

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
T.V. DATA, INC. : DETERMINATION
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, 1981 :
through May 31, 1984. :

Petitioner, T.V. Data, Inc., Northway Plaza, Glens Falls, New York 12801, 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, 1981 through May 31, 1984 (File No. 803016).

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, W. A. Harriman Office Campus, Albany, New York, on December 8, 1987 at 1:15 P.M., with all briefs to be filed by March 8, 1988. Petitioner appeared by Baker and Hostetler (Christopher J. Swift, Esq., of counsel). The Audit Division appeared by William F. Collins, Esq. (Arnold Glass, Esq., of counsel).

ISSUES

- I. Whether petitioner's sales constituted sales of tangible personal property or of information services.
- II. Whether purchases made by petitioner were exempt from the imposition of sales and use tax because they were used or consumed directly and predominantly in the production for sale of tangible personal property.
- III. Whether petitioner has established that its failure to pay sales and use taxes due was due to reasonable cause and not due to willful neglect.

FINDINGS OF FACT

1. Petitioner, T.V. Data, Inc., is in the business of providing television program listings to newspapers.
2. On November 22, 1985, the Division of Taxation (the "Division") issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1981 through May 31, 1984, assessing tax of \$93,689.95 plus penalty and interest.
3. The assessment resulted from an audit of petitioner's books and records. The Division informed petitioner that its books were adequate and sufficient to warrant a complete audit of all its records. In lieu of such an audit, petitioner elected to allow the Division to conduct a representative test period audit. Its consent to this audit method was executed on August 23,

1985.

4. Petitioner executed three consent forms which, taken together, extended the period of limitation for assessment of sales and use taxes for the period December 1, 1981 through August 31, 1982 to December 20, 1985.

5. The auditor analyzed petitioner's records in three areas.

(a) Sales. The auditor examined all sales for the period January 1, 1984 through June 30, 1984. This resulted in a determination that petitioner had failed to charge or collect tax from two vendors for whom no tax exemption certificates were on file. Petitioner's accounts receivable system disclosed that sales to these vendors were the same in each quarter; consequently, the results of the test period audit were used to determine additional taxable sales for the audit period of \$34,237.00 with a tax due on that amount of \$2,725.60. By written stipulation, the Division and petitioner agreed that the tax should be reduced to \$1,711.85, and petitioner conceded that this amount was due.

(b) Purchases. Purchase invoices for the year 1983 were analyzed to determine whether petitioner had paid tax on all of its taxable purchases. This resulted in a tax assessment of \$13,768.70 for the audit period. Petitioner conceded this portion of the assessment.

Petitioner disputed the Division's assessment of an additional tax of \$4,838.48 on the ground that those purchases were exempt from sales and use taxes. The disputed purchases consisted of repair and maintenance contracts on petitioner's computer equipment.

(c) Capital assets. Petitioner's records disclosed that petitioner had acquired capital assets during the audit period totalling \$1,033,673.89 on which no tax had been paid. At the time of audit, petitioner conceded that assets amounting to \$167,347.38 were taxable at the time of purchase and agreed to tax due on these assets of \$11,714.31. Petitioner contended that the remaining purchases of \$866,326.51 were not subject to sales tax on the ground that those assets consisted of machinery and equipment used directly and predominantly in the production of tangible personal property for sale. By a stipulation, the parties agreed that disputed purchases for the period ended February 28, 1982 should be reduced by a total of \$345,480.00, reducing the total amount of asserted tax due on capital assets to \$48,173.57 plus penalty and interest.

6. The following schedule summarizes the status of taxes assessed after stipulation by the parties:

<u>Category</u>	<u>Tax Assessed</u>	<u>Revised Assessment</u>	
Sales		\$ 2,725.60	\$ 1,711.85
Purchases		18,607.18	18,607.18
Capital assets		72,357.17	48,173.57
Totals		\$93,689.95	\$68,492.60

7. Newspaper readers are familiar with the television program listings found in most newspapers. Typically, these consist of a log or grid divided by time slots listing programs and the television channels on which these programs are broadcast. Petitioner provided these listings to newspapers in three different forms: camera-ready copy (also known as photo compositions); wire delivery (electronic impulses transmitted over telephone wires); and newspaper inserts.

8. In order to produce the listings, petitioner first gathered information from television broadcasters regarding the programs they offered in various time spots. This information was entered into petitioner's computers where it was stored in a program information file. Approximately nine percent of petitioner's operating expenses were attributable to the information gathering function.

9. Slightly less than 80 percent of petitioner's customers elected to receive the television listings in the form of camera-ready copy. This was a photo composition which the newspapers pasted on a board, either alone or with other copy. A photograph was taken of the paste-up to produce a mechanical which was used in the printing process. The production of the final camera-ready copy required a detailed process.

(a) Newspapers were able to select a program listing format which conformed to their own style and needs. Petitioner's employees met with a newspaper's representatives to determine that newspaper's specific formatting requirements. The customer was given a wide variety of logos (or type styles), type sizes, layout styles, and other information to choose from.

(b) Information regarding each customer's format specifications was stored in a separate computer file. The computer manipulated the data stored in each of the files (the program information file and the customer specifications file) to generate the television listings. This included merging of the files, editing of the listings, and justification of margins. A computer relayed commands to the typesetting (or photocomposition) equipment.

(c) The typesetters produced television program listings on photographic paper which could be pasted up by the newspaper.

10. Approximately 20 percent of petitioner's customers received the television listings through wire delivery. An electronic device called an Atlas or "BSD" was placed at the customer's location. Through telephone wires, petitioner transmitted information from its files to the Atlas or BSD which stored it until it was transferred to the newspaper's computers. The information transmitted included the newspaper's format specifications as well as television program information, i.e., the two files were merged before being transmitted.

11. Less than five percent of petitioner's customers elected to receive newspaper supplements. These consisted of small booklets containing articles, advertisements and television program listings. Petitioner produced the camera-ready copy for these inserts. They were printed by a subcontractor.

12. Petitioner consistently filed sales tax returns throughout the audit period, showing no tax due on its own purchases. The Division assessed tax on all capital assets acquired during the audit period, including equipment associated with gathering and storing information, manipulating information and conveying information to the customer, whether in the form of camera-ready copy, electronic impulses or paper inserts. Petitioner provided a listing of each item which it believed to be exempt from tax and a brief summary of that item's function. It appears, with omission of references to audit periods and workpapers, as Appendix A.¹ A description of the items petitioner claimed to be exempt from sales and use tax follows.

¹Included on this schedule were assets which petitioner agreed to as taxable at the time of audit, as shown in the auditor's workpapers.

(a) System C computer. Petitioner used five computer systems. Each system performed a specific function and also served as a backup to at least one other system. All five systems contained the same database or computer files, and each was connected to the other. Although all five systems were capable of performing all necessary functions, each one had a primary purpose. The bulk of the editing function, i.e., inputting new information, updating the information, merging files and justifying lines, was done in the System C computer. It was not directly connected to the typesetting equipment, and it did not operate that equipment.

(b) Typesetting machines and photocomposition equipment. This was the equipment which actually produced the camera-ready copy. It included: a disc drive containing the fonts or typefaces which were exposed by a cathode ray tube to produce print on photographic paper; the cathode ray tube; cassettes to hold rolls of photographic paper; and a water-saving device connected to the Logetronic ("Log-e"), the machine that developed the photographic paper.

(c) The Atlas and BSD units described in Finding of Fact "10".

(d) Video terminals and keyboards.

(e) Silver recovery unit. This device retrieved silver from the photocomposition fluids. The silver was sold to a film supplier who resold it.

(f) Raised floor tiling. A raised floor was installed in the computer room to allow electrical cables, pipefittings and air conditioning equipment to be installed under the floor.

(g) Miscellaneous. Other equipment included an electrical converter which prevented surges in electricity from damaging the electronic equipment, a bandprinter which printed the television listing information in draft form on regular paper, and electronic cables and devices linking the equipment.

CONCLUSIONS OF LAW

A. Tax Law § 1115(a)(12) provides an exemption from sales and use taxes for machinery or equipment with a useful life of more than one year used or consumed directly and predominantly in the production of tangible personal property. It is the Division's position that the equipment upon which petitioner has claimed this exemption (as summarized in Finding of Fact "12") is used predominantly in the furnishing of information services and thus does not qualify for the exemption. To determine whether any particular piece of equipment qualifies for the exemption, it must first be decided whether the products sold were information services or tangible personal property.

B. It is clear that at least a portion of petitioner's operation consisted of providing information to its customers. Tax Law § 1105(c)(1) describes the "furnishing of information" as "collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof". The fact that petitioner's customers were capable of collecting the program listing information themselves does not negate the fact that petitioner was engaged to collect, compile and edit the information for them. Petitioner's comparison of its own operations to those of the plaintiff in *Finserv Computer Corp. v. Tully* (94 AD2d 197), who converted information provided by its customers to microfilm or microfiche, is not persuasive.

Unless information is conveyed orally, it must be conveyed by means of some tangible or

electronic medium. Generally, where a transaction involves both the delivery of tangible personal property and the rendering of information services, it will be deemed to be taxable as an information service without regard to the relative value of the property delivered and the services rendered (Matter of Long Island Racing Publications v. City of New York, 31 Misc2d 286, affd 16 AD2d 637). However, it has been recognized that the conveyance of information may be merely incidental to the transfer of tangible personal property (Matter of Alan Drey Co. v. State Tax Commn., 67 AD2d 1055, lv denied 47 NY2d 708). In Drey Co., the transfer of mailing lists fell into two categories: lists transmitted via magnetic computer tape and lists transmitted on gummed labels. Purchasers of the tapes were required to process them in order to generate labels or inserts needed for mailing. Purchasers of the gummed labels simply attached the labels to the mailings. "The transactions involving the gummed labels clearly constituted taxable sales of tangible personal property since the gummed labels themselves, rather than just the data contained thereon, were directly used in the mailings." (Matter of Mertz v. State Tax Commn., 89 AD2d 396, 397.)

The decision in Drey Co. compels a conclusion that the sale of television program listings on camera-ready copy constituted the sale of tangible personal property. The purchasers of the copy pasted it up directly on boards used to produce mechanicals. The same conclusion is reached regarding the newspaper supplements. The conveyance of program listings by wire delivery dictates a different result. There, information was transmitted to the purchaser's computer where it was used to generate camera-ready copy for paste up. The information transmitted could be edited or re-formatted by the purchaser before the copy was generated, and nothing tangible was ever transmitted to the customer. Therefore, the service of providing television program listings by wire delivery was the sale of an information service.

C. As a general rule, statutory exemptions from tax are strictly construed against the party claiming the exemption. The burden is upon petitioner to clearly establish its right to the exemption provided by Tax Law § 1115(a)(12) for each piece of machinery and equipment on which the exemption was claimed (Matter of Grace v. State Tax Commn., 37 NY2d 193, 196).

D. Machinery and equipment used to provide information services are not exempt from the sales tax imposed by Tax Law § 1105(c) or use tax imposed by Tax Law § 1110. Because the record establishes that the Atlas and BSD units were used exclusively in the transmission of telephone program listings by wire delivery, the tax assessed on those items is sustained.

E. In order to be used "directly" in production, machinery, equipment or property must:

- "(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" (20 NYCRR 528.13[c][1]).

Use of machinery, equipment or property in activities collateral to the production of tangible

personal property is not deemed to be used "directly" in production (20 NYCRR 528.13[c][2]).

F. In accordance with 20 NYCRR 528.13(c)(1), all that machinery and equipment which acted upon or effected a change in the camera-ready copy or material used to produce the copy was exempt from sales tax. That includes: the cassettes which held the photographic paper; the disc drive which contained the fonts or typefaces; the Log-e saver which circulated water through the photo processor (or Log-e); and the cathode ray tube. Petitioner's purchase of a silver recovery unit which produced silver for resale was also exempt from the imposition of sales and use tax.

G. In order to qualify for the exemption from sales and use taxes, the System C computer must have been used directly and predominantly in the production of tangible personal property. Generally, it is the Division's position that computers used predominantly for typesetting qualify for the exemption (Tech. Serv. Bur. Mem., TSB-M-79(7.1)S, May 15, 1980). The Corporation Franchise Tax Law provides for an investment tax credit with respect to tangible personal property which, inter alia, is "principally used by the taxpayer in the production of goods by manufacturing, processing, assembling..." and by means of other production activities (Tax Law § 210.12[b]). The statute is similar to the sales and use tax exemption provided for at Tax Law § 1115(a)(12) in both construction and application. Accordingly, case law interpreting the language of the investment tax credit may provide guidance in the context of the sales and use tax exemption.

In Matter of Multimode, Inc. (State Tax Commission, May 20, 1983), the taxpayer's computer was used to make a list of names and addresses in the form of magnetic tape. The names and addresses on the magnetic tape were printed in various formats, including mailing labels, by using a computer which was directly connected to a printer. The Commission found that the computer qualified for the credit since its use by the taxpayer in its printing activities constituted processing. In Matter of Reader's Digest Assoc. v. State Tax Commn. (103 AD2d 926), the court upheld the Commission's determination that printing activities performed by the taxpayer's computer constituted processing of tangible personal property. The subject computer was used to maintain customer lists, to match customers to specific promotional materials, to rank customer names in the order of likelihood of response to the promotional offer, and to print the customer's name and address on the literature. The Commission found that the computer printed names on the promotional literature, thus changing the literature and performing a processing function.

These cases are consistent with the Technical Services Memorandum cited above in that the computers were directly connected to and operated printing equipment. Unlike those computers, petitioner's System C computer was not directly connected to and did not operate the typesetting equipment. Its primary functions were: the inputting of information which became part of the database shared by the five computers; the editing and updating of the database; the merging of information in the program and customer files; and the justification of margins in the required format. All of the activities engaged in by the System C computer involved the manipulation of information, which is itself intangible (see, Matter of National Planning Data Corp., State Tax Commission, June 28, 1985). The System C computer did not act upon or effect a change in tangible materials which became the final tangible product. Since it did not direct the operations of the typesetters, it cannot be said to have had an active causal relationship in the production of the copy. Therefore, petitioner's purchase of the System C computer was subject to sales and use tax.

H. The functions of the keyboard and video terminals were described in only a cursory

fashion. Vagueness and the failure to affirmatively provide evidence in support of the exemption must be construed against petitioner. Consequently, the purchase of the video terminals and keyboard is held subject to sales and use tax. Likewise, in failing to provide a more precise description of the equipment connecting computers to typesetters and the cable assembly, petitioner failed to carry its burden of proof to show that purchases of this equipment qualified for the exemption.

I. Petitioner's purchases of an electrical converter and bandprinter were subject to sales and use tax. Neither piece of equipment acted upon or effected a change in the camera-ready copy or material used to produce the camera-ready copy, and neither had a causal relationship in the production process.

J. "Machinery or equipment is used predominantly in production, if over 50 percent of its use is directly in the production phase of a process" (20 NYCRR 528.13[c][4]). Even if it were concluded that the raised floor tiling was an integral part of petitioner's computer system, its purchase still would not qualify for the exemption from sales and use tax, because petitioner did not establish that the computer system as a whole was used directly and predominantly in the production of tangible personal property.

K. Effective March 1, 1981, the sale of installation, repair and maintenance services rendered with respect to production machinery and equipment (including parts, tools and supplies) used directly and predominantly in production was exempt from State, but not local, sales and use tax (Tax Law § 1105-B[b],[c]). As stated above, petitioner did not establish that its computer system was used directly and predominantly in production. Therefore, its purchase of repair and maintenance contracts on its computer system is subject to sales and use tax imposed by Tax Law § 1105(c)(3). Petitioner's purchase of installation services for the Log-e do qualify for the exemption provided by Tax Law § 1105-B(b).

L. The penalty imposed for failure to timely file and pay sales taxes due may be remitted if the taxpayer establishes that the failure was due to reasonable cause and not to willful neglect (Tax Law § 1145[a][1][ii]; 20 NYCRR 536.1[c]). Petitioner consistently filed returns showing no tax due on its own purchases of materials and equipment. Yet an audit revealed that petitioner owed sales taxes in the amount of \$18,607.17 on recurring expense purchases alone. Petitioner conceded its liability for taxes on recurring purchases in the amount of \$13,768.70. It presented no evidence to establish that it made an attempt to ascertain its tax liability on its purchases of recurring expenses or capital assets. Therefore, it has failed to show that its noncompliance with the Tax Law was due to reasonable cause.

M. By stipulation, the Division agreed that the tax assessment at issue should be reduced to \$68,492.60 plus penalty and interest. The Division is directed to recalculate the tax due by subtracting from taxable purchases those items exempt from sales and use tax as summarized in Conclusions of Law "F" and "K".

N. The petition of T.V. Data, Inc. is granted to the extent indicated in Conclusions of Law "F", "K" and "M"; the Notice of Determination and Demand for Payment of Sales and Use Taxes Due shall be modified accordingly; and, in all other respects, the petition is denied.

DATED: Albany, New York
July 8, 1988

_____/s/_____

ADMINISTRATIVE LAW JUDGE

APPENDIX A

<u>Invoice No.</u>	<u>Petitioner's Description</u>	<u>Amount Disputed</u>
2103	System C computer.	\$331,488.06
1807	Equipment that connects computer system to typesetting machines.	24,495.02
3486	Standard industrial disc drive attached to and used solely by typesetter - stores commands from computer to language understandable to typesetter. ²	7,402.50
3620	Cassette - holds the unexposed paper supply that has the light-sensitive emulsion. Must be light-tight, and connects directly to the typesetter.	1,750.00
9859	Bi-synchronous devices (BSD) - receives information via telephone lines, and insures accuracy and integrity of that information, allowing our computers to instruct machinery on location to create paste-up.	16,240.00
9862	BSD.	2,320.00
9847	BSD.	9,280.08
9840	BSD.	6,186.72
_____	Atlas units - Brand name BSD's, serve same function.	19,333.00
82101	Special raised floor tiling installed in the computer room. Needed for pipefitting, other interconnections and special ventilation.	24,225.00
9888	Atlas units.	7,650.00
9869	BSD.	16,240.00
I-06073	Same as supply cassette described above.	2,850.00
9928	BSD.	3,600.00
9922	BSD.	5,100.00
9932	BSD.	3,600.00

²This description does not conform to the testimony of petitioner's operations manager. The latter provided the basis for Finding of Fact "12(b)".

<u>Invoice No.</u>	<u>Petitioner's Description</u>	<u>Amount</u> <u>Disputed</u>
I-07337	Cable assembly used directly in and for typesetter.	5,165.35
10317	The Log-e actually processes (like film) the photocopy paper, the "darkroom" aspect of the printing. This was the labor to install the necessary piping to run the Log-e.	\$1,735.95
10364		129.55
65791	Log-e Saver - a water saving device that recirculates water in order to let the Log-e run more efficiently - connected directly to typesetting.	895.00
I-07843	Cathode Ray Tube - the instrument that actually makes the reproduction on the paste-up.	6,250.00
I-08043	Silver recovery unit - employed to retrieve silver from used photocomposition fluids. This silver, a tangible product, is then sold to film supplier who resells it.	4,125.00
I-09565	Video terminal and keyboard. Can be hooked up to any of the systems and are shuffled around frequently for repairs, etc.	6,000.00
I-09029	4 Video terminals - same.	44,919.00
5042	BSD.	700.00
_____	BSD.	19,951.66
38086-01	An electrical converter that intercepts the electricity to the computers and typesetters - prevents any surges in electricity that might damage the machinery.	14,360.00
10074	Atlas unit.	950.00
045	Atlas units.	6,417.72
047	Atlas unit.	
1,604.43		
037	Atlas unit.	
8,022.15		
039	Atlas units.	12,835.44
030	Atlas units.	11,231.01
002	BSD.	660.00

12123

Bandprinter. This prints draft copies of the information contained in the paste-ups. Serves an editorial function in allowing a proofing of end-product to be sure what in fact the computer will put out without expense of running the typesetter.

29,138.13