

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:	
of	:	
<b>BT CAPITAL CORP.</b>	:	DECISION
for Redetermination of Deficiencies or for	:	DTA Nos. 807195
Refund of Corporation Franchise Tax under	:	and 807686
Article 9-A of the Tax Law for the Years 1984	:	
through 1987.	:	

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The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on October 10, 1991 with respect to the petition of BT Capital Corp., 280 Park Avenue, New York, New York 10015 for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1984 through 1987. Petitioner appeared by Chadbourne and Parke, Esqs. (Richard M. Leder, Charles K. O'Neill and Lauren D. Kelly, Esqs., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in reply. Oral argument, at the request of the Division of Taxation, was heard on March 12, 1992.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

***ISSUE***

Whether a hydroelectric facility qualifies for the investment tax credit under Article 9-A, section 210.12(b) of the Tax Law as property principally used in the production of goods by manufacturing and processing.

***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, BT Capital Corp., is a Delaware corporation. During the years at issue, petitioner was a limited partner in Black River Hydro Associates, a New York limited partnership (the "Partnership"), which had constructed three separate hydroelectric facilities all located in Lewis County, New York (the "Facilities"). The Partnership operated the Facilities during the years at issue.

On its New York State Corporation Franchise Tax Report (Form CT-3) for each of the subject years, petitioner listed its principal business activity as "small business investment corporation". Petitioner was not formed for, nor is it principally engaged in, the business of supplying water, steam, gas, or electricity, or principally engaged in two or more of such businesses. Petitioner does not sell gas, electricity, steam, water, refrigeration, telephony or telegraphy, or furnish gas, electricity, steam, water, refrigeration, telephony or telegraphy services.

Petitioner claimed an investment tax credit in regard to the Partnership's Facilities on its New York franchise tax returns for the years at issue.

The Facilities were constructed by the Partnership after December 31, 1968, are depreciable pursuant to section 167 of the Internal Revenue Code, have a useful life of four years or more, were acquired by purchase as defined in section 179(d) of the Internal Revenue Code, and have a situs in New York State.

On May 20, 1988, the Division of Taxation issued to petitioner six notices of deficiency, asserting additional corporation franchise tax due for the years 1984, 1985 and 1986, plus interest. On December 8, 1989, the Division issued to petitioner two notices of deficiency asserting additional corporation franchise tax due for the year 1987, plus interest. The notices are listed as follows:

<u>Year</u>	<u>Notice No.</u> <sup>1</sup>	<u>Tax</u>
1984	C880520090N	\$116,793.00
1984	C880520091M	27,504.00
1985	C880520092N	369,695.00
1985	C880520093M	62,848.00
1986	C880520094N	131,221.00
1986	C880520095M	22,307.00
1987	C891019041N	7,351.00
1987	C891019042M	1,255.00

The sole basis for the deficiencies asserted by the Division of Taxation and remaining at issue for the subject years is whether or not the property for which petitioner claimed an investment tax credit (three hydroelectric facilities) is qualified property pursuant to section 210.12(b) of the New York Tax Law and 20 NYCRR 5-2.2(a) of the regulations applicable thereto.<sup>2</sup>

The three Facilities in question are all located within a 3.5-mile stretch of the Black River. These Facilities, known as Port Leyden Hydro ("Port Leyden"), Denley Hydro ("Denley") and Rock Island Hydro ("Rock Island"), are all comprised essentially of the same type of equipment.

Petitioner presented the testimony of one John Cordes, a civil engineer who was the project engineer for the design, construction, equipment purchase and installation at each of the Facilities. He described how a hydroelectric facility uses water to turn a turbine generator and produce electricity. Each of the facilities is located at its own dam on the Black River. The water from the river flows into an intake passageway (essentially a tunnel) and emerges from the same passageway at a lower elevation (the tailrace). The difference in elevation (the "drop"

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Those notice numbers ending with the letter "M" represent Metropolitan Transportation Business Tax Surcharge increases resulting (mathematically) from the basic franchise tax adjustments at issue herein.

