

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
LOWE’S HOME CENTERS, INC. : DECISION
for Revision of a Determination or for Refund of Sales : DTA NO. 819043
and Use Taxes under Articles 28 and 29 of the Tax Law :
for the Period December 1, 1995 through August 31, 1998. :

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on March 11, 2004 with respect to the petition of Lowe’s Home Centers, Inc., Highway 268 East, North Wilkesboro, North Carolina 28656. Petitioner appeared by Phillips, Lytle, Hitchcock, Blaine & Huber LLP (Edward M. Griffith, Jr., Esq. and Gary J. Gleba, Esq., of counsel). The Division of Taxation appeared by Christopher C. O’Brien, Esq. (Barbara J. Russo, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception and petitioner filed a brief in opposition. The Division of Taxation filed a reply brief. Oral argument, at the Division of Taxation’s request, was heard on April 14, 2005 in Troy, New York.

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

ISSUE

Whether the purchase of glass cutting machines, vertical panel and cross-cut saws and window trim cut-down machines by petitioner is 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.

Lowe's Home Centers, Inc. ("Lowe's") is a "big box" national retailer of home improvement products. At the beginning of the audit period, Lowe's operated one store in the State of New York; by the end of the audit period, it had seven stores in New York. Lowe's sells finished products and, in addition, has machinery on site at its stores which can alter stock product to customers' exact specifications. Approximately 90 percent of Lowe's business consists of sales to "do-it-yourselfers" with the remainder of its sales to contractors and exempt entities.

Lowe's sells windows (under the brand name "Reliabil") which it manufactures at two stand-alone facilities located in Tennessee and North Carolina. The remainder of its sales are of stock product purchased from third-party manufacturers. Lowe's does provide services by means of certain machinery and equipment in its stores which can alter some of its stock product to its customers' specifications. These machines include: pipe cutting and threading machines; glass cutting machines; vertical panel and cross-cut saws; wire measuring and coiling equipment; carpet and floor covering cutting machines; cardboard balers; and window trim cut-down machines.

Pipe threading machines look and operate in a manner similar to an industrial lathe in a machine shop. The machine has a hole in its center through which pipe stock is fed and measured. At the other end is a cutting chuck that can be rolled around the pipe to shear off the desired length. A threading chuck is then used to thread the pipe if so desired by the customer.

Glass cutting machines consist of a structural steel workbench, measuring device, straightedge and cutting scribe. The machine is used to cut glass by placing a pane of glass on the workbench and scribing the glass with a special cutter. The waste product resulting from cutting the glass panes is not purchased by Lowe's customers, but is a by-product of the process.

Vertical panel and cross-cut saws are large steel platforms equipped with a cross-cut power saw that can be maneuvered to cut or rip structural lumber, timber and large sheets of plywood. The saw includes a dust collection system and is chained off from the main store floor.

Wire cutting and coiling machines are used to measure, wind and cut electrical wire and cables, chains, ropes and other similar items which are purchased by Lowe's on large 500-foot spools. Some of the machines have an electrical cutting mechanism while others are hand-operated.

Carpet cutting machines are large structural steel towers with cutting units that are used to load, hold and cut 400-foot rolls of carpet and vinyl flooring. The machines include an electro-mechanical roller system to move the rolls into a cutting position, a measuring device and a cutting unit to slice the carpet or vinyl flooring.

Lowe's sells carpeting and vinyl floor covering on both an installed and uninstalled basis. When a customer enters into a contract with Lowe's for installation of carpeting or vinyl floor

covering, Lowe's subcontracts out these installation services to a subcontractor who is not an employee of Lowe's.

Vertical balers are heavy steel electro-mechanical compactors that compress old corrugated cardboard ("OCC") boxes into recyclable OCC bales which weigh up to 900 pounds. The cardboard originates from various vendors which package their products in cardboard and from cardboard boxes from Lowe's distribution centers. The bales are then twist-tied with bands of steel and are moved by forklift to the outside of Lowe's stores where they are picked up for recycling. Lowe's trash hauler, Waste Integrated Services Corporation ("WISC") arranges for the sale of the OCC bales on behalf of Lowe's to third-party recyclers. The recyclers pay WISC directly for the OCC bales. Lowe's reports the payments from the recyclers to WISC as "recycling income" on its books. WISC offsets the amount of the income it receives for the OCC bales as a credit to Lowe's against WISC's monthly service invoices.

Window trim cut-down machines are used to shear and shape stock plantation shutters and mini-blinds. The machines are several feet in length and include a device for measuring the materials to a customer's window specifications and a precision cutting device used to cut the length and round the corners of the multiple slats of wood or plastic that comprise the stock product.

Lowe's purchases electric "Mart Carts." The carts are placed just inside the entrance to each store. The carts have solid 8-inch diameter rubber tires and have a large shopping basket attached to the front of each cart. The manufacturer's brochure describing the Mart Cart notes that 2 out of 10 Americans have functional limitation, that 25.2 million Americans cannot walk 3 city blocks and that 23.7 million Americans lack the energy to lift a 10-pound bag of groceries.

Lowe's does not inquire into a customer's need to use a Mart Cart; it places no restrictions on their use to those who are disabled or in need as a result of a medical condition. No medical certification or prescription is needed to utilize a Mart Cart.

The Mart Cart web page notes that the carts enable a retailer to target and accommodate the needs of today's older shoppers.

The Division of Taxation's auditor visited Lowe's Utica, New York store for the purpose of examining the Mart Carts. She was told by a store representative that the Mart Carts were for the convenience of the customers who were not required to be handicapped in order to use them. In order to use a Mart Cart, it was not necessary to ask for the key which was already in the cart.

On July 13, 1999, the Division of Taxation ("Division") received a petition for an Advisory Opinion from Lowe's which raised the issue of whether certain types of equipment are used directly and predominantly in the production of tangible personal property for sale and are, therefore, exempt from sales and use tax under Tax Law § 1115(a)(12) of the Tax Law. In the petition for the Advisory Opinion, Lowe's included four types of equipment for which the exemption from tax was sought, to wit: (1) cardboard baler/compactor; (2) panel and cross-cut saws; (3) pipe cutting/threading equipment; and (4) carpet and vinyl floor cutting equipment.

In describing the equipment for which it sought an exemption from sales tax, Lowe's, in explaining the use of the cardboard baler/compactor, stated: "This equipment is used to compact and bale scrap cardboard that is later sold to recycling companies." Attached to the petition were a picture and an invoice from the vendor of the equipment.

Lowe's filed a refund claim dated September 15, 2000 seeking a refund in the amount of \$135,882.91 for sales and use taxes paid on various equipment located at its New York stores for the period at issue herein.

On November 30, 2000, the Division issued an Advisory Opinion (TSB-A-00[51]S) to Lowe's which held that the equipment outlined in its request was not exempt pursuant to Tax Law § 1115(a)(2). As to the cardboard baler/compactor, the Advisory Opinion held that it was not exempt because Lowe's was not producing tangible personal property for sale but, instead, was paying a commercial hauler to remove the crushed cardboard. As to the panel and cross cut saws, pipe cutting/threading equipment and carpet and vinyl floor cutting equipment, the Advisory Opinion also denied the exemption on the basis that the equipment was not used directly in the production of tangible personal property for sale. The Advisory Opinion held, in pertinent part, as follows:

Petitioner's materials have already left the production line and have entered into the retail distribution chain which cannot be construed to be a continuation of the production process. The materials may already be on display for sale. Thus, the equipment and tools used to size, cut or thread the materials to customers' specifications do not meet the requirement for the production exemption.

As previously noted, the Advisory Opinion did not specifically address Lowe's glass cutting machines, window trim cut-down machines or wire measuring and coiling equipment.

Based upon the Advisory Opinion, the Division denied Lowe's refund claim in full. Lowe's thereupon filed a request for a conciliation conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS"). On March 8, 2002, BCMS issued a Conciliation Order (CMS No.188403) which granted a refund in the amount of \$24,983.69, plus

applicable interest. On June 6, 2000, the Division of Tax Appeals received a petition seeking administrative review; the amount of refund sought in the petition was \$40,232.03.

At the hearing held in this matter, the parties stipulated that the amount remaining at issue, i.e., the total amount of the refund sought by Lowe's is \$25,886.45 which consists of tax paid by Lowe's on the following equipment:

TYPE OF EQUIPMENT	AMOUNT OF TAX
Mart Carts	\$1,650.69
Pipe Cutting & Threading Machines	\$1,300.32
Glass Cutting Machines	\$418.71
Vertical Panel & Cross Cut Saws	\$1,266.87
Wire Measuring & Coiling Equipment	\$150.01
Carpet & Floor Covering Cutting Machines	\$19,516.46
Cardboard Balers	\$1,406.75
Window Trim Cutdown Machines	\$176.64
TOTAL	\$25,886.45

The various pieces of equipment which are the subject of this claim for refund are located inside Lowe's stores. With the exception of the vertical balers which compress cardboard (these are located in the storage areas of the stores), each of these pieces of equipment is located in the customer display/sales floor near the specific product displays.

Lowe's customers may purchase the tangible personal property for sale (e.g., pipe, glass, window trimmings, wood or wire) in stock sizes or, in the alternative, may have it cut down to a specific size. Lowe's does not charge its customers an additional fee for its cutting services.

Tangible personal property such as glass or wood that is improperly cut due to Lowe's error is discarded and the cost is borne by Lowe's. It is Lowe's policy to charge the customer for the tangible personal property if it is improperly cut due to an error by the customer.

When a customer chooses to have a piece of wood (plywood or lumber) or glass cut down to his or her specifications, the customer must pay for the stock size piece prior to cutting. The customer may keep whatever is left over after the stock piece is cut or, in the alternative, Lowe's will dispose of it as waste.

In reviewing Lowe's refund claim and during the audit, the auditor performed "a small test of sales" and during that test did not see any invoices for installation of carpet. Lowe's Director of Sales and Use Tax, Craig J. Price, stated that for the 2002 fiscal year, Lowe's revenues were \$26.4 billion and the total revenues from its installed sales (this includes installed vinyl, carpet and kitchen cabinets) were \$1 billion. The record contains no breakdown as to what percentage of these installed sales were related to installation of carpet and vinyl flooring.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge concluded that petitioner's purchases of pipe cutting and threading machines, glass cutting machines, vertical panel and cross-cut saws, wire measuring and coiling equipment, carpet and floor covering cutting machines, cardboard balers, and window trim cut-down machines qualified for exemption from sales tax under Tax Law § 1115(a)(12) as "machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property . . . for sale, by . . . processing." The determination found the equipment in issue indistinguishable from the supermarket meat-slicing machines in Example (6) of 20 NYCRR 528.13(c)(2). The determination states in part:

While there may be times when the stock size of pipe, wood (lumber or plywood), glass or shutters or blinds is the size desired by a particular customer, it is highly unlikely that any of Lowe's customers are desirous of purchasing an entire 500-foot spool of wire (or cable, chain, rope, etc.) or a 400-foot roll of carpet or vinyl floor covering. That being the case, such tangible personal property is not . . . ready to be sold to Lowe's customers (Determination, conclusion of law "D").

The determination of the Administrative Law Judge also concluded that electric shopping carts purchased by petitioner and used in its stores did not qualify for exemption from sales tax under Tax Law § 1115(a)(3) as "medical equipment . . . purchased at retail for use in performing medical and similar services for compensation." The determination observed in this connection that while the carts may have been purchased with disabled customers in mind, they were nevertheless available to the general public and could be used by any customers who chose to ride rather than walk through Lowe's expansive stores.

ARGUMENTS ON EXCEPTION

The Division has taken exception to the determination of the Administrative Law Judge with respect to glass cutting machines, vertical panel and cross-cut saws, and window trim cut-down machines but not with respect to pipe cutting and threading machines, wire measuring and coiling equipment, carpet and floor covering cutting machines, and cardboard balers. On exception, the Division argues that the equipment at issue—viz. glass cutting machines, vertical panel and cross-cut saws, and window trim cut-down machines—are used on finished products which are past the last step of production and are on display and ready to be sold. Thus, the Division asserts that the equipment is used in the distribution phase and not the production phase. In support of its argument, the Division notes that a customer must pay for lumber or glass in a stock size whether or not it is cut into smaller sizes and that mini-blinds and shutters

are already priced and packaged and must be purchased as such regardless of whether the customer chooses to have them shortened.

The Division also draws support from Example (6) quoted above. The Division reads the reference to supermarkets in the example as contemplating the familiar routine at a delicatessen counter in which a portion of a large piece of meat is sliced, packaged, and sold to the customer and the remaining piece of meat is returned to the display. This is said to be analogous to the wire or carpet in the present case which is sold by the linear or square foot with the remaining product remaining in inventory on a spool for sale to others like baloney or mortadella. The Division has not taken an exception with respect to wire and carpet cutting machines and distinguishes the products that are sold in stock sizes.

Petitioner asserts, in opposition, that the customer's specifications define the product being sold and, accordingly, the product should not be viewed as "finished" or "ready to be sold" until it has been modified through the use of the equipment in question to meet the customer's specifications. Thus, if the store stocks two-by-fours in eight and ten foot lengths but the customer desires one that is 62 inches long, the tangible personal property is not "finished" and "ready to be sold" until it is cut regardless of whether the longer piece of wood must be paid for and the remaining 34-inch piece can be discarded or taken by the customer as he pleases.

