

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition	:	
	:	
of	:	
	:	
CARTER TOOL CORP.	:	DECISION
	:	
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 June 1, 1978	:	
through May 31, 1981.	:	

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Petitioner, Carter Tool Corp., 606 Hague Street, Rochester, New York 14606, 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 June 1, 1978 through May 31, 1981 (File No. 37647).

A hearing was held before Arthur Bray, Hearing Officer, at the offices of the State Tax Commission, 259 Monroe Avenue, Rochester, New York, on September 10, 1985 at 9:15 A.M., with all briefs to be submitted by December 18, 1985.

Petitioner appeared by Harter, Secrest & Emery (Michael R. McEvoy, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (James Della Porta, Esq., of counsel).

#### ISSUES

I. Whether the Notice of Determination and Demand for Payment of Sales and Use Taxes Due may be deemed to assess tax on transactions which occurred during periods other than that assessed on said Notice.

II. Whether the retrofitting of the machine tools constituted the purchase of services and, if so, whether said services are subject to sales tax pursuant to Tax Law §1105(c)(2) or Tax Law §1105(c)(3).

III. Whether, in the event it is concluded that a taxable service occurred, the reduced tax rate provided by Tax Law § 1105-B applies.

FINDINGS OF FACT

1. On February 26, 1982, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner, Carter Tool Corp., assessing sales and use taxes due in the amount of \$43,058.75, plus interest in the amount of \$9,539.05, for a total amount due of \$52,597.80. The assessment was premised upon the Audit Division's conclusion that the charges incurred by petitioner for the retrofitting of five machines used in petitioner's machine tool business were subject to sales and use taxes.

2. Petitioner is engaged in the machine tool business making tooled metal and plastic parts for sale to its customers. Petitioner had used numerically controlled machining centers ("NC Centers") in its operations for several years. These NC Centers were machine tooling work centers consisting of a large metal frame to which interchangeable drilling, boring, milling and other tooling bits were attached. Various control arms and a moveable block, to which the part to be tooled was clamped, enabled the machines to change machining bits and to work in two dimensions. The NC Centers included a separately housed hydraulic power unit which connected to the main frame by hoses and wires. This unit drove various pistons and other mechanisms attached to the main frame which performed the actual work. The NC Centers were controlled by a separately housed numerical control unit, which operated somewhat like an adding machine in allowing the operator to enter the precise distance he wished a drill bit, for instance, to travel. The numerical control unit would start and stop the drill bit so that it moved the desired distance in either of two dimensions. The NC Centers could not perform any work in three dimensions.

3. The NC Centers became obsolete in the late 1970's due to their inability to perform three dimensional tasks. A new generation of machining center using

different drive systems and computer controls had entered the market. The computer numerically controlled machining centers ("CNC Centers") were able to perform three dimensional machining tasks without operator intervention and at great speed.

4. Both NC Centers and CNC Centers used a standard metal body or frame known as the "iron." The iron in each machine was interchangeable with that in any other machine whether the machine was an NC Center or a CNC Center. It functioned simply as a base to which the operational parts of the machine could be attached.

5. Petitioner needed CNC Centers to compete in its market. The iron constituted an expensive component of the CNC Center. Accordingly, petitioner removed the mechanical parts from the iron of its NC Centers, removed the entire hydraulic drive system, including the separate power unit and all of the hoses, pistons, and other mechanisms attached to the frame, and removed the separate numerical control unit. The detached hydraulic drive system and the numerical control unit have subsequently remained idle at petitioner's premises. Petitioner shipped the basic iron to the manufacturer, which used it to construct the CNC Center.

6. The CNC Center consists of the basic iron with all new mechanical parts, including a new electric power system, known as DC drive, which replaces the old hydraulic system and which does not require a separate unit. The CNC Center does have a hydraulic system. However, the hydraulic system on the CNC Center merely injects oil, whereas the hydraulic system on the NC Center provided the driving force for the mechanical parts.

7. The CNC Center is much quieter, because of the use of an electronic power system instead of hydraulic drive, eighty to ninety percent faster, more

powerful and much more efficient than an NC Center. Since the CNC Center does not need repairs as often, it is operational a far greater percentage of the time than an NC Center. The CNC Center can perform all of the tasks that an NC Center could perform, plus hundred of other tasks. In particular, the computer controls permit three dimensional contouring of parts, a frequent request of petitioner's customers, which the NC Centers could not do.

8. Petitioner's first two purchases of CNC Centers involved the trade in of irons from existing NC Centers which it had owned and operated for some time. However, petitioner needed more CNC Centers than it had irons to trade in. Accordingly, in 1979 it purchased three NC Centers from other operators for approximately \$35,000.00 each. These NC Centers were operational when purchased, but two of them were never operated by petitioner. Rather, they were immediately stripped of their mechanical parts, controls and hydraulics and their irons sent to the manufacturer to produce CNC Centers. The third NC Center purchased was used by petitioner for a brief period of two to three months before being stripped for its iron, which was sent to the manufacturer.

9. It was not important to petitioner whether the CNC Center sent to petitioner contained the same iron which it had traded in.

10. The following sets forth the dates and amounts of the charges for the five transactions at issue herein:

<u>Invoice No.</u>	<u>Amount</u>	<u>Shipment Date</u>	<u>Invoice Date</u>
M9523	\$116,570	7/21/79	7/21/79
M9527	114,495	11/29/79	11/29/79
M9711	131,700	1/29/81	3/13/81
M9712	129,200	7/29/81	7/29/81
M9713	129,200	10/16/81	10/16/81

11. Some of the NC Centers were in need of repair at the time petitioner decided to acquire the CNC Centers. The maximum amount petitioner would have had to pay for the repair of any of its NC Centers was \$10,000.00.

12. Petitioner's net cost for a CNC Center when it traded in an iron was approximately \$115,000.00 for units shipped in 1979 and approximately \$130,000.00 for units shipped in 1981. It could acquire operational NC Centers at this time for approximately \$35,000.00.

13. In July of 1981, petitioner purchased a CNC Center from the same manufacturer without trading in an iron. It paid \$169,500.00 for this machine.

14. All of the CNC Centers purchased by petitioner during this period, whether or not the iron was traded in, carried a full manufacturer's warranty of one year for a new machine. The NC Centers had originally carried one year warranties, which had long since expired.

15. The CNC Centers have a useful life in excess of one year, and are used directly and predominantly in the production for sale of tangible personal property by manufacturing.

16. In determining which quarterly period the transactions should be attributed to on the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, the Audit Division utilized dates found on petitioner's invoices. With respect to invoices M9711 and M9523, the transactions were attributed to the quarterly period based on the invoice date. However, for transactions based on invoices M9527, M9712 and M9713, the transactions were ascribed to quarterly periods based on the order date. Prior to the issuance of the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, there were meetings between petitioner's representative and the Audit Division. During these meetings, the invoices, dates and amounts in issue were

called to petitioner's attention. Petitioner did not notify the Audit Division that there was an issue with respect to the dates of the transactions until one day before the hearing.

17. The parties have stipulated that the correct date for taxation is no sooner than the shipment date and further that, to the extent these charges are subject to tax, the reduced rate of tax provided for by §1105-B applies to those charges that are within its effective dates.

18. In accordance with New York State Administrative Procedure Act §307.1, petitioner's proposed findings of fact have been rejected since they are not set forth with sufficient specificity to permit response.

#### CONCLUSIONS OF LAW

A. That, in general, sales tax liability arises from the transfer of title or possession (20 NYCRR 525.2[a][2]). Therefore, the use of the order date to determine the quarterly period to which the transactions should be attributed is clearly erroneous. However, petitioner was aware of the transactions in issue and has not demonstrated any prejudice to the ascribing of transactions which arose during the audit period to the wrong quarterly period. Accordingly, it is concluded that the Notice was sufficient with respect to those transactions which occurred during the audit period (See Matter of Pepsico, Inc. v. Bouchard, 102 A.D.2d 1000, 1001). However, the Notice improperly assessed two transactions which occurred outside of the audit period -- invoices M9712 and M9713. Therefore, the assessment is cancelled with respect to those transactions represented by invoices M9712 and M9713.

B. That the essence of the remaining transactions in issue was not the rendering of a service but the purchase of tangible personal property. In effect, petitioner purchased new machines on existing frames.

C. That the machines purchased by petitioner are exempt from sales tax since the machinery was used directly and predominantly in the production of tangible personal property for sale within the meaning of section 1115(a)(12) of the Tax Law.


D. That, in view of Conclusion of Law "C", the remaining issue is moot.

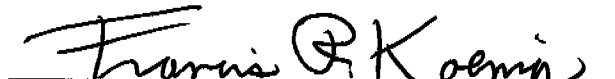
E. That the petition of Carter Tool Corp. is granted and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due is cancelled.

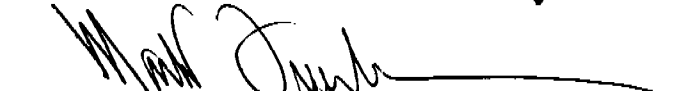
DATED: Albany, New York

STATE TAX COMMISSION

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