STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
IMPATH, INC.	:	DECISION DTA NO. 818143
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, 1994 through November 30, 1997.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on October 10, 2002 with respect to the petition of Impath, Inc., 521 West 57th Street, New York, New York 10019-2901. Petitioner appeared by John M. Harrison, Tax Director. The Division of Taxation appeared by Mark F. Volk, Esq. (Cynthia E. McDonough, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner did not file a brief in opposition. Oral argument, at the Division of Taxation's request, was heard on July 9, 2003 in Troy, New York. Petitioner did not appear at oral argument.

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

ISSUE

Whether petitioner's monthly lease payments pursuant to a leasing arrangement, which financed the purchase of computers and related hardware, equipment and supplies, qualified for an exemption from sales and use taxes under Tax Law § 1115(a)(10) and 20 NYCRR 528.11

because such items were used by petitioner in research and development in the experimental or laboratory sense.

FINDINGS OF FACT

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

During the period at issue, petitioner was a self-described "Healthcare Service Provider" and indicated on its sales tax examination questionnaire that the services it provided customers consisted of the "prognosis/diagnosis of cancer specimen." Similarly, on its Federal corporate income tax returns during the period at issue, petitioner described its business activity as "medical laboratory" and its product or service as "medical testing." During the period at issue, 99% of petitioner's revenue was from its Physician Services division and 1% from the provision of biological testing under contract with certain pharmaceutical companies. Petitioner's annual report for the year 1996 to the Securities and Exchange Commission (Form 10-K) showed the following revenues for petitioner and subsidiaries:

	1994	1995	1996
Net diagnostic and prognostic services	$ 9,888,084.00	$14,578,326.00	$21,755,193.00
Contract laboratory services	126,258.00	135,238.00	210,270.00
Total revenues	$10,014,342.00	$14,713,564.00	$21,965,463.00

From the period at issue to date, petitioner has grown dramatically and is currently widely-known as "The Cancer Information Company." Expanding its activities to include a Predictive Oncology division, petitioner now conducts an increasing array of activities, including the

acquiring of live, cancerous tissue, which it resells to pharmaceutical companies, and services related to the development and commercialization of targeted gene-based therapies. Petitioner is currently working on more than 75 projects including 20 clinical trials with approximately 40 genomics, biotechnology and pharmaceutical companies. In addition, an Information Services division currently derives revenues through the licensing of tumor registry software to hospitals that treat cancer patients and the provision of information based upon analyses of petitioner's data concerning cancer specimens. Petitioner's annual report for the year 2000 to the Securities and Exchange Commission (Form 10-K) showed the following increasing revenues for petitioner and subsidiaries:

	1998	1999	2000
Net diagnostic and prognostic services	$53,183,356.00	$77,433,164.00	$124,224,462.00
Biopharmaceutical/ Genomics Services	1,685,984.00	3,838,181.00	9,538,554.00
Information Services	1,390,106.00	4,095,050.00	4,457,800.00
Total revenues	$56,259,446.00	$85,366,395.00	$138,220,816.00

During the period at issue, petitioner diagnosed 7,000 to 8,000[1] cancer specimens per month by the performance of 4 to 20 tests on each specimen. Such diagnoses produced an extraordinary repository of information concerning cancer specimens, and petitioner now maintains a database for over 700,000 cancer patients. During the period at issue, the mission of petitioner's Impulse Project was to develop technological tools in the nature of computer software that could analyze this information concerning cancer specimens so as to ultimately

[1] Petitioner currently diagnoses 14,000 cancer specimens per month.

provide petitioner's customers, such as pharmaceutical companies, with information in a format that would give insight into the treatment of cancer patients from diagnosis through treatment to outcomes.

Petitioner filed a claim for refund of sales and use tax dated May 19, 1998 in which it sought, in part, a refund of tax in the amount of $29,600.30 based upon the research and development exemption for tax paid on what it called "basic rent" on its "Finova Lease Transactions." Attached to its refund claim was a schedule which (i) listed monthly payments pursuant to 15 so-called "rental schedules," (ii) an acquisition date and cost for the particular item leased, (iii) the monthly "basic rent" and amount of sales and use tax paid on the monthly "basic rent," and (iv) the number of months for which a refund of tax paid was claimed as follows:

Rental Schedule No.	Acquisition Date	Acquisition Cost	Basic rent	Tax on basic rent	Number of Months	Amount of refund claimed
1	April '95	$3,826.90	$ 94.51	$7.80	31	$ 241.80
2	Aug. '95	44,011.76	1,086.97	89.68	27	2,421.36
6	Oct. '95	7,310.00	234.91	19.38	24	465.12
11	Feb. '96	7,986.00	256.64	21.19	22	466.18
13	Feb. '96	45,379.00	1,458.42	120.32	21	2,526.72
15	June '96	28,345.00	1,052.85	86.86	17	1,467.62
16	July '96	30,371.00	976.30	80.55	15	1,208.25
17	Aug. '96	44,295.00	1,093.97	90.25	14	1,263.50
18	Sept. '96	114,823.956 [sic]	2,771.85	228.68	14	3,201.52
19	Oct. '96	132,423.21	3,203.32	364.27	13	3,335.51

20	Dec. '96	116,039.94	2,807.01	231.58	11	2,547.38
21	Jan. 97	193,922.29	4,690.98	387.01	10	3,870.10
22	Mar. 97	139,647.52	3,378.07	278.69	8	2,229.52
23	May '97	117,841.71	2,850.79	235.17	6	1,411.02
25	June '97	295,108.95	7,138.68	588.94	5	2,944.70
					Total	$29,600.30

With its refund claim, petitioner provided the following explanation in support of its claim that the above purchases qualified for the research and development exemption:

> To capture all of the costs associated with the data base development project, the Company has established a specific account for tangible personal property purchases. The machinery, equipment and supplies charged to this database development account are utilized more than fifty percent of the time to perform functions necessary to enhance and advance the technology available for the diagnosis, prognosis and treatment of cancer.

The record includes a document consisting of over 300 pages described by the Division of Taxation ("Division") as its refund file. In this document is information provided by petitioner to the Division detailing the various rental schedules noted above. Looking at the information concerning rental schedule "23," as a random example, it is noted that petitioner has provided considerable details concerning the items acquired. With regard to rental schedule "23," the acquisition cost shown in the chart above of $117,841.71 is itemized in six pages, which includes a copy of the lease, a schedule noting the three vendors, MicroWarehouse of Boston, Ma., DataComm Warehouse ("DataComm") of Boston, Ma., and Advanced Network Consulting of New York City, which provided the equipment to petitioner, and a detailed listing of such equipment: 15 items from Micro Warehouse, 6 items from DataComm and 2,291 items from

Advanced Network Consulting. For example, the six items purchased from DataComm were detailed as follows:

Quantity	Description	Invoice Number	Equipment Cost
1 1 1	External Courier 1-Modem Int Courier I-Modem Sportster ISDN 128K	A0279323	$ 907.30
1	Ctrlr Cyberpro Dual I/O	A0413492	59.95
1 1	Ctrl Cyberpro Quad I/O 4Port Courier 1 Modem	A0373621	472.35
		Subtotal	$1,439.60

By a letter dated February 28, 2000, the Division denied the portion[2] of petitioner's refund claim relating to leases of equipment and related supplies used primarily and predominantly in research and development for the following reason:

> Auditor has determined on audit that the purchases made do not qualify for exemption under the definition of research and development.

The supervisor of the auditor explained further at hearing the reason for the denial:

> We felt it was not for research and development. It didn't fall into the criteria. We felt it was for - - to be used in a database for information. (Tr., p. 40.)

She added during her redirect examination, "I know they were using it to develop a database, that was my understanding" (Tr., p.59).

[2]The Division allowed part of the refund claim filed by petitioner, in the amount of $6,831.03, for property purchased in bulk and reshipped.

The items detailed above may be described in general as computers and computer related equipment and supplies. They were used by petitioner's Impulse Project which was located at petitioner's location in midtown Manhattan, on the sixth floor of 521 West 57th Street, in an office and two cubicles by the front reception area. The Impulse Project was headed by an individual with a background in computer programming, Yaitin Chu,[3] who was responsible for developing an analytical tool, in the nature of computer software, that could be used internally by petitioner to analyze its extraordinary repository of information concerning cancer specimens. The goal of the Impulse Project was to develop software that could be used, in the words of Peter Torres, petitioner's controller, "to extract patient specific information such as age, type of tissue, type of cancer the person had, type of treatment and follow-ups on that information" (Tr., p. 88). In this way, petitioner could develop its repository of information into an asset of value to third parties, such as pharmaceutical companies. As noted above, petitioner has been successful in this endeavor and *now* provides information through its Information Services division, which did not even exist during the period at issue, for a fee to pharmaceutical companies. Petitioner is now capable of providing information in a bulk or aggregated format that gives insight into the treatment of cancer patients from diagnosis through treatment to outcomes. For example, petitioner can now provide to a customer interested in developing a drug to treat prostate cancer information on how long people live with a diagnosis of prostate cancer having a specific gene marker and given certain varying treatments . In contrast, during the period at issue, the analytical software being developed by the Impulse Project remained in the development stage.

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[3] According to Ray Rodriguez, petitioner's current vice president of information technology, Ms. Chu is no longer with the company.

Petitioner noted at the hearing that it no longer contested the Division's Notices of Determination dated November 15, 1999 and January 31, 2000, so that only the Division's partial disallowance dated February 28, 2000 of petitioner's refund claim dated May 19, 1998 remains in dispute.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted that Tax Law § 1115(a)(10) exempts from the imposition of sales tax receipts from the sale of "[t]angible personal property purchased for use or consumption directly and predominantly in research and development in the experimental or laboratory sense." The Department's regulations at 20 NYCRR 528.11 define "research and development in the experimental or laboratory sense" to include the improvement of existing products and the development of new uses for existing products. That same section defines "directly" to mean actual use in the research and development operation and "predominantly" to mean used directly in research and development over fifty percent of the time.

The Administrative Law Judge also observed the Division's recognition that software research and development may qualify as "research and development in the experimental or laboratory sense" in its Advisory Opinion in ***Neuromedical Sys.*** (TSB-A-93[36]S).

The Administrative Law Judge concluded that petitioner presented two credible witnesses who established that during the refund period at issue, the technological tools or software being developed by the Impulse Project were in the developmental stage. The Administrative Law Judge found that based on the financial data introduced into evidence, it was not until after the

refund period at issue that petitioner began to generate revenue from the provision of information based upon analyses of its data concerning cancer specimens.

The Administrative Law Judge also found that petitioner had established that the items at issue were used directly and predominantly in research and development. The Administrative Law Judge rejected the Division's contention that because petitioner's witness was unable to confirm that the computers at issue could not be accessed by someone outside of the Impulse Project it undermined petitioner's position. Rather, the Administrative Law Judge found that although petitioner's witness could not testify that the items at issue were used exclusively by the Impulse Project, petitioner nonetheless did establish through the credible testimony of its witness that they were used predominantly and directly for research and development by such project. The Administrative Law Judge concluded that since the purchases at issue were made with the ultimate goal of developing a new product, i.e., aggregate information based upon analyses of petitioner's data concerning cancer specimens, petitioner had met the regulatory definition of "research and development" and established its entitlement to the refund at issue.

ARGUMENTS ON EXCEPTION

In its exception, the Division argues that the Administrative Law Judge erred in concluding that petitioner met its burden of proof to substantiate that petitioner's computer equipment was used directly and predominantly for research and development in a laboratory or experimental sense. The Division maintains that petitioner failed to show that any actual research or testing occurred during the refund period in which the computer equipment was used. The Division believes that petitioner's witnesses were not credible and they failed to demonstrate that the computer equipment was predominantly used in research and development.

The Division also asserts that developing a software tool to facilitate the information retrieval process does not constitute research and development in a laboratory or experimental sense per se. The Division argues that no new information or product was discovered or created by use of the computer equipment at issue, no process of experimentation was shown to have been undertaken and the computer equipment was not used in petitioner's laboratory operations. Rather, the Division maintains that petitioner merely extracted and manipulated existing data into reports for sale to its customers.

Petitioner did not file a brief on exception but, relying on the record before the Administrative Law Judge, stated that the Administrative Law Judge had correctly determined the issues in this case in its favor and that his determination should be affirmed.

OPINION

Tax Law § 1105(a) imposes sales tax on "[t]he receipts from every retail sale of tangible personal property, except as otherwise provided in this article." All sales of tangible personal property are presumptively subject to tax pursuant to Tax Law § 1132(c) "until the contrary is established." Tax Law § 1115(a)(10) exempts the receipts from the sale of "[t]angible personal property purchased for use or consumption directly and predominantly in research and development in the experimental or laboratory sense" from the imposition of sales tax.

The terms "research and development in the experimental or laboratory sense" and "directly and predominantly" are defined in the Commissioner's regulations at 20 NYCRR 528.11 as follows:

> (b) *Research and development*. (1) Research and development in the experimental or laboratory sense, means research which has as its ultimate goal:
>
> (i) basic research in a scientific or technical field of endeavor;

(ii) advancing the technology in a scientific or technical field of endeavor;
(iii) the development of new products;
(iv) the improvement of existing products; and
(v) the development of new uses for existing products.

(2) Research and development in the experimental or laboratory sense does not include:

(i) testing or inspection of materials or products for quality control. . . .
(ii) efficiency surveys;
(iii) management studies;
(iv) consumer surveys, advertising and promotions; and
(v) research in connection with literary, historical or similar projects.

(c) *Directly, predominantly, exclusively*. (1) Direct use in research and development means actual use in the research and development operation. Tangible personal property for direct use would broadly include materials worked on, and machinery, equipment and supplies used to perform the actual research and development work. Usage in activities collateral to the actual research and development process is not deemed to be used directly in research and development.

(2) Tangible personal property is used predominantly in research and development if over fifty percent of the time it is used directly in such function.

(3) Tangible personal property is exempt only if it meets the tests of direct and predominant use.

The Administrative Law Judge concluded that petitioner's equipment rentals were used in research and development in the laboratory or experimental sense and, thus, were exempt from taxation. The Administrative Law Judge stated that "the purchases at issue were made with the ultimate goal *of developing a new product*, in the nature of aggregate information based upon analyses of petitioner's data concerning cancer specimens" (Determination, conclusion of law "F," emphasis added). The Division argues on exception that what petitioner developed through the use of its computers and related equipment was not a new product. We agree. Nor, it appears, did petitioner use the equipment at issue to develop new uses of an existing product.

Petitioner developed a methodology to extract specific information from the voluminous data it had compiled as a result of tests it performed in the diagnoses of many thousands of cancer specimens. Any new uses to which this data was ultimately put were determined by petitioner's clients.

The Division argues that developing a software tool to facilitate the information retrieval process does not constitute research and development in a laboratory or experimental sense. We note that in ***Neuromedical Sys.*** (***supra***), the Division acknowledged that tangible personal property purchased for use or consumption in software research and development may qualify for exemption if such research has "as an ultimate goal any of the resulting activities listed under Section 528.11(b)(1) of the Regulations." We find that petitioner did not exhibit such a goal in developing its software.

We are not absolutely bound by an Administrative Law Judge's determination of witness credibility (***Matter of Wachsman***, Tax Appeals Tribunal, November 30, 1995, ***confirmed Matter of Wachsman v. New York State Commr. of Taxation & Fin.***, 241 AD2d 708, 660 NYS2d 462). We note that the credibility of witnesses is a determination within the domain of the trier of the facts, the person who has the opportunity to view the witness first hand and evaluate the relevance and truthfulness of their testimony (***Matter of Spallina***, Tax Appeals Tribunal, February 27, 1992). Credibility has two components: competency and veracity. Opportunity and capacity to perceive combined with capacity to recollect and communicate constitute the ingredients of competency. The truthfulness of the witness determines his veracity (***Matter of Avildsen***, Tax Appeals Tribunal, May 19, 1994).

In the matter at hand, after reviewing the testimony and evidence before us, we disagree with the Administrative Law Judge's conclusion that petitioner's witnesses' testimony was credible. We find that neither of petitioner's witnesses had the requisite competency to provide a basis for concluding that the property at issue was leased for "research and development in the experimental or laboratory sense" nor that such property was used "directly and predominantly" for such purpose in order to qualify for exemption. Neither witness was employed by petitioner throughout the audit period nor was either personally familiar with the software development conducted by petitioner during that period.

We are mindful of the fact that exemptions from tax must be strictly construed. "An exemption from taxation 'must clearly appear, and the party claiming it must be able to point to some provision of law plainly giving the exemption'" (***Matter of Grace v. State Tax Commn.***, 37 NY2d 193, 371 NYS2d 715, 718, ***lv denied*** 37 NY2d 708, 375 NYS2d 1027 quoting ***People ex rel. Savings Bank of New London v. Coleman***, 135 NY 231). In this case we disagree with the Administrative Law Judge that petitioner has demonstrated that it met the requirements of the statute, as implemented by the Commissioner's regulations, in that it leased the equipment at issue for use directly and predominantly in research and development in the experimental or laboratory sense.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;

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

3. The petition of Impath, Inc. is denied; and

4. The Division's partial denial of the claim for refund, dated February 28, 2000, is sustained.

DATED: Troy, New York
January 8, 2004

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner