STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition

of

HOWARD JOHNSON CO.

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 September 1, 1978 through November 30, 1981.

DETERMINATION

In the Matter of the Petition

of

MARRIOTT FAMILY RESTAURANTS, INC. AS SUCCESSOR IN INTEREST TO HOWARD JOHNSON, CO.

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 September 1, 1981 through November 30, 1985.

Petitioner Howard Johnson Co., One Monarch Drive, North Quincy, Massachusetts 02269, 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 September 1, 1978 through November 30, 1981 (File No. 800927).

Petitioner Marriott Family Restaurants, Inc., as successor in interest to Howard Johnson Co., One Marriott Drive, Washington, DC 20058, 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 September 1, 1981 through November 30, 1985 (File No. 803275).

On March 13, 1989 and March 20, 1989, respectively, petitioners and the Division of Taxation, through their duly authorized representatives, waived a hearing and agreed to submit the cases for determination based on a stipulation of facts agreed to by the parties hereto and memoranda of law to be submitted by the parties by June 15, 1989. After due consideration of the record, Frank W. Barrie, Administrative Law Judge, hereby renders the following determination.

ISSUES

I. Whether the Division of Taxation properly determined that the installation of walk-in freezers, parking lot poles and lights and theHoward Johnson rooftop cupola were not capital improvements, but rather properly subject to sales tax as purchases of tangible personal property.

II. Whether the Division of Taxation properly disallowed 76% of petitioners' claimed manufacturing exemption under Tax Law §§ 1115(c) and 1105-B and 100% of petitioners' claimed manufacturing exemption under Tax Law § 1115(a)(12) for its Queens Village plant operations because 76% of the food manufactured at such plant was used by petitioners in their own restaurant operations.

FINDINGS OF FACT

Pursuant to 20 NYCRR 3000.7, the parties hereto, by their respective representatives, executed a stipulation of facts in these matters. The stipulation of facts concerning the matter of the petition of Howard Johnson Co. with regard to the period September 1, 1978 through November 30, 1981 is set forth below.

Petitioner, Howard Johnson Co., at all relevant times, was engaged in business in the State of New York and in other states in the United States, inter alia, operating restaurants/motor lodges, selling food, tangible personal property and services subject to sales tax.

For the period at issue, petitioner operated a plant located at Queens Village, New York.

At the Queens Village plant, a wide variety of food products were produced from raw materials received in basic form and then frozen or canned.

The products were shipped from the plant either directly to petitioner's distribution centers outside New York State or, in the case of canned products, to a warehouse in Jamaica, New York from which they were shipped to the distribution centers. Twenty-four percent of the products were shipped from the distribution centers in fulfillment of sales by petitioner to restaurants operated by licensees and other wholesale food account customers, and the remaining 76% was shipped from the distribution centers to restaurants owned or operated by petitioner both within and without New York State where it was served to paying customers in such restaurants.

The products had a different identity from their ingredients and were tangible personal property.

All of the liquid nitrogen consumed at the Queens Village plant was used solely in its manufacturing activities, while 93% of the utilities used at the plant were for manufacturing purposes.

No restaurant or other retail facility owned or operated by petitioner was located at or adjacent to the Queens Village plant, petitioner's warehouse in Jamaica, or any distribution center.

Petitioner made expenditures at its restaurants and motor lodges at various locations in New York State for the conversion of outside parking lights to high sodium vapor lamps, and for the installation of walk-in freezers and the Howard Johnson cupola on rooftops of its facilities.

On or about 1983, the Division of Taxation conducted an audit of petitioner's sales and use tax liability for the period September 1, 1978 through November 30, 1981.

The Division for this period determined tax due as follows:

<u>Sales Tax</u>

Unsubstantiated exempt sales	$ 2,380.32

<u>Use Tax</u>

Recurring purchases (not including the Queens Village plant)	71,528.06
Capital expenditures (all locations except the Queens Village plant)	48,324.51

<u>Queens Village Plant Audit</u>

Petitioner claimed a tax refund of $74,057.77 for 93% of the utilities used in manufacturing at the Queens Village plant. Of this amount, 24% was allowed as a refund (based on 24% of the Queens Village plant's food which was manufactured for sale).

