conceded that the amounts due from petitioners to the Port Authority for the heated and chilled water were separately stated and were based upon separately metered charges (tr., p.15).

13. British Airways filed a claim for refund of sales tax paid to the Port Authority on its purchases of the heated and chilled water for the period March 1, 1994 through February 28, 1997.[3] The amount of refund sought was $642,589.17, of which approximately $100,265.00 represented tax paid on purchases of heated water and $542,323.00 represented tax paid on chilled water purchases. On February 23, 2000, the Division denied, in full, the claim for refund.

Terminal One filed three claims for refund of sales tax paid to the Port Authority on its purchases of the heated and chilled water for the period June 1, 1998 through September 30, 1999. The first claim sought a refund in the amount of $269,367.76 ($28,014.33 attributable to heated water, $241,353.43 to chilled water), the second claim sought a refund of $77,592.71 (all attributable to tax paid on purchases of chilled water) and the third refund claim was in the amount of $84,852.09 (all attributable to tax paid on purchases of chilled water). By letters dated January 20, 2000, the Division denied, in full, each refund claim.

While the denial letter issued to British Airways indicated that the refund was based on tax paid on HVAC (heating, ventilation and cooling) services "as part of your monthly rental charges," it also indicated that "[r]eview of the books, records and documentation submitted fail to substantiate the basis of the amount of refund claimed."

With respect to the three claims for refund submitted by Terminal One, the Division issued letters denying the claims, each of which contained the following explanation:

> Tax Law section 1105(b) imposes a tax on the 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. The words 'of whatever nature' indicate that a broad construction is to be given the terms describing the items to be taxed (Regulation section

[3] The claims for refund filed by British Airways and Terminal One are not part of the record herein. Accordingly, the exact date of their filing with the Division cannot be ascertained.

> 527.2(a)(2)). Regulation section 527.2(c) further defines refrigeration to include air conditioning.
>
> Utility charges imposed by a landlord to a tenant to real property, if not based on actual consumption, are considered to be additional rental charges and not subject to tax. For example, if the rental of property includes electricity service in the base rental charge or the building's electricity expenditures are prorated among the tenants based on square footage or some other method not based on actual usage, these charges would be considered additional rent. However, if the electricity is charged to the tenant based upon usage determined by separate meters, the charge is deemed to be a charge for electricity and is taxed.
>
> The charges by the Port Authority of New York and New Jersey to Terminal One Group Association, LLP ("TOGA") are metered charges for electricity measured in BTU's for heating and air conditioning of TOGA's passenger terminal at JFK International Airport. Since the charges are based on actual consumption, your refund application is denied in full.

14. Jerome Levine is a consulting engineer in the HVAC industry who began working in the industry in the early 1930s. He has been involved in the installation, service and design of heating, cooling and refrigeration systems and worked full-time in the business from 1947 through 1982. In the early 1950s, he founded Jerome G. Levine, Inc., an engineering consulting company whose clients included the Empire State Building, the Met Life Building and the Marriott Marquis hotel in New York City. Mr. Levine, who was qualified at the hearing as an expert witness, has testified in other matters, as an expert, with respect to HVAC systems.

Mr. Levine knows of no individuals or independently owned companies that sell heated or chilled water in New York State. His knowledge is obtained from his many years in the business as well as his attendance at meetings and seminars over the years. Cushman & Wakefield is a company which sells condensed water (an open system which is exposed to the atmosphere) through which premises are cooled through the use of compressors which compress Freon. The Freon leaves the compressor at a highly elevated temperature and is then delivered to a condensor where the water is used to cool it. The condensor water picks up the BTUs or heat

from the Freon and is circulated to a water tower on the roof of the building where it is recooled somewhat by the passage of circulating air and is then recirculated once more down to the condensor. The condensor water ends up evaporating somewhat so additional water must be added.

The chilled water system which is used by British Airways and Terminal One in its terminals at JFK Airport is a "closed system" and since the chilled water is never actually used, it is not necessary to add water.

15. The heating system utilized at petitioners' terminals begins with KIAC's manufacture of electricity at its cogeneration plant. A by-product of the cogeneration plant is heat which is used to heat the water to a temperature of between 240 and 280 degrees Fahrenheit. The water is delivered in a single loop at a pressure of 250 psi. Because the water is under this pressure, it does not boil despite its temperature. Since the water does not boil, there is no steam produced. In a steam system, the steam is delivered by underground pipes into buildings. It goes through a reducing valve because the pressure of the steam is very high. The steam then goes through radiators and subsequently becomes condensate which is discarded. The condensate is delivered into a sewer and is never returned to the company (Con Edison sells steam in New York City) which produced it. The steam is not returned to the supplier because it would be very difficult to do so, i.e., the condensate is a fluid under no pressure and an additional set of pipes would be needed to return it. The customer of a steam system actually uses the steam which is in the radiators. A larger piping system than the one utilized at JFK is needed; in a steam system, the pipes must be slanted or pitched so that condensate does not build up. In the 1930s, steam systems were more prevalent; Mr. Levine has not installed a steam system in approximately 45 years. Steam systems are more difficult to install than hot water systems and are difficult to zone

within a building. Hot water is more easily zoned, and since there is no condensate, there is no need to pitch or slant pipes.

In the system at issue in the present matter, the water leaves the Port Authority plant, goes underground in piping through all of the terminals and is returned in the same pipe. As it goes through the terminals, the water loses some of its heat so it is returned to the cogeneration plant where it is reheated.

As the water enters the terminals, it goes through a heat exchanger which transfers the heat from the water to the water in the terminal. Each terminal has its own separate loop where water circulates through the terminal by means of terminal-owned pumps and piping through air handlers. In the air handler, there is another heat exchanger. The heated water passes through the heat exchanger and, utilizing filters, delivers air with a fan over the heat exchanger where the air picks up heat. This heated air is then delivered to various spaces throughout the terminal. The water in the pipes from the cogeneration facility never gets into the possession or control of the terminal operator.

16. For purposes of the cooling system at issue herein, the chilled water is produced by using an absorption chiller (the water is chilled by absorption of a salt product). The end result is water at a temperature of approximately 45 degrees Fahrenheit. The chilled water is circulated underground in separate piping. From this piping, the water enters the terminals and is later returned to the cogeneration plant. The chilled water, upon its entry into the terminal, goes through a heat exchanger, draws air through a filter and fan and exits as chilled air which can be delivered to individual portions of the terminal. Condensate drips off the coils and is collected in a condensate pan which is delivered to a safe discharge point.

Air conditioning requires filtering and cleaning the air and then moving the air. It involves a heat exchange so the air can be chilled and the humidity removed. If the fans do not operate, there can be no air conditioning; the cold air would simply fall to the floor as it exits the system. While there is always a need to clean the air, it is especially necessary at these airline terminals due to the exhaust from the airplanes.

17. Refrigeration is primarily used to preserve food and drugs. It aims for temperatures from 20 to 40 degrees Fahrenheit. Unlike an air conditioning system, there are no fans necessary for refrigeration. The refrigeration process is one which operates below the freezing point of water. The medium used has to be at a temperature of approximately 20 degrees below the temperature sought, i.e., if one wants to maintain a refrigeration unit at 40 degrees, the medium must be at a temperature of approximately 20 degrees. Water cannot be used as a medium for refrigeration at 45 degrees or below since to be so utilized, the water would have to be at a temperature of 25 degrees or below and water freezes at 32 degrees.

While ventilation is an important element of air conditioning, it is not so in refrigeration since people do not reside inside the refrigerating unit. There is, therefore, no need to filter the air, add fresh air or remove the humidity from the air. For refrigeration, the air must merely be cooled and contained in a closed environment. De-icing is very important in refrigeration, but not so in air conditioning.

18. The Division introduced, from Microsoft's Encarta Encyclopedia 2001, a definition of "refrigeration"which was defined as the "process of lowering the temperature and maintaining it in a given space for the purpose of chilling foods, preserving certain substances, or providing an atmosphere conducive to bodily comfort."

From the same source, the Division introduced a definition of "air conditioning"which provides as follows:

> Theoretically, an air-conditioning system consists of centralized equipment that provides an atmosphere with controlled temperature, humidity, and purity at all times, regardless of weather conditions. In popular usage, however, the term *air conditioning* often is applied improperly to air cooling. Many so-called air-conditioning units consist merely of blower-equipped refrigerating units that provide only a flow of cool, filtered air.
>
> * * *
>
> Air-conditioning units are rated in terms of effective cooling capacity, which properly should be expressed in kilowatt units. Usage still supports the term *ton of refrigeration*, which implies the amount of heat that would have to be absorbed to melt a ton of water-ice in 24 hours . . . .

19. Morris A. Pierce, PhD, was qualified at the hearing as an expert in HVAC systems and district heating and cooling systems as well as in the history of technology. Dr. Pierce is employed by the University of Rochester (New York) as the university energy manager for the Facilities Department (he is responsible for the heating, cooling and ventilation of a 10 million square foot facility). He also holds a position in the History Department where he teaches the history of technology, American military technology and the history of the City of Rochester. The subject of Dr. Pierce's PhD thesis was the historical origins of district heating. He worked as a consultant on a district heating and cooling system with the City of Buffalo and on large systems in Rochester, Albany, and Boston, as well as for the State of New York in Albany.

"District heating and cooling" is an application where energy for heating and cooling is provided from a central plant and is then distributed to individual buildings through underground pipes. "Thermal energy" is energy used to add heat or reject heat from a facility or building. District heating is done either with steam or hot water; district cooling is done with chilled water. Historically, attempts were made to use hot or chilled air, but this did not work well.

In addition to the terminals at JFK Airport, there are a small number of systems in New York State that use hot water and chilled water, to wit: Nassau County, where the county purchases thermal energy from a privately-owned plant and then resells it to a number of consumers; the City of Jamestown; and the City of Buffalo. Dr. Pierce is aware of no other cases in the State where heated or chilled water is offered for sale; there are no nongovernmental entities which sell chilled or heated water in New York State. Dr. Pierce's conclusion is based upon his research in the history and application of district heating and cooling as well as his reading of reports and magazines on the subject. This conclusion is also the result of Dr. Pierce's activities as the historian for the International District Energy Association for which he has written several articles and maintained its web site and archives.

The district heating industry began in New York State in the City of Lockport in 1877. The patents from that original process were purchased by the New York Steam Company which installed the system in New York City. Shortly thereafter, a number of competing systems were established which used hot water. Some of these hot water systems were in Pennsylvania; most were in Ohio, Illinois, Indiana and other midwestern states. No hot water system was installed in New York State until after World War II.

In the early 1900s, there was a trend to regulate utilities at the state level. In New York State, the Public Service Law was adopted in the early 1900s. While steam was subject to regulation, hot water was not since there were no hot water companies.

20. Dr. Pierce described how hot water is used in a district heating system. The water is heated at a central facility and is distributed through underground pipes to customers' buildings. The customers' systems take the heat out of the water to heat the buildings and then send the water back to the facility to be reheated. In hot water systems, the water can be as hot as 400

degrees although, in most newer systems, the water is heated to between 180 and 200 degrees. Because of the pressure, the water never becomes steam even if heated to a temperature of more than 212 degrees Fahrenheit.

There are numerous differences between steam district heating systems and hot water district heating systems. Hot water systems generally use smaller pipes although two pipes are required since the hot water is returned to the central facility. The pipes in a hot water system do not move as much as in steam systems. Steam systems have extensive expansion joints and safety devices because, as Dr. Pierce described it, "steam is a very nasty gas at high pressures and the pipes move . . . ." (Tr., p. 110.) At petitioners' terminals, no steam is involved.

21. In 1983, the Cogeneration Development Corporation petitioned the New York State Public Service Commission ("PSC") for a ruling as to whether the PSC had jurisdiction over a hot water heating system which the corporation proposed to construct in the City of Rochester. The Declaratory Ruling, served on April 22, 1983, stated, in relevant part, as follows:

> The hot water district heating system, as described in the March 17, 1983 petition, does not constitute 'steam plant', within the meaning of § 2(21) of the Public Service Law and the corporation which owns, operates or manages the system is not a 'steam corporation' within the meaning of § 2(22) of Public Service Law.

22. Inside petitioners' terminals where refrigeration service must be provided for restaurants and other food services, this service is provided using stand-alone compressors. The services purchased by petitioners from the Port Authority are not used at all in the refrigeration service. If petitioners were purchasing refrigeration, they could supply that refrigeration directly to their subtenants who are operating the food services.

Refrigeration is technically a thermodynamic process to reduce or reject heat through a mechanical process. The range of temperatures which is typically associated with refrigeration,

for commercial application, is from 20 degrees below zero up to freezing (32 degrees) or slightly above in the case of storage of milk and other fluids. The medium delivering the thermal energy to cause a reduction in temperature has to be at least 20 degrees less than the desired temperature.

In the present matter, the plant where the water is chilled could be referred to as a refrigeration plant since a refrigerant is often used to produce the chilled water. Chilled water cannot be used for refrigeration because in order to cool to 45 degrees or below, the cooling medium would have to be at 25 degrees or below and chilled water would be frozen at these temperatures. Chilled water can be used for cooling and dehumidification.

Mechanical refrigeration began in the 19th century for industrial and food storage. It was widely used on ships to transport food. As electricity became available, smaller and smaller refrigerating machines were produced. Refrigeration is primarily the production of cold and is generally not concerned with the conditions inside the particular refrigerating unit.

In the early 20th century, there were district refrigeration companies in New York State. There were several such companies in New York City. Some of them used ammonia as a refrigerant while others used very cold brine. In the early 20th century, there were numerous attempts to adapt refrigeration for use in cooling areas to make people more comfortable. They were generally unsatisfactory because they did not deal with the other factors involved in the air conditioning comfort cooling. In the early 1920s, if a business such as a movie theater was attempting to inform the public that it was cool inside its facility, it would use the word "refrigeration." In the 1920s, with the adoption of electricity, the heating and ventilation industry got involved in comfort cooling and this industry began to make small cooling units that they adapted to the heating and refrigeration units. By the end of the 1920s, the heating and

ventilating industry won out over the refrigeration industry for the space cooling market. By the early 1930s, the term "refrigeration" reverted back to the industrial meaning which was simply the process of dealing with colder temperatures such as with food storage and industrial activities.

23. The term "air conditioning" was first used in a 1906 patent application. The earliest published definition of "air conditioning" occurred in 1908 to describe an air conditioning system in a textile factory and included temperature control (both heating and cooling), humidification, dehumidification and filtering of the air. After the 1930s, the term "refrigeration" was not used for what is presently known as air conditioning.

24. There are approximately 100 district cooling companies in the United States. There are "only a handful" of district hot water systems in the United States ( the largest is in St. Paul, Minnesota) and even fewer in New York State which still has more steam systems (the Con Edison system which began in 1882 is the largest in the world).

In the 1890s and early 1900s, most of the large cities in the United States had at least one district refrigeration system. In New York City, Merchant's Refrigeration Company, which began operation in 1906 or 1907, is still in business today. It supplies refrigeration service to a number of food storage facilities.

***SUMMARY OF THE PARTIES' POSITIONS***

25. Petitioners allege:

a. The hot water service and chilled water service purchased by petitioners from the Port Authority are not subject to tax pursuant to Tax Law § 1105(b)(1) because they are not enumerated services under the statute. Petitioners' purchase of hot water is not the

purchase of steam or a steam service and their purchase of chilled water is not the purchase of refrigeration or a refrigeration service as the terms are commonly understood;

b. The provider of the hot water and chilled water services, the Port Authority, is a governmental unit and since these services are not ordinarily sold by private persons, the services are exempt from tax pursuant to Tax Law § 1116(a)(1); and

c. The seller of the hot water and chilled water services was petitioners' landlord; therefore, the services were part of petitioners' nontaxable rent.

26. In response, the Division contends:

a. The Port Authority's sales of the hot water and chilled water services are identifiable sales transactions subject to tax under Tax Law § 1105(b)(1), i.e., the chilled water service falls within the broad definition and plain meaning of "refrigeration" and the hot water services were purchases of "steam" or a "steam service";

b. The Port Authority's sales of the hot water and chilled water services are not exempt from taxation by Tax Law § 1116(a)(1) because: (1) the application of the statute is not confined only to New York vendors (and there is evidence that similar services are sold in other states) and (2) the exemption is not restricted to private persons using the identical technology used in the present matter, i.e., the general category of the subject services is steam and refrigeration services, not just companies supplying those services through district heating and cooling technology using circulating hot and chilled water; and

c. The Port Authority's charges to petitioners for the hot and chilled water services are identifiable sales transactions since they reflect actual utility usage measured in a way so that the tax thereon can properly be computed and, pursuant to the provisions of the lease

agreements between petitioners and the Port Authority, such charges are not treated as additional nontaxable rent.

## *CONCLUSIONS OF LAW*

A. Tax Law § 1105(b)(1) imposes a sales tax upon the receipts from every sale, other than a sale for resale of "refrigeration and steam . . . refrigeration and steam service of whatever nature."

Clearly, the statute does not *specifically* impose a tax upon the sale of hot or chilled water services. Petitioners contend that such services are not subject to tax because they are not specifically enumerated in the statute. The Division, in response, maintains that the term "refrigeration and steam service" encompasses the services sold to petitioners by the Port Authority and, therefore, the issue is one of statutory interpretation.

It is interesting to note that in their briefs, in support of these positions, both petitioners and the Division cite to ***Patrolmen's Benevolent Assn. v. City of New York*** (41 NY2d 205, 391 NYS2d 544). In that case, an action was brought by the Patrolmen's Benevolent Association of the City of New York seeking to enforce an order and judgment requiring the City to pay a salary increase. The City contended that it was prohibited from paying the increase by wage freeze legislation adopted by the Legislature. The Court of Appeals, asked to decide whether this legislation was applicable to a salary increase embodied in a judicial judgment, stated:

> It is fundamental that a court, in interpreting a statute, should attempt to effectuate the intent of the Legislature . . . and where the statutory language is clear and unambiguous, the court should construe it so as to give effect to the plain meaning of the words used . . . . Hence, where as here the statute describes the particular situations in which it is to apply, 'an irrefutable inference must be drawn that what is omitted or not included was intended to be omitted or excluded.
> ***(Id***., at 208, 209, 391 NYS2d at 546; citations omitted.)

"[T]ax laws should be interpreted as the ordinary persons reading them might be led to expect them to be, or as the ordinary person would interpret them" (McKinney's Cons Laws of NY, Book 1, Statutes § 313[a]).

> It is a basic general rule that tax statutes are to be strictly construed, and not given a wider scope than their language justifies. Such statutes are not to be extended by implication, or beyond the clear import of the language employed, and their operations should not be enlarged so as to embrace matters not specifically pointed out. Thus where property is not expressly included in a taxing act it may not be taxed by implication or by stretching statutory language, or by invoking their spirit (McKinney's Cons Laws of NY, Book 1, Statutes § 313[b].

In ***Debevoise & Plimpton v. New York State Dept. of Taxation and Finance*** (80 NY2d 657, 661, 593 NYS2d 974, 976), the Court stated:

> When the particular statute is one which levies a tax, it is well established that it must be narrowly construed and that any doubts concerning its scope and application are to be resolved in favor of the taxpayer. . . . Thus, a taxing agency may not extend the meaning of legislation so as to permit the imposition of a tax in situations not embraced within the statute (citations omitted).

B. As previously noted, Tax Law § 1105(b) does not impose a tax upon the sale of hot or chilled water, but rather on refrigeration and steam services. The Division seeks to have the statute construed to include chilled water within what it refers to in its brief as the "broad definition" of refrigeration and to include hot water within the scope of steam services.

Petitioners have offered the testimony of two experts in the HVAC industry, Jerome Levine, who has been involved in the installation, service and design of heating, cooling and refrigeration systems for nearly 70 years, and Dr. Morris A. Pierce, an expert not only in HVAC systems and district heating and cooling systems, but in the history of technology as well. Both of these experts stated unequivocally that there are significant differences between the hot and

chilled water services sold by the Port Authority to petitioners and "refrigeration and steam" services.

With respect to the hot water service at issue herein, Mr. Levine indicated that in the heating system utilized at petitioners' terminals, the water is heated to a temperature of between 240 and 280 degrees Fahrenheit and is delivered at a pressure of 250 psi. Because of this pressure, the water does not boil and no steam is, therefore, produced. Mr. Levine described the various differences between a steam system and a hot water system such as: (1) steam is delivered into radiators through large pipes which must be slanted or pitched due to the buildup of condensate and the steam subsequently becomes the condensate which is discarded; in a hot water system, the delivery pipes are much smaller and the water is never discarded but is returned to the cogeneration plant to be reheated and reused; and (2) the customer of a steam system actually uses the steam which is in the radiators for heat; in the hot water system herein, the water enters the terminals and, by means of heat exchangers, pumps and air handlers, heats the air inside the terminals but never gets into the possession or control of the terminal operator.

Dr. Pierce noted that in hot water systems, unlike steam systems, two pipes are used since the water must be returned to the central facility. In addition, in steam systems, extensive expansion joints and safety devices must be employed due to potential danger from the high steam pressure. Dr. Pierce indicated that no steam was involved in the heating of petitioners' terminals. He was also familiar with a PSC ruling wherein the PSC held that a hot water district heating system, proposed in the City of Rochester where Dr. Pierce resides and is employed (at the University of Rochester), did not constitute a steam plant and was, therefore, not subject to regulation by the PSC.

As to the chilled water service sold by the Port Authority to petitioners for use in cooling the air within their terminals, Mr. Levine described the process in detail, noting that petitioners purchased chilled water at a temperature of approximately 45 degrees Fahrenheit. He indicated that the service utilized at the terminals was vastly different from the refrigeration process which, he noted, operates below the freezing point of water. This is true because the refrigerating medium has to be at a temperature of approximately 20 degrees below the temperature sought. Since refrigeration is primarily used to preserve food and drugs, it aims for temperatures from 20 to 40 degrees Fahrenheit and if water was used, it would have to be at a temperature 20 degrees colder, or between 0 and 20 degrees Fahrenheit at which temperatures the water would be frozen. Mr. Levine also drew distinctions between air conditioning for which the chilled water service was utilized and the refrigeration process. He noted that air conditioning requires a filtering and cleaning of the air which must then be moved by fans. In addition, air conditioning needs a heat exchange so that the air can be chilled and the humidity removed. On the other hand, refrigeration needs no ventilation. The air must merely be cooled and contained in a closed environment and, therefore, there is no need to filter or remove the humidity from the air. De-icing is necessary in the refrigeration process but not in air conditioning. When asked, during cross examination, why KIAC's plant was called CHPP (Central Heating and Refrigeration Plant), Mr. Levine stated that while KIAC manufactures some of the energy via a refrigeration system, what is sold to the Port Authority is chilled water which, in turn, is delivered to the terminals. Once the Port Authority has control of it, no refrigeration is involved. What is being sold by the Port Authority to petitioners is water, not refrigeration.

Dr. Pierce agreed with Mr. Levine that in the case of refrigeration, since the medium delivering the thermal energy to cause the reduction in temperature has to be at least 20 degrees less than the desired temperature, water cannot be used since it would be frozen at the temperature sought in refrigeration. He testified regarding the history of the refrigeration industry and noted that in the early 1920s, the term "refrigeration" was often used to inform the public that the inside of a facility had been cooled. However, he stated that after the 1930s, the term "refrigeration" was not used for what is commonly referred to as "air conditioning" today. As to the chilled water system at issue in this case, Dr. Pierce stated that it was not a refrigeration system.

C. The Division, as its primary support, seeks to utilize a dictionary definition of "refrigeration" where terms such as "cause to become cool" and "make or keep cold or cool" are used. The Division then contends that because the Port Authority causes water which is chilled by a "refrigeration" unit owned by KIAC to circulate via pipes to petitioners' terminals, that this constitutes a sale of a refrigeration service. The Division cites to various articles on air conditioning submitted by petitioners, which explain that air conditioning involves the *refrigeration* of air when it is too hot. It must be noted that these articles were written from the 1930s through the 1950s, long before the enactment of Article 28 of the Tax Law in 1965.

The Division contends that there is no proof that in imposing the tax, the Legislature meant to use the term "refrigeration" in any but its broadest sense, and therefore, petitioners' claim that it has a specialized industrial meaning of cooling to 45 degrees or lower is without merit. The Division also asserts that one of the difficulties it has with the position of petitioners, i.e., that the Port Authority's service is not refrigeration, is that petitioners "are unable to adequately describe how that service should be classified if not refrigeration" (Division's brief,

p. 12). However, when claiming an exemption from tax, it is not necessary for the party claiming such exemption to properly categorize the property or service for which exemption is claimed. It is quite sufficient for the claimant to merely prove that the subject property or service is not an enumerated service under the taxing statute, and these petitioners have sustained that burden of proof. Clearly, had the Legislature intended to impose a tax upon air conditioning services and any products which produce air conditioning, it could have done so, either at the time of the enactment of section 1105(b) or by subsequent amendment thereto. Accordingly, it is hereby determined that the sale of chilled water is not a sale of refrigeration or a refrigeration service and petitioners should not have been required to pay sales tax upon their purchases of the chilled water from the Port Authority.

D. With respect to the sale of the hot water service, the Division states that hot water and steam are identical with respect to their molecular or chemical composition and, if not for the pressure (250 psi), the water would be converted to steam. The Division cites to 20 NYCRR 527.2(a)(2) wherein it is stated that the words "of whatever nature" in Tax Law § 1105(b) indicate that "a broad construction is to be given the terms describing the items taxed." However, to subscribe to the Division's position would be to totally ignore the rules of statutory construction previously set forth (***see***, Conclusion of Law "A"). In this instance, the Division has not pointed to a dictionary definition of "steam" which is: "a vapor arising from a heated substance" or "the invisible vapor into which water is converted when heated to the boiling point" or "water vapor kept under pressure so as to supply energy for heating, cooking or mechanical work" (Webster's Collegiate Dictionary 1153 [9th ed 1988]).

There is no vapor utilized in the service provided by the Port Authority to petitioners. As both of petitioners' expert witnesses have clearly shown, there are marked differences between a

steam system and the hot water system at issue herein. Section 1105(b) of the Tax Law imposes a tax upon the sale of steam and steam service; there is no tax imposed on substances with similar molecular or chemical composition such as water or ice. It must, therefore, be determined that the sale of the hot water service by the Port Authority to petitioners is not subject to tax, and accordingly, petitioners should not have been required to pay sales tax on their purchases of this service.

E. ***Debevoise & Plimpton*** (***supra***) must again be addressed because it has been cited by the parties and, accordingly, may have some relevance to the issues presented herein. The case involved a challenge by a commercial tenant to the State's right to impose and collect sales tax on payments by the tenant to its landlord for overtime heating, ventilation and air conditioning. Similarly, as with the present matter, the heating was accomplished not by steam directly (although, apparently, the landlord purchased steam from Consolidated Edison which it may have, in some way, used to dispense the HVAC services) but by heated water circulated throughout the premises. The air conditioning resulted from a circulation of glycol, not chilled water as in the case at issue. At the lower court level (***Debevoise & Plimpton v. New York State Dept. of Taxation and Finance***, 565 NYS2d 973), the State Supreme Court, New York County, held that provision of these HVAC services did not constitute a sale of gas, electricity or refrigeration or steam within the meaning of Tax Law §1105(b). This decision was made in spite of a Division regulation (20 NYCRR 527.2[c][1]) which provided that "the sale of air conditioning is a sale of refrigeration service." The Court stated that it was "satisfied that the legislative intent in enacting Tax Law § 1105(b) was . . . not to tax the provision of heat and air conditioning to business premises but rather the products that are used to produce these results" (***id***.at 978). The Appellate Division affirmed the decision of the Supreme Court (183 AD2d 521,

584 NYS2d 298). The Court of Appeals (80 NY2d 657, 593 NYS2d 974), affirming the Appellate Division, held as follows:

> The Department's only statutory basis for taxing the overtime supply of HVAC under section 1105(b) is that such supply constitutes a sale of 'refrigeration and steam service'. But, steam and refrigeration costs constitute only a minor component of the landlord's charges for heating and air conditioning which include purchase of electricity, labor, maintenance, depreciation and overhead and furnishing of ventilation and air circulation (***id***. at 663).

In its brief, the Division attempts to distinguish the present matter from ***Debevoise & Plimpton*** by contending that in the case at issue, the Port Authority was "providing only the refrigeration component which the tenants use for the air-cooling aspect of their air-conditioning systems" (Division's brief, p. 13). The Division is only partially correct. In ***Debevoise & Plimpton***, the air conditioning was accomplished not by chilled water but through the circulation of glycol, a substance containing alcohol. While it is unclear as to whether glycol can be used in refrigeration, it is evident from the testimony of Jerome Levine and Dr. Morris Pierce that chilled water cannot. In addition, the landlord in ***Debevoise & Plimpton*** was taxed by the Division on its acquisition of steam. In the present matter, there is no evidence that steam was used by KIAC or by the Port Authority in any manner. While, as the Division correctly points out, the piping, heat exchangers, pumps, fans, filters, etc., which are used to convert the chilled water into air conditioning are the property and responsibility of the terminal, i.e., petitioners, nowhere in the ***Debevoise & Plimpton*** decision did the Court hold that but for these additional components of the landlord's charges, the sales of *heated and chilled water* from a landlord to a tenant are taxable sales of steam and refrigeration services. Quite simply, while there are some similarities, there are enough factual differences to distinguish the cases. Accordingly, it must be found that ***Debevoise & Plimpton*** stands for the principle that Tax Law § 1105(b) does not

impose a tax upon the sale of HVAC services as sales of steam and refrigeration services because the intent was not to tax the provision of heat and air conditioning, but to tax the products that are used to produce them. If steam and refrigeration were major components of the heating and air conditioning, it seems clear that tax would be properly imposed. In the present matter, however, not only are steam and refrigeration not major components of the services purchased by petitioners from the Port Authority, but as has been shown from the testimony of Jerome Levine and Dr. Morris Pierce, steam and refrigeration are not components at all.

F. Tax Law § 1116(a)(1) provides as follows:

> Except as otherwise provided in this section, any sale or amusement charge by or to any of the following or any use or occupancy by any of the following shall not be subject to the sales and compensating use taxes imposed under this article:
>
> (a) The state of New York, or any of its agencies, instrumentalities, public corporations (including a public corporation created pursuant to agreement or compact with another state or Canada) or political subdivisions where it is the purchaser, user or consumer, or where it is a vendor of services or property of a kind not ordinarily sold by private persons;

Pursuant to a stipulation entered into between the parties, it is agreed that the Port Authority is a governmental body that is described in section 1116(a)(1) of the Tax Law (***see,*** Finding of Fact "4"). Therefore, if it is determined that its sales of the hot and chilled water services to petitioners were services "of a kind not ordinarily sold by private persons," such sales would have been exempt from tax.

