

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-81(61)S
Sales Tax
December 8, 1981

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. S801110B

On November 10, 1980 a Petition for Advisory Opinion was received from Consolidated Rail Corporation, Six Penn Central Plaza, Philadelphia, Pennsylvania 19104 and the Metropolitan Transportation Authority, 347 Madison Avenue, New York, New York.

The issue raised is whether the Consolidated Rail Corporation (hereinafter "Conrail"), is required to pay sales, use or other excise taxes on materials, equipment, facilities or supplies purchased for use on lines it operates under joint service agreements entered into with the Metropolitan Transportation Authority (hereinafter "MTA").

MTA is a public benefit corporation created under Title II of Article 5 of the Public Authorities Law for the purpose, among other things, of continuing and furthering the development and improvement of commuter transportation and other related services within the Metropolitan Commuter Transportation District. In the furtherance of its purposes, MTA has entered into joint service agreements with Conrail, a private, for-profit corporation created under the Regional Rail Reorganization Act of 1973 (PL. 93-236), as successor to the Penn Central Transportation Company. Conrail, however, is "not...an agency or instrumentality of the Federal Government" P.L. 93-236, §301(b). Pursuant to one of these joint service agreements, Conrail operates the Harlem-Hudson passenger train service. Conrail also operates the New Haven suburban passenger train service under another joint service agreement with MTA, to which the Connecticut Department of Transportation (acting by the Connecticut Transportation Authority, hereinafter "CTA") is also a party. The two agreements are substantially similar in their terms.

Under the subject agreements, Conrail bears "sole responsibility for the day to day operation," to be performed according to service standards constituting a part of the agreements. Section 503 of the Harlem-Hudson agreement states that Conrail is to appoint an individual to be the Harlem-Hudson manager, who is to be in overall charge of the Harlem-Hudson Service, and who is to report directly to the chief passenger operating officer of Conrail. MTA reserves the right to amend the Harlem-Hudson schedule, consists, service standards, fares, and pass policy, subject to certain limitations. Conrail is nonetheless permitted to modify the prescribed scheduling in order "to accommodate fluctuations in travel or to effect more efficient equipment utilization." Equipment, including rolling stock, is either leased to Conrail by MTA or CTA, or is dedicated to the Harlem-Hudson Service or the New Haven Service by Conrail.

Conrail is required to maintain a separate set of Harlem-Hudson Accounts to which all Harlem-Hudson revenues are to be credited and against which all Harlem-Hudson costs are to be charged. Harlem-Hudson costs include, inter alia,

"all costs . . . incurred by . . . [Conrail] in the operation of the Harlem-Hudson Service, including, without limitation, the operation, maintenance and repair of track, interlockers, roadbed, passenger stations, electric power, power furnishing and distribution systems, rolling stock, repair shops and all other appurtenances and premises owned or operated by . . . [Conrail] and used in the Harlem-Hudson Service" Section 409 of the Harlem-Hudson agreement provides for the submission of proposed annual budgets by Conrail to MTA, and for MTA's approval thereof. MTA retains the right to modify an already approved budget, at any time. Conrail is required to submit to MTA monthly reports setting forth actual revenues and costs. Conrail is required to submit to MTA a quarterly income statement reflecting the financial operation of the Harlem-Hudson Service as shown by the Harlem-Hudson Accounts. If the operation produces net income Conrail is to remit such income (less taxes thereon) to MTA. If the operation incurs a deficit, MTA is required to remit to Conrail a check for the amount of such deficit. Provisions similar to the foregoing apply under the New Haven Agreement, except that MTA and CTA share equally in net income or loss. As compensation for its contributed expertise, Conrail is to receive an annual fee of \$125,000 under the Harlem-Hudson agreement, and \$100,000 under the New Haven agreement.

It is asserted that Conrail derives its exempt status with respect to sales and use taxes pursuant to section 1275 of the Public Authorities Law. It is there provided, with respect to MTA (referred to as "the authority" in the statutory provision), in relevant part, that "without limiting the generality of the following provisions of this section, property owned by the authority, property leased by the authority and used for transportation purposes, and property used for transportation purposes by or for the benefit of the authority exclusively pursuant to the provisions of a joint service arrangement or of a joint facilities agreement or trackage rights agreement shall all be exempt from taxation and special ad valorem levies. The authority shall be required to pay no fees, taxes or assessments, whether state or local, including but not limited to fees, taxes or assessments on real estate, franchise taxes, sales taxes or other excise taxes, upon any of its property, or upon the use thereof, or upon its activities in the operation and maintenance of its facilities or any fares, tolls, rentals, rates, charges or other fees, revenues or other income received by the authority and the bonds of the authority and the income therefrom shall at all times be exempt from taxation, except for gift and estate taxes and taxes on transfers. This section shall constitute a covenant and agreement with the holders of all bonds issued by the authority. The terms 'taxation' and 'special ad valorem levies' shall have the same meanings as defined in section one hundred two of the real property tax law and the term 'transportation purposes' shall have the same meaning as used in titles two-a and two-b of article four of such law."

The first sentence of the quoted material exempts from "taxation and special ad valorem levies" property which is owned or leased by MTA, and property used for specified purposes. The terms "taxation" and "special ad valorem levies" are explicitly stated to refer to real property taxation and not to any tax imposed under the Tax Law. The second sentence of the quoted material provides for an exemption from the payment of "sales taxes or other excise taxes", but this exemption is made applicable to MTA and to no other entity. Under section 1266.5 of the Public Authorities Law, however, such exemption may also be made applicable to subsidiary corporations of MTA. Inasmuch

as Conrail is not a subsidiary of MTA, the exemption language of section 1275 of the Public Authorities Law is not applicable thereto.

Section 1116(a)(1) of the Tax Law exempts from subjection to the sales and use taxes imposed under Article 28 of the Tax Law "The state of New York, or any of its agencies, instrumentalities, public corporations . . . or political subdivisions where it is the purchaser, user or consumer . . ." As indicated above, Conrail is a private, for-profit corporation and has been neither asserted nor demonstrated to be an agency, instrumentality, public corporation or political subdivision of the State of New York. MTA itself, of course, does come within the ambit of this section.

Not only is Conrail not itself an exempt governmental entity within the meaning of Section 1116(a)(1) of the Tax Law, it can not be said to make the purchases in question as an agent of the State, nor of MTA. Thus, there has not been shown to exist any explicit designation of Conrail as such an agent. Nor do the facts set forth warrant an inference that such an agency has been otherwise created. Thus, one important factor in determining whether an agency relationship exists is the degree of control that can be exercised over the performing party by the other party. If not only the result of the contract performance but the way in which the work is to be performed is subject to such control, an agency relationship may be found to exist. Matter of Morton, 284 N.Y. 167. Such control is absent under the agreements in question. Section 202 of both the New Haven and the Harlem-Hudson Agreements provides that Conrail is to have sole responsibility for the day-to-day operations of the services and is to provide its own supervising personnel. Although this same section also provides that operation of the service is to be in accordance with detailed service standards, the effect of this section is to give the operator control over the daily actions it takes in operating the services. Each agreement gives the operator the right to appoint a service manager who will be in charge of the service and need report only to the operator. Although MTA must be notified of such appointments, its approval of them is not required. MTA does set train schedules, rates, the Harlem-Hudson pass policy, and the service standards noted above. The provisions here described thus appear to leave policy matters and standards of performance to MTA while reserving the details of daily operations to Conrail.

Conrail's purchasing activities also appear to be largely free of MTA's control under the agreements. Although the operator's annual budgets must be approved by MTA, expenditures made in the course of operations need not be contained in the budget or approved by MTA unless the expenditures are part of outlays exceeding \$50,000 for capital projects or leases. MTA has general control over the operator's spending by way of monthly financial reports which the operator must submit to it. Specific spending decisions appear to be made by the operator. There is no indication that Conrail makes purchases in MTA's name, nor in any other way holds itself out to be an agent of MTA. Thus, MTA does not have the control over details of performance which the courts have required as a precondition for a finding of agency.

Part of the service provided by Conrail consists of the service of maintaining, servicing or repairing both tangible personal property not held for sale in the regular course of business and real property. Insofar as tangible personal property is involved, Section 1119(c) of the Tax Law provides

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for a refund with respect to sales and compensating use taxes paid on the purchase of property which becomes "a physical component part of [tangible personal] property upon which the service is performed or . . . [which is] transferred to the purchaser of the service in conjunction with the performance of the service . . ." Inasmuch as Conrail possesses a Direct Pay Permit, it is in effect relieved of any obligation to make an initial payment of tax, followed by the filing of a claim for refund. The same considerations apply with respect to tangible personal property purchased for use in the service of maintaining, servicing or repairing real property. In addition, where the real property upon which the service is performed is owned by MTA, Conrail's purchases of property to be used in such service, where such tangible personal "property is to become an integral component of" the real property, is exempt from sales and compensating use taxes pursuant to Section 1115(a)(16) of the Tax Law.

It is to be noted that pursuant to Section 217(c) of The Regional Rail Reorganization Act of 1973 (45 U.S.C. 711 et seq.), as added by Section 1140(a), of the Omnibus Budget Reconciliation Act of 1981, (P.L. 97-35) effective August 13, 1981 Conrail became exempt from liability for any state tax, except for any tax imposed by a political subdivision of a state. Such exemption is to continue in effect until the property of Conrail is transferred by the Secretary of Transportation pursuant to Title IV of the Regional Rail Reorganization Act of 1973, such Title added by P.L. 97-35, §1142.

Accordingly, prior to August 13, 1981, Conrail was required to pay sales and use taxes on purchases made in connection with its operations performed pursuant to the subject agreements, with the exception, relating to the service of maintaining, servicing and repairing real and tangible personal property, noted above. It was also similarly subject to all applicable excise taxes imposed under the Tax Law, based on the considerations set forth above. On and after August 13, 1981, Conrail was no longer subject to the sales and compensating use taxes, or other taxes, imposed under the Tax Law. It is to be noted that this includes New York City's sales and compensating use taxes, which are imposed under Sections 1107 and 1108 of the Tax Law. Conrail remains subject, however, to taxes imposed by political subdivisions of New York State, including the local sales and use taxes and other taxes imposed pursuant to the authority of Article 29 of the Tax Law.

DATED: November 23, 1981

s/LOUIS ETLINGER
Deputy Director
Technical Services Bureau