($17,699.81)

Use <u>Tax</u>

Recurring purchases		55,792.45
Liquid nitrogen used in manufacture		14,948.86
Manufacturing supplies (hot dog casings)		16,601.76
Capital expenditures	34,802.10	
Credit for tax overpaid on capital		(6,085.31)
Total additional tax due for period:		<u>$220,592.94</u>

As a result of the audit, petitioner was assessed for sales and use taxes due of $185,634.03 for the period September 1, 1978 to February 28, 1981, via notice of determination No. 831125001A, and assessed for sales and use tax due of $34,958.91 for the period March 1, 1981 to November 30, 1981 via notice of determination No. 831125002A.

Of the deficiencies in tax stated in the above notices, $104,985.33 plus interest was paid on or about February 17, 1984, leaving in dispute a balance of $115,607.61 in tax. In addition, a timely claim for refund of $74,057.77 was allowed only to the extent of $17,699.81 leaving in dispute a balance of $56,357.96 in tax. The total of $115,607.60, the portion of the deficiency remaining in dispute, and $56,357.96, the portion of the refund claim still in dispute, is $171,965.56. Of this total amount, $132,197.31 is attributable to Issue II, set forth above.

The portion of the stipulation of facts concerning the petition of Marriott Family Restaurants, Inc. as successor in interest to Howard Johnson Co. for the period September 1, 1981 through November 30, 1985 is set forth below.

Petitioner, at all relevant times, was engaged in business in the State of New York operating restaurants/motor lodges, selling food, tangible personal property and services subject to sales taxes.

Up until October 1983, petitioner operated a plant located at Queens Village, New York. Of the food products manufactured at the plant, 24% was sold by petitioner and the remaining 76% was shipped to restaurants owned or operated by petitioner.

The Division of Taxation conducted an audit of petitioner's sales and use tax liability for the period September 1, 1981 to November 30, 1985 and determined that petitioner owed additional use tax of $435,474.55, plus interest.

On or about February 13, 1986, the Division issued to the petitioner a notice of determination No. S860214003A for the period September 1, 1981 through November 30, 1985 setting forth use taxes due, plus interest, a portion of which has been paid.

On June 30, 1986, petitioner was issued two statements of proposed audit adjustments: the first statement was for tax due of $317,240.21, plus interest, which was agreed to and paid by petitioner; the second statement was for tax due of $118,234.34, plus interest, and the subject of this proceeding.

The $118,234.34 in dispute, constitutes the New York State Tax (4-1/4%) imposed on the disallowed manufacturing exemption for fuel, utilities, supplies (disposable hot-dog casings), and equipment purchased for use at petitioner's Queens Village plant.

The following additional findings of fact are hereby made.

According to the audit report for the period September 1, 1981 through November 30, 1985, petitioner Howard Johnson Co. was a wholly-owned subsidiary of Imperial, Ltd. Such parent corporation spun off the Ground Round Restaurant Division of the Howard Johnson Co. to form a new separate division of Imperial, Ltd. The parent corporation then sold Howard Johnson Co., in a stock transfer, to Marriott Corp. Marriott Corp., in turn, sold the Howard Johnson Company's motor lodge operation and reorganized Howard Johnson Co. as Marriott Family Restaurants, Inc.

The field audit report concerning the assessment for the period September 1, 1978 through February 28, 1981 notes that the vendor stated that it was nearly impossible to trace the food processed at the Queens Village plant to individual restaurants. Because Howard Johnson Co. owned and operated 76% of all the Howard Johnson restaurants, Ground Round and Red Coaches, while the remainder were operated by licensees, it was decided that only 24% of the food processed was for sale, and 76% was for self-use.

The amount of $132,197.31, as noted in Finding of Fact "12", supra, represents sales tax imposed on Howard Johnson Co.'s purchases of fuel, liquid nitrogen, hot dog casings and certain unspecified expenditures for the Queens Village plant. Further, since the parties stipulated at Finding of Fact "12", supra, that the total amount that remains in dispute is $171,965.56 and that the amount of $132,197.31 is attributable to Issue II, set forth above, the difference of $39,768.25 is therefore attributable to the disallowance by the Division of Taxation of capital improvement exemptions for petitioner's installation of parking lot lights, Howard Johnson cupolas, and walk-in freezers at various restaurants operated by it. The record on submission, however, is inadequate to allocate this amount among these various items. Further, the record on submission provides no factual details concerning any of these installations. There is no evidence concerning the number, location, procedures for installation, or lifetime of these items.

A lease dated June 27, 1961, between Howard D. Johnson Co., a predecessor entity to petitioner, Howard Johnson Co., as lessee and Motor Lodge Properties, Inc., as lessor for the lease of land on Route 7 in Colonie, New York, for the purpose of constructing a Howard Johnson restaurant provides that:

> "[U]pon the termination or expiration of the lease for whatsoever cause, the Lessee shall have the privilege and right at its own expense of removing its movable

business fixtures, movable office furniture, machinery, equipment, signs, insignia and other indicia of the lessee's tenancy or use including the right to remove the orange colored roof and cupola when the same has been erected on the building on the demised premises."

A lease dated March 8, 1976, between petitioner, Howard Johnson Co. as lessee, and Capital Plaza at Latham Associates as lessor, for the lease of land situated on Route 9 in Colonie, New York similarly provides that petitioner may upon the termination or expiration of the lease for whatsoever cause remove the roof tile and cupola when the same has been erected on the building on the demised premises. The audit papers include two other leases and one lease assignment to petitioner. Of these, none specifically refer to the petitioner's right to remove the Howard Johnson cupola although one gives petitioner the right to remove the "roof tile" upon the termination of the lease.

The field audit report concerning the assessment for the period, September 1, 1981 through November 30, 1985, notes that the vendor Marriott Family Restaurant, Inc., agreed to additional tax due of $317,240.21 but disagreed with $118,234.34 tax due pending the resolution of the prior audit protest of Howard Johnson Co. concerning the assessment for the earlier period. This disagreed tax was the result of the Division's not allowing in full petitioner's claim of manufacturing exemption for its Queens Village plant.

SUMMARY OF THE PARTIES' POSITIONS

In the stipulation of facts, the parties also elaborated upon their respective positions concerning the exemption for capital improvements. Petitioners argue that the capital improvements were permanent installations to real property, were so intended, and that their removal would do material damage to the real property. On the other hand, the conflicting position of the Division of Taxation is that the parking lot poles and lights "could easily be removed without damage to the property" and that the walk-in freezers "could be dismantled and removed in the same manner, without significant damage to the property." It was further stipulated that the reason the Division of Taxation maintains that petitioners' installations of the cupolas were not capital improvements is because "under the terms of petitioner's leases, petitioner retained the right to remove the cupolas at the end of the leases. They were therefore not permanent installations to real property, but remained tangible personal property and not capital improvements."

In their brief, petitioners contend that the Division of Taxation's ground for refusing to recognize the installation of the rooftop cupolas, walk-in freezers and parking lot lights as capital improvements, i.e., that the properties could be removed without significant damage, was improper. On the other hand, the Division of Taxation in its brief argues that such installations were neither permanent nor intended to be permanent because of their removability without material damage to the real property or the items themselves and therefore were not capital improvements.

