

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
HAND ASSEMBLY AND PACKAGING, INC. :
for Redetermination of a Deficiency or for :
Refund of Corporation Franchise Tax under :
Article 9-A of the Tax Law for the Fiscal Years :
Ended September 30, 1981 and September 30, 1982. :

DECISION

In the Matter of the Petition :
of :
YOUR MAIL SACK, INC. :
for Redetermination of a Deficiency or for :
Refund of Corporation Franchise Tax under :
Article 9-A of the Tax Law for the Fiscal Years :
Ended February 28, 1982 and February 28, 1983. :

Petitioner Hand Assembly and Packaging, Inc., P.O. Box 529, Corona, Elmhurst Station, Flushing, New York 11373, filed an exception to the determination of the Administrative Law Judge issued on November 22, 1989 with respect to its petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended September 30, 1981 and September 30, 1982 (File No. 804939).

Petitioner Your Mail Sack, Inc., 43-23 91 Place, Elmhurst, New York 11373 filed an exception to the determination of the Administrative Law Judge issued on November 22, 1989 with respect to its petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended February 28, 1982 and February 28, 1983 (File No. 804940).

Petitioners appeared by Richard S. Kestenbaum, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel). Both petitioners and the Division filed briefs on exception.

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

ISSUE

I. Whether a "Cheshire" glueing machine, a shrink wrap machine, a "bursting" machine, "heat sealers" and a "fabricating unit" acquired by petitioners during the years in question were "principally used by the taxpayer in the production of goods by manufacturing, processing, assembling..." so as to qualify for the investment tax credit under section 210.12(b) of Article 9-A of the Tax Law.

II. Whether a change of the Administrative Law Judge after the hearing was completed deprived petitioners of a fair hearing.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

Petitioner Hand Assembly and Packaging, Inc. (sometimes known as HAPPI), a subsidiary of petitioner Your Mail Sack, Inc., claimed investment credits of \$310.14 for its fiscal year ending September 30, 1981 and \$1,659.00 for its fiscal year ending September 30, 1982. The 1981 credit was based on the acquisition of a "fabricating" unit said to be used in "assembling and fabricating". The 1982 credit was comprised of a credit of \$1,504.00, based on the acquisition of another "fabricating" unit said to be used in assembling and fabricating, and an additional credit under Tax Law § 210.12-A(a) of \$155.00.

Your Mail Sack, Inc. (the parent of Hand Assembly and Packaging, Inc.) claimed investment credits of \$571.60 for its fiscal year ending February 28, 1982 and \$969.00 for its

fiscal year ending February 28, 1983. The 1982 claim is based on the acquisition of a "Cheshire" machine said to be used in "fabricating". The 1983 claim is based on the acquisition of a "shrink wrap" machine, a "bursting" machine and "heat sealers" also said to be used in "fabricating".

A Notice of Deficiency for the fiscal year ending September 30, 1981 was issued on August 24, 1984 against Hand Assembly and Packaging, Inc. for corporation franchise tax in the amount of \$310.14, plus interest of \$70.17, for a total of \$380.41. On the same date a notice was also issued for the fiscal year ending September 30, 1982 in the amount of \$1,659.00, plus interest of \$375.36, for a total of \$2,034.36. On October 25, 1985 a Notice of Deficiency was issued for the fiscal year ending February 28, 1982 against Your Mail Sack, Inc. for corporation franchise tax in the amount of \$571.60, plus interest of \$302.69, for a total of \$874.29. On January 10, 1986 a notice was issued for the fiscal year ending February 28, 1983 in the amount of \$969.00, plus interest of \$351.82, for a total of \$1,320.82. On the same date a second Notice of Deficiency was issued against Your Mail Sack, Inc. for the fiscal year ending February 28, 1983 in the amount of \$179.00, plus interest of \$65.00, for a total of \$244.00.

A Cheshire machine is used to glue various items together. This is called "spot gluing" or "tipping". Examples of its use by petitioners were to attach a small box of 12 aspirin tablets to a booklet explaining the uses of aspirin, as well as to join credit cards with letters soliciting the use of the credit card and to attach perfume sachets to cards for distribution by department stores. In the use of this machine, petitioners receive items such as those mentioned above, separately from a printer, and then proceed to attach them and then return them to the printer or to the printer's customer.

A shrink wrap machine places plastic wrap around an object and by the use of heat shrinks the plastic wrap tight around the object. The object is typically a box (either with or without a top) which petitioners' employees have folded into shape for shipment and filled with a commercial product. This process provides security from tampering since any breaking or removal of the plastic wrap would be obvious to a customer. It also keeps the object in the

wrap orderly and clean during storage on petitioners' premises and during shipping. The boxes thus folded are sold to retail stores where the wrap is necessary to be commercially acceptable. Examples of the use of this machine by petitioners are to wrap a box of Christmas cards (which has no top except as provided by the plastic wrap) and to wrap a box (with a separate top) containing a game which consisted of many separate pieces.

Both the Cheshire machine and the shrink wrap machine are tangible personal property, depreciable pursuant to the Internal Revenue Code, have a useful life of four years or more, were acquired by purchase and have a situs in New York State.

OPINION

In the determination below the Administrative Law Judge decided that petitioners were not entitled to the Tax Law § 210.12(b) investment tax credit on the purchases of a Cheshire glueing machine and a shrink wrap machine. Specifically, it was determined that these machines were not used in the production of goods by assembling since the machines did not assemble components so as to produce a finished product. It was concluded that the machines merely packaged the goods and that the use of the goods after such packaging was in every respect identical to the use prior to the packaging. The Administrative Law Judge also denied the investment tax credit for the equipment described only as a "fabricating unit," the "bursting" machine and the "heat sealers."

On exception petitioners contend that their machines do qualify for the investment tax credit. Petitioners assert that the equipment at issue was used in the production of goods by manufacturing, processing and assembling. Petitioners argue further that the raw materials delivered to them were changed into wares suitable for use which were of a new quality, combination or shape from the raw materials acted upon by the machinery in dispute. As a result, petitioners claim that the machines were an integral part of the manufacturing process as they were involved in the production of certain goods. In addition, petitioners argue that they have not been afforded a fair hearing because the Administrative Law Judge who issued the determination was not the same Administrative Law Judge who presided over the hearing.

In response the Division argues that petitioners' machines were not involved in production by assembling but were used only to package goods which had been previously produced by other manufacturers. The Division's central argument is that the machines at issue did not perform a function on the product which altered the shape, quality or combination of the product. As a result, the Division asserts that the machines do not qualify for the investment tax credit.

We modify the determination of the Administrative Law Judge.

Tax Law § 210.12(b), for the years at issue, allowed for an investment tax credit against the tax imposed by Article 9-A of the Tax Law with respect to certain qualifying property. To qualify the property had to: (1) be tangible personal property or other tangible property; (2) be depreciable pursuant to Internal Revenue Code (hereinafter IRC) § 167 or recovery property pursuant to IRC § 168; (3) have a useful life of four years or more; (4) have been acquired by purchase as defined in IRC § 179(d); (5) be located in New York State; and (6) be principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floristry, viticulture or commercial fishing (Tax Law § 210.12[b]). Further, "manufacturing" is specifically defined as "the process of working raw materials into wares suitable for use or which gives new shapes, new quality or new combinations to matter which has already gone through some artificial process by the use of machinery, tools, appliances and other similar equipment" (20 NYCRR 5-2.4[a]). The only element in dispute is whether the machines at issue qualify as principally used in the production of goods by one of the methods delineated in element (6) above.

The first issue we will address is whether the Cheshire glueing machine of petitioner Your Mail Sack, Inc. qualifies for the Tax Law § 210.12(b) credit. The Division argues that the glueing machine does not qualify for the credit because the final identity of the goods being produced is established prior to the use of the machine. In essence, the Division contends that the goods are already manufactured and assembled prior to the application and use of the machine, thus, the machine is not necessary to the manufacture and assembly of the product. In

short, the Division argues, the glueing machine merely aids in the presentation of the already completed product.

We disagree. The crux of the matter is determining what is the final product, i.e., the goods, produced by the manufacturing and assembly process. In this case, the line the Division seeks to draw is not justified by the facts.

In our view, the facts presented here support the conclusion that the final product manufactured is the whole item which is finally transferred to the purchaser. Here, the aspirins and instructions for use, the credit card and letter of salutation, the perfume sachets and distribution cards, all become the final products transferred to the purchaser by virtue of the application of the glueing machine. This is clearly different from mere packaging as asserted by the Division. Stated alternatively, without the function of the glueing machine, the products would not be finished. Accordingly, we conclude that the Cheshire glueing machine was used in the production of goods by manufacturing and assembly so that petitioner Your Mail Sack, Inc. qualifies for the Tax Law § 210.12(b) investment tax credit.

The next issue which we will address is the claim of petitioner Your Mail Sack, Inc. that its shrink wrapping machine was used in production in a manner which qualifies it for the investment tax credit. The facts before us indicate that the shrink wrap machine places plastic wrap around an object and by the use of heat shrinks the plastic wrap tight around the object. For example, this machine was used to plastic wrap a box containing a game which consisted of many separate pieces. This process provides security from tampering of the products which are shrink wrapped as any breakage or removal of the plastic would be obvious to a customer. The products being wrapped are sold to retail stores where the wrap is necessary for the products to be commercially acceptable. In order for the shrink wrap machine to qualify for the investment tax credit it must be shown that it was used by petitioners in the production of goods by one of the enumerated options in Tax Law § 210.12(b).

The Division argues that the shrink wrap machine does not qualify for the credit because the final identity of the goods being produced is established prior to and separate from the application of the shrink wrap machine. In particular, the Division contends that the shrink wrap machine merely serves to package an already finished product. Further, the Division asserts that packaging is not a use which can qualify a machine for the Tax Law § 210.12(b) credit.¹ We disagree.

We find that the shrink wrap machine was used in the production of goods by manufacturing and qualifies for the investment tax credit for the same reasons we articulated above in reference to the glueing machine. Under the facts here, the shrink wrap becomes an integral part of the final product being sold and, therefore, the machine used to apply the wrap is part of the manufacturing process.

The next issue which we will address is the investment tax credit claimed by petitioner Hand Assembly and Packaging, Inc. upon a "fabricating unit" and the credit claimed by Your Mail Sack, Inc. for the "bursting" machine and "heat sealers." Since we find no evidence whatsoever which describes what these machines are and the sort of specific functions they perform we reject the claimed investment credit in these instances. Contrary to the Cheshire glueing machine and the shrink wrap machine previously discussed, there is no explanation in the record which provides a basis for the investment tax credit claimed.

The last issue which we will address is petitioners' claim that they were not afforded a fair hearing since the Administrative Law Judge who issued the determination was different from the Administrative Law Judge who presided over the hearing. Where a presiding officer in an administrative action is replaced with another presiding officer the case may properly be continued unless it is shown that substantial prejudice to a party will result from the change (SAPA § 303; 2 NY Jur 2d, Administrative Law

¹ The Division's regulations on the Article 9-A investment tax credit do not address the subject of packaging (20 NYCRR 5-2.4). We note, however, that the Division's regulations under the sales tax manufacturing exemption of § 1115(a)(12) of the Tax Law specifically include packaging as part of production (20 NYCRR 528.13[b][4] example 3).

§ 22). Petitioners have only put forth the conclusory allegation that the fact that there was a change in and of itself violates petitioners' rights to a fair hearing. We find this claim to be lacking the requisite specificity needed to show substantial prejudice resulting from the change in the Administrative Law Judges. Further, our review of the record does not indicate any prejudice to petitioners as a result of the change. Thus, we conclude the hearing was conducted and the determination rendered in a fair and proper manner.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners, Hand Assembly and Packaging, Inc. and Your Mail Sack, Inc. is granted with respect to the credit claimed for the Cheshire glueing machine and the shrink wrap machine and is in all other respects denied;

2. The determination of the Administrative Law Judge is reversed with respect to the Cheshire glueing machine and the shrink wrap machine and is in all other respects sustained;

3. The petitions of Hand Assembly and Packaging, Inc. and Your Mail Sack, Inc. are granted with respect to the Cheshire glueing machine and the shrink wrap machine and are in all other respects denied; and

4. The notices of deficiency issued on August 24, 1984, October 25, 1985 and January 10, 1986 are to be modified in accordance with paragraph "3" above but are otherwise sustained.

DATED: Troy, New York
August 30, 1990

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

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

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