

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

TSB-A-07(29)S
Sales Tax
November 15, 2007

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S060920A

On September 20, 2006, the Department of Taxation and Finance received a Petition for Advisory Opinion from Abeles Building Company LLC, 75 Thruway Park Drive, West Henrietta, NY 14586.

The issue raised by Petitioner, Abeles Building Company LLC, is whether a refund or credit is allowed for sales tax paid on building materials used to rehabilitate a mixed-use retail/residential building located in an Empire Zone.

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

The property in question (the "Property") is located at 681-685 South Avenue in Rochester, New York. The Property was designated by the Empire State Development Corporation as property located in an Empire Zone in 2003. Petitioner states that the Property was rehabilitated in 2006 and currently consists of a grocery store and a coffee shop on the first floor and four residential apartments on the second floor. The contractor that performed the rehabilitation allocated the building materials incorporated into the Property between the first floor commercial space and the second floor residential space.

Applicable law and regulations

Section 1119(a) of the Tax Law provides, in part:

Subject to the conditions and limitations provided for herein, a refund or credit shall be allowed for a tax paid pursuant to subdivision (a) of section eleven hundred five or section eleven hundred ten . . . (6) on the sale of tangible personal property purchased for use in constructing, expanding or rehabilitating industrial or commercial real property (other than property used or to be used exclusively by one or more registered vendors primarily engaged in the retail sale of tangible personal property) located in an area designated as an empire zone pursuant to article eighteen-B of the general municipal law, but only to the extent that such property becomes an integral component part of the real property. . . .

A Guide to Sales and Use Tax Incentives within Empire Zones, Publication 30 (2/01), explains the Tax Law and regulations applicable to the sales tax refund or credit available for construction activities in an Empire Zone ("EZ"). The publication also lists the criteria that must be met to qualify for the refund or credit of sales tax paid on building materials used in construction within an EZ. The publication provides, in part:

First, the building materials must be physically incorporated into real property located in an EZ. This means that a refund or credit is allowed only for the sales or use tax paid on those building materials that become an integral component part of the structure.

* * *

Second, the real property on which the construction is performed must be classified as industrial or commercial real property. Commercial real property is any income producing real property, other than residential real property. Commercial real property includes hotels (nonresidential), restaurants, nightclubs, beauty salons, travel agencies, movie theaters, banks, automobile repair shops, clothing stores, food stores, office buildings, and so forth.

Industrial real property is real property that is used primarily for the manufacturing, processing, generating, assembling, refining, mining, or extracting of goods. Industrial real property includes factories, manufacturing plants and facilities, refineries, assembly plants, and so forth.

Constructing, expanding, or rehabilitating residential real property does not qualify. For these purposes, residential real property is real property that consists of a building or structure containing one or more dwelling units that are used or to be used as the permanent home or residence of one or more persons. Residential real property includes apartment hotels, apartment buildings, apartment houses, condominiums, cooperative housing, townhouses, private homes, and facilities that contain multiple dwellings (such as two- and three-family homes).

* * *

Third, the completed construction must result in either the construction of new industrial or commercial real property, or the rehabilitation or expansion of existing industrial or commercial real property.

The term *construction* means the act of building a new structure. For example, erecting a building on a vacant lot, or razing an old structure and erecting a new structure in its place are examples of constructing.

The term *expansion* means the addition of entire rooms or floors to existing buildings to increase the available space. Adding another floor to a building by raising the building's roof and installing supporting walls is an example of expansion.

The term *rehabilitation* means performing activities necessary to restore real property to an acceptable condition of fitness and safety for habitation, as required by all

applicable governmental building codes, laws, and regulations. The replacement or repair of heating, plumbing, and electrical systems to bring them up to code is an example of rehabilitation.

* * *

The terms construction, expansion, and rehabilitation do not include renovations, general maintenance, or minor repairs. Examples are replacing through-the-wall mounted air conditioning units, replacing damaged bricks, repairing or replacing faucets, patching and painting walls, sanding and shellacking floors, repairing or replacing door frames, repairing or replacing electrical switches and wiring, removal of debris, replacing missing roof tiles, replacing toilet seals and seats, repairing termite damage, repairing dry rot and replacing window frames and panes.

Fourth, the real property cannot be used exclusively, or be intended for use exclusively, by one or more vendors whose primary business is the retail sale of tangible personal property. For example, property that is constructed exclusively as retail space, such as a shopping mall, is not qualifying property. Thus, even though property may qualify as industrial or commercial real property, its exclusive use by retailers disqualifies the property for purposes of the EZ refund or credit.

* * *

For purposes of the EZ refund or credit, *exclusively* means 100% of the real property is used or is intended to be used in the retail sale of tangible personal property by one or more vendors. Thus, if a building is constructed, expanded, or rehabilitated in an EZ, and the building is going to be used partly as retail space and partly as commercial or industrial space, the credit or refund is allowed on the total tax paid on the building materials used in constructing, expanding, or rehabilitating the entire building.

* * *

The person who is eligible to claim a refund or credit for sales tax paid on the purchase of qualifying tangible personal property (building materials, fixtures, plumbing components, heating components, and so forth) used in constructing, expanding, or rehabilitating real property in an Empire Zone is the person who, under the Tax Law, has the liability for payment of the sales tax due on the purchase of the tangible personal property.

When the construction, expansion, or rehabilitation results in a capital improvement, and the property owner or tenant purchases the tangible personal property and performs the labor, the property owner or tenant is liable for the sales tax, that must be paid to the supplier at the time the tangible personal property is purchased. In this

situation, then, the property owner or tenant is the person who is eligible to file for a refund or credit of the sales tax paid on the purchase of that tangible personal property which becomes an integral component part of the real property. The same is true if the property owner or tenant purchases the tangible personal property and hires a contractor to perform the labor.

If the property owner or tenant hires a contractor, and the contractor purchases the tangible personal property, then the contractor is liable for the sales tax, which must be paid to the supplier at the time the tangible personal property is purchased. In this situation, the contractor is the person who is eligible to file for a refund or credit of the sales tax paid on the purchase of that tangible personal property that becomes an integral component part of the real property.

A capital improvement is any addition or alteration to real property that meets all three of the following conditions: (1) it substantially adds to the value of the real property or appreciably prolongs the useful life of the real property; and (2) it becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the real property or to the property that was affixed to the real property; and (3) it is intended to become a permanent installation.

When a building is being constructed, expanded, or rehabilitated, and the construction, expansion, or rehabilitation does not result in a capital improvement to the real property, if the property owner or tenant purchases the tangible personal property and performs the labor, the property owner or tenant is liable for the sales tax due on the purchase of the tangible personal property. In this situation, the property owner or tenant is the person eligible to file for a refund or credit of the sales tax paid on the purchase of that tangible personal property that becomes an integral component part of the real property. This is also true in cases where the property owner or tenant purchases the materials and hires a contractor to perform the labor.

Opinion

Section 1119(a)(6) of the Tax Law allows a refund or credit for the sales and compensating use tax paid "on the sale of tangible personal property purchased for use in constructing, expanding or rehabilitating industrial or commercial real property (other than property used or to be used exclusively by one or more registered vendors primarily engaged in the retail sale of tangible personal property) located in an area designated as an empire zone pursuant to article eighteen-B of the general municipal law, but only to the extent that such property becomes an integral component part of the real property." However, the statute does not define the phrase "industrial or commercial real property" and does not address the application of the refund or credit to mixed-use properties. The refund or credit may only be claimed by the person who is liable for the tax due on the purchase of the qualifying tangible personal property.

It is assumed for purposes of this Opinion that the Property was rehabilitated as required by section 1119(a)(6). It should be noted that for purposes of section 1119(a)(6) of the Tax Law, *rehabilitating* industrial or commercial real property means performing activities necessary to restore real property to an acceptable condition of fitness and safety for habitation, as required by all applicable governmental building codes, laws, and regulations. Rehabilitation does not include renovations, general maintenance, or minor repairs. See Publication 30, *supra*, at 8.

As the Legislature did not define the phrase "industrial or commercial real property," the phrase may be interpreted in light of its commonly used meaning. When determining the commonly used meaning of a term, the general method is to use the dictionary definition. The dictionary defines *industrial* as relating to industry, while *commerce* is defined as buying and selling of commodities. (Merriam-Webster's Collegiate Dictionary 231, 594 (10th ed 1993)) One might consider how a property is zoned in determining how to classify it for purposes of section 1119(a)(6) of the Tax Law, although the zoning classification would not necessarily be the sole determining factor.

Publication 30, *supra*, defines *commercial real property* and *industrial real property* as follows:

Commercial real property is any income producing real property, other than residential real property. Commercial real property includes hotels (nonresidential), restaurants, nightclubs, beauty salons, travel agencies, movie theaters, banks, automobile repair shops, clothing stores, food stores, office buildings, and so forth.

Industrial real property is real property that is used primarily for the manufacturing, processing, generating, assembling, refining, mining, or extracting of goods. Industrial real property includes factories, manufacturing plants and facilities, refineries, assembly plants, and so forth.

In the present case, the Property is divided between a grocery store and coffee shop on the first floor and four residential apartments on the second floor. Since the first floor is commercial in nature and is not used exclusively by vendors primarily engaged in the retail sale of tangible personal property, the first floor is qualifying commercial real property for purposes of section 1119(a)(6) of the Tax Law. See Publication 30, *supra*. The second floor is nonqualifying residential space. While section 1119(a)(6) is silent as to how to treat mixed-use real property for purposes of this refund or credit, it is reasonable to allow the amount spent for tangible personal property incorporated into rehabilitated mixed-use property to be allocated in a reasonable manner between tangible personal property, such as building materials, that is incorporated into the part of the building used in a qualifying manner and the part of the building not used in a qualifying manner.

Thus, with respect to the refund or credit under section 1119(a)(6) of the Tax Law, when real property has been rehabilitated and the rehabilitated property has a mixed use (here,

TSB-A-07(29)S
Sales Tax
November 15, 2007

qualifying commercial use and nonqualifying residential use), the amount of sales tax paid on the building materials used to rehabilitate the commercial space may be determined by any reasonable method. If costs to rehabilitate the commercial and residential spaces were substantially the same, a reasonable method would be to multiply the total sales tax by a fraction, the numerator of which is the number of square feet of commercial space and the denominator of which is the total number of square feet in the building.

DATED: November 15, 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.