

**New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Taxpayer Guidance Division**

TSB-A-07(25)S
Sales Tax
August 29, 2007

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S060725A

On July 25, 2006, the Department of Taxation and Finance received a Petition for Advisory Opinion from Universal Compression, Inc., 4444 Brittmoore Road, Houston, Texas 77041. Petitioner, Universal Compression, Inc., submitted additional information pertaining to the Petition on October 17, 2006.

The issues raised by Petitioner relate to the application of sales tax to Petitioner's reorganization and changes in business practices. Petitioner asks:

1. Whether its Master Services Agreement will be construed to be a service agreement rather than a rental of compressors.
2. Whether the sales tax resale exemption will apply to the transfer of Petitioner's existing assets to the Lease Partnerships created as a result of Petitioner's reorganization.
3. Whether charges for compression services are subject to sales tax.

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

Petitioner assembles compressors in Texas that are used in connection with natural gas exploration, production, processing, and transportation. Historically, the assembled compressors were either sold to third-party customers or Petitioner retained ownership and the compressors were used at customer locations to provide compression for a fee. Most of Petitioner's contractual agreements with its customers where Petitioner retained ownership of the compressors were structured to be rental agreements for the compressors.

As the result of a recent reorganization, Petitioner has four primary entities, including Petitioner itself, involved in the compression business in New York State. The new entities are UCLP Leasing, L.P., and UCI Compressor Holding, L.P. (collectively "Lease Partnerships"), and UC Operating Partnership, L.P. (collectively with Petitioner "Service Businesses"). Petitioner is a partner in the three new partnerships.

Petitioner will contribute a portion of its current fleet of compressors, subject to certain liabilities representing security interests in the transferred compressors, to each of the Lease Partnerships upon their inception. Petitioner states that these contributions are considered tax free for federal income tax purposes, and the Lease Partnerships are disregarded entities for federal income tax purposes. The Lease Partnerships will lease the compressors to the Service

Businesses. Petitioner may sell compressors to third-party customers on occasion. The Service Businesses may sometimes obtain compressors from third parties.

Petitioner and each partnership are separate and distinct entities that operate independently of each other. Petitioner and each partnership have names that are different from each other; hold themselves out to the public as separate entities; enter into business relationships and contractual obligations in their own names; maintain their own books, records, and bank accounts; and have their own officers, who overlap with each other. The Lease Partnerships are sole owners of the contributed equipment and are the sole owners of all rights under all related warranties.

A Service Business will enter into a Master Compression Services Agreement (“Agreement”) with customers under which the Service Business will compress a customer’s product (generally, gas) to a specified number of pounds per square inch of gage pressure in field or pipeline applications used to transport the product from one point to another. Under the provisions of the agreement:

- A Service Business agrees to provide to customers specified gas compression services as detailed on the schedules to the Agreement.
- A Service Business, or its affiliates or a third party other than the customer (under an agreement whereby such affiliates or third party lease the compressors to the Service Business) maintain ownership or possession and control of the compressors located at the customer’s premises. The Service Companies are responsible for all operating expenses such as insurance, maintenance, repair, and the fuel or electricity to run the equipment.
- Risk of loss will be with the Service Business rather than the customer.
- The Service Business is not required to use any particular compressor model to perform the service as specified; rather it is stipulated that compression will be provided based on certain agreed-upon parameters.
- Ad valorem taxes are the responsibility of the Service Business.
- The fee charged for compression services is substantially higher than the cost of renting a compressor.
- The contract term is typically for a period of approximately 3 years, which period is less than 15 percent of a compressor's economic life.

- To the extent that the Service Business is unable to provide the stipulated compression to a customer, the Service Business will reduce the fee it charges the customer.
- The Service Business does not own the gas at any point in the process; it merely compresses the gas for its customers, which typically sell the gas to third parties.

The Service Businesses retain dominion and control of the compressors at customer locations and assume all operating expenses of the equipment, including costs related to the personnel installing, operating, servicing, maintaining, and repairing the equipment. Petitioner has its own employees and retains the right to hire and fire its employees. The other Service Business, UC Operating Partnership, L.P., does not have its own employees but pays Petitioner for the use of its employees. Each Service Business bills customers based on the pressure parameters specified by the Agreement. In general, charges to the customer also reflect the type of compressors used and the cost of personnel to monitor, service, and maintain such equipment. The compressors run 24 hours a day, 7 days a week while at a customer location. In some instances, the Service Business will charge customers a monthly fee for miscellaneous equipment, such as inlet separators.

Applicable law and regulations

Section 1101 of the Tax Law provides, in part:

(a) When used in this article the term “person” includes an individual, partnership, limited liability company, society, association, joint stock company, corporation, estate, receiver, trustee, assignee, referee, and any other person acting in a fiduciary or representative capacity, whether appointed by a court or otherwise, and any combination of the foregoing.

(b) 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:

* * *

(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 . . .

* * *

(iv) The term retail sale does not include:

(A) The transfer of tangible personal property to a corporation, solely in consideration for the issuance of its stock, pursuant to a merger or consolidation effected under the law of New York or any other jurisdiction.

(B) The distribution of property by a corporation to its stockholders as a liquidating dividend.

(C) The distribution of property by a partnership to its partners in whole or partial liquidation.

(D) The transfer of property to a corporation upon its organization in consideration for the issuance of its stock.

(E) The contribution of property to a partnership in consideration for a partnership interest therein.

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

(6) Tangible personal property. Corporeal personal property of any nature. However, except for purposes of the tax imposed by subdivision (b) of section eleven hundred five, such term shall not include gas, electricity, refrigeration and steam. . . .

Section 1105 of the Tax Law provides, in part:

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

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

(b) (1) The receipts from every sale, other than sales for resale, of the following:
(A) gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature; . . .

* * *

(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.

Section 526.6 of the Sales and Use Tax Regulations provides, in part:

(a) The term *retail sale* or *sale at retail* means the sale of tangible personal property to any person for any purpose, except as specifically excluded.

* * *

(c) Resale exclusion. (1) Where a person, in the course of his business operations, purchases tangible personal property or services which he intends to sell, either in the form in which purchased, or as a component part of other property or services, the property or services which he has purchased will be considered as purchased for resale, and therefore not subject to tax until he has transferred the property to his customer.

(2) A sale for resale will be recognized only if the vendor receives a properly completed resale certificate . . .

(3) Receipts from the sale of property purchased under a resale certificate are not subject to tax at the time of purchase by the person who will resell the property. The receipts are subject to tax at the time of the retail sale.

* * *

(d) Exclusions relating to corporate and partnership transactions.(1) The following transfers of property are not retail sales:

* * *

(iv) The transfer of property to a corporation upon its organization in consideration for the issuance of its stock.

(v) The contribution of property to a partnership in consideration for a partnership interest therein.

* * *

(6) Mergers and consolidations.

* * *

(iv) Where a corporation purchases another corporation's assets in consideration of issuance of stock of the purchasing corporation, or the parent of the purchasing corporation, such as under section 368(a)(1)(C) of the Internal Revenue Code, the transaction does not qualify as a merger or consolidation, even if the selling corporation is subsequently liquidated.

Section 526.7 of the Sales and Use Tax Regulations provides, in part:

(a) Definition. (1) The words *sale*, *selling* or *purchase* mean any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration.

(2) Among the transactions included in the words *sale*, *selling* or *purchase* are exchanges, barter, rentals, leases or licenses to use or consume tangible personal property.

* * *

(c) Rentals, leases, licenses to use. (1) The terms *rental*, *lease* and *license to use* refer to all transactions in which there is a transfer for a consideration of possession of tangible personal property without a transfer of title to the property. Whether a transaction is a "sale" or a "rental, lease or license to use" shall be determined in accordance with the provisions of the agreement. . . .

* * *

(e) *Transfer of possession*. (1) . . . a sale is taxable at the place where the tangible personal property or service is delivered, or the point at which possession is transferred by the vendor to the purchaser or his designee.

* * *

(4) *Transfer of possession* with respect to a rental, lease or license to use, means that one of the following attributes of property ownership has been transferred:

- (i) custody or possession of the tangible personal property, actual or constructive;
- (ii) the right to custody or possession of the tangible personal property;
- (iii) the right to use, or control or direct the use of, tangible personal property.

Section 541.2(p) of the Sales and Use Tax Regulations provides, in part:

Rental, lease and license to use. (1) The terms *rental*, *lease* and *license to use* refer to all transactions in which there is a transfer of possession of tangible personal property without a transfer of title to the property.

(2) For the purposes of this Part, when a rental, lease or license to use a vehicle or equipment includes the services of a driver or operator, such transaction is presumptively the sale of a service, rather than the rental of tangible personal property, where dominion and control over the vehicle or equipment remain with the owner or lessor of the vehicle or equipment. Dominion and control remain with the owner or lessor of the vehicle or equipment when pursuant to an agreement or contract the lessor:

- (i) does not transfer possession, control and/or use of the equipment or vehicle to the lessee during the term of the agreement or contract;
- (ii) maintains the right to hire and fire the drivers and operators;
- (iii) uses his own discretion in performing the work (even though the lessee may designate the area where material is to be picked up and delivered) and generally selects his own routes;
- (iv) retains responsibility for the operation of the equipment or vehicle; and
- (v) directs the work, pays all operating expenses, including drivers' and/or operators' wages, insurance, tolls and fuels.

Whether a transaction is a sale (license to use, rental or lease) of a vehicle or equipment or is the sale of a service, such as a transportation service, must be determined

in accordance with the facts and circumstances of the particular transaction and provisions of the agreement between the contractor and his customer.

Opinion

Petitioner recently reorganized its structure and changed its business practices. As a result, Petitioner is a partner in three partnerships, two of which own compressors and lease them to Petitioner and the third partnership. Petitioner and the third partnership are Service Businesses that provide compression services to unrelated third parties pursuant to the Master Compression Services Agreement.

Issue 1

The Master Compression Services Agreement (“Agreement”) indicates that ownership or possession and control of the compressors remains with the Service Business, or its affiliates or third parties that lease compressors to the Service Business. The Agreement also indicates that the Service Business is responsible for all operating expenses such as insurance, service, maintenance, repair, and the fuel or electricity to run the equipment. The Service Business personnel install, operate, service, maintain, and repair the equipment at the customer’s premises. The Service Business bills customers based on the pressure parameters specified by the Agreement.

The threshold question in regard to the application of the sales and use tax to the transactions between each Service Business and its customers is whether these transactions constitute a lease or a license to use the compressors or whether these transactions are properly viewed as the sale of a service. The key factor is whether the Service Business, in providing the equipment along with the technical expertise of personnel, is maintaining dominion and control over the equipment or relinquishing dominion and control to its customers. The terms of the Agreement respecting the nature of these transactions must also support the practical aspects of the transactions. See section 541.2(p) of the Sales and Use Tax Regulations.

Under the Agreement, the Service Business is responsible for all costs of operating and maintaining the compressors, including insurance, maintenance, repair, and fuel. The Service Business bears the costs of salaries and other compensation to its personnel who operate and monitor the performance of the equipment. Such personnel are employees of Petitioner and Petitioner retains the right to hire and fire its employees. The other Service Business, UC Operating Partnership, L.P., does not have its own employees but pays Petitioner for the use of its employees. Accordingly, the Service Business maintains dominion and control of equipment while it is on the customer’s premises. The Agreement also provides that the fee charged by the Service Business will be reduced if the Service Business is unable to provide the compression specified in the Agreement. Therefore, for sales tax purposes, the Service Business is providing

a service rather than the lease or rental of the equipment. However, to the extent that the Service Business provides optional equipment (e.g., inlet separators) for a monthly fee and does not provide personnel to operate the equipment or retain dominion and control over the equipment, such charges are for the rental of equipment.

Issue 2

Partnerships are persons for sales tax purposes even if they are disregarded entities for federal income tax purposes. See section 1101(a) of the Tax Law. Therefore, any transfers of compressors by Petitioner to the Lease Partnerships for consideration would be sales of tangible personal property subject to sales tax under section 1105(a) of the Tax Law, unless otherwise exempt.

Petitioner reorganized itself into four entities. Petitioner states that its contributions of compressors to the newly created partnerships were tax free transfers for federal income tax purposes. Certain transfers as part of a business reorganization and restructuring, including transfers of property to partnerships in exchange for a partnership interest, are not considered to be sales at retail and are thus not subject to New York State sales and use tax. (See section 1101(b)(4)(iv) of the Tax Law). However, not every tax free reorganization for federal income tax purposes is a nontaxable transfer for New York State sales and use tax purposes. (See section 526.6(d)(6)(iv) of the Sales and Use Tax Regulations). If Petitioner's transfers of compressors to the Leasing Partnerships were in exchange for a partnership interest, then the transfers are nontaxable pursuant to section 1101(b)(4)(iv). If the transfers of the compressors were not in exchange for a partnership interest but for some other consideration, the transfers may qualify as sales for resale the receipts from which are not subject to tax under section 1105(a) of the Tax Law. To qualify as a sale for resale, the Lease Partnerships must purchase the compressors exclusively for the purpose of reselling or leasing them. See section 1101(b)(4)(i)(A) of the Tax Law and section 526.6(c) of the Sales and Use Tax Regulations. The Lease Partnerships must register for New York State sales tax purposes in order to issue a *Resale Certificate* (Form ST-120).

Issue 3

Except for purposes of the tax imposed by section 1105(b) of the Tax Law on sales of gas and gas service (utilities), the natural gas compressed by the Service Businesses is not otherwise considered to be tangible personal property for the purposes of the sales and use taxes imposed by Article 28 of the Tax Law (see section 1101(b)(6) of the Tax Law). Therefore, the compression service provided by the Service Businesses is not the *producing, fabricating, or processing of tangible personal property* for purposes of the tax imposed by section 1105(c)(2) of the Tax Law and is not any of the other enumerated services upon which tax is imposed

TSB-A-07(25)S
Sales Tax
August 29, 2007

pursuant to section 1105 of the Tax Law. Therefore, Petitioner's charges for the services of compressing natural gas for its customers are not subject to sales tax.

DATED: August 29, 2007

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Taxpayer Guidance Division

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.