Jerome Levine stated that he is aware of no individuals or private companies that sell heated or chilled water in New York State. Dr. Morris Pierce testified that there are no private providers of hot and chilled water services in New York State. Other than the Port Authority, the only provider of hot and chilled water services in the State is Nassau County. In addition, the

City of Buffalo and the City of Jamestown provide a hot water service. He acknowledged, however, that there is a private company in Hartford, Connecticut which supplies steam and chilled water. There are also approximately 100 district cooling companies in the United States and "a handful" of companies, the largest of which is in St. Paul, Minnesota, which are hot water district heating companies in the United States.

Petitioners assert that the purpose of imposing tax on sales by governmental entities of property and services ordinarily sold by private persons is to ensure that the governmental entities do not gain an unfair competitive advantage that would harm businesses operating in New York State. Therefore, petitioners maintain, it is irrelevant that there may be private persons selling these hot and chilled water services in states other than New York since such sales would not be causing any disadvantage for New York businesses.

In response, the Division argues that petitioners have mistakenly assumed that only the existence of private persons making sales *in New York* and using the identical technology to deliver the hot and chilled water services would render the exemption inapplicable to the transactions at issue herein. The Division contends that the statutory language does not support these assumptions. It cites to the fact that there are private companies which sell similar services in other states and companies, within New York State, which sell refrigeration services and steam services using different technology. Therefore, the Division contends that this exemption is inapplicable to the matter at issue herein.

G. The Division's position that the exemption does not apply because there are private companies which sell refrigeration services and steam services using different technology is rejected. As petitioners, in their reply brief, assert, the provision of hot and chilled water cannot

be grouped into a general category of heating and cooling services (or steam and refrigeration services) for purposes of section 1116(a)(1).

However, it must be found that the Division is correct in its position that the language of the statute does not provide that the exemption applies only if the services or property are of a kind not ordinarily sold by private persons *in the State of New York*. The fact that there are other private companies, in other states, which sell similar services, renders the exemption provided by Tax Law § 1116(a)(1) inapplicable to these petitioners.

H. Finally, petitioners contend that the charges by the Port Authority to petitioners for heated and chilled water were not identifiable sales transactions subject to tax under Tax Law § 1105(b)(1) but were, instead, part of petitioners' rent and thereby not subject to tax. The Division, citing ***Debevoise & Plimpton v. New York State Dept. of Taxation and Finance*** (***supra***) and ***Matter of Mutual Redevelopment Houses, Inc.*** (Tax Appeals Tribunal, June 6, 2002), asserts that since the charges by the Port Authority to petitioners are based on actual thermal energy used and are based on separately metered charges, they are identifiable sales transactions, separate articles of commerce which may be subject to the imposition of tax.

In ***Matter of Mutual Redevelopment Houses, Inc***.(***supra***), the Tribunal, in its analysis of ***Debevoise & Plimpton,*** stated that the Court of Appeals concluded that section 1105(b) of the Tax Law authorizes a tax on utility service only when furnished in an identifiable sale transaction as a commodity or article of commerce and did not apply to additional rent paid for HVAC services when supplied as an incident to the rental of the premises. The Tribunal stated: "We interpret this as meaning that the charges for utility service must reflect the tenants' actual utility usage measured in some way, so that the tax thereon can be properly computed." The Tribunal then, stating it another way, held that "if otherwise taxable gas, electricity, refrigeration

and steam or such services are provided as an incident of a lease agreement and *not as separate transactions*, then they are not subject to tax."

While I agree with the Division that, contrary to petitioners' contentions, the lease provisions between petitioners and the Port Authority do not treat petitioners' charges for the hot and chilled water services as additional rent and, therefore, such services were furnished in an identifiable sales transaction, the fact remains (***see***, Conclusions of Law "C" and "D") that these services are not otherwise taxable as refrigeration or steam services. Accordingly, despite being identifiable sales transactions, the charges from the Port Authority to petitioners for the hot and chilled water services are not subject to tax under Tax Law § 1105(b) because they were not for enumerated services, i.e., they were not for refrigeration or steam services.

I. The petitions of British Airways, P.L.C. and Terminal One Group Associates, LLP are granted.

DATED: Troy, New York
February 6, 2003

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE