STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

PABX SYSTEMS CORP. F/K/A :
ITT COMMUNICATIONS EQUIPMENT & DETERMINATION
SYSTEMS DIVISION :

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, PABX Systems Corp. f/k/a ITT Communications Equipment & Systems Division, Fulton Drive, P.O. Box 831, Corinth, Mississippi 38834, filed a 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 (File No. 800202).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on September 14, 1989 at 1:15 P.M., with all briefs filed by March 19, 1990. Petitioner appeared by Rene L. Basile, Esq. The Division appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

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

PABX Systems Corporation f/k/a ITT Communications Equipment and Systems Division[1] was issued four notices of determination and demands for payment of sales and use

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[1]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

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 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).

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to PABX Systems Corporation.

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.

SUMMARY OF THE PARTIES' POSITIONS

As stated above, the Division takes the position that the sale by ITT of the telephone equipment is subject to tax pursuant to Tax Law § 1105 and not eligible for the exemption set forth at Tax Law § 1115(a)(12) primarily because petitioner is not in the business of furnishing telephone services. The Division's position is identical to that set forth in the regulations promulgated pursuant to Tax Law § 1115(a)(12).

ITT takes the position that it is eligible for the exemption set forth in 1115(a)(12) and that the regulations relied upon by the Division are not applicable to it since they were promulgated after the audit period herein and, in any event, they are beyond the scope of the statute pursuant to which they were promulgated.

CONCLUSIONS OF LAW

A. Before proceeding to the central issue of whether or not the telephone central office equipment and station apparatus sold by petitioner is exempt from sales tax pursuant to Tax Law § 1115(a)(12), it is necessary to deal with the tangentially raised issue of whether the Division's assessments based upon a use tax liability should be cancelled. As petitioner's representative correctly pointed out in its brief and at hearing, following several court decisions in 1981, the Division issued a memorandum, TSB-M-81(2)S, which stated the Division's policy with regard to the sale of private telephone systems, treating such sales as the sale of tangible personal property and not as capital improvements. Thus, materials incorporated into those capital improvements, i.e., the private telephone systems themselves, were no longer taxable as materials purchased by a contractor for use in capital improvements. Based upon this change in policy, petitioner contends that all use tax assessments against it for the audit period herein be cancelled.

However, there really was no change in position with regard to tax on the property in issue. Tax Law § 1101(b)(4)(i) provides that:

> "[A] sale of any tangible personal property to a contractor, subcontractor or repairman for use or consumption in erecting structures or buildings, or building on, or otherwise adding to, altering, improving, maintaining, servicing or repairing real property, property or land, as the terms real property, property or land are defined in the real property tax law, is deemed to be a <u>retail</u> <u>sale</u> regardless of whether the tangible personal property is to be resold as such before it is so used or consumed...." (Emphasis supplied.)

Therefore, in actuality, the tax which went unpaid by petitioner herein on its purchases of material was in fact unpaid sales tax on its purchase of said materials. Hence, the characterization of the tax imposed herein, as either sales or use tax is moot, since it was sales tax which was unpaid, and it is sales tax which is now being claimed by the Division as due on the sales of said equipment to petitioner's customers.

Further, it is noted that the Technical Services Bureau memorandum referred to above in which the Division modified its policy with regard to the treatment of installations of telephone systems as capital improvements was issued on January 23, 1981 and became effective on

March 1, 1981. The notices of determination in this case were issued on September 18, 1981 and, thus, both the Division and petitioner were aware, or should have been aware, that the basis for the tax liability assessed was not rooted in the theory of capital improvement but in the sale of tangible personal property. Additionally, petitioner's petition filed on December 7, 1981 only addresses itself to the sales of telephone central office equipment and its entitlement to an exemption pursuant to 1115(a)(12). Likewise, the perfected petition filed on June 22, 1982 makes the same allegations.

In any event, it appears that both the Division and petitioner were aware of the theory upon which the assessments were issued, and petitioner's request for cancellation of those assessments because they may have been based upon use tax is denied.

B. Petitioner correctly points out in its brief that the settled law in New York State is that statutes imposing tax are to be construed strongly in favor of the taxpayer, but where a taxpayer claims the benefit of a statute providing an exemption from taxation, the taxpayer has the burden of proving exemption. (Tripp v. State Tax Commission, 53 AD2d 763, 764 [1976].) Petitioner herein is claiming an exemption from Tax Law § 1105(a) which imposes the tax on the receipts from "every retail sale of tangible personal property, except as otherwise provided in this article." During the period in issue, Tax Law § 1115(a)(12) provided an exemption from the tax on retail sales, on receipts from the following:

> "Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property, gas, electricity, refrigeration or steam for sale, by manufacturing, processing, generating, assembling, refining, mining or extracting, or telephone central office equipment or its station apparatus or comparable telegraph equipment for use directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication, but not including parts with a useful life of one year or less or tools or supplies used in connection with such machinery, equipment or apparatus." (Emphasis added.)

This precise issue has very recently been handled in a memorandum decision from the New York State Supreme Court (Eastman Kodak Company v. Department of Taxation and Finance of the State of New York, Sup Ct, Monroe County, Nov. 22, 1989, Siracuse, J.). The two parties in that case made the same basic arguments that were made in the instant matter, i.e., the Division contended that the exemption was intended to be available only to telephone companies, i.e., those which provide telephone service, and plaintiff argued that the rule is inconsistent with the statutory language and took the position that the plain language of section 1115(a)(12) should be followed and an exemption granted regardless of ownership of the telephone equipment. In relevant part, the Eastman Kodak case provided as follows:

> "An agency may not create a rule out of harmony with a statute (citation omitted). However, the construction given the statute by the agency 'will be upheld if not irrational or irresponsible' (citation omitted). The burden is upon the plaintiff to show that its interpretation of the law was plausible and the only reasonable construction available (citation omitted). Furthermore, statutes creating tax exemptions are to be strictly and narrowly construed and the burden of proving entitlement to an exemption rests with the taxpayer (citation omitted). To determine whether a regulation is contrary to a statute, it is necessary to look at the statute's legislative history (citation omitted).
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> The Court finds that the bill jackets and memorandum at plaintiff's exhibits G and H and defendant's Exhibit D constitute the legislative history. While defendant's Exhibits A, B and C are interesting, there is nothing to establish that these documents and the recommendations contained therein, were ever before the Legislature. Therefore, they are not considered. There is nothing contained in the legislative history specifically addressed to the exemption for telephone equipment. The legislative history does convey, however, a concern for a pyramiding of the sales tax which would serve to decrease the competitiveness of New York State industries and manufacturers.
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> In broad terms, Section 1115(a)(12) was designed to eliminate the imposition of the sales tax on production equipment for tangible personal property and utilities. By eliminating this tax, the State satisfied itself with the collection of the sales tax on the distribution of the 'finished product,' whether that be an item of tangible personal property or a utility or service such as gas, electricity, refrigeration, steam or telephone and telegraph services. Under Tax Law § 1105(b), tax is collected upon the sale of telephone services. In the case of a 'private' telephone company, in which there is no sale of telephone services, there is no opportunity to ultimately collect the tax. Thus, there is a total avoidance of tax as opposed to a mere deferral of tax.
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> The placement of the telephone equipment exemption in the same section as the production equipment exemption is significant. Had the Legislature intended to completely exempt telephone equipment from tax liability, the exemption would have been more appropriately placed in another paragraph of section 1115 separate and apart from the production exemptions. By this placement, it appears that the intent was to create a parallel exemption for machinery and equipment used to produce tangible personal property, gas, and electric services for sale and for machinery and equipment used to switch telephone and telegraph services for sale.
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> A look at the genesis of the term 'central office equipment' reveals why the words 'for sale' may not have been deemed necessary by the Legislature. At the time of passage of section 1115, central office equipment was a term of art used by the Public Service Commission and defined at 16 NYCRR § 221. By the very use of that term, the public services connotation is conveyed. Under the rule of statutory construction known as in pari materia (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."

Petitioner's argument that the Eastman Kodak case should be distinguished from the instant matter on the basis that ITT's customers were connected to a telephone operating company and paid sales tax on the services furnished to them fails since it appears that Eastman Kodak, although it purchased the telephone central office equipment station apparatus and cable terminals, did not operate a telephone company but also purchased taxable telephone services. ITT has offered no other basis for distinguishing itself from the Eastman Kodak case.

Finally, it is noted that the regulation promulgated pursuant to Tax Law § 1115(a)(12), 20 NYCRR 528.13(f), took effect one year prior to the end of this audit period. The interpretation of the statute in the regulations was subsequently ratified by the court in Eastman Kodak. Therefore, the Division's reliance upon the regulation is not misplaced given the subsequent Court decision in Eastman Kodak.

Given the striking similarities between Eastman Kodak and the instant matter, and the application of the reasoning therein to this case, it is determined that ITT has not established an entitlement to the exemption set forth in Tax Law § 1115(a)(12) and the additional tax remains due and owing.

C. The petition of PABX Systems Corporation f/k/a ITT Communications Equipment and Systems Division is denied and the four notices of determination and demands for payment of sales and use taxes due dated September 18, 1981 are sustained together with such additional interest as may be lawfully due and owing.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE