STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ALAN RITCHEY, INCORPORATED	:	DETERMINATION DTA NO. 818627
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Year 1999.	:	

Petitioner, Alan Ritchey, Incorporated, P.O. Box 249, Valley View, Texas 76272, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the year 1999.

On April 16, 2002 and April 23, 2002, respectively, petitioner, by Robert W. Endsley, CPA, and the Division of Taxation, by Barbara G. Billet, Esq. (Kathleen D. O'Connell, Esq., of counsel), waived a hearing in the Division of Tax Appeals and agreed to submit the case for determination based on documentation and briefs to be submitted by September 19, 2002, which date began the six-month period for issuance of this determination. After due consideration of the record, Arthur S. Bray, Administrative Law Judge, hereby renders the following determination.

ISSUE

Whether the Division of Taxation properly disallowed petitioner's claim for a refund of corporation franchise tax for the year 1999 on the ground that petitioner's purchase of certain equipment did not qualify for the investment tax credit.

FINDINGS OF FACT

1. Petitioner, Alan Ritchey, Incorporated ("ARI"), was incorporated in the State of Texas on August 30, 1976.

2. In 1998, petitioner was awarded a five-year renewable contract with the United States Postal Service ("USPS"). The contract provided that, in 1999, petitioner was to operate Mail

Transport Equipment Service Centers ("MTESC") in Springfield, MA, Philadelphia, PA and Long Island, NY. Under this agreement, petitioner received and performed services on various types of mail transport equipment ("MTE").

3. During the year in issue, petitioner filed as a subchapter S corporation for Federal tax purposes. However, it filed a General Business Corporation Franchise Tax Return for New York State. On its New York return for the year 1999, petitioner claimed an investment tax credit on its purchase of equipment used to operate MTESC in accordance with its contract with the USPS. On the form CT-46, Claim for Investment Tax Credit, petitioner claimed an investment tax credit of $168,309.00 on its purchases of $3,366,186.00. Schedule A of the form described the property as "Various Asset additions and machinery for factory that is a *repair facility* for the U.S. Post Office. *Repair* is made to their mail containers which we transport." (Emphasis added.) Petitioner described the principal use of the property upon which the investment tax credit was claimed as "*Repairing* of transport for the U.S. Post Office." (Emphasis added.)

4. The Division of Taxation ("Division") issued a Notice of Deficiency to petitioner, dated February 22, 2001, which asserted a deficiency of corporation franchise tax in the amount of $16,559.00 plus interest in the amount of $1,457.77 for a balance due of $18,016.77. To the extent at issue in this proceeding, the asserted deficiency of tax was premised upon the disallowance of the investment tax credit which had been claimed by petitioner on its corporation franchise tax return.

5. Petitioner paid the asserted deficiency of tax and filed a form which sought a refund of the investment tax credit in the amount of $166,580.00. In a letter dated December 19, 2000, petitioner was advised that its request for refundable investment tax credits was denied because it was engaged in the repairing and reconditioning of previously manufactured mail transport containers rather than in the manufacture of new mail transport containers. According to the Division, "remanufacturing" did not constitute "the production of goods by manufacturing, processing or assembling . . . ." It was explained that petitioner conducted a service business and that service businesses did not qualify for investment tax credits pursuant to Tax Law § 210(12).

6. Petitioner filed a request for a conciliation conference which was held on April 17, 2001. In an order dated June 29, 2001, petitioner's request was denied and the notice of deficiency was sustained. This proceeding ensued.

7. The United States Postal Service provides the following overview of MTE processing:

> Each MTESC is designed to process the following four basic types of MTE: mailbags, trays/sleeves/lids, pallets/pallet boxes, and containers. Although the exact procedures used to process each type of MTE are different, MTE processing generally consists of receiving MTE from USPS facilities; unloading it from trailers; segregating the MTE by type; inspecting each item for defects; sorting it by condition; preparing the MTE for redeployment, repair, or disposal/recycling (depending upon condition); entering it into storage; and, ultimately, loading it onto trailers for shipment. (MTESC Statement of Work, Revision - December 19, 1997, p. 46.)

8. The MTE owned by the Postal Service and is sent to petitioner's plant when it has been selected for repair. Depending upon the type, the containers weigh between approximately 130 pounds and 475 pounds. Some of the containers are equipped with a manual braking system. The containers are made from steel, polyethylene plastic or aluminum. Following their arrival at the MTESC, the containers are inspected to determine what repairs are required. The MTESC Statement of Work contains a listing of "the mechanical repair operations for each container type" and provides that "[t]he Mechanic shall complete all repairs in accordance with the procedures and completed repair standards described in the appropriate Container Technical Manuals." The listing of "the mechanical repair operations" contained in the MTESC Statement of Work shows that petitioner performed a wide range of services including: repairing wheels, replacing casters, making weld repairs, greasing wheels and casters, adjusting brakes, installing safety labels, replacing wheels, replacing latch pins, repairing or replacing bumpers, straightening frames, repairing hinges, replacing brake cables, and replacing door locks. Petitioner's New York MTESC plant maintains a large variety of replacement parts in order to perform this work.

9. The primary purpose of the MTESC network is to ensure that there is a sufficient supply of MTE for the use of postal facilities and the customers of these facilities. In order to fulfill this function, MTESC operating contractors receive unprocessed MTE, process and store

the MTE and, upon request, supply serviceable MTE to designated postal facilities. The Postal Service has specified very detailed and precise processing procedures.

10. On September 8, 1998, the Town of Islip Industrial Development Agency (the "Agency") passed a resolution authorizing petitioner and Heartland Boys II, L.P. ("Heartland Boys"), a New York limited partnership, to act as its agents for the purpose of acquiring, constructing and equipping a building of approximately 150,000 square feet. The resolution provided that the land was to be sold by Heartland Boys to the Agency, leased back to Heartland Boys and then subleased to petitioner. The first paragraph of the resolution provided that the facility was to be "used by the Sublessee for the maintenance and *manufacture* of United States Postal Services mail handling equipment and machinery." (Petitioner's exhibit "C"; emphasis added.) An addendum to the resolution also provided that the facility was to be used "for the maintenance and *manufacture* of United States Postal Services mail handling equipment and machinery and for warehouse/distribution and office purposes." (***Id.***; emphasis added.)

11. In accordance with the resolution, on September 8, 1998, the Agency, Heartland Boys and ARI signed a Lease Agreement and Inducement Agreement. Each agreement stated that the facility would be for the purpose of "maintenance and *manufacture* of United States Postal Services mail handling equipment and machinery. . . ." (Petitioner's exhibit "D"; emphasis added.)

12. William G. Mannix, Administrative Director of the Agency, sent a letter to ARI, dated October 5, 1998, which, among other things, advised ARI of the resolution of September 8, 1998. The letter explained that the new building was to be "used by the Sublessee for the maintenance and *manufacture* of United States Postal Services mail handling equipment and machinery and for warehouse/distribution and office purposes. . ." (Petitioner's exhibit "E"; emphasis added.)

13. Negotiations between petitioner and Heartland Boys resulted in the execution of four agreements dated February 14, 2000: Agency Compliance Agreement between ARI and the Agency; Closing Certificate of the Town of Islip Industrial Development Agency; Closing

Certificate of Heartland Boys II, L.P. and Closing Certificate of Alan Ritchey, Inc. With the exception of the Closing Certificate of the Town of Islip Industrial Development Agency, the agreements state that the purpose of the facility is for the "*manufacture* of United States Postal Services handling equipment and machinery. . . ." (Petitioner's exhibits "F," "G," "H" and "I"; emphasis added.)

14. On February 29, 2000, the Town of Islip Industrial Development Agency passed a resolution which formally approved the acquisition, construction and equipping of the industrial development facility and certain related agreements between the Agency, Heartland Boys and petitioner. The second paragraph of the resolution designated that the purpose of the facility was to be for the "maintenance and *manufacture* of United States Postal Services and mail handling equipment and machinery. . . . " (Emphasis added.)

SUMMARY OF THE PARTIES' POSITIONS

15. It is petitioner's position that it is engaged in the "production of goods" by "manufacturing," "assembling" and "processing." Petitioner contends that its Long Island plant restores the MTE to new condition or is discarded. The fact that the MTE containers become serviceable to the Postal Service constitutes a new quality. Further, petitioner submits that the renovation process involves the application of "raw materials" such as casters, wheels and brake mechanisms. According to petitioner, there is no statutory or regulatory justification for the Division's position that petitioner must be engaged in "original" manufacturing in order to qualify for the credit. Further, relying upon Generally Accepted Accounting Principles and federal income tax regulations, petitioner submits that an item must be capitalized, and not treated as a repair when, as here, the property is put into a new condition. Lastly, petitioner maintains that the State of New York, through the Town of Islip Industrial Development Agency, has already determined that petitioner is engaged in "manufacturing." According to petitioner, it made extensive investment decisions based on negotiations with the Town of Islip Industrial Development Agency and its commitments regarding tax advantages and incentives.

16. The Division argues that petitioner is not involved in the production of goods. Rather, the Division maintains that petitioner performs repairs and replaces parts on the MTE to keep the MTE in service. It is submitted that petitioner may enhance the value of the goods but it does not produce them. According to the Division, petitioner restores them to serviceable condition through repair. The Division also posits that petitioner's activities do not constitute manufacturing or processing. In addition, it is submitted that they do constitute incidental repairs within the meaning of the Federal income tax regulations.

CONCLUSIONS OF LAW

A. During the years in issue, Tax Law former § 210(12)(b) allowed for an investment tax credit against the tax imposed by Article 9-A of the Tax Law with respect to certain qualifying property. To qualify, the property had to: (1) be tangible personal property or other tangible property; (2) be depreciable pursuant to Internal Revenue Code ("IRC") § 167; (3) have a useful life of four years or more; (4) have been acquired by purchase as defined in IRC § 179(d); (5) be located in New York State; and (6) be principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floristry, viticulture or commercial fishing (Tax Law § 210[12][b]).

B. The central issue presented in this matter is whether petitioner is engaged in performing repairs or in the production of goods. As set forth above, a taxpayer may claim the investment tax credit only if it is engaged in the production of goods. If it is not engaged in the production of goods, it is irrelevant whether petitioner's activity constitutes manufacturing or processing within the meaning of Tax Law § 210(12)(b) because petitioner would not be performing a qualifying activity.

C. The issue presented here has arisen in other contexts. Section 606(c) of the Revenue Act of 1932 imposed a tax on automobile parts "sold by the manufacturer, producer, or importer" thereof. When confronted with this provision, certain taxpayers argued that they were not subject to the tax because they were engaged in the repair of goods rather than the production or manufacture of goods. In response, the courts explained that usually a repairer furnishes labor or

material to the owner of an article in order to restore the article to its normal condition. Consequently, a significant factor in determining whether a party is engaged in repair or production is whether title to the property remains with the party for whom the service is being performed (***Clawson & Bals v. Harrison***, 108 F2d 991, 40-1 US Tax Cas ¶ 9116, ***cert denied*** 309 US 685, 60 S Ct 808; ***United States of America v. J. Leslie Morris Co.***, 124 F2d 371). The courts also examined whether the parties or the trade treated the restored item as a repaired item or as a newly produced item for sale in the trade (***id***).

D. Evaluated by the foregoing factors, it is clear that petitioner was performing repairs on the MTE. Petitioner furnished labor and materials to items which were owned by the Postal Service. The contract with the Postal Service specified the service to be supplied and the manner in which it was to be preformed. Significantly, the parties viewed the process as repair. Section 7.1 of the Postal Service's MTESC Statement of Work states that "[c]ontainers are selected for *repair* at Initial Inspection as described in Section 6.5.2 of this SOW." (Emphasis added.) Similarly, on its Claim for Investment Tax Credit, petitioner described its activity as a repair facility for the U.S. Postal Service. In sum, petitioner was not engaged in the production of MTE. Rather, its process began and ended with MTE. Accordingly, it is not entitled to claim an investment tax credit.

E. In reaching the foregoing conclusion, it is noted that the authority relied upon by petitioner pertaining to whether a cost should be "expensed" as a repair or capitalized relates to the proper reporting of income and is irrelevant to the issue presented here. Similarly, the characterization of petitioner's process as manufacturing in the documents concerning its becoming an agent for the Town of Islip Industrial Development Agency has no bearing on whether petitioner is engaged in manufacturing for purposes of the investment tax credit.

F. In view of the foregoing, the issue of whether petitioner was engaged in manufacturing, assembling or processing is academic.

G. The petition of Alan Ritchey, Incorporated is denied.

DATED: Troy, New York
January 30, 2003

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE