

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-06(1)M
Miscellaneous Tax
February 1, 2006

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M041122A

On November 22, 2004, the Department of Taxation and Finance received a Petition for Advisory Opinion from American Sugar Holdings, Inc., One Federal Street, Yonkers, New York 10702, c/o Christopher L. Doyle, Hodgson Russ, LLP, One M&T Plaza, Suite 2000, Buffalo, NY 14203-2391. Petitioner, American Sugar Holdings, Inc., provided additional information pertaining to the Petition on March 21, 2005.

The issues raised by Petitioner are:

1. Whether Petitioner is a *petroleum business* for purposes of the Petroleum Business Tax (“PBT”) under Article 13-A of the Tax Law.
2. Whether unenhanced diesel motor fuel (heating oil) purchased at retail by Petitioner for consumption in the production of sugar for sale through a process known as “refining” constitutes *manufacturing gallonage* under the PBT.
3. Whether Petitioner may be held liable for payment of PBT on heating oil consumed other than as manufacturing gallonage.

Petitioner submitted the following facts as the basis for this Advisory Opinion.

Petitioner is engaged in the production of crystal sugar and liquid sucrose for sale. The production includes the conversion of raw sugar and other material into saleable products through a process sometimes referred to in the industry as “refining.” Petitioner purchases heating oil and natural gas to use in an on-site power plant to create steam and to generate electricity for this process.

Raw sugar and other materials are delivered and unloaded into storage sheds at Petitioner’s production facility, then they are weighed, mingled with affination syrup, and transferred to a centrifugal station. The raw sugar is melted, clarified and treated with phosphoric acid and lime to create a precipitate that removes insoluble impurities. Additional impurities are removed by filtering the clarified liquid through activated carbon. When crystal sugar is the desired end-product, the crystallization process involves a boiling sequence followed by a drying process that greatly reduces the moisture content of the crystals.

The power plant generates electricity and produces steam for all production, packing, and warehousing facilities. The vast majority of steam is used in melting, boiling, drying and crystallizing the sugar. The vast majority of the electricity is used to operate the machinery used to produce the crystal sugar and liquid sucrose from raw sugar.

Petitioner accepts title and delivery of heating oil at its manufacturing site in Yonkers, New York. Petitioner is not a business formed for, engaged in, or conducting the business, trade, or occupation of importing petroleum into New York for sale in New York, or of extracting, producing, refining, manufacturing, or compounding petroleum. Petitioner does not designate an agent for importing heating oil into New York for its account.

Applicable law and regulations

Section 285-a(1) of Article 12-A of the Tax Law provides, in part:

No person shall purchase motor fuel in this state, excluding a purchase at retail, unless the taxes imposed by this article have been assumed by a distributor registered under this article in accordance with a certification under subdivision three of this section or paid by such distributor, and, in each of such instances, are passed through to such purchaser. In addition to any other civil and criminal penalties which may apply, any person who purchases motor fuel without having received a certification from the seller in accordance with subdivision three of this section shall be jointly and severally liable to pay the taxes imposed by this article with respect to such motor fuel.

Section 289-c(1) of Article 12-A of the Tax Law provides, in part:

The tax imposed by this article though payable by the distributor, shall be borne by the purchaser and when paid by the distributor shall be deemed to have been so paid for the account of the purchaser. . . .

Section 300 of Article 13-A of the Tax Law provides, in part:

(b) The term "petroleum business" means:

* * *

(2) With respect to diesel motor fuel, every corporation and unincorporated business (i) importing diesel motor fuel or causing diesel motor fuel to be imported into the state for use, distribution, storage or sale in the state, (ii) producing, refining, manufacturing or compounding diesel motor fuel within the state, (iii) engaging in the enhancement of diesel motor fuel within the state, (iv) making a sale or use of diesel motor fuel in the state, other than a retail sale not in bulk or self-use of diesel motor fuel which has been the subject of a retail sale to such corporation or unincorporated business, . . .

* * *

(m) "Manufacturing gallonage" means residual petroleum product or diesel motor fuel (which is not enhanced diesel motor fuel) used and consumed directly and exclusively in the production of tangible personal property for sale by manufacturing, processing or assembly, but only if all of such fuel or product is delivered on the manufacturing site and is consumed other than on the highways of this state. "Manufacturing gallonage" shall in no event include diesel motor fuel delivered at a filling station or into a repository which is equipped with a hose or other apparatus by which such fuel can be dispensed into the fuel tank of a motor vehicle. The commissioner shall require such documentary proof to substantiate the classification of product as "manufacturing gallonage" as the commissioner deems appropriate.

Section 301-a of Article 13-A of the Tax Law provides, in part:

(a) General. Notwithstanding any other provision of this chapter, or of any other law, for taxable months commencing on or after the first day of September, nineteen hundred ninety, there is hereby imposed upon every petroleum business for the privilege of engaging in business, doing business, employing capital, owning or leasing property, or maintaining an office in this state, a monthly tax for each or any part of a taxable month equal to the sum of the motor fuel component determined pursuant to subdivision (b) of this section, the automotive-type diesel motor fuel component determined pursuant to paragraph one of subdivision (c) of this section, the nonautomotive-type diesel motor fuel component determined pursuant to paragraph two of subdivision (c) of this section and the residual petroleum product component determined pursuant to subdivision (d) of this section.

* * *

(c)(2) Nonautomotive-type diesel motor fuel component. The nonautomotive-type diesel fuel component shall be determined by multiplying the nonautomotive-type diesel motor fuel rate times the number of gallons of nonautomotive-type diesel motor fuel sold or used by a petroleum business in this state during the month covered by the return under this section. Provided, however, that no diesel motor fuel shall be included in the measure of the tax unless it shall have previously come to rest within the meaning of federal decisional law interpreting the United States constitution, nor shall any nonautomotive-type diesel motor fuel be included in the measure of the tax imposed by this article more than once.

* * *

(f)(4) Notwithstanding any other provision of this article, commencing January first, nineteen hundred ninety-eight, nonautomotive-type diesel motor fuel which is "*manufacturing gallonage*," as such term is defined in subdivision (m) of section three

hundred of this article, *shall be exempt* from the measure of the nonautomotive-type diesel motor fuel component of the tax imposed under this section. (Emphasis added)

Section 301-c (j) of Article 13-A of the Tax Law provides:

Reimbursement for manufacturing gallonage. Commencing January first, nineteen hundred ninety-eight, *a subsequent purchaser shall be eligible for reimbursement* of any taxes imposed under this article with respect to gallonage of residual petroleum product and *diesel motor fuel (which is not enhanced diesel motor fuel), subsequently sold by such purchaser to a consumer as "manufacturing gallonage."* This reimbursement may be claimed only where (1) any tax imposed pursuant to this article has been paid with respect to such gallonage and the entire amount of such tax has been absorbed by such purchaser, and (2) such purchaser possesses documentary proof satisfactory to the commissioner evidencing the absorption by it of the entire amount of such tax. Provided, however, that the commissioner shall require such documentary proof to qualify for any reimbursement of tax provided by this subdivision as the commissioner deems appropriate including a certificate by the consumer that such product is to be used and consumed exclusively as "manufacturing gallonage". (Emphasis added)

Section 315(b) of Article 13-A of the Tax Law provides, in part:

Joint administration of taxes. In addition to the powers granted to the commissioner in this chapter, *the commissioner is hereby authorized to make provisions for the joint administration, in whole or in part, of the taxes imposed by articles twelve-A and twenty-eight and pursuant to the authority of article twenty-nine of this chapter upon automotive fuel and the taxes imposed by this article*, including the joint reporting, assessment, collection, determination and refund of such taxes, and for that purpose to prescribe that any of the commissioner's functions under such articles, and any returns, forms, statements, documents or information to be submitted to the commissioner under such articles, any books and records to be kept for purposes of the taxes imposed or authorized to be imposed by such articles, any schedules of amounts to be collected under such articles, any registration required under such articles, and the payment of taxes under such articles, shall be on a joint basis with respect to the taxes imposed by or pursuant to such articles. Provided, notwithstanding any provision of this article to the contrary, *in the furtherance of joint administration, the provisions of subdivision one of section two hundred eighty-five-a and subdivision one of section two hundred eighty-nine-c of this chapter shall apply to the taxes imposed under this article* with the same force and effect as if those provisions specifically referred to the taxes imposed hereunder and all the products with respect to which the taxes are imposed under this article . . . Also, the commissioner may require . . . (ii) a certification that particular gallonage of motor fuel, diesel motor fuel or residual petroleum product has been included in the measure of the tax imposed by this article and such tax has been paid, and (iii) that the

certification required pursuant to section two hundred eighty-five-a or two hundred eighty-five-b of this chapter be expanded to include the tax imposed by this article.
(Emphasis added)

Section 1115(c)(1) of Article 28 of the Tax Law provides:

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, refining, mining or extracting 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 of this article.

Section 527.4(d) of the Sales and Use Tax Regulations provides, in part:

Processing. Processing is the performance of any service on tangible personal property for the owner which effects a change in the nature, shape, or form of the property.

Section 528.13(b)(1)(ii) of the Sales and Use Tax Regulations provides:

Production includes the production line of the plant starting with the handling and storage of raw materials at the plant site and continuing through the last step of production where the product is finished and packaged for sale.

Section 528.22(c) of the Sales and Use Tax Regulations provides, in part:

Directly and exclusively. (1) *Directly* means the fuel, gas, electricity, refrigeration and steam and like services, and must during the production phase of a process, either:

- (i) operate exempt production machinery or equipment; or
- (ii) create conditions necessary for production; or
- (iii) perform an actual part of the production process.

* * *

(3)(i) *Exclusively* means that the fuel, gas, electricity, refrigeration and steam and like services are used in total (100%) in the production process.

* * *

(iv) The user must maintain adequate records with respect to the allocation of fuel, gas, electricity, refrigeration and steam used directly and exclusively in production and for nonexempt purposes.

(v) For the purpose of substantiating the allocation of fuel, gas, electricity, refrigeration and steam and like services used directly and exclusively in production from that used for nonexempt purposes, the user must, when claiming a refund or credit, submit an engineering survey or the formulae used in arriving at the amounts used in an exempt manner.

Example 2: A producer of electricity purchases fuel oil in bulk. The oil is used both to create steam to operate turbines which produce electricity and to heat buildings. The oil used for steam to operate the turbines is used directly in production while the oil used to heat buildings is not used in production.

Publication 852, entitled *Sales Tax Information For: Manufacturers, Processors, Generators, Assemblers, Refiners, Miners and Extractors, and Other Producers of Goods and Merchandise* (12/97) provides, in part, the following definitions:

Production is the means by which products are created using one or more of the following operations (or production processes):

- manufacturing
- processing
- generating
- assembling
- refining
- mining
- extracting

* * *

Processing generally results in a change in the nature, shape, or form of materials.

* * *

Refining is the operation by which impurities or unwanted elements are removed from a product.

* * *

Mining is the operation by which minerals are removed from the earth through either surface excavations (such as open-pit mines and strip mines) or underground excavations. Mining includes any activities involved in the removal of the minerals from their original location. The preparation, washing, cleaning, or other processing of the minerals at the mine location is also part of the mining operation.

* * *

Extracting is a manufacturing operation, or an adjunct to a manufacturing operation, in which oil, gas, or mineral deposits are removed from their natural underground reservoirs.

Opinion

Petitioner is engaged in the production of crystal sugar and liquid sucrose for sale. The process includes the conversion of raw sugar and other material into saleable products, a process referred to in the industry as “refining.” Petitioner purchases heating oil to use in an on-site power plant to create steam and to generate electricity. The vast majority of the steam created is used in the production process and the vast majority of the electricity created is used to operate machinery used in the production process.

In Issue 1, Petitioner asks if it is a *petroleum business* for purposes of the petroleum business tax (PBT) imposed by Article 13-A of the Tax Law. Petitioner does not import diesel motor fuel (heating oil) or cause heating oil to be imported into New York State, produce, refine, manufacture or compound heating oil within New York, or engage in the enhancement of heating oil within New York. Petitioner purchases heating oil at retail and uses it to create steam and to generate electricity. Accordingly, Petitioner is not a petroleum business for purposes of section 300(b)(2) of Article 13-A of the Tax Law.

In Issue 2, Petitioner asks whether the heating oil it purchases qualifies as *manufacturing gallonage* for purposes of the PBT imposed by Article 13-A of the Tax Law. *Manufacturing gallonage* is petroleum product or diesel motor fuel (heating oil) used and consumed *directly and exclusively* in the production of tangible personal property for sale by manufacturing, processing or assembly but only if the fuel is delivered on the manufacturing site and is not consumed on New York State highways. See section 300(m) of the Tax Law.

Section 315(b) of Article 13-A of the Tax Law provides that the PBT may be jointly administered with the sales and compensating use tax imposed by Article 28 of the Tax Law and with the excise tax on gasoline and similar motor fuel imposed by Article 12-A of the Tax Law. Therefore, pursuant to section 315(b), it is appropriate to look at the sales and use tax regulations and publications concerning the meaning of the terms *production*, *processing*, *refining*, and *directly and exclusively*, since there are no provisions in the PBT dictating contrary definitions or results.

Section 1115(c)(1) of Article 28 of the Tax Law exempts fuel used directly and exclusively in the production of tangible personal property, for sale, by manufacturing, processing, assembling, generating, refining, mining or extracting from sales and use tax.

Section 528.13(b)(1)(ii) of the Sales and Use Tax Regulations states that “*Production* includes the production line of the plant starting with the handling and storage of raw materials at the plant site and continuing through the last step of production where the product is finished and packaged for sale.”

Publication 852, entitled *Sales Tax Information For: Manufacturers, Processors, Generators, Assemblers, Refiners, Miners and Extractors, and Other Producers of Goods and Merchandise* (12/97) states that “Processing generally results in a change in the nature, shape or form of materials.” Section 527.4(d) of the Sales and Use Tax Regulations defines processing as “the performance of any service on tangible personal property for the owner which effects a change in the nature, shape, or form of the property.”

For the purpose of the sales and use tax production exemption, the courts have viewed the production process as an integrated whole. From this perspective, the on-site power plant would be viewed as part of an integrated whole. See *Niagara Mohawk Power Corp. v Wanamaker*, 286 AD 446. Therefore, the heating oil which is used in Petitioner’s on-site power plant to provide electricity to power equipment used in the production process is used directly in the production process for purposes of the sales and use tax production exemption, and for purposes of the PBT. The heating oil which is used in Petitioner’s on-site power plant to provide steam used for the process of melting, boiling, drying, and crystallizing sugar is also used directly in the production process. The remaining heating oil which is used for lights, heat and other administrative purposes is not used directly in production. See section 528.22(c) of the Sales and Use Tax Regulations. Heating oil used for such purposes, therefore, is not manufacturing gallonage and is subject to the PBT.

Petitioner begins by mingling raw sugar with affination syrup and converting the sugar into a liquid form by melting. The liquid is then subject to further treatment to remove impurities. If crystal sugar is the desired end-product, Petitioner continues its production with a crystallization process in which the liquid sugar is boiled and then dried to produce crystal sugar. Petitioner then sells the purified liquid sucrose or the crystal sugar. Petitioner starts with the handling of raw materials at the plant site and continues through the last step of production where the product is finished. Petitioner changes the nature, shape or form of the raw material. Therefore, for purposes of both the sales tax and the petroleum business tax, Petitioner is engaged in the production of tangible personal property for sale by processing. Accordingly, the heating oil used by Petitioner directly and exclusively in the production of sugar is manufacturing gallonage for purposes of section 300(m) of the Tax Law.

It should be noted that *manufacturing gallonage* does not include petroleum product or Diesel motor fuel which is used and consumed directly and exclusively in the production of tangible personal property for sale by refining, mining or extracting. The sales tax exemption set forth in section 1115(c)(1) of the Tax Law does exempt fuel which is used and consumed directly and exclusively in the production of tangible personal property for sale by, among other things, refining, mining or extracting.

Publication 852, *supra*, defines *refining* as the operation by which impurities or unwanted elements are removed from a product. It defines *mining* as the operation by which minerals are removed from the earth through either surface excavations (such as open-pit mines and strip mines) or underground excavations. It defines *extracting* as a manufacturing operation, in which oil, gas, or mineral deposits are removed from their natural underground reservoirs.

Though the processes used by Petitioner to produce its sugar products are referred to in the industry as “refining,” the terms *refining*, *mining* and *extracting* as they are used in section 1115 of Article 28 of the Tax Law appear to generally relate more to activities relating to materials mined or extracted from the earth, such as fossil fuels, minerals and ores, than to agricultural products. Therefore, for purposes of Articles 13-A and 28 of the Tax Law, Petitioner’s activities do not constitute refining.

In claiming the manufacturing exemption, Petitioner may provide the seller a Form FT-1012, *Manufacturing Certification for Diesel Motor Fuel and Residual Petroleum Product*. However, since a portion of the fuel purchased may be consumed other than in the production process, Petitioner must indicate on the exemption document the percentage of fuel used in qualified manufacturing and the percentage used for other purposes. Petitioner must maintain adequate records to substantiate the percentage attributed to manufacturing. (For example, Petitioner may want to obtain an engineering survey to substantiate its allocation formula.) See Technical Services Bureau Memorandum entitled *Article 13-A Changes Effective September 1, 1994*, August 26, 1994, TSB-M-94(5)M.

Although Petitioner is not a *petroleum business* as defined pursuant to section 300(b) of Article 13-A of the Tax Law, heating oil purchased by Petitioner for purposes other than production (e.g., lighting and heating Petitioner’s production facility) is subject to the PBT. Under section 315(b) of Article 13-A of the Tax Law, the provisions of section 285-a(1) of Article 12-A of the Tax Law respecting joint and several liability of purchasers of motor fuel for the Article 12-A tax apply to the PBT with the same force and effect as if those provisions specifically referred to the PBT and all the products with respect to which the PBT is imposed under Article 13-A. Likewise, under section 315(b), the provisions of section 289-c(1) of Article 12-A providing that the tax is “borne by the purchaser and when paid by the distributor shall be deemed to have been so paid for the account of the purchaser” apply to the PBT. Thus, to the extent the PBT has not been paid or passed through to Petitioner with respect to heating oil

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purchased by Petitioner and consumed other than in production, the provisions of section 315(b) of the Tax Law make Petitioner jointly and severally liable to pay the PBT due on such heating oil.

DATED: February 1, 2006

/s/
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Technical Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.