STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CORTELCO, SUCCESSOR IN MERGER[1] WITH PABX SYSTEMS CORP., F/K/A ITT COMMUNICATIONS EQUIPMENT & SYSTEMS DIVISION	:	DECISION DTA No. 800202
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 December 1, 1969 through May 31, 1978.	:	

Petitioner Cortelco, successor in merger with PABX Systems Corp., f/k/a ITT Communications Equipment & Systems Division, Fulton Drive, P.O. Box 831, Corinth, Mississippi 38834 filed an exception to the determination of the Administrative Law Judge issued on November 29, 1990 with respect to its 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 December 1, 1969 through May 31, 1978. Petitioner appeared by Rene L. Basile, Esq. The Division of Taxation appeared by Williams F. Collins, Esq. (James Della Porta, Esq., of counsel).

Petitioner did not file a brief on exception. The Division of Taxation filed a letter in lieu of a brief. Oral argument, at petitioner's request, was heard on May 16, 1991.

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

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[1] Cortelco was named as petitioner in this matter based on information supplied by petitioner on the exception filing.

ISSUE

Whether sales of telephone central office equipment or station apparatus by petitioner were exempt from sales tax pursuant to Tax Law § 1115(a)(12).

FINDINGS OF FACT

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

PABX Systems Corporation f/k/a ITT Communications Equipment and Systems Division[2] was issued four notices of determination and demands for payment of sales and use taxes due dated September 18, 1981. The notices set forth the following information:

Date of Notice	Notice No.	Total Tax Due	Total Interest Due	Total Amount Due
9/18/81	S810911015A	$260,423.50	$157,734.19	$418,157.69
9/18/81	S810911016A	170,280.48	111,907.78	282,188.26
9/18/81	S810911018A	116,890.93	67,000.58	183,891.51
9/18/81	S810911017A	37,157.26	24,347.88	61,505.14

The notices encompassed the period December 1, 1969 through February 29, 1976. It is noted that for the quarters ended May 31, 1976 through May 31, 1978, the Division and ITT Communications Equipment and Systems Division ("ITT") agreed on tax of $153,135.48 and interest of $38,814.08 for a total amount due of $191,949.56.

Additionally, the Division and ITT executed consents extending the period of limitation for assessment of sales and use taxes until September 20, 1981 for all periods between September 1, 1969 and May 31, 1978.

The sales tax audit for the period December 1, 1969 through May 31, 1972 was estimated due to a lack of records available for this period, but a detailed audit was performed for the subsequent period June 1, 1972 through March 31, 1976. There was a third sales tax audit performed for the period April 1, 1976 through May 31, 1978. The tax for this period was

[2]PABX Systems Corporation is the successor corporation to the corporation of which ITT Communications and Equipment Systems was a division during the period in issue. After several subsidiaries of ITT were purchased by a French company, petitioner's name was changed to PABX Systems Corporation.

agreed upon by the Division and ITT as set forth above. Additionally, additional tax due on recurring expenses and fixed assets was also calculated.

As stated above, the only issue left for resolution herein, is whether or not the sales of telephone central office equipment or station apparatus by ITT should have been exempt from sales tax pursuant to Tax Law § 1115(a)(12). ITT also raised the argument that, originally, the Division's theory was that a use tax was due on said equipment since it was purchased for use in the installation of a capital improvement. However, when case law and the Division itself reversed itself on this interpretation, the Division then alternatively argued that ITT was liable for sales tax pursuant to Tax Law § 1105 on the sale of tangible personal property and not entitled to the exemption provided for in Tax Law § 1115(a)(12).

Prior to 1969, telephone operating companies were required to provide "end to end" or "bundled" service to subscribers who were prohibited from purchasing discrete components of equipment from different suppliers. Only equipment furnished by the telephone operating company could be attached or connected to the facilities of the telephone operating company. Beginning in 1969, subscribers were permitted to connect equipment purchased or leased from nontelephone operating companies to telephone operating company facilities.

ITT began business in April 1969 and was headquartered in Hartford, Connecticut. The company was engaged in the business of selling and installing complete telephone systems which included as component parts "PBX" (private branch exchanges), telephones, central office and related equipment. The telephone equipment was connected directly to the telephone operating company for use directly and predominantly in receiving at destination or initiating and switching telephone communication. ITT ceased operations in 1979.

Sales of telephone systems by ITT were specifically designed based on the requirements of the customer. Customers included advertising companies, law firms, and other commercial businesses. All components were purchased from various suppliers and installed on the customer's site.

OPINION

In the determination below, the Administrative Law Judge denied petitioner's request to cancel the Division's tax assessments against it. The Administrative Law Judge determined that while petitioner properly pointed out that a use tax on its telephone equipment may not be imposed for the period in question, it should be clear to the parties that the theory upon which the assessments were issued was based upon liability for sales tax and that the focus of this controversy has been narrowed to the issue of whether petitioner was entitled to an exemption from sales tax pursuant to Tax Law § 1115(a)(12). On this issue, the Administrative Law Judge concluded that petitioner was not entitled to the exemption. Relying on a Supreme Court memorandum decision (Eastman Kodak Co. v. Department of Taxation & Fin., Sup. Ct., Monroe County, November 22, 1989, Siracuse, J.), he observed that the exemption was only available to a taxpayer who operates a telephone company and who purchased equipment for use in switching telephone and telegraph services for sale. The Administrative Law Judge wrote that since petitioner did not operate a telephone company and offered no other basis for distinguishing itself from Eastman Kodak, it was not entitled to the exemption set forth in Tax Law § 1115(a)(12).

On exception, petitioner argues that it is eligible for the exemption. Petitioner contends that the Division's regulations in 20 NYCRR 528.13(f) were not applicable to it because they were promulgated after the audit period in question. Petitioner further argues that the regulations are invalid because they imposed the added language that the equipment at issue must be "purchased or leased by the vendor of such service for sale" which does not appear in the statute.

In response, the Division of Taxation (hereinafter the "Division") argues that the telephone equipment exemption stated in Tax Law § 1115(a)(12) only applies to equipment used by telephone companies furnishing telephone service to customers. It maintains that the fact that the regulations were adopted after the period at issue is irrelevant because the regulations merely

codify the intent of the Legislature in enacting the exemption.[3]

We affirm the determination of the Administrative Law Judge.

We first address petitioner's contention that the regulation in 20 NYCRR 528.13(f) is inconsistent with Tax Law § 1115(a)(12). Petitioner asserts that since the words "for sale" were omitted from the portion of the statutory language exempting telephone equipment, it need not purchase such equipment for purposes of selling telephone services to qualify for the exemption. We do not agree. Section 1115(a)(12) of the Tax Law provides an exemption from sales tax on receipts from the sale of the following:

> "[m]achinery and equipment for use or consumption directly and predominantly in the production of tangible personal property, . . . for sale, . . . or telephone central office equipment or station apparatus or comparable telegraph equipment for use directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication" (Tax Law § 1115[a][12]).

The corresponding regulation in 20 NYCRR § 528.13(f) states, in part, as follows:

> "Telephone and telegraph equipment. (1) Telephone and telegraph central office equipment and station apparatus, used directly and predominantly in receiving at destination, initiating or switching telephone and telegraph communication is exempt, when such equipment and apparatus is purchased or leased by the vendor of such service for sale" (20 NYCRR § 528.13[f]).

It is well established that statutes creating exemptions from tax are to be strictly construed (see, Matter of Grace v. New York State Tax Commn., 37 NY2d 193, 371 NYS2d 715, lv denied 37 NY2d 708, 375 NYS2d 1027; Matter of Blue Spruce Farms v. New York State Tax Commn., 99 AD2d 867, 472 NYS2d 744, affd 64 NY2d 682, 485 NYS2d 526; Matter of Modern Refractories Serv. Corp. v. Dugan, 164 AD2d 69, 563 NYS2d 200). The taxpayer's argument must satisfy the burden of demonstrating clear and unambiguous entitlement to the

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[3] The Division also relied on our decision in Matter of Stoddard Communications, Tax Appeals Tribunal, August 30, 1990 as support for their position. Since the substantive issue of the taxability of the telephone equipment was not raised by the parties on exception in Stoddard and was not addressed by this Tribunal, our decision in Stoddard is not precedential on this point (see, Matter of Velez v. Division of Taxation of the Dept. of Taxation & Fin., 152 AD2d 87, 547 NYS2d 444).

exemption claimed (Matter of W.T. Wang v. State of New York State Tax Commn., 113 AD2d 189, 495 NYS2d 792; Matter of Marriott Family Rests. v. Tax Appeals Tribunal, ___ AD2d ___, 570 NYS2d 741).

In determining whether petitioner was entitled to the telephone equipment exemption, we find Judge Siracuse's analysis in a Supreme Court decision particularly instructive. In Eastman Kodak Co. v. Department of Taxation & Fin. (supra), Judge Siracuse rejected Kodak's challenge based on the same ground as the one raised by petitioner herein. The court there stated that section 1115(a)(12) was designed to eliminate pyramiding of the sales tax by exempting equipment used by a telephone company and taxing only the distribution of the "finished product," whether that be an item of tangible personal property or a utility or service such as gas, electricity or telephone service. Moreover, it was stated that since a "private" telephone company never sells telephone services to others, an exemption for its equipment would mean that sales tax would be avoided rather than merely deferred. We believe that the court's observation in Eastman Kodak with respect to the underlying intent of this exemption is fully consistent with its legislative history and case law (see, Budget Report on Senate Bill 9899-B, Bill Jacket, L 1974, ch 851; Matter of Burger King v. State Tax Commn., 70 AD2d 447, 421 NYS2d 668, mod on other grounds 51 NY2d 614, 435 NYS2d 689; Matter of Imperial Mfg. Co. v. State Tax Commn., 99 AD2d 874, 472 NYS2d 753, lv denied 63 NY2d 604, 480 NYS2d 1026).

In reaching his conclusion, Judge Siracuse examined: (1) the placement of the telephone equipment exemption and (2) the origin of the "central office equipment" language in the statute. He reasoned that because the telephone equipment exemption was placed in the same section as the production equipment exemption, the Legislature intended to create a parallel exemption for machinery and equipment used to produce tangible personal property, gas and electric services for sale and equipment used to switch telephone services for sale. Judge Siracuse also declared that at the time the exemption was enacted, "central office equipment" was a term of art used by the Public Service Commission. He stated that this term conveyed a specific public service

connotation and that under the rule of in pari materia (McKinney Statutes § 222), the Legislature is presumed to have acted with knowledge of this meaning of the term in so choosing this particular language for inclusion in the statute.

We agree with the Supreme Court's reasoning and conclusion in Eastman Kodak and we think the same responds to petitioner's arguments. Clearly, the Legislature did not intend to exempt telephone equipment from tax liability in the case of a "private" telephone company, in which there is no sale of telephone services. Given the placement of the telephone equipment exemption, the inclusion of a specific term of art, and the underlying purpose of the section 1115(a)(12) exemption, we think that the "for sale" language of the regulation is wholly consistent with the meaning and scope of the statute. Accordingly, we conclude that petitioner's sales of telephone equipment were not exempt from sales tax pursuant to Tax Law § 1115(a)(12).

Next, we reject petitioner's argument that the regulation in 20 NYCRR 528.13(f) did not apply to it because it was adopted after the audit period in question. The regulation was simply the Division's interpretation of the statute itself. Viewed in light of the foregoing analysis, it neither changes nor narrows the scope of the exemption with respect to telephone equipment. In this case, it is the language and intent of Tax Law § 1115(a)(12) which controls (see, Matter of Manhattan Cable Tel. v. New York State Tax Commn., 137 AD2d 925, 524 NYS2d 889, 891, appeal dismissed 72 NY2d 839, 530 NYS2d 554, lv denied 72 NY2d 808, 534 NYS2d 666). Beginning from the enactment of this statutory exemption, the Legislature sought to limit its benefit to telephone companies. Thus, we conclude that the regulation at issue cannot be said to have been applied retroactively (see, Matter of Mattone v. State of New York Dept. of Taxation & Fin., 144 AD2d 150, 534 NYS2d 478; Matter of Sanjaylyn Co. v. State Tax Commn., 141 AD2d 916, 528 NYS2d 948, appeal dismissed 72 NY2d 950, 533 NYS2d 55).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Cortelco, successor in merger with PABX Systems Corp., f/k/a ITT Communications Equipment & Systems Division is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Cortelco, successor in merger with PABX Systems Corp., f/k/a ITT Communications Equipment & Systems Division is denied; and

4. The four notices of determination dated September 18, 1981 are sustained.

DATED: Troy, New York
October 31, 1991

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

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

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