OPINION

Tax Law § 1115(a)(12) provides an exception from sales tax for purchases of the following:

[m]achinery or equipment for use or consumption directly and predominantly in the production of tangible personal property . . . for sale, by manufacturing, processing, generating, assembling, refining, mining or extracting, but not including parts with a useful

life of one year or less or tools or supplies used in connection with such machinery or equipment.

The regulations (20 NYCRR 528.13[b][1]) define the activities constituting “administration,” “production” or “distribution,” as follows:

(i) *Administration* includes activities such as sales promotion, general office work, credit and collection, purchasing, maintenance, transporting, receiving and testing of raw materials and clerical work in production such as preparation of work, production and time records.

(ii) *Production* includes the production line of the plant starting with the handling and storage of raw materials at the plant site and *continuing through the last step of production where the product is finished and packaged for sale.*

(iii) *Distribution* includes all operations subsequent to production, such as storing, *displaying, selling,* loading and shipping finished products (emphasis added).

20 NYCRR 528.13(b) also provides as follows:

(2) The exemption applies only to machinery and equipment used directly and predominantly in the production phase. Machinery and equipment partly used in the administration and distribution phases does not qualify for the exemption, unless it is used directly and predominantly in the production phase.

* * *

(4) *Production ends when the product is ready to be sold* (emphasis added).

20 NYCRR 528.13(c) defines the terms “directly” and “predominantly” as follows:

(1) *Directly* means the machinery or equipment must, during the production phase of a process:

(i) act upon or effect a change in material to form the product to be sold, or

(ii) have an active causal relationship in the production of the product to be sold, or

(iii) be used in the handling, storage, or conveyance of materials or the product to be sold, or

(iv) be used to place the product to be sold in the package in which it will enter the stream of commerce.

(2) Usage in activities collateral to the actual production process is not deemed to be used directly in production.

* * *

Example 6: Machines to grind meat, make hamburger patties, cube steaks, or slice meat; power saws and scales when used by slaughterhouses, wholesale meat houses and supermarkets, are used directly in processing tangible personal property for sale, and are exempt.

* * *

(4) Machinery or equipment is used predominantly in production, if over 50 percent of its use is directly in the production phase of a process.

Under the statute and regulations, two tests must be met for the mechanical devices in this case to qualify for exemption from sales tax under Tax Law § 1115(a)(12) as machinery and equipment used “directly and predominantly in the production of tangible personal property . . . for sale, by . . . processing.” First, the use of the machinery must qualify as “processing.” The term “processing” is defined in 20 NYCRR 527.4(d) as “the performance of any service on tangible personal property for the owner which effects a change in the nature, shape, or form of the property.” Second, the processing must occur predominantly during the “production” rather than the “distribution” phase (*see*, 20 NYCRR 528.13[b][2]). Under the regulations, production continues through the last step of production where the product is finished and packaged for sale.

Distribution includes all operations subsequent to production, such as storing, displaying, selling, loading and shipping finished products. The determination of the Administrative Law Judge found, and the Division apparently does not question, that petitioner's glass cutting machines, vertical panel and cross-cut saws, and window trim cut-down machines are used in "processing" the tangible personal property on which they operate. Accordingly, the sole issue is whether that processing occurs during the production phase or the distribution phase.

In order to answer this question, we must examine the words of three parts of the regulations—*i.e.*, the definition of "production," the definition of "distribution," and Example (6). For the reasons discussed below, we do not find the definition of distribution or Example (6) to be helpful.

The definition of distribution includes "displaying" and "selling" and it might be suggested that once merchandise is put on display and subject to selling activities, the distribution phase has begun. For example, under such an interpretation, carpet on rolls hundreds of feet long would be in the distribution phase once it arrived on the selling floor where it would be subject to visual and tactile examination by retail customers and presentation by sales personnel. We think that this interpretation would be incorrect. The definition of distribution is phrased in a way that is entirely subservient to the definition of production. It refers to "all operations subsequent to production" and includes as examples "displaying [and] selling . . . *finished products*" (20 NYCRR 528.13[b][1][iii], emphasis added). Thus, in order to determine that distribution has begun one must first determine that production has ended which would be the case if the objects of displaying and selling activities were "finished products" (*see*, Determination, conclusion of law "D"). Moreover, this reading would move the dividing line of

production and distribution to a point earlier than that asserted by the Division on its exception to the determination of the Administrative Law Judge. Accordingly, we think that the proper focus of our analysis is the definition of “production” and whether the equipment at issue was used before or after “the last step of production where the product is finished and packaged for sale” and is “ready to be sold” (20 NYCRR 528.13[b][1][ii]).

The Division reads Example (6) in section 528.13(c)(2) of the regulations as suggesting the operation of a delicatessen counter in a supermarket where large pieces of ham or baloney are sliced to a customer’s order and the remainder is restored to the display case. While the reference to supermarkets in Example (6) makes clear that the production phase can occur in a retail establishment, it is hard to draw much more from it. The example describes machines used “to grind meat, make hamburg patties, cube steaks, or slice meat; power saws and scales when used by slaughterhouses, wholesale meat houses and supermarkets.” Applying familiar tools of interpretation, such as *ejusdem generis* and *noscitur a sociis*, one might well conclude that a large scale butchering operation is closer to the writer’s intent. The reference in Example (6) to “supermarkets” in the company of “slaughterhouses [and] wholesale meat houses” and the statement that the exemption applies “when [the equipment] is used by” such a business, might be read as contemplating the sort of equipment that is found in walk-in refrigerators for use in reducing large animal carcasses to portions of retail size rather than baloney slicing machines found at a delicatessen counter.

In a traditional butcher shop, a customer ordering a pound of ground beef or pork might find that the meat is cut, weighed and priced before it is ground. Similarly, an electric band saw might be used to trim a crown roast after it is weighed. The purchaser of a leg of lamb will not

find that the price is reduced if he asks to have it boned and butterflied. In those circumstances, it could be argued that the processing occurs after the tangible personal property is “finished” and “ready for sale” because the merchandise has been sized and priced and the customer has agreed to purchase it before the processing. Even if a roast were weighed after it was trimmed, the weighing at this point would be for the purpose of calculating the price, not determining the nature or quality of what the customer is buying. There is nothing put back in the display case. On the other hand, if meat is ground in advance and placed in plastic wrapped packages with price stickers attached so that it can be taken directly to the cashier, one would conclude that the meat grinding has taken place during the production phase. Under the regulations, such a situation would require a calculation of whether more than 50% of the use of the machine was for meat ground in advance or meat ground to order of the customer. Petitioner would no doubt say that in both cases the customer is buying ground meat or a trimmed roast and the “product is [not] finished” and “ready to be sold” until it is in the condition that the customer wants to bring home. There is nothing in Example (6) that is fatal to either of these alternative positions. More to the point, however, the example does not contain expressly or impliedly the baloney slicing paradigm that the Division seeks to apply by analogy to glass and lumber and windows.

While the definition of “distribution” and the facts of Example (6) do not directly provide a basis for applying the definition of “production,” the structure and themes contained in the regulations are valuable in weighing the persuasiveness of the parties’ arguments. The regulations contemplate that processing may occur during the production phase or the distribution phase. While it seems clear that a retail establishment may conduct processing during the production phase, one would also expect that handling of the processed merchandise

at such a business would involve a distribution phase to some extent before it arrives at the cash register. Under petitioner's proposed rule, it is difficult to see how the distribution phase could ever involve processing since the finished product would be defined by the customer's requirements which would be met only as a result of the processing. By contrast, the Division's proposed rule seems to reflect a reasoned and balanced distinction between products made to order and products sold in standard forms and sizes accompanied by an alteration service. While the line drawn by the Division involves a subtle distinction, the handling of merchandise through production and distribution is a continuous operation and distinctions at the margins of these categories inevitably involve finely wrought rules. The alternative proposed by petitioner would, in effect, abandon the effort to draw the appropriate line and instead treat all processing as occurring in the production phase—a result that we view as less harmonious with the regulations.

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 to the extent that it concludes that sales of glass cutting machines, vertical panel and cross-cut saws and window trim cut-down machines are exempt from tax under Tax Law § 1115(a)(12), but is otherwise affirmed;
3. The petition of Lowe's Home Centers, Inc. is granted to the extent that the pipe cutting and threading machines, the wire measuring and coiling equipment, the cardboard balers, and carpet and floor covering cutting machines are exempt under Tax Law § 1115(a)(12), but is otherwise denied; and

4. Petitioner's claim for refund is granted in accordance with paragraph "3" above.

DATED: Troy, New York
October 13, 2005

/s/Donald C. DeWitt

Donald C. DeWitt
President

/s/Carroll R. Jenkins

Carroll R. Jenkins
Commissioner

/s/Robert J. McDermott

Robert J. McDermott
Commissioner