

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition

of

CRUCIBLE, INC. - SPECIALTY METALS DIVISION

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 March 1, 1980
through February 28, 1983.

Petitioner, Crucible, Inc. - Specialty Metals Division, P.O. Box 977,
Syracuse, New York 13201, 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, 1980 through February 28, 1983 (File No. 57841).

A hearing was held before Timothy J. Alston, Hearing Officer, at the
offices of the State Tax Commission, 333 East Washington Street, Syracuse, New
York, on July 10, 1986 at 9:15 A.M., with all briefs to be submitted by
December 1, 1986. Petitioner appeared by James T. Prendergast, Esq. The Audit
Division appeared by John P. Dugan, Esq. (James Della Porta, Esq., of counsel).

ISSUE

Whether certain purchases of machinery and equipment and labor in
connection with the installation and modernization of four electric substations
at petitioner's steel manufacturing plant were used directly in the production
of tangible personal property for sale and were therefore exempt from the
imposition of sales tax.

FINDINGS OF FACT

1. On September 20, 1984, following an audit, the Audit Division issued
to petitioner, Crucible, Inc. - Specialty Metals Division, a Notice of

Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1980 through February 28, 1983 asserting additional tax due of \$114,239.19, plus interest of \$38,559.87, for a total of \$152,799.06.

2. At all times relevant herein, petitioner operated a steel mill in the Town of Geddes, New York, engaged in the manufacture of specialty steel products.

3. On September 13, 1985, petitioner executed a Consent to Fixing of Tax Not Previously Determined and Assessed with respect to a portion of the deficiency and remitted \$87,564.38 (\$58,589.53 in tax and \$28,974.85 in interest) to the Audit Division. The amount of tax remaining at issue was thereby reduced to \$55,649.66.

4. On November 27, 1985, petitioner remitted payment of \$26,131.00 in partial payment of the tax remaining at issue. Thus, in the instant proceeding, petitioner seeks refund of the amount previously paid and cancellation of the notice of determination and demand with respect to the unpaid portion, \$29,518.66 in tax, plus interest, of the amount at issue.

5. On audit, the Audit Division examined in detail petitioner's purchase invoices and other documents for the period March 1, 1980 through February 28, 1983 and determined that certain purchases of machinery and equipment and labor charges amounting to \$794,994.77 were subject to the tax in dispute of \$55,649.66. Petitioner did not dispute the amount of such purchases, but rather the taxability thereof. This machinery and equipment and labor were purchased in connection with the installation and modernization of four electric substations at petitioner's steel mill. Broken down by substation, the purchases and taxes due were as follows:

	<u>Substation #1</u>	<u>Substation #3</u>	<u>Substation f6</u>	<u>Substation #7(b)</u>
Purchases	\$309,337.33	\$63,960.00	\$211,292.44	\$210,405.00
Taxes Due	\$ 21,653.63	\$ 4,477.20	\$ 14,790.47	\$ 14,728.36

6. Substation #1 transformed the electric power supplied by Niagara Mohawk Power Corporation, petitioner's supplying utility, so that this power could be used in petitioner's manufacturing operations. Niagara Mohawk supplied 115 kilovolt electricity, which had a low amperage. Petitioner's operations required electric power consisting of lower voltage and higher amperage than the power supplied by Niagara Mohawk. Substation #1 transformed the supplied power by lowering the voltage to 12 kilovolts and simultaneously increasing the amperage. The audited purchases with respect to Substation #1 added a new relaying system to this substation thus providing two separate systems running parallel in the production power lines. This was done to avoid the possibility of interruption of the flow of power throughout the plant. All electricity consumed by petitioner flowed through Substation #1. Eighty-nine percent of this electricity was consumed in petitioner's production activities.

7. Of petitioner's Substation #1 purchases, \$27,648.98 were purchases of labor in connection with the installation and operation of the machinery and equipment at the substation,

8. Substation #3 functioned as a circuit breaker for petitioner's operations further along the line. This substation received 12 kilovolt power from Substation #1 and functioned as a shutoff switch in the event that a short circuit or other problem were to develop. Substation #3 would enable petitioner's operations to continue below this substation and avoid the necessity of a plant shutdown in the event of a malfunction. Substation #3 was necessary for the safe operation of the other substations and, consequently,

petitioner's other production machinery which was integrated with the substations.

9. All of the audited purchases for Substation #3 were for machinery and equipment necessary for and integral to the proper operation of this substation.

10. Substation #6 functioned as a transformer for the 12 kilovolt electricity which proceeded along the line from petitioner's Substation #1 and passed through Substation #3. The 12 kilovolt electricity was transformed into 480 volts while the amperage was simultaneously increased. This transformation was necessary to convert the electricity into a usable form to operate petitioner's "Western Gear Grinders", which were connected to this substation and which received electricity from this substation. The "Western Gear Grinders" shaped and improved petitioner's steel product. Certain of the equipment which was powered by the electricity transmitted from Substation #6 filtered steel dust produced by the grinders. The filtering process protected the other grinding equipment and the steel dust collected was returned to the manufacturing process as a raw material.

11. Of petitioner's Substation #6 purchases, \$2,129.44 were purchases of labor in connection with the installation and operation of the machinery and equipment at the substation.

12. Substation #7(b)'s function was similar to Substation #6 in that it acted as a transformer converting 12 kilovolt electricity received from Substation #1 and transforming that electricity into 480 volt electricity, while simultaneously increasing the amperage. This transformation was necessary in order to operate an induction furnace connected to this substation. Charged by

electricity, the induction furnace generated heat which melted steel into a molten state.

13. All of the audited purchases for Substation #7(b) were for machinery and equipment and were necessary for and integral to the operation of this substation.

14. All four substations were used predominantly in production; at issue herein was whether the substations were used "directly" in production within the meaning of the relevant statute and regulations.

15. Petitioner submitted proposed findings of fact in this matter. Proposed findings of fact "1" through "3" and "5" through "15" have been substantially incorporated herein. Proposed finding of fact "4" is accepted in part and rejected in part as being unsupported by the record. Proposed finding of fact "16" is rejected as being in the nature of a conclusion of law.

CONCLUSIONS OF LAW

A. That section 1115(a)(12) of the Tax Law 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".

B. That, for purposes of said section 1115(a)(12), 20 NYCRR 528.13(c) sets forth the following definition of "directly":

"(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 used directly in production."

C. That the machinery and equipment and labor purchased in connection with Substations #1 and #3 were "collateral" to petitioner's actual production process (20 NYCRR 528.13[c][2]) and were therefore not used "directly" in production within the meaning of section 1115(a)(12) of the Tax Law. In view of Finding of Fact "6" it is clear that the purpose of the substation #1 expenditures was to make a second electrical system to serve as a backup for petitioner's operations. Similarly, the purpose of the expenditures in connection with substation #3 was to support petitioner's other production machinery (Finding of Fact "8"). In view of their respective functions, it cannot be said that the machinery and equipment and labor in connection with these substations were used directly in the production of steel. Accordingly, the Audit Division properly asserted sales tax due with respect to substations #1 and #3.

D. That it is determined that the machinery and equipment at Substations #6 and #7(b) had an "active causal relationship" in the production of steel within the meaning of 20 NYCRR 528.13(c)(1)(ii) and were therefore used "directly" in production within the meaning of section 1115(a)(12) of the Tax Law. In this regard, it is noted that the Audit Division contends the substations were "clearly passive" in regard to the steel manufacturing process. In fact, these substations were more than "mere conduits for the channeling of electricity". Substations #6 and #7(b)'s transformation of electricity into a usable form was necessary for and integral to petitioner's overall production system.

The Audit Division further contended that the activities engaged in by the substations were "collateral to petitioner's steel manufacturing process". While the existence of a causal link and the fact that equipment is essential


to production are not of themselves determinative factors with respect to qualifying for the production exemption (see Petition of Cole and Sand Gravel Corp., State Tax Commission, January 10, 1983), petitioner herein has established that these two substations were closely integrated with other exempt machinery in petitioner's production process. A line drawn between taxation and exemption as urged by the Audit Division would be artificial and not reflective of the integrated nature of the relationship between these substations and the production machinery with which they work.

E. That, in view of the exemption accorded the machinery and equipment for Substation #6, the services purchased by petitioner in connection with this substation are subject to reduced tax pursuant to section 1105-B of the Tax Law.

F. That the petition of Crucible, Inc. - Specialty Metals Division is granted as set forth in Conclusions of Law "D" and "E", the Audit Division is directed to modify the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, as revised (Finding of Fact "3"), in accordance therewith giving credit to amounts previously paid by petitioner; and except as so granted, the petition is in **all** other respects denied.

DATED: Albany, New York

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ADMINISTRATIVE LAW JUDGE