STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

REACTOR CONTROLS, INC., NORTHEAST SERVICES DIVISION

for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 & 29 of the Tax Law for the Period September 1, 1978 through November 30, 1981.

DECISION

Petitioner Reactor Controls, Inc., Northeast Services Division, 5854 Butternut Drive, East Syracuse, New York 13057 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. 41665).

A hearing was held before Arthur Johnson, Hearing Officer, at the offices of the State Tax Commission, 333 East Washington Street, Syracuse, New York, on October 16, 1984 at 10:45 a.m. with all briefs to be submitted by August 23, 1985. Petitioner appeared by James C. Watt, Jr., Esq. The Audit Division appeared by John P. Dugan, Esq. (Anne Murphy, Esq., of Counsel).

ISSUE

I. Whether certain equipment and expense purchases were exempt from sales and use taxes under section 1115(a)(12) of the Tax Law.

II. Whether materials used by petitioner in the performance of a contract with Niagara Mohawk Power Corporation were exempt from sales and use taxes under section 1115(a)(12) of the Tax Law.

III. Whether the Audit Division's assessment of additional tax due for the period September 1, 1978 through November 30, 1979 was issued beyond the statute of limitations.

FINDINGS OF FACT

1. Petitioner, Reactor Controls, Inc., Northeast Services Division, was engaged in the following business activities during the period at issue: One was as a consultant on electrical power generation with primary emphasis on nuclear power; a second was producing various items such as pipe hangers and rings for use in power generation as well as other areas of manufacturing; and a third was construction, retrofitting, maintenance and betterment work at nuclear power facilities.

2. On October 20, 1982, as the result of an audit, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner covering the period September 1, 1978 through November 30, 1981 for taxes due of $22,885.79, plus interest of $5,135.79, for a total of $28,021.58.

3. Petitioner did not file sales tax returns for the periods September 1, 1978 through November 30, 1979.

4. The audit conducted by the Audit Division disclosed no additional sales taxes due. However, an examination of purchase invoices revealed use taxes due as follows:

(a)	fixed assets	$16,284.26
(b)	expense purchases	3,714.83
(c)	materials incorporated into capital improvements	2,886.70
		$22,885.79

Petitioner agreed to and paid $5,287.53 which represented $3,988.23 in fixed assets and $1,304.12 in expense purchases that were attributable to the environmental engineering phase of petitioner's business. The remaining taxes in dispute amounted to $17,598.44.

5. The fixed assets ($12,301.03) consisted of machinery and equipment used by petitioner to produce items of tangible personal property. Expense

purchases ($2,410.71) were supplies and repairs consumed by petitioner in this phase of the business operations. The Audit Division took the position that petitioner was a fabricator and contractor and as such the foregoing purchases did not qualify for the exemption provided under sections 1115(a)(12) and 1210(a)(1) of the Tax Law. Petitioner on the other hand maintained that it was a manufacturer and/or assembler of tangible personal property, as such terms are defined in the regulations and, accordingly, the purchases of fixed assets and expenses qualify for the exemption afforded under Section 1115(a)(12) of the Tax Law.

6. The materials referred to in Finding of Fact "4"(c) were installed as part of a construction project for Niagara Mohawk Power Corporation. The contract provided that petitioner furnish, fabricate, deliver and install piping materials and equipment at Nine Mile Point Nuclear Station. Niagara Mohawk furnished petitioner with a Certificate of Capital Improvement. Petitioner's contract involved the construction of a Dow Radwaste System. This system removed radioactive materials and permitted the safe production of electrical power. The type of materials that the Audit Division held taxable were construction materials and supplies consumed in the performance of the contract.

7. With respect to the materials, petitioner took the position that the Radwaste System was an integral part of the production of electricity and therefore the purchases used to construct the system were exempt under section 1115(a)(12) of the Tax Law. The Audit Division maintained that the purchases it determined to be taxable were materials incorporated into a capital improvement rather than production equipment.

8. During the period under audit, the major items produced by petitioner were piping, pipe hangers and torus saddles, all of which were utilized in the

field of nuclear power. Petitioner usually made items to the specifications and drawings furnished by the customer. The process involved taking material from inventory, usually steel, and cutting, burning, welding, bending and shaping such material into the desired product.

9. Petitioner produced approximately 30 to 40 percent of its products for sale. The remainder were used or installed by petitioner or by a subcontractor in construction projects.

CONCLUSIONS OF LAW

A. That section 1115(a)(12) of the Tax Law provides an exemption from sales and use taxes for "(m)achinery or equipment for use or consumption directly and predominantly in the production of tangible personal property... for sale, by manufacturing..., but not including supplies used in connection with such machinery, equipment or apparatus...".

B. 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)].

C. That the New York State Sales and Use Tax Regulations at Sec. 531.2(b), (c) and (d) define the following terms:

> "(b) Manufacturing. Manufacturing is the production of tangible personal property that has a different identity from its ingredients. Manufacturing includes the production of standardized items as well as the production of items to a customer's specifications.
>
> * * *
>
> (c) Assembling. Assembling is the coupling or the uniting of parts or materials as a manufacturing process or as a step in the manufacturing process which results in a new product.
>
> * * *
>
> (d) Fabrication. Fabrication is the alteration or modification of a manufactured product without a change in the

> identity of the product. Fabrication includes cutting, perforating and similar operations...".

D. That petitioner produced various items of tangible personal property that had different identities from their ingredients. Accordingly, petitioner was a manufacturer. Petitioner was also a contractor that installed its manufactured products in the performance of construction contracts with utility companies. The manufactured items when installed constituted capital improvements to real property. Since only 30 to 40 percent of its manufactured goods were produced for sale as opposed to consumed or used in capital improvement work, petitioner's machinery and equipment was not used <u>predominantly</u> in production within the meaning and intent of section 1115(a)(12) of the Tax Law. Therefore, the purchases of machinery and equipment were subject to the taxes imposed under sections 1105(a) and 1110 of the Tax Law. Likewise, the expense purchases were taxable.

E. That section 1101(b)(4) of the Tax Law specifically provides that a sale of any tangible personal property to a contractor for use or consumption in erecting structures or buildings, or otherwise adding to or improving real property is deemed to be a retail sale.

F. That it has been held that the term "equipment", as used in section 1115(a)(12) of the Tax Law, means having an identifiable character as equipment at the time of purchase at retail which is adapted by its design to perform in conjunction with machinery or otherwise, have some particular function in a stage of the manufacturing process (<u>Slattery Associates, Inc., v. Tully</u>, 54 NY 2d 711). The construction materials at issue herein clearly did not possess the requisite "identifiable character," as machinery or equipment at the time of their purchase. Accordingly, petitioner's purchases of the materials constituted a retail sale and was subject to the tax imposed under section 1105(a) of the Tax Law.

G. That section 1147(b) of the Tax Law provides that an assessment of additional tax may be issued at any time where no return has been filed as required by law. Since petitioner did not file sales tax returns for the period September 1, 1978 through November 30, 1979 the notice of additional tax due issued on October 20, 1982 was timely.

H. That the petition of Reactor Controls, Inc., Northeast Services Division, is denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued October 20, 1982, as revised by the payment of $5,287.53, is sustained.

DATED: Albany, New York

FEB 18 1986

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER