STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **PARSONS & WHITTEMORE INCORPORATED** for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1978, 1979, 1980 and 1981.	:	DECISION DTA No. 802196

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on September 20, 1990 with respect to the petition of Parsons & Whittemore, Inc., 4 International Drive, 3rd Floor, Rye Brook, New York 10573 for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1978 through 1981. Petitioner appeared by Roberts & Holland (Joseph Lipari, Esq., and David A. Fruchtman, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Anne Murphy, Esq., of counsel).

Both parties filed briefs on exception. Oral argument was heard on May 16, 1991.

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

ISSUE

Whether petitioner may be required to recapture investment tax credits claimed on otherwise qualifying property on the ground that the subject property ceased to be used prior to the end of the taxable year in which the credit was taken.

FINDINGS OF FACT

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

On March 12, 1985 the Division of Taxation ("Division") issued to petitioner, Parsons & Whittemore, Inc., four notices of deficiency, asserting deficiencies of corporation franchise tax as follows:

Year	Deficiency
1978	$ 28,557.00
1979	187,625.00
1980	144,123.00
1981	173,267.00

Parsons & Whittemore is a New York corporation engaged in the business of providing engineering services. During the period in issue, Hempstead Resources Recovery Corporation ("HRRC") was the wholly owned subsidiary of Parsons & Whittemore. These corporations filed combined corporation franchise tax reports, along with other affiliated corporations, for the periods in issue. On reports filed for the years 1979, 1980 and 1981, investment tax credits were claimed for property located in New York and used by HRRC.

HRRC operated a solid waste disposal and recycling plant which essentially recycled garbage into electricity. The facility was constructed under the terms of an agreement with the Town of Hempstead, entered into in December 1974. Construction was completed in August 1978. The facility began operating in April 1979 but was closed in March 1980. The closing came about as a result of two events. First, a contractual dispute arose between HRRC and the Town of Hempstead, causing HRRC to refuse to accept solid waste until the dispute was resolved. At about the same time, the Environmental Protection Agency ("EPA") reported that tests conducted in 1979 indicated the presence of trace quantities of dioxin in smokestack emissions from the facility. In May 1980, then presiding Supervisor Alphonse D'Amato advised HRRC that he would not permit the operation of the plant until the EPA assured the Town that the facility operation would not pose a health threat, and, in July 1980, HRRC agreed with the Town to keep the facility closed until specific national guidelines regarding dioxin emissions were promulgated by the EPA.

At the time of the shutdown in March 1980, HRRC was in the process of installing approximately $10,000,000.00 worth of capital design improvements. These projects were 95% complete in July when the Town and HRRC made the decision to remain closed until the EPA guidelines were promulgated. The facility was placed in a "caretaking" mode until start-up became feasible. Parsons & Whittemore continued work on dioxin research, analysis of operating problems and possible technical solutions to those problems; it also conducted trials on further improvements to the facility.

In the summer of 1982, Parsons & Whittemore began active negotiations with the Town of Hempstead to restart the facility. By this time, EPA issued a memorandum regarding dioxin emissions which apparently contained nothing which would preclude the HRRC facility from reopening. In the fall of 1982, Parsons & Whittemore employees, primarily engineers and operators, were transferred from a facility in Dade County, Florida to the HRRC facility in the Town of Hempstead to begin "demothballing" the plant.[1]

Petitioner and the Division entered into a stipulation of facts which is adopted here in the following five paragraphs.

In accordance with a prehearing conference conducted by the former Tax Appeals Bureau, the Division of Taxation asserts a deficiency of $28,557.00 plus interest for 1978, asserts no deficiency for 1979, admits a refund of $54,874.00 for 1980, and asserts a deficiency of $175,767.00 for 1981.

The deficiency for 1981 results from the Division requiring certain credits allowed in prior years pursuant to Tax Law § 210(12)(a) ("investment tax credits") to be added to the tax otherwise due ("recaptured") in 1981 pursuant to Tax Law § 210(12)(g). The Division asserts that the subject property ceased to be in qualified use because it was no longer being used in the production of goods by manufacturing.

[1]In its brief, the Division states that the plant never became operational. In its reply brief, petitioner asserts that the plant was sold in 1986 and began operating after being substantially retrofitted by the new owner to satisfy EPA guidelines.

At the prehearing conference the investment tax credits sought to be recaptured by the 1979 and 1980 deficiencies were properly allowed for those years when the subject property was initially placed in service. The Division of Taxation agrees to the adjustments. On field audit, the Division determined that identified items of plant, machinery and equipment on which investment tax credits were claimed, met the requirements of Tax Law § 210(12)(b).

During 1981, due to circumstances beyond petitioner's control, the facility in which the subject property was located was not in operation, but throughout 1981 and thereafter, petitioner planned to recommence operations as soon as possible.

No recapture of the Federal investment tax credit (pursuant to Internal Revenue Code § 47[a][1] and [5]) would be required for 1981 because the subject property was not disposed of or abandoned during 1981.

The HRRC property upon which investment tax credits were claimed included: a conveying system, wet processing equipment, an iron recovery system, glass and aluminum recovery equipment, boilers, turbo-generators, a pit and unloading building, a process and recovery building, a fuel storage building and a generation building used to house the turbo-generators.

Petitioner has raised no issues with regard to the 1978 tax year. The only issue raised in this proceeding is whether petitioner may be required to recapture the investment tax credits claimed for periods subsequent to March 1980, resulting in a tax deficiency in 1981 of $175,767.00.

OPINION

In her determination below, the Administrative Law Judge held that the property was in qualified use in 1980 and 1981 and, thus, petitioner was entitled to the investment tax credit in both years. The Administrative Law Judge looked to Federal authority in formulating the framework for analyzing the issue presented. Specifically, she surveyed Federal case law on an analogous issue: when should property be deemed to have been "placed in service" for purpose of qualifying for the investment tax credit. Based on this inquiry, the Administrative Law Judge concluded that property may be deemed to have been used in the production of goods if it has been placed in service and is ready and available for use, even if it is not in actual usage during the period for which the credit is claimed. The Administrative Law Judge declared that because the property on which the credit was claimed was ready and available in 1981 for an assigned function, the production of goods by manufacture or processing, it was in qualified use and petitioner was entitled to the investment tax credit in such year.

On exception, the Division, relying on Tax Law § 210(12)(g), states that the recapture of New York's investment tax credit is mandated when the property in question is "disposed of or ceases to be in qualified use." The Division argues that since HRRC was not operational from mid-1980 through mid-1982, the property on which investment tax credits were claimed was not being principally used in the production of goods by manufacturing or processing. The Division further asserts that the Federal and State recapture provisions are not completely co-extensive. It maintains that the Federal concept of "placed-in-service" is irrelevant to the issue of recapture. The Division contends that New York State's "qualified use" requirement and the Federal "placed in service" standard are separate and distinct concepts and that there is no obvious or necessary correlation between them. The Division goes on to argue that the New York Legislature did not intend to completely conform this State's investment tax credit recapture scheme to its Federal counterpart.

In response, petitioner argues that the New York Tax Law provides investment tax credit and recapture rules that are virtually identical to those relating to the Federal investment credit. Further, petitioner maintains that the Legislature intended that recapture of New York investment tax credits would be required only when the subject property was disposed of or converted to an actual nonqualifying use. Therefore, petitioner argues that New York's approach was designed to be similar to the Federal rule. Petitioner asserts that a temporary shutdown of a facility, which has no conceivable use other than in manufacturing or processing, cannot be a ground for recapture. Petitioner argues that, given that the main goals of this State's investment tax credit were to expand the production capacity in New York and to simplify bookkeeping entries for the taxpayer, it should be permitted to avoid the recapture of the credit for the period in which its plant remained dormant.

We affirm the determination of the Administrative Law Judge.

Section 210 (subd. 12, par.[b]) of the Tax Law provides for an investment tax credit on tangible personal property and real property which is depreciable pursuant to section 167 of the Internal Revenue Code, has a useful life of four years or longer, is acquired by purchase as defined in section 179 (subd. d) of the Internal Revenue Code, has a situs in New York, and is principally used by the taxpayer in the production of goods by, inter alia, manufacturing, processing or assembling. If property on which an investment tax credit has been claimed "is disposed of or ceases to be in qualified use" prior to the end of its useful life, the difference between the credit claimed and the credit allowed for actual use must be added back to the tax otherwise due in the year of disposition or disqualification (Tax Law § 210[12][g][1]; 20 NYCRR 5-2.8[a]).

Underlying the present controversy is the interpretation given to the statutory language "ceases to be in qualified use." The only pertinent issue here is whether petitioner's property ceased to be used in the production of goods, which would subject petitioner to the addback of a portion of the investment tax credit previously claimed. The term "cessation" is not defined in the statute or regulations. The regulations, however, do state that property which ceases to be in qualified use includes, as relevant here, property which "is no longer used in the production of goods" (20 NYCRR 5-2.8[d][1]).

In her determination, the Administrative Law Judge opined that the question of whether the subject property ceased to be in qualified use is analogous to the question of when it should be deemed to have been "placed in service" for qualifying for the Federal investment tax credit. She observed that the Federal law holds that a facility should be deemed "placed in service" and in a condition or state of readiness and availability for an assigned function when it is determined to be operational, whether or not it is actually used during the taxable year. Applying this rule, she found that the subject property on which the credit was claimed was ready and available for producing goods by manufacturing or processing and concluded that the property was in qualified use. We decline to adopt this analysis.

The phrase "placed in service" is defined to be the earlier of "the taxable period when the taxpayer's depreciation begins" or "when the property is placed in a condition or state of readiness and availability" (Treas Reg § 1.47-2[a][2]). The date property is "placed in service" reflects the date the gradual deterioration of the completed asset begins (see, SMC Corp. v. United States, 675 F2d 113, 82-1 USTC ¶ 9309; Sears Oil Co. v. Commissioner, 359 F2d 191, 66-1 USTC ¶ 9384). The principal utility of this concept is to enable the taxpayer to determine when, at the earliest, he could start the period running for claiming depreciation deductions and the investment tax credit. Recapture under the State law, on the other hand, addresses the question of whether the subject property was engaged in "qualified use." It considers circumstances that have nothing to do with whether the equipment has begun to deteriorate. Thus, we believe that the Administrative Law Judge erred in adopting the Federal "placed in service" standard for determining whether the investment tax credit claimed on petitioner's property was subject to recapture.

We begin our analysis by first noting that the Division conceded at oral argument that a temporary slowdown or a temporary work stoppage in production due to a recession or a labor strike which is not precipitated by the taxpayer is not "ceasing to be in qualified use" as long as there is a subsequent continued qualified use (Oral Arg. Tr., p. 10).

The legislative history of New York's investment tax credit provisions makes it clear that the addback of the credit would be required if a taxpayer disposed of property or converted it to a nonqualified use (Letter from Tax Commissioner Joseph Murphy to Governor Nelson A. Rockefeller, Bill Jacket, L 1969, ch 1072; Budget Report on Senate Bill 5143-A, Bill Jacket, L 1969, ch 1072; Letter from New York State Bar Association to Hon. Robert R. Douglas, Counsel to Governor Nelson A. Rockefeller, Bill Jacket, L 1969, ch 1072). There is no indication in these legislative documents, however, to suggest that a temporary suspension of use was to be treated as a disposition or conversion to nonqualified use. Indeed, the basic purpose of the investment tax credit provisions argues against such an interpretation. New York's investment tax credit provisions were enacted to encourage the modernization of antiquated production facilities and stimulate capital investment (Memorandum of Approval of Governor Nelson A. Rockefeller filed with Senate Bill 5143-A, Bill Jacket, L 1969, ch 1072). This credit provides a substantial economic incentive for businesses to build, purchase, acquire or expand production facilities and to operate them as near to capacity as possible. If a taxpayer were required to recapture when he shut down his plant temporarily due to circumstances beyond his control, much of the incentive built into the investment tax credit would be eliminated. No taxpayer could undertake capital investments and count on receiving the full benefits of the credit. Consequently, the approach of construing cessation to encompass temporary suspension of operations would dampen production investment incentives and defeat the purpose and intent of the investment tax credit.

Further, requiring an addback in the case of a temporary stoppage of operations would also undermine another stated purpose of the investment tax scheme, that is, simplification. Memoranda in the Bill Jacket show that simplicity was an objective of the credit provisions since they replaced the double depreciation systems (see, e.g., Memorandum of Approval of Governor Nelson A. Rockefeller, Bill Jacket, L 1969, ch 1072, p. 2; Memorandum in Support from the New York State Department of Commerce, Bill Jacket, L 1969, ch 1072). Subjecting a taxpayer to a credit addback when his production facility is temporarily withdrawn from operations would create the need to maintain bookkeeping entries documenting all periods of activity and temporary inactivity for every production asset. In addition, once the property is returned to operations, it would be necessary to determine the taxpayer's ability or inability to reclaim the credit.

For all the reasons stated above, we conclude that a temporary shutdown is not "ceasing to be in qualified use" which would trigger an addback under Tax Law § 210(12)(g)(1).

Relying on the regulations in 20 NYCRR 5-2.8(d)(1), the Division argues that the subject property ceased to be in qualified use because it was no longer used for qualified purposes. Specifically, it was maintained that the shutdown of the facility in this case was not temporary since petitioner never recommenced operations of the same. Apparently, the Division's view is that the nature and duration of the shutdown must be determined based on knowledge of later events. We find this approach unsound and unworkable in determining if a "cessation" as contemplated by the statute exists.

By operation of the statute, the investment tax credit that was previously claimed is added back "<u>in the year that the property was disposed of or ceased to be in qualified use</u>" (Tax Law § 210[12][g][1], emphasis added). This means that the taxpayer must determine whether, at the close of a given taxable year (or any other relevant taxable periods), there occurred an event (i.e., disposition or cessation of qualified use) which would trigger an addback. Here, the Division was able to argue that petitioner's property was no longer used for qualified purposes only because it had all the benefits of hindsight. This would afford little comfort to a taxpayer, who must decide, at the close of the taxable period, with no opportunity for hindsight, whether a temporary shutdown would eventually turn out to be a permanent cessation of operations which would require an addback. It strains logic and common sense to expect the taxpayer to look ahead into the future and predict events that are unforeseeable (<u>see</u>, <u>Matter of D.J.H. Constr. v. Chu</u>, 145 AD2d 716, 535 NYS2d 249, 252 [where the court held that the sales tax exemption for production equipment must be determined based on the buyer's purpose at the time of purchase, not on events that occurred subsequently]). Thus, we hold that it is the taxpayer's intention at the time he makes the decision to cease using equipment (i.e., at the close of the relevant taxable period) which controls. In order to avoid an addback of credit previously claimed, it is sufficient to show that at the close of the taxable period in question, the taxpayer intended to shutdown the facility temporarily as a result of circumstances beyond its control. Later events, while perhaps relevant to ascertain the taxpayer's intent at the time of the shutdown, cannot be determinative of whether the addback provision applies.

In this case, the evidence conclusively demonstrates that at the close of the taxable period in question, 1981, petitioner intended to recommence operation as soon as the dioxin problem was resolved. By stipulation, the Division conceded that "[d]uring 1981, due to circumstances beyond petitioner's control, the facility in which the subject property was located was not in operation, but throughout 1981 and thereafter, petitioner planned to recommence operations" (Stipulation, ¶ 4). We conclude that because petitioner intended to recommence using the property throughout 1981, it did not cease to be in qualified use and, thus, petitioner was not subject to the addback of the investment tax credit.

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 affirmed;

3. The petition of Parsons & Whittemore Incorporated is granted to the extent indicated in conclusions of law "D," "E" and "F" of the Administrative Law Judge's determination, but such petition is otherwise denied; and

4. The Division of Taxation shall modify the notices of deficiency dated March 12, 1985 in accordance with paragraph "3" above, but such notices are otherwise sustained.

DATED: Troy, New York
October 3, 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