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The parties, by their representatives, entered into stipulations as to certain facts relevant to these proceedings. Such stipulated facts are reflected in these findings.

or amount of "head") is a key determinant in the amount of electricity which can be produced.<sup>3</sup> Within the passageway, the water flows past a water wheel which extends from a turbine shaft protruding through the water passageway. The flowing water strikes the blades on the water wheel and turns the connected turbine shaft. The turbine shaft is coupled to a generator shaft just outside the water passageway. The generator shaft, in turn, extends into a generator where, inside, it is attached to a rotor. The rotor is housed within and turns inside of a stator and electricity results (see, infra). From the generator, the electricity passes through a conduit copper wire to a substation where the voltage level is stepped up to a level compatible with that of the public utility transmission grid. The conduit is then interconnected to the public utility grid and the amount of electricity, measured in kilowatt hours by a meter owned and maintained by the public utility, is calculated. The entire output of each of the Facilities is sold to Niagara Mohawk Power Corporation ("Niagara Mohawk") pursuant to three separate long-term contracts.

Petitioner also presented the testimony of Christopher Turner, president of a consulting firm known as The Turner Group. Prior to forming The Turner Group, Mr. Turner was employed by Niagara Mohawk for some 25 years, during which time his job duties required him to become familiar with Niagara Mohawk's methods of purchasing and selling electricity. Mr. Turner described the two current markets for the wholesale purchase of electricity by utilities, to wit purchases from other utilities and purchases from non-utility suppliers such as the Partnership. Mr. Turner noted that purchases from non-utility suppliers have increased in emphasis since the passage of the (Federal) Public Utility Regulatory Policy Act of 1978 ("PURPA") (Pub L 95-617), and amendments to New York State's Energy Law and Public Service Law (Public Service Law

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<sup>3</sup>The subject Facilities are known as "low head projects", having relatively small output capacity, to wit, 2.2 megawatts at Port Leyden, 1.6 megawatts at Denley and 1.9 megawatts at Rock Island.

§ 66-c [L 1980, ch 553; L 1981, ch 843]).<sup>4</sup> Mr. Turner also described the New York Power Pool (the "Power Pool") as an association of seven investor-owned utilities and the New York State Power Authority which together provide electricity to virtually all of the State of New York. The Power Pool interacts with power pools in other states and with Canadian enterprises so as to buy and sell electricity from each other on the basis of the relative economics at the time of the transaction. Measurement, for pricing purposes in these transactions, is by the kilowatt hour. Mr. Turner described Niagara Mohawk's policy of negotiating long-term contracts for the purchase of electricity from non-utility suppliers such as the Partnership. Under these contracts, the measurement for pricing purposes is also the kilowatt hour.

In addition to the foregoing, petitioner presented the testimony of Dr. Charles Holbrow, professor of physics at Colgate University. Dr. Holbrow testified as an expert witness as to the characteristics and properties of electricity. Dr. Holbrow testified that all matter is electrical in nature, and that the various configurations of matter are determined by the electrical interactions of fundamental particles making up atoms, namely a core nucleus consisting of uncharged neutrons and positively-charged protons, surrounded by a shell of negatively-charged electrons. Dr. Holbrow testified that the word "matter" is used by physicists to describe those objects,

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The record does not provide extensive detail as to these enactments. However, the same were discussed at some length in Matter of Consolidated Edison Co. v. Public Service Commission (63 NY2d 424, 483 NYS2d 153, appeal dismissed 470 US 1075, 105 S Ct 1831). In 1980, the New York Legislature enacted section 66-c of the Public Service Law ("PSL"). Similar to the Public Utility Regulatory Policies Act of 1978 ("PURPA") (Pub L 95-617) enacted by the Federal government on the national level, the purpose of PSL § 66-c was to promote the State energy goals of development of alternative energy production facilities, cogeneration facilities, and hydroelectric facilities in order to reduce the dependence on traditional fossil fuels (Matter of Consolidated Edison Co. v. Public Service Commission, 63 NY2d 424, 483 NYS2d 153, 154-155). To foster this development, PURPA and PSL § 66-c required electric utilities to purchase electric power produced by independent power producers, such as the Partnership, that qualified under the law at purchase rates that were just, nondiscriminatory and in furtherance of the public policy underlying the legislation. Both PURPA and PSL § 66-c were enacted in recognition that one of the central problems that hindered the development of alternative energy sources was the traditional electric utilities' reluctance to buy power from such alternative power producers (*id.*, 483 NYS2d at 154; FERC v. Mississippi, 456 US 742, 749-751).

PURPA required that the purchase rate not exceed the purchasing utilities' avoided costs; that is, the amount it would have cost the utility to generate the same energy it bought from the qualifying facility had that purchase not been made (Matter of Consolidated Edison Co. v. Public Service Commn., *supra*, 483 NYS2d at 155, n. 2). However, PSL § 66-c provided a further incentive to energy developers by requiring a minimum purchase price of six cents per kilowatt hour for electricity which at times could exceed a utility's avoided-cost purchase rate inasmuch as the avoided-cost rate varied by utility and over time depending on market conditions (*id.*).

including electrons, which have mass and other properties when at rest. Dr. Holbrow noted that an electron in fact has mass, has a well-defined charge and can be weighed. He also indicated that a distinction can be made between matter and radiation.<sup>5</sup>

Dr. Holbrow described the commercial generation of electricity, such as is done at the Facilities, as being an activity which by the rotation of the rotor within the stator causes the otherwise random oscillation pattern (or motional state) of the electrons within the rotor field to be reconfigured into an ordered oscillation pattern. This reordering of the electrons continues, in turn, to be effected along the electrons in the conduit line to the transformer and thereafter into the utility grid. Dr. Holbrow noted that the generator must be in operation for this new configuration of electrons to be effected and thereafter maintained.

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On this question of tangibility, Dr. Holbrow testified as follows:

Q "Is electricity tangible matter?

A Yes. The electric charge which I consider forms the basic elements of electricity are definitely tangible matter.

Q What is it that causes you to conclude that?

A Well, that it has mass, that's very basic. One can make a distinction between radiation and matter. Radiation also has mass; radiation is an evanescent phenomenon. Light is radiation; it has a very slight amount of mass, has extremely transitory life, originates and is absorbed by matter; always travels at the speed of light.

A physicist makes a distinction between matter and radiation. We use the word matter for those objects which have mass and other properties when at rest. In 1989, the Nobel Prize for physics was awarded to a man who created a device that held a single electron in an experimental configuration for nine months.

Q When you talk about radiation, are you talking about the difference between electromagnetic radiation --

A Certainly.

Q Electromagnetic radiation, is that something that can be stored like electricity?

A No. Electromagnetic radiation is evanescent like noise. You can make it; it's either there or it's not. The sounds of my voice are not stored in my chest. I have a machine that generates them and then dissipates them. Very much the same thing is true of lights; it's not a stored phenomenon.

Q Are electromagnetic signals used in television?

A Electromagnetism is a wide range of phenomena. That's one of them." (Emphasis added.)

***OPINION***

The Administrative Law Judge concluded that: 1) electricity is a "good" within the meaning of Tax Law § 210.12(b); 2) the hydroelectric facilities produced electricity by "manufacturing" or "processing" within the meaning of Tax Law § 210.12(b); and 3) petitioner was entitled to claim the investment tax credit in Tax Law § 210.12(b) for its investment in the hydroelectric facilities.

On exception, the Division of Taxation (hereinafter the "Division") asserts that: 1) for purposes of the investment tax credit, electricity does not constitute a "good"; 2) the use of the term "electricity" in New York case law indicates that electricity is a form of energy and not a "good"; 3) (a) under Article 28, electricity is not considered tangible personal property and (b) both the courts and the Tax Appeals Tribunal have relied on Article 28 definitions of terms in defining identical or similar terms in Article 9-A; 4) Matter of Leisure Vue v. Commissioner of Taxation & Fin. (172 AD2d 872, 568 NYS2d 175) is determinative of whether electricity is tangible personal property and a "good"; 5) a hydroelectric facility is not engaged in manufacturing for the purposes of the investment tax credit because the "generation" of electricity is an activity distinct from manufacturing; 6) the fact that Article 9 does not contain an investment tax credit indicates that the Legislature did not intend to grant an investment tax credit to Article 9-A taxpayers engaged in the same activities; 7) the provisions of the Federal investment tax credit are relevant to the issue of whether generation of electricity is an activity which is eligible for the investment tax credit; 8) the level of precision in the language of Tax Law § 210.12(b) indicates that the activities encompassed by the terms "manufacturing," "processing," or "extracting" are to be interpreted narrowly; and 9) the Division's position in this matter is consistent with the overall public policy regarding the investment tax credit.

In response to the exception, petitioner argues that: 1) electricity is a "good" for purposes of the investment tax credit; 2) the production of electricity is covered by at least two of the activities described in Tax Law § 210.12(b), i.e., "manufacturing" and "processing"; 3) the production of electricity by a hydroelectric facility for sale to a public utility is not synonymous

with the furnishing of electrical service, which is typically provided by the utility itself; 4) the language of the Federal investment tax credit statute provides no support for the Division's position; 5) there is no support for the inference that the term "manufacturing" used in Tax Law § 210.12(b) is to be narrowly construed by reference to other terms used in or omitted from the section; and 6) it is fully consistent with New York State's avowed policy of promoting small hydroelectric facilities to liberally construe the investment tax credit legislation to include such facilities within its scope.

The Administrative Law Judge granted petitioner's petition and cancelled the notices of deficiency dated May 20, 1988 and December 8, 1989.

Tax Law (former) § 210.12(b),<sup>6</sup> in pertinent part, reads as follows:

"[a] credit shall be allowed under this section with respect to tangible personal property and other tangible property, including buildings and structural components of buildings, which are: depreciable pursuant to section one hundred sixty-seven of the internal revenue code . . . have a useful life of four years or more, are acquired by purchase as defined in section one hundred seventy-nine (d) of the internal revenue code, have a situs in this state and are principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing. For purposes of this paragraph, manufacturing shall mean the process of working raw materials into wares suitable for use or which gives new shapes, new quality or new combinations to matter which already has gone through some artificial process by the use of machinery, tools, appliances and other similar equipment" (emphasis added).

The identical issue presented by this case was recently decided by this Tribunal in Matter of Clark (Tax Appeals Tribunal, September 14, 1992). In Clark, we determined that a hydroelectric facility qualified for the investment tax credit in Tax Law § 606(a)(2)(A) and (B)(i) as property used in the production of goods by manufacturing and/or processing. The statutory provisions in Article 22, Tax Law § 606(a)(2)(A) and (B)(i) which provide the investment tax credit to taxpayers under the personal income tax are in essence identical to the provisions of Tax Law § 210.12(b) which provide the investment tax credit to taxpayers under the franchise tax on business corporations. Therefore, for the reasons stated in Clark, we

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L 1987, ch 817, § 36 divided the text into subparagraphs and made changes to the text not relevant here.



uphold the determination of the Administrative Law Judge and find that petitioner is entitled to the investment tax credit for its investment in the hydroelectric facilities here.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;
2. The determination of the Administrative Law Judge is sustained;
3. The petition of BT Capital Corp. is granted; and
4. The notices of deficiency dated May 20, 1988 and December 8, 1989 are cancelled.

DATED: Troy, New York  
October 1, 1992

/s/John P. Dugan  
John P. Dugan  
President

/s/Francis R. Koenig  
Francis R. Koenig  
Commissioner

/s/Maria T. Jones  
Maria T. Jones  
Commissioner