

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
DECO BUILDERS, INC. :
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 March 1, 1985 :
through November 30, 1985. :
: DETERMINATION

In the Matter of the Petition :
of :
NEWTON FALLS PAPER MILL, INC. :
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, 1983 :
through August 31, 1986. :

Petitioner Deco Builders, Inc., P.O. Box 267, 7 Starbuck Street, Gouverneur, New York 13642, 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 March 1, 1985 through November 30, 1985 (File No. 806415).

Petitioner Newton Falls Paper Mill, Inc., P.O. Box 253, Newton Falls, New York 13666, 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, 1983 through August 31, 1986 (File No. 806418).

A consolidated hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 207 Genesee Street, Utica, New York, on September 20, 1989 at 1:15 P.M., with all briefs to be submitted by January 4, 1990. Petitioners appeared by Nixon, Hargrave, Devans & Doyle (John R. McQueen, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Mark F. Volk, Esq.,

of counsel).

ISSUES

I. Whether petitioner Deco Builders, Inc.'s purchase of certain custom-made wooden staves later assembled on site into a penstock was exempt from sales tax as the purchase of machinery and equipment used directly and predominantly in the production of tangible personal property for sale pursuant to Tax Law § 1115(a)(12).

II. Whether petitioner Newton Falls Paper Mill, Inc.'s purchase of the service of constructing and installing certain stone and gravel dikes was exempt from sales tax as a capital improvement.

III. Whether petitioner Newton Falls Paper Mill, Inc.'s purchases made in connection with the repair, maintenance and ongoing operation of a water pollution abatement facility were exempt from sales tax as purchases made by a state agency pursuant to Tax Law § 1116(a)(1), where the development of such facility was financed through the St. Lawrence County Industrial Development Agency and where title to the facility was held by said agency.

FINDINGS OF FACT

Matter of Deco Builders, Inc.

On September 3, 1987, following an audit, the Division of Taxation issued to petitioner Deco Builders, Inc. ("Deco") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due which assessed \$30,472.67 in tax due, plus interest, for the period March 1, 1985 through November 30, 1985.

Deco is a construction contractor. The assessment herein results from the Division's imposition of tax on purchases of materials by Deco pursuant to a contract between it and Newton Falls Paper Mill, Inc. for the assembly and installation of a penstock. The materials in question were curved boards or staves assembled into a penstock on site by Deco. It is undisputed that the installation of the penstock constituted a capital improvement.

Newton Falls Paper Mill, Inc. ("Newton Falls") manufactures paper. As part of its operations, Newton Falls operates a hydroelectric facility for generating electricity that is used

in the production of paper. The penstock is a wooden tube approximately 9 feet in diameter and 1,225 feet in length that transports water from Newton Falls' dam on the Oswegatchie River and directs a stream of water against the moveable blades of a turbine unit that is also part of Newton Falls' hydroelectric facility. The force of the water directed against the blades of the turbine creates mechanical energy which is then converted into electrical energy by the generator.

The penstock was assembled from curved boards or staves that were four inches thick and six inches wide and that were joined together with tongue and groove joints to form a cylinder. The creosote-treated boards were purchased in curved sections in lengths ranging from 6 to 20 feet and had the tongue and groove edges already on them. These curved boards were custom-made for Deco by a firm in Canada. Deco's task was to assemble and install the penstock.

The penstock is made up of 66 staves around the circumference which were pre-cut and curved in such a way that they formed when joined together a nine-foot diameter pipe. A number of metal bands hold the staves together and a "thimble" serves as the connecting piece between the concrete dam structure and the penstock.

The penstock runs downhill a distance of approximately 1,225 feet from the dam to the powerhouse, which contains the turbine generator. The purpose of the penstock is to concentrate the flow of water and increase the "head" (i.e., the vertical drop in feet from the dam to the powerhouse) in order to create the maximum water pressure possible at the point where the water comes into contact with the blades of the turbine. The penstock is the man-made equivalent of a natural waterfall. Without the penstock, it would be virtually impossible to generate electricity since the water flow would not have sufficient force to turn the blades of the turbine.

According to a study done in 1975 in connection with a previous sales tax audit, 98% of the electricity consumed by Newton Falls is used in the process of producing paper.

Hydroelectric power accounts for approximately 15% of the total electricity consumed by

Newton Falls. The remainder is either purchased from Niagara Mohawk or produced by Newton Falls from steam.

Due to the size of the penstock, it is not possible to purchase it fully assembled off site.

In assembling the penstock, the endpoints of the staves must be staggered around the circumference of the penstock to maximize the mechanical strength of the structure. The staggering of the staves can be accomplished effectively only through on-site assembly.

Matter of Newton Falls Paper Mill, Inc.

On August 20, 1987, following an audit, the Division of Taxation issued to petitioner Newton Falls Paper Mill, Inc. a Notice of Determination and Demand for Payment of Sales and Use Taxes Due which assessed \$14,127.98 in tax due, plus interest, for the period September 1, 1983 through August 31, 1986.

By Conciliation Order dated November 4, 1988, the assessment against Newton Falls was reduced to \$10,579.86, plus interest. Of this amount, Newton Falls conceded \$1,775.39 in tax due. Remaining at issue, therefore, is \$8,804.47 in tax due, plus interest. This amount may be further broken down into two components: \$5,981.35 in tax due on capital asset purchases and \$2,823.12 in tax assessed on recurring purchases. The computation of the assessment is not in dispute. Both components of the assessment remaining in dispute arise from expenditures made by Newton Falls in connection with improvements, repairs, maintenance and operation of a water pollution abatement facility, the development of which was financed by the St. Lawrence County Industrial Development Agency (the "IDA").

As noted previously herein, Newton Falls manufactures paper. In 1974, it applied to the IDA for the purpose of financing the acquisition, construction and equipment of a water pollution control facility to be used for the purpose of water pollution abatement and control ("the project"). By resolution dated May 7, 1974, the IDA approved the application. The first and third whereas clauses of the IDA's resolution provided, respectively, as follows:

"WHEREAS, NEWTON FALLS PAPER MILL, INC. (the 'Company') has applied to the St. Lawrence County Industrial Development Agency (the 'Agency') to finance the acquisition, construction and equipment of a certain water pollution control system and related facilities, located on a site in the Town of Clifton,

St. Lawrence County, New York, and to be used for the purpose of abatement or control of water pollution at the Company's plant in furtherance of the purpose of compliance with Federal and State pollution control standards (the 'Project') and to sell the Project to the Company, such financing to be undertaken pursuant to Title 1 of Article 18-A of the General Municipal Law, Chapter 23 of the Consolidated Laws of the State of New York and Chapter 358 of the 1971 Laws of New York (the 'Act'); and

* * *

WHEREAS, the Agency desires to appoint the Company its agent for the purpose of acquiring, constructing and equipping the Project."

In its resolution, the IDA agreed (i) to issue bonds in an amount not exceeding \$2,000,000.00; (ii) to acquire, construct and equip the project; (iii) to sell the project to Newton Falls pursuant to a conditional sale agreement by and between the IDA and Newton Falls, whereby Newton Falls would be obligated, among other things, to make installment payments to the IDA in such amounts and at such times stated so that such payments would be adequate to pay the principal or redemption price and interest on all such bonds; and (iv) to secure the bonds by a mortgage on the project.

Section 3 of the IDA's resolution provided as follows:

"The Company is hereby appointed the true and lawful agent of the Agency to acquire, construct and equip the Project, to make, execute, acknowledge and deliver any contracts, orders, receipts, writings and instructions, as the stated agent for the Agency, and in general to do all things which may be requisite or proper for completing the Project with the same powers and the same validity as the Agency could do if acting in its own behalf. In addition, the Company is hereby authorized, on behalf of the Agency, to advance such funds as may be necessary to accomplish such purposes and, to the extent permitted by law, the Agency agrees to reimburse the Company therefor out of the proceeds of the Bonds."

In July 1974, in accord with the terms of its resolution, the IDA issued a \$1,800,000.00 industrial development revenue bond. Pursuant to a deed dated July 22, 1974 from Newton Falls to the IDA, Newton Falls conveyed to the IDA title and interest to the real property situated at the site of the facility. Newton Falls also transferred to the IDA all fixtures and equipment then owned or thereafter acquired in connection with the pollution control facility.

Pursuant to a Conditional Sale Agreement dated July 1, 1974, entered into between Newton Falls and the IDA, the IDA agreed, upon receipt of title to the project, to construct the project or cause it to be constructed in accordance with certain plans and specifications. In

furtherance of this agreement, Newton Falls and the IDA agreed as follows:

"[T]he Agency [IDA] and the Company [Newton Falls] agree that the Project has been or will be acquired, constructed, installed and equipped by the Company as agent for and on behalf of the Agency at the Plant, in accordance with the Company's specifications and directions."

The Conditional Sale Agreement also provided the following:

"The Agency hereby makes, constitutes and appoints the Company its true and lawful agent, and the Company hereby accepts such agency, (i) to construct and equip the Project in accordance with the Plans and Specifications, (ii) to make, execute, acknowledge and deliver any contracts, orders, receipts, writings and instructions, either in the name of the Company solely, or as the stated agent for the Agency with any other persons, and in general to do all things which may be requisite or proper, all for constructing the Project with the same powers and with the same validity as the Agency would do if acting in its own behalf, (iii) pursuant to the provisions of this Agreement, to pay all fees, costs and expenses incurred in the construction and acquisition of the Project, and (iv) to ask, demand, sue for, levy, recover and receive all such sums of money, debts, dues and other demands whatsoever which may be due, owing and payable to the Agency under the terms of any contract, order, receipt or writing in connection with construction and completion of the Project, and to enforce the provisions of any contract, agreement, obligation, bond or other performance security.

The Company agrees as agent for and on behalf of the Agency to proceed with Construction of the Project with all reasonable dispatch; and to use its reasonable efforts to complete such construction by October 1, 1975, or as soon thereafter as may be practicable...."

Under the Conditional Sale Agreement Newton Falls agreed that, at all times during the term of the agreement, it would, at its own expense, maintain, preserve and keep the project in good repair and working order. The agreement further provided:

"In addition the Company shall have the privilege of remodeling or relocating the Project or making substitutions, additions, modifications and improvements to the Project from time to time as it, in its discretion, may deem to be desirable for its uses and purposes...the costs of which remodeling or relocation, substitutions, additions, modifications and improvements shall be paid by the Company, and the same shall become the property of the Agency included under the terms of this Agreement as part of the Project, but excluding facilities not constituting a part of the Project or on land not belonging to the Agency, provided, however, that the nature of the Project shall not be changed so that it would not constitute a pollution control facility under the Act or cause the loss of the exemption from Federal income taxation contemplated by Section 7.6 hereof."

The seventh and ninth whereas clauses of the Conditional Sale Agreement provided, respectively, as follows:

"WHEREAS, it is desirable that the Company, rather than the Agency, arrange, on behalf of and as agent for the Agency, for the design, construction and

acquisition of the Project in furtherance of the abatement or control of water pollution and in furtherance of pollution control requirements of the appropriate Federal and State authorities, and the requirements of the Company for whose use the Project is intended as evidenced by the above mentioned resolution; and

* * *

WHEREAS, the Agency proposes to acquire the Project, to have the construction of the Project completed on its behalf by the Company and to sell the Project to the Company, and the Company desires to purchase the Project from the Agency upon the terms and conditions set forth herein."

Unfortunately, many of the terms of the Conditional Sale Agreement were not made part of the record. The record does establish, however, that the Conditional Sale Agreement was still in effect during the audit period and that the IDA held title to the project and the real property upon which it was situated during this same period. It is also clear that title to the property would return to Newton Falls upon retirement of the IDA bonds.

The assessed tax of \$5,981.35 on Newton Falls' capital asset purchases results from purchases totalling \$100,276.26 made during the audit period. \$71,433.00 of this amount was paid to Harmer Construction for the construction and installation of stone and gravel dikes (discussed below). Of the balance of the purchases classified as capital assets, \$25,949.43 was for the completion of a subsurface exploration program at Newton Falls' sludge disposal area. Newton Falls also purchased crushed stone for \$1,509.18 and galvanized culvert pipe for \$1,384.65. No evidence was presented in respect of the specific use and/or purpose of these latter three purchases, but it is clear that all three were made in connection with the repair, maintenance and continued operation of the water treatment facility.

The assessed tax of \$2,823.12 on Newton Falls' recurring purchases was premised upon the results of a test period analysis of its purchases and the application of an error rate to its total purchases made during the audit period. As noted previously, the computation of tax due is not in dispute. All of the disputed recurring expense purchases made during the test period were necessary for the repair, maintenance and continued operation of the water treatment facility.