With respect to the second issue set forth above, petitioners argue that they have met the elements prescribed (1) in Tax Law § 1115(a)(12) for application of the manufacturing machinery exemption, (2) in Tax Law § 1115(c) for the exemption of certain purchases of electricity consumed in the operation of the food manufacturing plant, and (3) in Tax Law § 1105-B for the reduced tax rates on purchases of parts, tools, supplies and services used or consumed in the production of tangible personal property. In particular, petitioners contend that the tangible personal property produced at the Queens Village plant was tangible personal property "for sale" as required by these sections of the Tax Law. The Division of Taxation, by contrast, contends that only 24 percent of the tangible personal property produced was "for sale" with the balance of 76 percent being produced for petitioners' own use.

CONCLUSIONS OF LAW

A. Tax Law § 1105(c)(3)(iii) excepts from the sales tax imposed by said paragraph (3) receipts from the services of installing tangible personal property "which, when installed, will constitute a capital improvement to real property, property or land...." "Capital improvement" for purposes of subparagraph (iii) is defined in Tax Law § 1101(b)(9) as follows:

> "Capital improvement. An addition or alteration to real property which:
>
> (i) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and
>
> (ii) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and
>
> (iii) Is intended to become a permanent installation."

Each of these three separately numbered requirements must be met in order for an addition or alteration to qualify as a capital improvement and thus not be subject to sales tax.

B. Petitioners contend that the installation of the Howard Johnson rooftop cupola, walk-in freezers, and parking lot lights should be treated as capital improvements not subject to sales tax because the Division of Taxation used an erroneous standard in rejecting such installations as capital improvements. The Division of Taxation's position, as noted in the parties' stipulation, is that the parking lot lights, which consisted of metal poles attached to a concrete base by bolts, were not permanent installations and not capital improvements because the poles and lights could easily be removed without damage to the property. Similarly, according to the Division of Taxation, the cupolas were not permanent installations but remained tangible personal property because under the terms of petitioners' leases, petitioners retained the right to remove the cupolas at the end of the leases. Finally, the Division of Taxation's position is that the walk-in freezers were neither permanent installations nor capital improvements, because they could be dismantled and removed in the same manner that they had been installed without significant damage to the property. Petitioners argue that the second requirement of Tax Law § 1101(b)(9) sets forth alternative factors and the extent to which removal of the addition or alteration without material damage might be feasible is irrelevant. This attempt by petitioners to shift the burden of proof to the Division of Taxation, however, must fail. Tax Law § 1132(c) provides that "it shall be presumed that all receipts for property or services of any type mentioned in subdivisions (a), (b), (c) and (d) of section eleven hundred five...are subject to tax until the contrary is established, and the burden of proving that any receipt, amusement charge or rent is not taxable hereunder shall be upon the person required to collect tax or the customer." Further, the ability to remove the particular installation without damage is relevant for determining whether the installation was intended to become a permanent installation, the third requirement noted, supra (Charles R. Wood Enterprises v. State Tax Commission, 67 AD2d 1042).

C. Petitioners point to the Court of Appeals decision in Metromedia, Inc. v. Tax Commission of New York (60 NY2d 85, modfg 91 AD2d 107, revg 106 Misc 2d 1001) in support of their argument that the Division of Taxation used an improper standard in rejecting installations as capital improvements. First, it should be noted that Metromedia, Inc. v. Tax Commission of New York (supra) analyzes the definition of real property for purposes of the

Real Property Tax Law. This is not particularly relevant herein because the section of the RPTL classifying structures as real property for real estate tax purposes does not determine the status of such structures under the Sales Tax Law (Roberson v. State Tax Commission, 65 AD2d 898). Nonetheless, a review of the Court of Appeal's decision shows that its determination concerning whether outdoor advertising signs constituted real property for purposes of New York City real property tax assessments involved a detailed factual analysis including: how the frames for the signs were attached, how much time it would take to remove the signs, who was responsible for their construction and maintenance, who had an insurable interest, and what happened to the frames after the tax period at issue. This decision lends credence to the proposition that any determination concerning whether a particular addition or alteration to real property is a capital improvement involves a detailed factual analysis. Such factual analysis cannot be made with regard to the installations at issue herein because of an inadequate evidentiary record on submission, and petitioners must bear the consequences of this inadequate record.

D. Petitioners' rooftop cupola has been a familiar sight on American highways for decades. Probably one of the most easily recognized commercial symbols, its rooftop perch would seem to make it a capital improvement. On the other hand, it might very well be categorized as a removable tenant's trade fixture (Tifft v. Horton, 53 NY 377 [cited in People ex rel. 100 Park Avenue, Inc. v. Boyland, 144 NYS 2d 88, 93]). Unfortunately, the record on submission is inadequate to resolve this issue. In Matter of McDonald's-Alps Management Inc. (State Tax Commission, June 9, 1987) the former Commission determined that the drive-thru window at a McDonald's restaurant was a capital improvement based on its conclusion that it added to the value of the real property, any attempt to remove it would reduce it to scrap, and the petitioner in that matter "did not gain, hold or reserve any right to remove the improvement constructed at any time after its improvement." Based on the record herein, it cannot be similarly concluded. In fact, two of the leases which are part of the record give petitioners the specific right to remove the cupola upon lease termination. Moreover, petitioners have failed to rebut the presumption in law that tenant-installed fixtures and improvements are not made with an intention to enhance the permanent or lasting value of the property (People ex rel. 100 Park Avenue, Inc. v. Boyland, 144 NYS 2d 88, mod on other grounds, 284 App Div 1033, revd on other grounds, 309 NY 685; Tifft v. Horton 53 NY 377 [cited in Matter of McDonald's-Alp Management, Inc., supra]).

E. Similarly, it cannot be concluded that the installation of the walk-in freezers constituted capital improvements because petitioners have failed to make a showing that the installation of the freezers was intended to be permanent. The record is devoid of any factual detail concerning the freezers, even a description of their size and method of installation is lacking. The conflicting positions concerning whether the freezers could be removed without damage, as noted in Finding of Fact "24", supra, cannot be resolved. Petitioners point to the determination of a Division of Tax Appeals administrative law judge in Matter of Dairy Barns, Inc. (Division of Tax Appeals, December 8, 1988) in support of their position. However, under Tax Law § 2010(5), determinations of administrative law judges are not considered precedent, nor are they given any force or effect in other proceedings in the Division of Tax Appeals.

F. Petitioners have also failed to provide evidence that the installation of the parking lot poles and lights were intended to be permanent. Further, the conflicting position concerning whether the parking lot poles and lights could be removed without damage, as noted in Finding of Fact "24", supra, cannot be resolved based on the record on submission. As a result, petitioners have also failed to shoulder their burden of proving that they were capital improvements. The type of factual analysis as conducted in Matter of Doubleday Sports, Inc. (State Tax Commission, February 20, 1987) concerning the lighting system for Shea Stadium cannot be made concerning petitioners' parking lot poles and lights.

G. The analysis of whether petitioners should be allowed their claimed manufacturing exemption in full must begin with the well-settled principle of law that statutes creating a tax exemption must be strictly and narrowly construed (Matter of Mobil Oil Corp. v. Finance Administrator, 58 NY2d 95, 98; Matter of Grace v. New York State Tax Commission, 37 NY2d 193, 195 [cited in Dental Society of New York v. New York State Tax Commission, 110 AD2d 988, affd, 66 NY2d 939]).

H. Under Tax Law § 1115(c), utilities for use or consumption directly and exclusively in the production of tangible personal property for sale by manufacturing are exempt from the imposition of sales and use tax. Tax Law § 1105-B(a) provides, in pertinent part, that sales tax imposed on the retail sale of "parts with a useful life of one year or less, tools and supplies for use or consumption directly and predominantly in the production of tangible personal property...for sale by manufacturing...shall be paid at the rate of two percent for the period commencing September 1, 1980 and ending February 28, 1981 and such retail sales shall be exempt from such tax on and after March 1, 1981." Tax Law § 1115(a)(12) provides, in pertinent part, that receipts from the sale of "[m]achinery or equipment for use or consumption directly and predominantly in the production of tangible personal property...for sale, by manufacturing" are exempt from sales and use tax. Predominantly, as used in Tax Law § 1115(a)(12), means that the machinery or equipment is used more than 50% in the production of tangible personal property for sale (see 20 NYCRR 528.13[c][4]).

I. Although the series of cases involving a taxpayer who manufactures tangible personal property for its own use in a business performing capital improvement construction projects or maintaining capital improvements (and therefore did not produce such property "for sale" but for self-use) are not determinative of this matter, they provide a good example of the distinction between "for sale" and "self-use". For example, machinery used by a taxpayer to produce asphalt was not exempt as production machinery where 90 percent of the asphalt was used by it to maintain capital improvements and only 10 percent was held for sale to customers (Matter of Midland Asphalt Corporation v. Chu, 136 AD2d 851). Shop machinery and equipment utilized to fabricate steel which the taxpayer used in its steel erection business were not exempt (Matter of Southern Tier Iron Works v. Tully, 66 AD2d 921). Machinery and equipment to produce sheet metal products, which were then installed in capital improvement construction projects, were not exempt (Matter of Lawrence Hunter, State Tax Commission, May 27, 1983). Where only 30 to 40 percent of its manufactured goods were produced for sale as opposed to consumed or used in capital improvement work, the taxpayer's machinery and equipment were not exempt (Matter of Reactor Controls, Inc., Northeast Services Division, State Tax Commission, February 18, 1986). Equipment for production of gravel which the taxpayer used in its road construction business was not exempt (Matter of Tupper Lake Drive-In Custard Stand, State Tax Commission, July 18, 1980).

J. The recent case of Matter of D.J.H. Construction, Inc. v. Chu (145 AD2d 716) requires that the analysis of whether the petitioner was entitled to claim the manufacturing exemption focus on the purpose of the acquisition of the machinery, equipment, supplies, etc. at the time of sale. "Later events, while perhaps relevant to ascertain the buyer's intent at the time of sale, should not be determinative of whether the exemption applies" (Matter of D.J.H. Construction Inc. v. Chu, supra). At the time it purchased the various items for which it claims a manufacturing exemption, Howard Johnson Co.'s purpose was to use them to manufacture food products for sale to its licensees and for use in its own restaurant operations (24% to be sold to its licensees, 76% to be used in its own restaurant operations). It should be noted that the record has no evidence concerning petitioners' procedures to account for the transfer of the food products from the Queens plant to the company-owned restaurants. There is no evidence that such food products were "sold" by the Queens plant to the company-owned restaurants as that term is defined at Tax Law § 1101(b)(5), in pertinent part, as "[a]ny transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume...for a consideration...." The fact that, at some subsequent time, the food products used in its own restaurant operations would be sold to patrons at its restaurants is not relevant for resolving whether sales and use tax was owed on its purchases of the items for use at the plant. Rather, since at the time it purchased such items, Howard Johnson Co.'s purpose was to produce "for sale" only 24% of its production, it was not entitled to the manufacturing exemption under Tax Law § 1115(a)(12) because the equipment was not used more than 50% in the production of food products for sale. Furthermore, at the point in time where the food products were sold by petitioners to their customers at their restaurants, they were being sold as "restaurant food", a category distinct from tangible personal property (Matter of Burger King, Inc. v. State Tax Commission, 51 NY2d 614). Similarly, the Division of Taxation correctly allowed only 24% of petitioners' claimed manufacturing exemption under Tax Law §§ 1115(c) and 1105-B because only 24% of the food products manufactured were produced "for sale".

K. The petitions of Howard Johnson Co. and Marriott Family Restaurants, Inc., as successor in interest to Howard Johnson Co., are denied, and the notices of determination and demands for payment of sales and use taxes due issued November 21, 1983 and February 13, 1986, except to the extent indicated in Findings of Fact "12" and "23", are sustained.

DATED: Troy, New York
September 21, 1989

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE