STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BROOKLYN UNION GAS COMPANY	:	DETERMINATION DTA NO. 817453
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period August 1, 1993 through November 30, 1997.	:	

Petitioner, Brooklyn Union Gas Co., One Metrotech Center, Brooklyn, New York 11201, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period August 1, 1993 through November 30, 1997.

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York on August 16, 2000 at 10:30 A.M., with briefs to be submitted by March 7, 2001 which date began the six-month period for the issuance of this determination. Petitioner appeared by Carolyn Joy Lee, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Cynthia B. McDonough, Esq., of counsel).

ISSUE

Whether natural gas imported into New York by petitioner and used as fuel in its own motor vehicles is subject to the compensating use tax.

FINDINGS OF FACT

1. Petitioner, Brooklyn Union Gas Company, is an investor-owned, regulated public utility incorporated in New York State. Petitioner sells natural gas and the service of furnishing natural gas to customers in the boroughs of Brooklyn, Staten Island and part of Queens.

2. During the assessment period, petitioner purchased large quantities of natural gas from suppliers located outside New York State. It took title to the natural gas outside of New York and imported the natural gas into New York.

3. When it is brought into New York, the natural gas imported by petitioner is pressurized at a rate of approximately 300 pounds per square inch ("psi"). The pressure is gradually reduced at regulator stations operated by petitioner, and it enters people's homes at less than one psi.

4. The bulk of the natural gas imported by petitioner is sold to residential and commercial customers for use as a fuel for boilers, water heaters, stoves and other appliances that run on natural gas. A small portion of the natural gas imported by petitioner is used by petitioner to heat its own plants and offices and to fuel its own water heaters and other appliances.

5. Less than one percent of the natural gas imported by petitioner is sold to customers for use in natural gas vehicles. Customers operating natural gas vehicles in the New York City area include the New York City Transportation Authority, the State of New York, United Parcel Service ("UPS") and the operator of a fleet of taxicabs. All of petitioner's own motor vehicles are fueled by natural gas.

6. Petitioner operates several fueling stations where natural gas is compressed to approximately 3,000 psi and pumped directly into fuel storage cylinders installed in the motor vehicle. The purpose of compressing natural gas is to allow the vehicle to carry a sufficient amount of natural gas to travel for extended distances. Without pressurization, a natural gas

vehicle would have little ability to travel at all. When natural gas is pressurized for the purpose of using it as fuel in a natural gas vehicle, it is commonly referred to as CNG (compressed natural gas). As the name implies, CNG is gas; that is, the compression of the gas does not change its composition or its essential nature as a gas. The CNG is decompressed and mixed with oxygen before it is injected into the engine's combustion chamber. The natural gas is burned in the combustion chamber at pressures equal to, or slightly higher than, normal atmospheric pressure. Increased storage is the only purpose served by compressing the natural gas.

7. Some of petitioner's CNG customers fill the tanks of their vehicles at petitioner's fueling stations. Others, such as UPS, own their own compression equipment and are able to fuel their natural gas vehicles at their own facilities. Natural gas, whether sold at petitioner's fuel stations or pumped at a customer's own facility, is measured at low pressure as it flows through meters. Meters measure natural gas in centimeters per cubic foot. The gas is then compressed and pumped into the fuel tanks of the natural gas vehicle. Petitioner sold compression equipment to those customers who wished to compress and pump the natural gas at their own facilities.

8. In 1987, petitioner filed an Application for Motor Fuel Tax and Sales and Use Tax Registration stating that it was in the business of manufacturing compressed natural gas to fuel CNG test vehicles. Petitioner is registered as a distributor of motor fuel. However, it does not prepay the tax imposed on motor fuel at the time of first import of natural gas into New York, since the amount of natural gas that is imported for use in natural gas vehicles is unknown until the natural gas is actually pumped into the vehicle. Petitioner collects and remits sales tax on natural gas sold to its CNG customers.

9. Petitioner maintains a service center in Canarsie, in Brooklyn, New York. Natural gas entering the Canarsie facility is used to heat petitioner's own buildings. In addition, a small amount of natural gas is used to fuel petitioner's own fleet of natural gas vehicles. The same meters measure both the natural gas used to heat the facility and the natural gas used to fuel vehicles.

10. In October 1995, the Division of Taxation ("Division") conducted a combined motor fuel and sales tax audit of petitioner's books and records for the period January 1, 1993 through December 31, 1995. The audit period was later extended through November 30, 1997. As a result of this audit, the Division determined that petitioner correctly calculated and remitted sales tax on its sales of CNG to other parties. However, the Division determined that petitioner had not remitted use tax on its use of CNG in its own motor vehicles. On audit, petitioner claimed that its self-use of CNG was not subject to the use tax provisions of Tax Law § 1110. The Division took the position that natural gas, when it is compressed for use in a motor vehicle, becomes motor fuel, and as motor fuel, CNG is subject to the use tax provisions.

11. The Division calculated the use tax based upon petitioner's own records using a formula to convert the amount of gas used from centimeters per cubic inch, as measured by petitioner's meters, to gallons. As a result of this audit, the Division issued to petitioner a Notice of Determination, dated June 22, 1998, assessing use taxes due for the period September 1, 1994 through November 30, 1997 of $85,352.07 plus interest.

SUMMARY OF THE PARTIES' POSITIONS

12. Tax Law § 1105(a) imposes sales tax on receipts from the retail sale of tangible personal property. As relevant here, Tax Law § 1105(b) imposes sales tax on receipts from the retail sale of gas and gas service. For purposes of article 28 of the Tax Law, tangible personal

property is defined as "[c]orporeal personal property of any nature. However, *except for the purposes of the taxes imposed by [Tax Law § 1105(b)(1)]*, such term shall not include gas" (Tax Law § 1101[b][6]). Petitioner argues that pursuant to this definition natural gas is not tangible personal property and is never taxable under section 1105(a) of the Tax Law. Inasmuch as Tax Law § 1110 imposes the compensating use tax only on tangible personal property and certain enumerated services, not including the furnishing of gas or gas service, petitioner takes the position that its self-use of natural gas as a motor fuel is not subject to tax. Moreover, petitioner argues that compression of natural gas causing it to be CNG does not change its essential nature as gas; therefore, there is no basis to tax its use of CNG.

13. The Division maintains that Tax Law § 1102(a) imposes a tax on motor fuel which is separate and distinct from the sales and use taxes imposed by sections 1105 and 1110 of the Tax Law. Based on this contention, the Division takes the position that CNG is subject to the compensating use tax when it is used as motor fuel.

14. Alternatively, the Division argues that since sales of gas in cylinders having a capacity of less than 100 pounds are considered to be sales of tangible personal property, petitioner's use of CNG is subject to the use tax when CNG is pumped into the fuel tanks, or cylinders, of its own vehicles.

15. In response to the Division's alternative argument, petitioner notes that it does not sell natural gas in containers or cylinders.

CONCLUSIONS OF LAW

A. The parties agree that for most purposes the self-use of natural gas by a person importing that gas into New York State was not subject to use tax during the audit period.[1] The use tax is imposed "for the use within the State . . . (A) of any tangible personal property purchased at retail, (B) of any tangible personal property, however acquired, where not acquired for purposes of resale, upon which any of the services described in [Tax Law § 1105(c)(2), (3) and (7)] have been performed." Accordingly, the use tax applies to tangible personal property purchased at retail and tangible personal property upon which certain services, not relevant here, have been performed (producing, fabricating, processing, printing or imprinting tangible personal property [Tax Law § 1105(c)(2)]; installing tangible personal property [Tax Law § 1105(c)(3)] and interior decorating and designing services [Tax Law § 1105(c)(7)]).

Tax Law § 1101(b)(6) defines the term "tangible personal property" as used in article 28 of the Tax Law as "[c]orporeal personal property of any nature." The provision then states: "However, *except for purposes of the tax imposed by subdivision (b) of section 1105*, such term shall not include gas" (emphasis added).

It is well-established that "statutes . . . are to be read according to the natural and obvious import of their language without resorting to subtle or forced construction either limiting or extending their effect" (***Cooper-Snell Co. v. State of New York***, 230 NY 249, 255). Based on the clear wording of Tax Law § 1101(b)(6), it must be concluded that gas, as a substance, is deemed to be tangible personal property for purposes of Tax Law § 1105(b), but not for purposes

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[1] In 2000, the use tax imposed by Tax Law § 1110[a] was extended to include the use "of any gas or electricity described in [Tax Law § 1105(b)]." This amendment will be discussed later in this detemination. Unless otherwise specified, references here are to the former statute.

of Tax Law § 1105(a) or Tax Law § 1110. Furthermore, since Tax Law § 1110 makes no reference to the tax on gas or gas services imposed by section 1105(b), it can also be concluded that section 1110 does not impose use tax on the use of natural gas or the use of a natural gas service.

This is the conclusion reached by the Tax Appeals Tribunal in ***Matter of Penn York*** (Tax Appeals Tribunal, October 1, 1992). Based on the reasons stated in the Administrative Law Judge's conclusions of law "A" through "H", the Tribunal affirmed his determination that the compensating use tax did not apply to natural gas used by the petitioner as a base gas. The Administrative Law Judge examined the statutes in issue here, sections 1105(b), 1101(b)(6) and 1110, and found that by restricting the imposition of the use tax to tangible personal property, the Legislature intended to exclude the in-state use of gas purchased outside of New York from the imposition of use tax. The Administrative Law Judge specifically rejected the Division's argument that natural gas might be considered tangible personal property under Tax Law § 1110 or under any other section of article 28 other than section 1105(b). (***Cf.***, ***Matter of Tenneco***, State Tax Commission, January 17, 1986 [where the Commission held that gas withdrawn from the petitioner's pipeline for its own consumption was not subject to use tax, but also held that under certain circumstances natural gas may be subject to the tax imposed by section 1105(a). To the extent that the conclusions in ***Matter of Tenneco*** are in conflict with the opinion in ***Penn York***, the latter must be considered to be the controlling precedent (***see***, ***Matter of Racal Corp.***, Tax Appeals Tribunal, May 13, 1993)].)

Further support for concluding that natural gas purchased outside New York and used inside New York was not subject to the compensating use tax during the audit period is found in

the amendment to Tax Law §1110 which became effective May 15, 2000 (L 2000, ch 63, § 24-a). As amended, Tax Law § 1110 now imposes a tax for the use within New York "of any gas or electricity described in [Tax Law § 1105(b)]" (Tax Law § 1110[h]). The amendment imposes a tax where one was not imposed before. It imposes a use tax on gas and gas services.

B. The linchpin of the Division's position is its claim that Tax Law § 1102 imposes a discrete tax on motor fuel sold in New York State and on motor fuel purchased outside of New York and used in-state. Thus, the Division finds that section 1102 was intended to broaden the scope of the compensating use tax to include any compound used as motor fuel, including CNG. This position is premised on the Division's construction of Tax Law § 1102 and on the theory that the 1985 amendments to articles 28 and 29, known as the "First Import Act" (L 1985, ch 44), substantially changed the taxability of CNG by imposing a new prepaid tax on all sales and uses of motor fuel in New York State. Petitioner argues that the language of Tax Law § 1102 does not support the Division's interpretation of it. It also maintains that the First Import Act did not impose a new, discrete tax on motor fuel but merely created a new regime for regulating the sale of motor fuel and the collection of taxes imposed on motor fuel.

C. Generally, the cardinal function in interpreting any statute is to effectuate the intent of the Legislature, and where the meaning of a statute is unequivocal, resort to extrinsic matter is inappropriate (***Matter of 1605 Bookstore v. Tax Appeals Tribunal***, 83 NY2d 240, 609 NYS2d 144). While each of the parties claims that the clear wording of Tax Law § 1102 supports its position, each relies on the legislative history of the First Import Act to demonstrate the merit of its claim. Since the Legislature's intent in adopting the First Import Act is in dispute, this discussion begins with a brief history of that act.

D. Since the adoption of articles 28 and 29, sales tax has been imposed on the retail sale of gasoline, diesel motor fuel and other liquid fuels. Sales tax was imposed on those products as tangible personal property pursuant to Tax Law § 1105(a). There was no independent sales or use tax on motor fuel as such. Since liquid fuels are tangible personal property, they were also subject to the compensating use tax imposed by Tax Law §1110. Natural gas was not subject to use tax, no matter how it was used, because it is not tangible personal property.

Prior to September 1, 1982, sales tax was collected on each gallon of gasoline sold at a retail service station (Tax Law § 1111[former (d), (e)]). The tax was imposed at the combined State and local rate, if any, which was applied to the actual selling price. The individual retail service station was thus required to collect and remit the tax on each retail sale.

Beginning September 1, 1982, the collection regime was modified to protect State and local revenue from evasion of taxes (L 1982, chs 454 and 469). At that point, the retail sales tax on motor fuel was collected, not from the ultimate consumer, but on sales by distributors to non-distributors, such as retail service stations. This change was accomplished by defining a sale of automotive fuel by a distributor to be a retail sale (Tax Law former § 1101[b][4][ii]). As a result, the tax was actually imposed at a higher point in the distribution chain than the point of sale by the service station to the consumer. Partly because it allowed distributors to buy and sell motor fuel to each other tax-free (***see***, 20 NYCRR former 410.7), this enactment proved inadequate to detect and deter tax evasion with respect to motor fuel taxes and sales taxes on motor fuel. For purposes of this discussion, it is important to add that the 1982 amendments did not change the scope of the sales or use tax. Gasoline and other liquid fuels continued to be taxed as tangible personal property pursuant to Tax Law § 1105(a). Natural gas was not subject to use tax.

To combat the continued evasion of tax in the motor fuel industry, the Legislature enacted the First Import Act (L 1985, ch 44). The Memorandum in Support of chapter 44 discussed the large revenue loss caused by evasion of the taxes on motor fuel and the purpose of the new legislation:

> This bill is aimed at deterring tax evasion with respect to motor fuel sold in the State. This evasion has promoted unfair competition and erosion of the State and local tax bases for which the Governor's Task Force on Administration of Taxes on Petroleum Products and Businesses estimates an annual State local loss of at least $90 million. Industry estimates of the combined State and local revenue loss range as high as $200 million annually. (Memorandum in Support, Governor's Bill Jacket, L 1985, ch 44.)

Two methods of tax evasion were identified: (1) daisy chain schemes obfuscated liability for payment of the taxes due by setting up multiple tax-free sales of motor fuel between distributors, with the taxable event being the sale of motor fuel by a nonexistent or insolvent distributor, and (2) bootlegging schemes simply involved the evasion of tax by failing to report the import and sale of motor fuel (see, Memorandum of James J. Lack, 1985 NY Legis Ann, at 55). The First Import Law enhanced the enforcement of the motor fuel and sales tax laws through several complementary strategies. Tax Law § 284 was amended to impose the excise tax upon motor fuel imported into New York. Thus, for the purpose of the tax imposed by article 12-A, the taxable event became the first import rather than the first sale in New York and tax-free sales between distributors were eliminated (see, Memorandum in Support, Governor's Bill Jacket, L 1985, ch 44). In addition, Tax Law § 1102 was added to article 28 introducing, for the first time, the concept of a prepaid sales tax.

There is no evidence in the legislative history that the First Import Act was intended to broaden existing taxes or to tax transactions not previously subject to tax. Rather, the entire thrust of the act was to combat several pervasive schemes of tax evasion as described above.

E. Moreover, the plain language of the statutes relied on by the Division does not demonstrate that Tax Law § 1102 was intended to impose a new tax on motor fuel or to broaden the scope of the compensating use tax. In construing a taxing statute in order to determine whether the taxpayer's activities fall within its scope, the statute is to be strictly construed in favor of the taxpayer and against the taxing authority (***Matter of Nehi Bottling Co. v. Gallman***, 39 AD2d 256, 333 NYS2d 824, ***affd*** 34 NY2d 808, 359 NYS2d 44; ***Matter of American Locker Co. v. Gallman***, 38 AD2d 105, 327 NYS2d 973, ***affd*** 32 NY2d 175, 344 NYS2d 358). Consequently, any well-founded doubt about the meaning of the statute must weigh against the Division and in favor of petitioner (***Matter of Grace v. State Tax Commn.***, 37 NY2d 193, 371 NYS2d 715, 718). A close reading of the statutory provisions imposing the sales and use taxes confirms that petitioner's use of CNG as a motor fuel was not subject to the provisions of Tax Law § 1110 during the assessment period.

Reduced to its essentials, section 1102 requires the importer of motor fuel to prepay any sales or use taxes imposed by other sections of articles 28 and 29.

Section 1102(a)(1) provides as relevant:

> Every distributor of motor fuel shall pay, *as a prepayment on account of the taxes imposed by this article* and pursuant to the authority of article twenty-nine of this chapter, a tax on each gallon of motor fuel (i) which he imports or causes to be imported into this state for use, distribution, storage or sale in the state or produces, refines, manufactures or compounds in this state (emphasis added).

Tax Law § 1102(b) provides, as relevant:

> The taxes *required to be prepaid pursuant to this section* shall be administered and collected in a like manner as the taxes imposed by sections eleven hundred five and eleven hundred ten of this article. All the provisions of this article relating to or applicable to the administration, collection and disposition of the taxes imposed by such sections shall apply *to the tax required to be prepaid under this section* so far as such provisions can be made applicable to such prepayments of tax with such limitations as set forth in this article and such modifications as may be necessary in order to adapt such language to the tax so imposed. . . . *For purposes of this section, any reference in this article to the tax or taxes imposed by this article shall be deemed to refer to the tax required to be prepaid pursuant to this section unless a different meaning is clearly required* (emphasis added).

Tax Law § 1102(c) provides:

> Nothing in this article shall be construed to require the payment of the tax required to be prepaid pursuant to this section more than once upon motor fuel or diesel motor fuel sold within the state. When the foregoing prepaid tax imposed pursuant to this section is paid *it shall have been so paid on account of the taxes imposed by this article or pursuant to the authority of article 29 of this chapter with respect to the retail sale or use of motor fuel or diesel motor fuel. Nothing in this section shall modify or affect the taxes imposed by [§ 1105 or § 1110] of this article as applied to the receipts from the sale or use of such fuel* (emphasis added).

F. The plain language of the statutory provisions relied on by the Division contradicts its claims. Tax Law § 1102(a)(1) did not impose a new tax. It provides that each distributor of motor fuel shall pay a tax on motor fuel "as a prepayment on account of the taxes imposed by this article." Requiring motor fuel distributors to make a "prepayment on account" of the articles 28 and 29 sales and use taxes is not the same as imposing a new tax on motor fuels. As petitioner notes, when the Legislature wants to impose a tax it uses clear language to do so. Petitioner cited to 25 imposition provisions in the Tax Law where the Legislature imposed a tax using direct and simple language. A sample of these provisions will suffice to make the point: "Every . . . corporation . . . *shall pay a tax* . . . ." (Tax Law §180[1][a]); "[a] tax *is hereby imposed* upon the transfer of any property real or personal . . . ." (Tax Law § 220); "[t]here *is hereby levied and*

imposed an excise tax of four cents per gallon upon motor fuel" (Tax Law § 284); "there *is hereby imposed* upon every petroleum business . . . an annual tax (Tax Law § 301); and "there *shall be paid* a tax of four percent" (Tax Law § 1105).

The Division finds an imposition of a new tax by reading the phrase "*as a prepayment on account of the taxes imposed by this article*" as though it referred to taxes imposed by section 1102. This is an untenable reading of the statutory language. If a separate and discrete tax were imposed by Tax Law § 1102, there would be no reason to collect the tax as a "prepayment." It only makes sense to require a prepayment if the prepayment is for a tax imposed later in the chain of distribution. This is exactly what section 1102 does. It requires prepayment of the sales and use taxes which are imposed at the point of the retail sale pursuant to Tax Law § 1105(a) or for use in New York pursuant to Tax Law § 1110. Section 1102 does not impose a tax on any transaction not already taxed by sections 1105 or 1110.

The Division also points to section 1102(c) which provides: "When the foregoing prepaid tax *imposed pursuant to this section* is paid it shall have been so paid on account of the taxes imposed by this article or pursuant to the authority of article 29 of this chapter with respect to the *retail sale or use* of motor fuel or diesel motor fuel." (Emphasis is from the Division's brief.) The Division argues that the phrase "prepaid tax imposed pursuant to this section" establishes that Tax Law § 1102 imposed a new tax, a prepaid tax. By taking a few words out of context, the Division renders the rest of the provision meaningless. Clearly, the purpose of the entire subdivision is to explicitly state that the tax prepaid pursuant to section 1102 is paid "on account of" the sales and use taxes imposed in other sections of article 28.

The Division also relies on the following provisions of Tax Law § 1132(h) as support for its position that the First Import Act was intended to broaden the scope of Tax Law § 1110.

> For the purpose of the proper administration of this article and to prevent the evasion of the tax on motor fuel imposed by and pursuant to this article, it shall be presumed that all motor fuel . . . manufactured . . . or possessed in the state is *intended for use,* distribution, storage or sale in the state *and subject to the tax required to be prepaid by section eleven hundred two of this article until the contrary is established*. (Tax Law § 1132[h][1][ii]; emphasis added).

The Division contends that the inclusion of "use" in the litany of intended purposes for which the motor fuel is imported demonstrates the Legislature's intention to impose a compensating use tax on CNG when used as motor fuel. This is an unsupportable reading of section 1132(h)(1)(ii). That statute creates a presumption that motor fuel possessed in New York is subject to "*the tax required to be prepaid by section eleven hundred two."* If the tax is not required to be prepaid by section 1102, the presumption does not apply. When section 1102 was added to article 28 in 1985, the use tax was not imposed on CNG because CNG is not tangible personal property. If the Legislature wished to amend the compensating use tax statute in order to impose a use tax on CNG when used as motor fuel, it would certainly have taken a more direct route than amendment of the statutory presumptions found in section 1132.

Tax Law §1132(h)(3)(i) provides:

> For the purpose of the proper administration of this article and to prevent evasion of *the tax [on motor fuel imposed by and pursuant to this article*], it shall be presumed that all retail sales of motor fuel or diesel motor fuel are subject to the tax required to be collected by subdivision (a) of section eleven hundred five of this article or paid by the provisions of section eleven hundred ten of this article until the contrary is established (Tax Law § 1132[h][3][i]; emphasis added).

The Division claims that the highlighted language shows that section 1102 was intended to impose a discrete tax on motor fuel. As petitioner points out, this is one of the few places in

either section 1102 or section 1132 that employs this construction, as opposed to literally dozens of places where the statute refers to "the tax required to be prepaid by [section 1102]." Again, if the Legislature intended to impose a new tax it would have declared its intention more clearly than by its use of language in a presumption provision.

G. Tax Law § 1102(e) provides as follows:

> For the purposes *of this section and article twelve-A of this chapter* the term "use" shall mean, in addition to the meaning set forth in [section 1101(b)(7)] of this article, the exercise of any right or power over motor fuel or diesel fuel by any person, whether or not a purchaser, including, but not limited to, the receiving, the withdrawal from storage or any consumption of such fuel.

The Division points to this provision and to section 561.2(b) of the regulations as evidence that the Legislature intended to broaden the scope of Tax Law § 1110 to include within its ambit the use of all motor fuel in New York State, including CNG. This construction of the statute is unfounded. The words of the statute confine the definition of "use" found there to Tax Law §1102 and article 12-A of the Tax Law. To apply the definition of use found there to Tax Law § 1110 would directly contravene the plain language of the statute.

H. In order to clearly see the flaw in the Division's argument it is helpful to review other provisions of the First Import Act which provide for collection and payment of the sales tax on motor fuel.

Section 1102(a)(1) states that every distributor "shall pay a tax . . . on each gallon of motor fuel." But the tax base is not the number of gallons of motor fuel imported, manufactured or sold by the distributor; the tax is not calculated by applying a tax rate or levy to the number of gallons imported. The tax is calculated by multiplying the number of gallons imported by an average retail selling price determined by the Commissioner of Taxation and Finance and applying the

applicable tax rate to the product (Tax Law § 1111[d],[e]). The distributor then passes the tax through to its customers, and ultimately the tax is passed through to the consumer purchasing the motor fuel at retail. This process was summarized by the Tax Appeals Tribunal in ***Matter of Fourth Day Enterprises*** as follows:

> Chapter 44 divided the state into two regions for purposes of the imposition of the tax: a downstate region consisting of the Metropolitan Commuter Transportation District and an upstate region consisting of the remainder of the State (***see***, Tax Law § 1111[e][1], as added by L 1985, ch 44, § 22). The prepaid tax was imposed at the rate of 7% upon the regional average retail sales price established by the Energy Commissioner for the downstate region and at the rate of 6% upon the regional average retail sales price established by such Commissioner for the upstate region (Tax Law § 1111[e][2], as amended by L 1985, ch 44, § 22).
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> Section 18 of Chapter 44 of the Laws of 1985 amended section 1101(b)(4)(ii) to delete the special definition of "retail sale" that had deemed the sale of automotive fuel by a distributor to be a retail sale. Accordingly, on and after June 1, 1985, service stations were required to collect the tax imposed by section 1105 upon their sales of motor fuel to consumers based upon the combined state and local sales tax rate in effect in the particular locality and the actual sales price.
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> Tax Law section 1101(b)(4)(ii), as amended by Chapter 44 of the Laws of 1985, provided that the prepaid tax was to be passed through [from the distributor to each subsequent purchaser]. (***Matter of Fourth Day Enterprises,*** Tax Appeals Tribunal, October 27, 1988, quotations from statutes omitted).

This summary of the statutory scheme created by the First Import Act makes it plain that the tax required to be prepaid by Tax Law § 1102 is the sales tax imposed on the retail sale of tangible personal property pursuant to Tax Law § 1105(a). That tax was to be prepaid by the distributor and passed through to each subsequent purchaser until the sales tax was collected from the ultimate consumer. Section 1102 did not impose a new tax or broaden the scope of the existing sales and use taxes.

I. There is no question that the CNG sold by petitioner and used in its own natural gas vehicles was motor fuel as that term is defined in various statutes and regulations. "Motor fuel" is defined in section 282(2) of article 12-A as "gasoline, benzol or other product . . . suitable for use in operation of a motor vehicle." Tax Law § 1101(b)(4)(ii) directs that the term "motor fuel" when used in article 28 shall have the same meaning as that established in Tax Law § 282(2). Thus, CNG is motor fuel for purposes of articles 28 and 29 (***see also***, 20 NYCRR 561.2[a][1][i], [motor fuel "means gasoline, benzol or other product . . . which is suitable for use in the operation of any vehicle"]).

However, the sales tax regulations go on to state that the prepayment provisions of Tax Law § 1102 are not applicable to CNG when it is sold as a motor fuel. Section 561.2(a)(1)(ii) provides:

> However, any product that is not commonly or commercially known or sold as gasoline or a blend thereof, will not generally be considered to be suitable for use in the operation of a motor vehicle engine until one of the following, whichever is the earliest, takes place:
>
> * * *
>
> (d) The product is pumped into the fuel tank of a motor vehicle for use in the operation thereof on the public highways of New York State or is pumped into the fuel tank of a pleasure or recreational motor boat for use in the operation thereof on the waterways of New York State, including any waterways bordering on the State.
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> Example 4: 'D' sells compressed natural gas for heating purposes. In addition, 'D' sells such product to persons operating motor vehicles that have been specially adapted to operate on compressed natural gas. Such compressed natural gas is motor fuel suitable for use in the operation of a motor vehicle engine when it is pumped into the fuel tank of a motor vehicle for use in the operation of the vehicle. 'D' is deemed to have produced motor fuel in this State because 'D' established the compressed natural gas as motor fuel. Consequently, 'D' must be registered under article 12-A of the Tax Law and pay the taxes imposed on such motor fuel.

Because the regulation does not treat CNG as a motor fuel until it is pumped into the fuel tank of a motor vehicle, the prepayment requirements of article 12-A and articles 28 and 29 of the Tax Law do not apply. However, petitioner is deemed to be a manufacturer or processor of motor fuel for purposes of article 12-A of the Tax Law because it compresses natural gas for use as a motor fuel.

Tax Law § 1110(B) imposes a tax for use "of any tangible personal property manufactured, processed or assembled by the user, if items of the same kind of tangible personal property are offered for sale by him in the regular course of business." The Division argues that petitioner, by processing gas into CNG for use as a motor fuel, is a manufacturer of tangible personal property for sale in the regular course of business, and that its use of CNG is subject to use tax pursuant to section 1110(B). This argument also fails in light of the clear language of Tax Law § 1101(b)(6). Natural gas is not tangible personal property except for purposes of Tax Law § 1105(b) (Tax Law § 1101[b][6]; ***see also***, ***Matter of Penn York***, ***supra***). Accordingly, it is not tangible personal property for purposes of Tax Law § 1110(B).

J. Alternatively, the Division argues that petitioner's sales of CNG are subject to the following regulation:

> Sales of gas in containers or cylinders having a capacity of less than one hundred pounds of gas are considered to be sales of tangible personal property subject to tax under [Tax Law § 1105(a)] and the sale of gas service or gas for the purposes of this section. (20 NYCRR 527.2 [b][3].)

As the Division reads this regulation, "gas contained in a cylinder less than 100 pounds is considered to be tangible personal property for purposes of § 1105(a)" (Division's brief, p. 33). This is an unjustifiable reading of the regulation and the statute which it implements. The

regulation states that sales of gas in containers with a capacity of less than 100 pounds are considered to be mixed transactions made up of two parts: (1) the sale of tangible personal property and (2) the sale of gas service or gas. The sale of tangible personal property is subject to sales tax under Tax Law § 1105(a), and the sale of gas service or gas is subject to tax under Tax Law 1105(b).

There is no factual basis for the Division's claim that petitioner sells gas in cylinders. It sells gas or a gas service. Petitioner compresses and pumps natural gas directly into the fuel tanks of natural gas vehicles. The gas flows through petitioner's pipelines and meters directly into the fuel tanks of motor vehicles. The fuel tanks are an integral part of the motor vehicles. (***See also***, 20 NYCRR 561.2[a][1][ii], Example 4, ***supra*** [The example exactly describes petitioner's transactions with its CNG customers; clearly the example does not contemplate treating the pumping of CNG into the fuel tanks of a motor vehicle as a sale of gas in a cylinder].) Petitioner does not sell gas in cylinders. Moreover, as noted by petitioner, gas is deemed to be tangible personal property for purposes of Tax Law § 1105(b), but it is explicitly excluded from the definition of tangible personal property for purposes of Tax Law § 1110 (Tax Law § 1101[b][6]). No sales tax is imposed on gas pursuant to Tax Law § 1105(a) because section 1101(b)(6) provides that gas is not tangible personal property except for purposes of Tax Law § 1105(b). No use tax is imposed on gas under Tax Law § 1110 because, once again, gas is not tangible personal property except for purposes of section 1105(b).

K. The petition of Brooklyn Union Gas Company is granted, and the Notice of Determination, dated June 22, 1998 is canceled.

DATED: Troy, New York
August 9, 2001

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE