

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

TSB-A-02(31)S
Sales Tax
July 22, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S001002C

On October 2, 2000, the Department of Taxation and Finance received a Petition for Advisory Opinion from Deloitte & Touche LLP, Two World Financial Center, New York, New York 10281.

The issue raised by Petitioner, Deloitte & Touche LLP, is whether purchases of steel and of design, engineering and fabrication services in connection with construction projects as described below are subject to sales and compensating use tax.

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

Corporation X ("X") is an alien (i.e., non-U.S.) corporation that provides integrated complex structural steel design, engineering and fabrication services to general contractors, project owners and engineering firms involved in the construction of non-residential facilities in North America. X operates through a number of subsidiary corporations including Corporation Y ("Y"), a New York corporation that is responsible for the sale and erection of projects in New York. Y is a vendor registered to collect sales tax in New York pursuant to Section 1134 of the Tax Law.

Once a client awards a contract to Y, Y subcontracts with X for the design, engineering and fabrication of the structural steel components required under the client's contract with Y. X appoints an outside contractor as project manager. The project manager is responsible for the design, engineering and fabrication of the structural steel components of the project. Specifically, the manager is responsible for the commencement and coordination of the drawings and engineering works, production planning and the hiring of subcontractors, if any, as well as the planning of the resources required for erection. The project manager performs the drawing and design of structural steel in close collaboration with Y's client's professionals in order to identify and resolve any potential issues as quickly as possible. X purchases the steel directly from the mill and performs all fabrication. X performs all of this work in Canada.

The structural components of the project are developed with the assistance of a three-dimensional software application that enables X to achieve significant gains in productivity by providing better management of the production costs and by assisting the draftspeople in the creation of the complete structure including each of the individual components of the design. The drawing of structural steel components and connections is done by a group of approximately 60 draftspeople and 28 engineers. Pursuant to service agreements with four companies specializing in the drafting of structural steel components, the services of the draftspeople and engineers are provided to X on an exclusive basis. X has also entered into a priority services agreement with an engineering consulting firm providing X with engineering services on a priority basis.

Y purchases the fabricated components from X and then uses them in the erection of the particular project in New York. X charges Y a single price for the fabricated steel that includes X's cost of the steel and the costs of design, engineering and fabrication of the steel in accordance with project specifications. Y pays compensating use tax to New York State on the purchase price of the fabricated components.

Petitioner presented the following additional scenarios:

1) Assume the facts as stated above except that Y separately purchases from X (a) the steel for the project and (b) the services of design, engineering and fabrication.

2) Assume the facts as stated above except that Y (a) separately purchases the steel from the mill and (b) purchases from X the services of design, engineering and fabrication of the steel which Y purchased separately from the mill.

3) Assume that Y enters the contract for the erection of the project with its client and (a) separately purchases the steel for the project and (b) uses its own employees for the design, engineering, fabrication and erection of the project.

Applicable Law and Regulations

Section 1101(b) of the Tax Law provides, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c) and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

* * *

(3) Receipt. The amount of the sale price of any property and the charge for any service taxable under this article . . . without any deduction for expenses. . . .

(4) Retail sale. (i) A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property, or (B) for use by that person in performing the services subject to tax under paragraphs (1), (2), (3), (5), (7) and (8) of subdivision (c) of section eleven hundred five where the property so sold becomes a physical component part of the property upon which the services are performed or where the property so sold is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax. Notwithstanding the preceding provisions of this subparagraph, a sale of any tangible personal property to a contractor, subcontractor or repairman for use or consumption in erecting structures or buildings, or building on, or otherwise adding to, altering, improving, maintaining,

servicing or repairing real property, property or land, as the terms real property, property or land are defined in the real property tax law, is deemed to be a retail sale regardless of whether the tangible personal property is to be resold as such before it is so used or consumed. . . .

Section 1105 of the Tax Law provides, in part:

Imposition of sales tax.-On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax of four percent upon:

(a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

* * *

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

* * *

(2) Producing, fabricating, processing, printing or imprinting tangible personal property, performed for a person who directly or indirectly furnishes the tangible personal property, not purchased by him for resale, upon which services are performed.

* * *

Wages, salaries and other compensation paid by an employer to an employee for performing as an employee the services described in paragraphs (1) through (9) of this subdivision (c) are not receipts subject to the taxes imposed under such subdivision.

Section 1110 of the Tax Law provides, in part:

Imposition of compensating use tax. (a) Except to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state on and after June first, nineteen hundred seventy-one except as otherwise exempted under this article, (A) of any tangible personal property purchased at retail, (B) of any tangible personal property (other than computer software used by the author or other creator) manufactured, processed or assembled by the user, (i) if items of the same kind of tangible personal property are offered for sale by him in the regular course of business or (ii) if items are used as such or incorporated into a structure, building or real property by a contractor, subcontractor or repairman in erecting structures or

buildings, or building on, or otherwise adding to, altering, improving, maintaining, servicing or repairing real property, property or land, as the terms real property, property or land are defined in the real property tax law, if items of the same kind are not offered for sale as such by such contractor, subcontractor or repairman or other user in the regular course of business . . . (D) of any tangible personal property, however acquired, where not acquired for purposes of resale, upon which any of the services described in paragraphs (2), (3) and (7) of subdivision (c) of section eleven hundred five of this part have been performed. . . .

(b) For purposes of clause (A) of subdivision (a) of this section, the tax shall be at the rate of four percent of the consideration given or contracted to be given for such property, or for the use of such property, including any charges for shipping or delivery as described in paragraph three of subdivision (b) of section eleven hundred one, but excluding any credit for tangible personal property accepted in part payment and intended for resale.

(c) For purposes of subclause (i) of clause (B) of subdivision (a) of this section, the tax shall be at the rate of four percent of the price at which items of the same kind of tangible personal property are offered for sale by the user, and the mere storage, keeping, retention or withdrawal from storage of tangible personal property by the person who manufactured, processed or assembled such property shall not be deemed a taxable use by him; provided, however, that if the user uses such an item itself on its own premises (not including making a gift of such tangible personal property), solely in the conduct of the user's own business operations, and the item retains its characteristic as tangible personal property when so used, the tax shall be at the rate, and on the consideration, described in subdivision (d) of this section.

(d) For purposes of subclause (ii) of clause (B) of subdivision (a) of this section, the tax shall be at the rate of four percent of the consideration given or contracted to be given for the tangible personal property manufactured, processed or assembled into the tangible personal property the use of which is subject to tax, including any charges for shipping or delivery as described in paragraph three of subdivision (b) of section eleven hundred one.

(e) Notwithstanding the foregoing, provisions of this section, for purposes of clause (B) of subdivision (a) of this section, there shall be no tax on any portion of such price which represents the value added by the user to tangible personal property which he fabricates and installs to the specifications of an addition or capital improvement to real property, property or land, as the terms real property, property or land are defined in the real property tax law, over and above the prevailing normal purchase price prior to such fabrication of such tangible personal property which a manufacturer, producer or assembler would charge an unrelated contractor who

similarly fabricated and installed such tangible personal property to the specifications of an addition or capital improvement to such real property, property or land.

(f) For purposes of clauses (C), (D), and (E) of subdivision (a) of this section, the tax shall be at the rate of four percent of the consideration given or contracted to be given for the service, including the consideration for any tangible personal property transferred in conjunction with the performance of the service and also including any charges for shipping and delivery of the property so transferred and of the tangible personal property upon which the service was performed as such charges are described in paragraph three of subdivision (b) of section eleven hundred one.

Section 526.5(e) of the Sales and Use Regulations provides:

Expenses. All expenses, including telephone and telegraph and other service charges, incurred by a vendor in making a sale, regardless of their taxable status and regardless of whether they are billed to a customer are not deductible from the receipts.

Example 1: A photographer contracts with a customer to furnish photographs at \$50 each in addition to expenses.

The customer is billed as follows:

Photographs (2).....	\$100
Model fees.....	60
Meals.....	10
Travel.....	25
Props (Flowers).....	<u>5</u>
Total due.....	\$200

Receipt subject to tax is \$200

Example 2: An appliance repairman charges \$10 per hour plus expenses when on a service call. The customer is billed as follows:

3 hrs. at \$10	\$ 30
Travel.....	15
Parts.....	20
Meals.....	<u>5</u>
Total due.....	\$ 70

Receipt subject to tax is \$70

Section 531.3(b)(2)(iv) of the Sales and Use Tax Regulations provides:

(iv) Where tangible personal property is purchased out of state to be fabricated and installed to the specifications of a capital improvement in New York State, and the fabrication of such property is done by the user, the value added to the property as a result of the fabrication is not included in the basis on which compensating use tax is computed. The use tax in such case is based on the consideration given or contracted to be given for the property, as provided in subdivision (a) of this section, including any charges by the seller to the user for shipping or delivery of the property to be fabricated to the user. If the user does not fabricate the property but purchases fabrication services performed on the property out of state, the consideration given or contracted to be given for such fabrication service will be included in the basis on which compensating use tax is computed, as provided in paragraphs (2) and (3) of subdivision (c) of this section, including any charges by the seller to the user for shipping or delivery of the property to the user.

Section 541.5(b) of the Sales and Use Tax Regulations provides, in part:

Capital improvements contracts. (1) Purchases. All purchases of tangible personal property (excluding qualifying production machinery and equipment exempt under section 1115(a)(12) of the Tax Law) which are incorporated into and become part of the realty or are used or consumed in performing the contract are subject to tax at the time of purchase by the contractor or any other purchaser. A certificate of capital improvement may not be validly given by any person or accepted by a supplier to exempt the purchase of these materials.

Section 541.11 of the Sales and Use Tax Regulations provides, in part:

Fabrication and manufacturing. [Tax Law, §§ 1105(c)(2), 1110, 1111(a)]

(a) Fabricators and manufacturers who install their fabricated or manufactured product into real property are contractors.

(b) *Fabricators as contractors.* (1) When a contractor-fabricator purchases tangible personal property which he fabricates and installs to the specifications of a capital improvement, the value added by such fabrication is not subject to the use tax.

Example 1: A contractor-fabricator purchases steel beams from a manufacturer and pays the sales tax on his cost. His employees fabricate the beams to job specifications and install the beams in a capital improvement job. The contractor-fabricator is not subject to a use tax on the value added by his fabrication.

(2) However, where a contractor fabricates tangible personal property of others, without installation, he is required to collect the tax on his total charges even

if the property is to be installed by another to the specifications of a capital improvement. If he fabricates tangible personal property and sells the tangible personal property, the total charge for the tangible personal property and services performed thereon is subject to tax.

Example 2: A contractor purchases steel beams which must be fabricated before they can be installed. The work is subcontracted out for fabrication. The fabricator's charge to the contractor for the fabrication of the steel beams which the contractor will install is subject to the tax.

Opinion

Design, engineering, and project management services, per se, are not among the enumerated services that are subject to sales and compensating use tax. However, where a contract provides that a person shall design, engineer and fabricate a product and then sell the finished product to the customer, the seller's receipts from the sale of the product will generally be considered as receipts from a single transaction pursuant to Section 1101(b)(3) of the Tax Law and Section 526.5(e) of the Sales and Use Tax Regulations, whether or not the charges are separately stated. See Artex Systems, Inc. v. Michael Urbach, 252 AD2d 750. Such receipts will be subject to tax under Section 1105(a) of the Tax Law as receipts from the sale of tangible personal property if such property is purchased in New York. If the tangible personal property is purchased outside New York and then used in New York the compensating use tax will apply based on the consideration paid for the tangible personal property, including any charges for design and engineering services. See Section 1110(a)(A),(b) of the Tax Law.

Basic Scenario

Under the facts presented in this opinion, where Y purchases the fabricated steel components from X in Canada for Y's use in a construction project in New York, and X charges Y a single price for the fabricated steel, compensating use tax is due upon Y's use of the fabricated steel in New York. The use tax in this case would be based upon the entire amount that Y paid X for the fabricated steel, including the cost of design, engineering, and fabrication of the steel.

Additional Scenario 1

Under this scenario the compensating use tax due upon the fabricated steel purchased by Y in Canada would also be based upon the entire amount that Y paid X for the fabricated steel, including the cost of design, engineering, and fabrication of the steel. This would be true despite the fact that the charges for design and engineering were separately stated in the billing or invoice presented to Y or that Y's contract with X provided separately for the sale of design and engineering services and the sale of fabricated steel. In accordance with the above discussion, the design and engineering services which go into the sale of fabricated steel by X are considered expenses incurred by X in making the sale. These expenses are included in the taxable receipts from the sale of the

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steel whether or not the expenses are separately stated. Nothing in the facts submitted by Petitioner indicates that the sale of fabricated steel by X to Y is not an integrated transaction in which the design and engineering services are integral components of the sale that are part of X's expenses.

Additional Scenario 2

Where Y enters a contract for the erection of the project with the customer, separately purchases the steel from the mill, and purchases from X the services of design, engineering and fabrication, the purchase of steel from outside the State is subject to compensating use tax as provided in Section 1110(a) of the Tax Law. The charge to Y by X for the fabrication performed outside the State is also subject to tax. See Section 1110(a)(D) of the Tax Law and Section 531.3(b)(2)(iv) of the Sales and Use Tax Regulations. As discussed above, the design and engineering services are part of the expenses incurred by X in fabricating the steel for Y. Charges for the design and engineering services are subject to tax whether or not such charges are separately stated or the contract between X and Y provides separately for such services.

Additional Scenario 3

Where Y enters into a contract with a client for the erection of a project and Y purchases the steel for the project and uses its own employees for the design, engineering, and fabrication of the steel, Y would owe sales or use tax on its purchase of the steel depending on whether the steel is purchased within or outside New York. The design, engineering, and fabrication services performed by Y's own employees in New York, as well as any value added to the steel by such services, are not subject to sales and use tax. See Section 1105(c) of the Tax Law and Section 541.11(b)(1) of the Sales and Use Tax Regulations.

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