

1.0 Introduction

This document presents analysis and supporting documentation concerning the applicability of taxes in the State of New York on Direct Customers and other Market Participants of the New York Independent System Operator (NYISO).

2.0 New York State Sales Tax

Discussions between the NYISO and the NYS Tax Department have been ongoing for some time regarding the remittance of State Sales Tax. It is our understanding that:

1. Direct Customer purchasers of electric commodity from the NYISO should remit NYS Sales Tax unless proof of exemption status is provided to the NYISO.
2. A variety of means of remittance have been discussed and approved which require Direct Customer purchasers to hold one or more certificates provided by the NYS Tax Department. While the NYISO must technically be registered with the NYS Tax Department as a sales tax collection agency, use of the certificates is sufficient to produce a state in which the NYISO does not need to collect any sales tax in practice. The following certificates have been approved that allow sales tax remittance in a manner acceptable to the NYISO and the NYS Tax Department:
 - a) Direct Pay Certificate
 - b) Sale For Resale Certificate
3. The resulting benefit to the NYISO and its Market Participants is the ability to avoid the implementation and operational costs that would be incurred if the NYISO in practice was required to collect NYS Sales Tax.
4. Under this arrangement (NYISO as a registered sales tax vendor) the only liability the NYISO could face would be a determination of negligence in collecting proper evidence of the appropriate valid certificates. This should constitute a minimum likelihood of occurrence, covered by liability insurance. Additionally, the NYISO could not be held liable for a typical default of a Direct Customer, in any way beyond any liability incurred by the default of any Market Participant in general.

We believe that these requirements are reasonable and fair, and are intended to ensure that Direct Customers have a proper means of remitting applicable State Sales Tax.

3.0 New York State Gross Receipts Tax (GRT)

The following table presents a variety of assertions and associated comments, along with supporting references provided in the Appendix.

Item	Assertion	Comments	References
A1	The GRT is an <i>income</i> tax.	The GRT is a tax imposed as a Corporate Income (Franchise) tax, implying that there is an income component to the event which creates a tax liability.	SD-001 SD-002
A2	GRT is based on the gross receipts deriving from the sale and transportation of the commodity, including receipts for the tax collected from the purchaser.	Tax is computed on gross receipts received from a sale transaction, which allows for interpretation of what constitutes a sale for provisions of this tax.	SD-001 SD-002
A3	Tax liability is imposed on the “last” seller of the commodity.	Tax is imposed on the party who performs the retail sale to the end user.	SD-001 SD-002
A4	Exemption from NYS Sales Tax does not establish exemption from Gross Receipts Tax.	Example: municipalities which engage in the selling of commodity are liable for GRT. If they purchase commodity in a retail transaction, the supplier is responsible for remitting the tax – no exemption is given for their tax exempt status. A municipal cooperative which is sales tax exempt was deemed to be liable for GRT. However, the opinion of the NYS Tax Department was that the sales to its <i>members</i> did not constitute a taxable sale for the purposes of GRT, per Section 186A.	SD-002 SD-003
A5	There is no fiduciary responsibility for GRT to be passed on to the end user (as is the case with Sales Tax.)	The responsibility for payment of this tax rests solely with the seller – the choice to pass the cost onto the end user is the choice of the seller – there is no statutory requirement. This is consistent with the <i>income tax</i> nature of the GRT.	SD-002

<u>Item</u>	<u>Assertion</u>	<u>Comments</u>	<u>References</u>
A6	The sale of commodity to an entity's own members does not constitute a taxable sale for the purposes of GRT.	<p>Example: a municipal cooperative which acts as an aggregator for other municipal entities purchases and resells commodity to its members. The Cooperative sought exemption from GRT based on its status as a sales tax exempt entity.</p> <p>The NYS Tax Department denied the exemption from GRT based solely on the municipality's sales tax exempt status, but declared that <i>the sale did not constitute taxable sales for the purposes of assessing GRT</i> – even though the Cooperative charges a fee on the commodity for its services, and the Cooperative is not the ultimate consumer of the commodity.</p>	SD-003
A7	Parity has been established between GRT and Corporate Franchise Tax: one (GRT) is being phased out with the expectation that the other is replacing it.	Tax is repealed and phased out while the same taxpayers are now required to pay Corporate Franchise Tax under article 9A of the NYS Tax Code.	SD-004 SD-005 SD-007 SD-008 SD-009
A8	Payments of Gross Receipts Tax are deductible taxes in the computation of the Article 9 Corporate Franchise Taxes.	This is consistent with the concept of parity with Corporate Franchise Tax – if one tax does not apply the appropriate tax revenues can be collected through the other.	SD-009

<u>Item</u>	<u>Assertion</u>	<u>Comments</u>	<u>References</u>
A9	The NYISO is not liable for GRT.	<p>The NYS Tax Department concluded through an advisory opinion that the NYISO is not liable for GRT taxes.</p> <p>Central in this discussion is the Tax Department's focus on the "nature of the corporation's activities". The Tax Department concludes that the NYISO is not liable for this tax because they are "not supplying electricity pursuant to Section 186 and not selling electricity or furnishing electric service pursuant to section 186A of the Tax Law." The Tax Department continues on to state that the franchise taxes which the NYISO would be liable for would fall under Article 9-A of the tax law, which however the NYISO is exempt from by virtue of its 501(C)3 status.</p> <p>It is important to note that the Tax Department links the absence of GRT tax liability to its replacement by corporate franchise tax liability.</p>	SD-006
A10	The application of GRT to non-utility entities is both burdensome and inappropriate.	The NYS Legislature has determined that GRT has been inappropriately passed through to end use ratepayers, and has cited this condition as its reason for repealing the tax.	SD-010

<u>Item</u>	<u>Assertion</u>	<u>Comments</u>	<u>References</u>
A11	The creation of a pseudo-affiliate "Seller" by a Direct Customer to purchase energy, ancillary services and capacity from the NYISO and resell same to itself (i.e., its members) will not create taxable transactions subject to Gross Receipts Tax (GRT).	<p>The Petitioner indicated to the NYS Tax Department that it was, in fact a reseller of commodity, charged an administrative fee in addition to the cost of the commodity, and itself did not consume the commodity thus purchased.</p> <p>The NYS Tax Department determined that the resale of commodity by the Petitioner to its members did not constitute a taxable sale for the purpose of GRT, presumably because the Petitioner's activities were those of distribution and disaggregation to its members, as opposed to intent to generate income.</p>	SD-003

3.1 GRT Applicability to Direct Customers of The NYISO

Summarizing the assertions above, it is our belief that GRT does not apply to Direct Customers of the NYISO, for the following reasons :

1. GRT is an income tax. Since Direct Customers do not derive income from the purchase of commodity, GRT does not apply. [A1]
2. GRT is an income tax on the seller of commodity. Direct Customers are not sellers of commodity – they purchase commodity for self-use. Even in the instance where a municipal cooperative sells commodity to its members, the NYS Tax Department determined that such sales did not constitute taxable sales. [A3, A4]

3.2 GRT Applicability to NYISO

It is our belief that GRT does not apply to the NYISO itself, for the following reasons [A9]:

1. The NYS Tax Department issued an advisory opinion concluding that GRT does not apply.
2. The nature of the corporation's activities are key to assigning liability, with the NYS Tax Department's conclusion that no Section 186A relevant sales or furnishing of electric service exists to establish such liability.
3. Franchise tax would otherwise apply to the NYISO, except for the NYISO's 501(C)3 status, which makes it (the NYISO) exempt.

3.3 GRT Applicability to Generators

It is our belief that GRT does not apply to the Generators participating in the NYISO for the following reasons:

1. Requiring Generators to pay GRT on sales of commodity to Direct Customers violates several basic premises of tax theory, and additionally violates the legislative intent of the NYS Legislature.
2. Basic tax theory requires that several conditions be present for a taxable event to occur:
 - a) The point of realization: the criteria that there must be at least one specific point at which the amount of tax can be computed and levied with reasonable certainty and accuracy. In other words, there must be the ability to accurately quantify the liability and

identify the liable parties. Presently, there is no fair and accurate method to identify these components. The bus and zonal nature of sales by Generators into the NYISO markets does not map to well-defined geographic zones governed by specific individual tax authorities, except arguably for the state as a whole. We therefore agree with those parties that have expressed that Generators selling into the NYISO do so with no upfront knowledge, or ability to determine, the ultimate end-use recipient of such a sale.

Furthermore, Generators selling into the Day Ahead Market, for example, do so in a bid process in which the ultimate cost of the commodity is determined by the calculation of a market-wide LBMP base price, in what amounts to a discovery process. This underscores the fact that such sales cannot accurately be defined as a conventional “supplier to end-user” transaction in that even the magnitude of the sale is not under the direct control of the market participants.

- b) In view of this difficulty, the Tax Department would have to examine whether the ability exists to calculate this tax and the cost associated with calculating it. Since the cost to enable the NYISO to calculate this tax would very likely be prohibitive, and perhaps overwhelming, this approach would be in direct conflict with the Legislative intent given for repealing this tax.

Legislative history speaks directly to the fact that the reason for repealing this tax is both economic and political: primarily, that the Legislature views this tax as a regressive tax, which disproportionately and perhaps unfairly burdens the smaller tax payer, and then is passed on to the end use utility rate payer. The Legislature is clear in its position that it is repealing the tax to eliminate this unfair burden and encourage a more competitive energy market which will in turn both encourage business in New York State and provide rate payers with more competitive energy prices.

- c) Legislative history clearly states that the Corporate Franchise Tax is the intended replacement for the declining GRT Tax revenues. In its advisory opinions issued regarding GRT, the Tax Department consistently states that in the event that GRT does not apply, Corporate Franchise Tax under Article 9A does apply. The plain conclusion can be made that if one tax is not paid, the tax revenues are compensated through the collection of the other. Any analysis by the Tax Department would have to include a determination of the declining GRT tax revenues versus the Corporate Franchise Taxes paid by both the Generator and the Direct Customer. The cost to calculate the liability in comparison

with the actual tax revenues to be collected net of an adjustment for Corporate Franchise tax would have to exceed the exposure to legal opposition on the part of the taxpayer and any other parties affected, including issues of legislative intent. [A7, A8, A10]

4.0 Alleged Competitive Disadvantage Created by Direct Customer Participation

It has been claimed that ESCO's are placed at a competitive disadvantage if the same taxes that apply to ESCO's are not remitted by Direct Customers. We believe that:

1. The question of proper tax liability lies squarely in the domain of those Tax authorities that enforce it, and with all due respect to all Market Participants, does not fall under the domain of the NYISO to determine.
2. In the case of Direct Customers, the legislative intent of New York State's tax laws that speak directly to GRT clearly indicate that Corporate Franchise Tax is the appropriate mechanism for tax remittance, and is compensatory for the inapplicability of GRT on those end-purchasers of energy. We believe that any attempt to impose GRT on Direct Customers contrary to the intent and content of the tax law is not only improper, but would be met with direct and compelling arguments for the requirement of an addition of a corresponding mechanism for compensatory reductions in Corporate Franchise Tax.
3. Parties that have made claims that the differences between the tax liabilities of individual NYISO Market Participant sectors (most notably ESCO's and Direct Customers) have created a competitive disadvantage are encouraged to examine this assertion more completely. We observe the following:
 - a) Direct Customers are required to purchase or develop and execute the requisite resources to operate as LSE's of the NYISO – resources which are at least comparable to those needed for ESCO's to function. In this respect, Direct Customers do not get a free pass – they must meet many requirements of the NYISO that span logistic and technical requirements, accounting needs, and financial requirements including appropriate levels of credit. These requirements come at a significant cost.
 - b) We do not subscribe to the idea that attempts to modify the individual tax liabilities of Market Participants is properly addressed within the organization of the NYISO. It is the governing tax authorities that enforce and clarify the scope and applicability of tax laws defined by Legislators. If parties believe that extant tax law is somehow deficient, misguided, or otherwise

improper, the relevant arguments can and should be made to the Legislature(s) which create and modify the appropriate laws. To do otherwise is to knowingly disregard and undermine the authority of the State of New York.

- c) If the service of facilitating Direct Customer participation as an LSE of the NYISO represents a serious competitive threat to an entity such as Con Edison Solutions, what precludes Con Edison Solutions from offering the same service? It should be understood that many prospective customers do not find the Direct Customer approach desirable or in their specific interests – in general, a Direct Customer is by necessity required to make more decisions, be willing to be exposed directly to market pricing, and in general engage in a more complex process than that typically involved when purchasing energy from an ESCO / Marketer. However, those customers that are willing to invest a higher level of effort and engagement feel the Direct Customer approach serves them well. It is not accurate to claim that Direct Customers have an inherent competitive advantage and represent a serious threat to the market.
- d) In many instances, Direct Customers conduct business in a manner which is cooperative and mutually beneficial to ESCOs. ESCOs are invited to bid competitively for services required by Direct Customers where appropriate, for example.
- e) Since Direct Customers are primarily concerned with purchasing energy for their own or their members' operational needs, Direct Customers are highly self-motivated as reliable, conscientious Market Participants and contribute positively to the NYISO's stability and market efficiency. Direct Customers have established a history of participation which reflects a high level of technical competence and integrity which we believe the NYISO staff would attest to.

5.0 Locality-Specific Gross Receipts Tax (GRT) Within New York State

Local municipalities that have established GRT tax requirements within their jurisdictions do so through the authority and approval of the New York State Tax Department, as established under municipal law. In other words, the authority to levy tax derives from New York State, and this authority is granted subject to the intent of the tax law that defines the nature and scope of the tax. (For example, a local municipality could not properly apply the GRT to the sale of potatoes.)

We observe the following:

1. Local GRT applies to resellers of energy, consistent with its character as an income tax applied to entities that derive income from the sale of energy.
2. We believe that local municipalities have no jurisdiction over Generators bidding into the New York ISO. It cannot be properly claimed that Generator bids into the NYISO markets constitute sales to any specific entity, most especially “local” entities. If it is being claimed that local municipalities do have jurisdiction over Generators selling in to the NYISO, we would like to understand how said jurisdiction is established.
3. The premise advanced by Con Edison Solutions in the NYISO’s Business Issues Committee (BIC) that “if Direct Customers do not pay GRT, then someone else must – if the NYISO does not pay, then Generators must pay” has not been established. The tax law and the legislative intent behind the law determine to whom and in what manner a specific tax is properly applied.
4. If the New York ISO will in effect seek to require Direct Customers to assume “potential” tax liabilities (either directly or indirectly) that have not been even remotely established, will it then seek to address all “potential” tax liabilities that Market Participants “might” pose to other Market Participants ? For example, will it require evidence that other Load Serving Entities (LSE’s) such as ESCO / Marketers have properly remitted GRT in each applicable local jurisdiction, as a condition of NYISO participation ? Where will the NYISO draw the line when considering the tax liabilities of Market Participants, now and in the future?

6.0 Summary

We believe that we understand the essential concerns of the variety of Market Participants represented in the discussions on tax issues that have been ongoing in the NYISO's BIC and S&PWG (Scheduling and Pricing Working Group) Committees. In order to appreciate and fairly address the variety of issues raised, Fluent Energy has invested significant time and effort to research and analyze these issues, which have been compiled in this document and are submitted for your review.

It is our sincere hope that each Market Participant with a vested interest in the subject matter will present its own analyses to the S&PWG for review, in order to ensure that any action that may be considered by the NYISO to limit or eliminate the participation of Direct Customers in the NYISO administered markets be well reasoned, and does not expose any Market Participant or the NYISO itself to undue liability. We believe that most Market Participants will strive to respect the competing interests of a significant and diverse population of Participants, and will not seek to take unfair or uninformed advantage. We also appreciate that the New York ISO administration has attempted to fairly address the concerns of all of its Market Participants in an unbiased manner, in what is clearly a complex and challenging forum.

Thank you for your consideration in these matters.

Appendix A: Supporting Documentation

Supporting Documentation Reference	Document Title
SD-001	Section 186A, Article 9, New York State Tax Code
SD-002	TSB-A-02(20)C – Corporation Tax
SD-003	TSB-A-00(8)C – Corporation Tax
SD-004	TSB-M-00(04)C – Corporation Tax (Specific to Legislation)
SD-005	TSB-M-00(2)C – Corporation Tax (General summary of Tax Legislation Changes)
SD-006	TSB-A-00(1)C – Corporation Tax
SD-007	Highlights of Prior-Year Budget Tax Legislation in SFY 2002-03
SD-008	Subsidiary Capital Tax Exclusion for Gas and Electric Subsidiaries – Summary of Tax Provisions in SFY 1999-2000
SD-009	Overview of Fiscal Year 2000-01 Budget Tax Actions
SD-010	Bill Summary – A05558 (Proceedings of the New York State Assembly)