With respect to the construction of the dikes referred to above, in the process of paper manufacturing, certain raw materials, such as fiber and clay, which are contained in a watery

sludge, fall out of the manufacturing process. This material is recycled and reused as much as possible. A certain portion, however, cannot be reused and must be disposed of. This sludge is pumped from Newton Falls' manufacturing plant into a settling pond. The property (title to which is held by the IDA) has two settling ponds. The ponds are used alternately, with one having sludge pumped into it while in the other the sludge is left to settle. At the end of the settling period (one to two years), the water is drained from the pond and passed through the water treatment facility. A contractor is then hired to remove the sludge which has settled at the bottom of the pond and to haul the sludge to a designated area and dump it. The land surrounding the water treatment facility and settling ponds is very hilly and the land where the sludge is dumped is located above the settling ponds. The hilly terrain necessitated the construction of the stone and gravel dikes, for the dikes prevent the sludge from running down into the settling pond. Once dumped into the designated area, water contained in the sludge eventually evaporates, the raw materials eventually decompose and the sludge thus fills in a part of the hillside. Over time these sludge deposits cover the dike and the dike becomes a part of the hillside. It is clear that the hilly terrain would not be useful as a sludge dumping site without the dikes.

CONCLUSIONS OF LAW

Matter of Deco Builders, Inc.

A. Generally, purchases of tangible personal property by a contractor which are incorporated into and become part of realty (i.e. capital improvement contracts) are retail purchases subject to tax at the time of the contractor's purchase (Tax Law § 1101[b][4][i]). Purchases of qualifying production machinery and equipment exempt from tax under Tax Law § 1115(a)(12), however, are exempt from tax when purchased by a contractor (20 NYCRR 541.5[b][1]). Accordingly, petitioner Deco Builders, Inc.'s purchase of the curved boards or staves herein was properly exempt from tax if it can show that such purchase was exempt under Tax Law § 1115(a)(12).

B. Tax Law § 1115(a)(12) provides for an exemption from sales and use taxes for

receipts from the sale of the following:

"Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property...for sale, by manufacturing, processing, [or] generating...."

C. The Division contended that the disputed materials purchases did not constitute "machinery and equipment" within the meaning of Tax Law § 1115(a)(12) and therefore did not qualify for exemption thereunder.

The Division's contention is rejected. As used in Tax Law § 1115(a)(12), "machinery and equipment" refers to the following:

"[O]nly such personalty as has an identifiable character as equipment at the time of purchase at retail...which is adapted by its design to perform either in conjunction with machinery or otherwise, some particular function in a stage of the generating process" (Matter of Slattery Associates, Inc. v. Tully, 79 AD2d 761, 434 NYS2d 788, 790, affd 54 NY2d 711, 442 NYS2d 978 quoting Matter of Slattery Contr. Co., State Tax Commission, March 9, 1970).

At the time of purchase by Deco, the staves or curved boards clearly had an "identifiable character" as machinery or equipment, for the staves were unique and could be used solely for the purpose for which they were created, i.e. assembly into a penstock of specified dimensions.¹ Obviously, given the size of the penstock, off-site assembly was not feasible (cf. 20 NYCRR 541.6[d][1]). Moreover, the staves, once assembled into the penstock, were obviously designed to work in conjunction with other machinery in the production of hydroelectric power at the Newton Falls facility. The Division's contention that the staves did not constitute machinery and equipment is thus without merit.

D. Having concluded that the purchases in question constituted machinery or equipment within the meaning of Tax Law § 1115(a)(12), the next issue to be addressed is whether the penstock was used directly and predominantly in the production of tangible personal property (paper) for sale.

¹The staves at issue herein are clearly distinguishable from the concrete, reinforced steel, sand, joint filler and sealer, timber and piping at issue in Matter of Slattery Associates v. Tully (supra). In contrast to the material at issue herein, the raw materials at issue in Slattery were not unique and could have been used for any number of purposes.

E. 20 NYCRR 528.13(c) sets forth, in relevant part, the following definition of "directly and predominantly" for purposes of Tax Law § 1115(a)(12):

"(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 use directly in production."

F. Deco has failed to establish entitlement to the production exemption with respect to its purchase of staves later assembled into the penstock. The penstock did not produce paper for Newton Falls. Rather, together with the turbine, the penstock was involved in the production of hydroelectric energy which served to provide about 15% of the power necessary to operate the actual production equipment. The penstock was thus not used directly in production. The definition of "directly", as set forth in the regulations noted above, supports this conclusion. The penstock did not "act upon or effect a change in materials to form the product to be sold." The penstock provided a source of power for the turbine which, in turn, converted that power into a form usable by machinery which actually produced Newton Falls' paper product. The penstock also did not have an "active causal relationship in the production of the product to be sold." The machinery that actually produced Newton Falls' paper had such a relationship to production. The penstock, at best, had a secondary relationship to production. Additionally, the penstock was not "used in the handling, storage or conveyance of materials or the product to be sold." The term "materials" as used in the regulation clearly refers to materials which form the product to be sold. The penstock was not involved in the handling, storage or conveyance of such material. Finally, subparagraph (iv) of 20 NYCRR 528.13(c)(1) does not apply to the

instant matter.

G. Deco contended that the penstock was properly exempt from taxation and argued that 20 NYCRR 528.13(c)(2), Example 3, and Matter of Climax Manufacturing Company (State Tax Commission, November 27, 1974) were analogous to and supportive of the instant situation. Both the above-noted Example 3 and former State Tax Commission determination have similar facts. (In fact, it would appear that the example in the regulations was taken from or based upon the Climax Manufacturing Company determination.) In both the example and the determination, a manufacturing plant has two boilers which generate steam carried by piping systems through two turbines. The determination specifies that the plant manufactures paper. In both the determination and the example, the steam passes through the turbines which generate power part of which is sold to a power company and part of which is used to power production machinery. In the example, after passing through the turbines, the steam is "used in other phases of the manufacturing process." In the determination, after the steam passes through the turbines, it was also used in the manufacturing process. Specifically, the steam was used in the drying section of the plant to remove moisture from the paper. It also heated chemicals used in the manufacturing process and also heated water which was used as an affluent to convey paper fibers through a machine (see, Matter of Climax Manufacturing Company, supra, Finding of Fact "13"). Both the example and the determination concluded that the boilers and piping system (along with a condenser) were entitled to the production exemption.

Deco's reliance upon the above-noted example and determination is misplaced, for the example and determination are factually distinguishable from the instant matter. This distinction lies in the direct use in the manufacturing process of the steam generated by the boilers. This use would seem to constitute a use directly in production within the meaning of 20 NYCRR 528.13(c)(1) (supra). In the instant matter, however, the water carried by the penstock to the turbines has no use other than the production of hydroelectric power. Unlike the steam in the example and determination discussed above, the water herein has no direct use in

production. Matter of Climax Manufacturing Company (*supra*) and Example 3 of 20 NYCRR 528.13(c)(2) are thus unresponsive of Deco's position herein.

Matter of Newton Falls Paper Mill, Inc.

H. The receipts for the service of adding to or improving real property, property or land by a capital improvement are not subject to sales tax (Tax Law § 1105[c][5]). Petitioner bears the burden of proving that particular services result in a capital improvement (Matter of Gem Stores, Inc., Tax Appeals Tribunal, October 14, 1988).

I. Tax Law § 1101(b)(9) defines "capital improvement" 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."

J. The stone and gravel dikes discussed herein, when installed, constituted capital improvements to property. The Division's assessment of tax on such expenditures was therefore improper. That the dikes became part of the real property and that the dikes were intended to permanently remain part of the real property is obvious (Finding of Fact "23"). Further, the dikes also substantially added to the value and prolonged the useful life of the real property. The area in question would not have been useful as a sludge dumping site without the dikes. Also, as the raw materials in the sludge decomposed over time, the filled-in area could be used for other purposes.

The record establishes that \$71,433.00 of the purchases in question went to the construction and installation of the dikes. The Division is directed to adjust the notice of determination accordingly.

K. With respect to the purchases remaining at issue, generally retail purchases of tangible personal property and retail purchases of repair and maintenance services are subject to sales tax pursuant to Tax Law § 1105(a) and (c). Tax Law § 1116(a)(1) provides for an exemption from

sales tax for purchases made by New York State agencies, instrumentalities, public corporations and political subdivisions. Industrial development authorities (IDA's) are public benefit corporations (General Municipal Law § 874[1]) and, as such, purchases made by IDA's are exempt from payment of sales tax pursuant to Tax Law § 1116(a)(1). Additionally, the Division of Taxation has recognized that where an agent has been appointed by an IDA to act on its behalf, purchases made by the agent acting within the authority granted by the IDA are deemed to be made by the IDA and are therefore exempt from tax (see, Tax Status of IDA Projects, TSB-M-87[7]S).

L. The issue of taxability of purchases made in connection with an IDA-financed project was the subject of Matter of Fagliarone, Grimaldi & Associates (Tax Appeals Tribunal, May 4, 1989). In that case, the Tribunal analyzed the decision of the Supreme Court, Monroe County in Wegmans Food Markets, Inc. v. Department of Taxation and Finance (126 Misc 2d 144, 481 NYS2d 298, affd 115 AD2d 962, lv denied 67 NY2d 606), and concluded as follows:

"From the Court's decision in Wegmans we perceive three conditions for the determination that purchases with respect to an IDA financed project are exempt from sales tax. First, that the property purchased is essential to the IDA's activities (Wegmans Food Markets, Inc. v. Department of Taxation and Finance, supra, at 150). Second, that the sales tax should not be imposed where the result would increase the cost of the project required to be financed by the IDA financing (Wegmans Food Markets, Inc. v. Department of Taxation and Finance, supra, at 152). Finally, that the property purchased became the property of the IDA." (Matter of Fagliarone, Grimaldi & Associates, supra.)

M. Applying these criteria to the instant matter compels the conclusion that the remaining purchases at issue were not exempt from tax.

First, as to whether such purchases were essential to the IDA's activities, it is clear that the purchases were made subsequent to the initial acquisition, construction and equipment of the water treatment facility and were, in fact, made in connection with the continued operation of the facility. As in Fagliarone, then, the issue becomes whether purchases for the operation of the facility were essential to the IDA's activities. As in Fagliarone, the record herein clearly evinces an intent on the part of the IDA to limit the scope of its activities to the development of the water treatment facility. Specifically, in the first whereas clause of the IDA's resolution

dated May 7, 1974, Newton Falls applied to the IDA to finance the "acquisition, construction and equipment" of the facility. In the third whereas clause of the resolution, the IDA expressed a desire to appoint Newton Falls its agent "for the purpose of acquiring, constructing and equipping" the facility. In the body of the resolution, the IDA agreed to "acquire, construct and equip" the facility and appointed Newton Falls its agent to "acquire, construct and equip" the project and "to do all things which may be required or proper for completing the project." Similarly, the seventh whereas clause of the Conditional Sale Agreement expresses a desire that Newton Falls, as agent for the IDA, arrange for "the design, construction and acquisition of the Project." The ninth whereas clause states that the IDA proposes to acquire the project, to have construction completed on its behalf by Newton Falls and to sell the project to Newton Falls. In the Conditional Sale Agreement the parties thereto agreed that the project would be "acquired, constructed, installed and equipped" by Newton Falls as agent for the IDA. Finally, the Conditional Sale Agreement provided for the appointment of Newton Falls by the IDA as its agent "to construct and equip the Project."

In contrast to the provisions noted above, the Conditional Sale Agreement specifically places responsibility upon Newton Falls, at its own expense, to "maintain, preserve and keep". The agreement also provided for Newton Falls, in its discretion and at its own expense, to make additions, modifications, improvements and substitutions to the project.

A review of the record thus compels the conclusion that the IDA limited its involvement in the project to the acquisition, construction and equipment thereof. Its appointment of Newton Falls as its agent was limited to this acquisition, construction and equipment phase. All of the purchases at issue were made in connection with the repair and maintenance of and improvements to the project and occurred in the operational phase. Accordingly, the purchases at issue cannot be found to have been essential to the IDA's activities herein (Matter of Fagliarone, Grimaldi & Associates, supra).

The second criterion for exemption as discussed in Fagliarone (supra) is that sales tax should not be imposed where such tax would increase the cost of the project financed by IDA

financing. Here, the purchases at issue were made by Newton Falls at its own expense. The purchases were not made with IDA bond proceeds. These purchases therefore have no impact upon the cost or amount of financing which was necessary to acquire, construct and equip the project. Application of this criterion to the facts herein thus weighs against exemption.

The final criterion for exemption is that the property purchased must become the property of the IDA. Although the IDA held title to the property which was installed at or which became part of the facility, there is no evidence in the record that the IDA either enjoyed or exercised any benefits of ownership. Rather, the IDA's title was apparently held solely for security purposes. The transfer of title to the IDA thus was merely part of the arrangement to provide financing for the project. Moreover, by the Conditional Sale Agreement, the IDA was to transfer title back to Newton Falls at the end of the term of the agreement. It is concluded that the mere holding of title pursuant to a financing arrangement is insufficient to exempt the purchases at issue from taxation under Tax Law § 1116(a)(1).

N. The petition of Deco Builders, Inc. is denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated September 3, 1987, is sustained.

O. The petition of Newton Falls Paper Mill, Inc. is granted to the extent indicated in Conclusion of Law "J"; the Division is directed to adjust the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated August 20, 1987, in accordance therewith and in accordance with Finding of Fact "11"; except as so granted, the petition is in all other respects denied; and except as so adjusted, the notice of determination is sustained.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE