STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of Hershey Enterprises, Inc.	AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision of a Determination or Refund of Sales & Use Tax under Article 28 & 29 of the Tax Law for the Period 12/1/77-11/30/81.	

State of New York :
ss.:
County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 29th day of April, 1985, he served the within notice of Decision by certified mail upon Hershey Enterprises, Inc., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Hershey Enterprises, Inc.
642 Kreag Rd.
Pittsford, NY 14534

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
29th day of April, 1985.

David Parchuck

Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of Hershey Enterprises, Inc.	AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision of a Determination or Refund of Sales & Use Tax under Article 28 & 29 of the Tax Law for the Period 12/1/77-11/30/81.	

State of New York :
ss.:
County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 29th day of April, 1985, he served the within notice of Decision by certified mail upon Thomas E. Willett, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Thomas E. Willett
Harris, Beach, Wilcox, Rubin & Levey
Two State Street
Rochester, NY 14614

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
29th day of April, 1985.

David Parchuck

Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

April 29, 1985

Hershey Enterprises, Inc.
642 Kreag Rd.
Pittsford, NY 14534

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1138 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Thomas E. Willett
Harris, Beach, Wilcox, Rubin & Levey
Two State Street
Rochester, NY 14614
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of HERSHEY ENTERPRISES, 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 December 1, 1977 through November 30, 1981.	DECISION

Petitioner, Hershey Enterprises, Inc., 642 Kreag Road, Pittsford, New York 14534, 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 December 1, 1977 through November 30, 1981 (File No. 38372).

A small claims hearing was held before John F. Koagel, Hearing Officer, at the offices of the State Tax Commission, One Marine Midland Plaza, Rochester, New York, on December 7, 1983 at 1:15 P.M., with all briefs to be submitted by April 9, 1984. Petitioner appeared by Harris, Beach, Wilcox, Rubin and Levey (Thomas E. Willett, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Thomas C. Sacca, Esq., of counsel).

ISSUE

Whether petitioner's time-based transactions involving its energy control systems were leases under section 1101(b)(5) of the Tax Law and thus subject to tax under section 1105(a) of the Tax Law.

FINDINGS OF FACT

1. Petitioner, Hershey Enterprises, Inc. ("Hershey"), is engaged in the business of selling and installing energy control systems. These systems are adapted to customers' existing heating, ventilating and air conditioning

systems (HVAC's) by petitioner such that, through the control of various mechanical and electro-mechanical devices installed by petitioner, a more energy efficient HVAC system results. Petitioner sells these systems to its customers on either an outright cash basis or, in the alternative, under a time-based agreement. The Audit Division concedes that the outright cash sales of these systems are sales of capital improvements and are exempt from sales tax. The Audit Division asserts, however, that the time-based sales are subject to sales tax because they are "true leases" of tangible personal property, rather than the sale and installation of capital improvements.

2. On March 19, 1982, the Audit Division issued to petitioner two notices of determination and demand for payment of sales and use taxes due covering the periods December 1, 1977 to May 31, 1981, and June 1, 1981 to November 30, 1981. The amounts claimed as due for these periods were $20,397.23 and $1,926.27, respectively, plus interest, and were based on a February 2, 1982 audit of petitioner's books and records. Petitioner disagreed with the Audit Division's conclusions and it duly filed a petition for revision of the determination maintaining, inter alia, that the time-based sales arrangements were exempt from sales taxes because they were sales of permanent additions to real property which constituted capital improvements. The aggregate deficiency of $22,323.50 consists of two separate portions: (a) $21,986.24 of sales tax assessed on time-based agreements and (b) $327.26 of use tax assessed on miscellaneous purchases.

3. Petitioner described the disputed time-based sales as its "fuel savings participation program". In these transactions, customers signed a formal written agreement entitled "Lease Agreement with Purchase Option". The customers paid petitioner a down payment of approximately 30 percent of the

system's cost at the time installation of the system was completed, and continued making monthly payments until the purchase price was fully paid. Monthly payments were determined by reference to each customer's monthly fuel cost savings resulting from the installation of petitioner's energy control system. Monthly fuel cost savings were determined by comparing customers' previous years' average monthly consumption of fuel per degree day with fuel consumption per degree day after installation. The monthly payments also included interest charges based on the (declining) amount of the outstanding total purchase price remaining unpaid, calculated by petitioner at "...(p)rime plus two percent payable monthly".

4. The written agreement labelled the respective parties "lessor" (petitioner) and "lessee" (customer). Title was expressly stated to remain with petitioner during the term of the agreement. The contract did not set a specific term for the agreement. Customers could withdraw at any time or continue until the purchase price was paid. Petitioner reserved the right to remove the system from the customer's premises in case the customer did not pay. The purchase option was exercisable by the customer at any time and the option price was the amount of the purchase price then unpaid. In addition, the agreement expressly stated that the system was to be regarded as "personal property", in case petitioner chose to file a financing statement to protect its security interest.

5. The actual length of the agreement was determined by reference to the ultimate purchase price. If, due to changes in the customer's facility, it became impossible to make the comparative calculations necessary to determine fuel savings, the time-based arrangements ended and the then-unpaid remaining purchase price became due.

6. The written form used in the time-based arrangements was supplied by petitioner. It was not designed for such use, but was a form petitioner had in its files. The form was always modified by the use of a "special conditions section": a one-page rider attached to the agreement which set forth the specifics of each particular arrangement such as the purchase price, the dollar amount down, and the method of calculating the payment amount per month based on fuel savings.

7. In none of the time-based arrangements did a customer pay a static or fixed monthly amount, but rather payments were based on monthly savings. Petitioner never attempted to calculate a "fair rental value" for the systems it installed.

8. Petitioner provided maintenance on the systems it installed, the extent of which and the separate charge for which was the same regardless of whether an outright sale or a time-based arrangement was involved. Once a system was installed, the customer bore the risks of loss and had a corresponding duty to insure the property.

9. Petitioner's president testified that the intention regarding the time-based arrangement was not to lease the system but to make a sale with installment payments. The "fuel savings participation program" was established to accommodate those customers unable or unwilling to pay the full purchase price at the time of installation.

10. The ultimate purchase price for a given system, except for the interest charged on time-based arrangements, was the same regardless of whether an outright sale or a time-based arrangement was involved. Under the latter arrangement, a customer could prepay the purchase price at any time, or could

continue making monthly payments based on savings until the system was paid off. The term "amortization" (of the purchase price) was used.

11. Installation of the energy control system required adaptation and/or removal of the components, wiring, and piping of the customer's existing HVAC system. Although petitioner never had the occasion to do so, removal of petitioner's system, once installed, would leave little value remaining in the system's components. In addition, the customer's system would require substantial reconstruction before it could become operational again. Finally, the procedure for installation of a system was the same regardless of the chosen method of purchase or sale (i.e., outright cash sale or time-based sale).

12. Petitioner carried the time-based arrangements on its books as sales with installment payments. Petitioner did not claim depreciation deductions or investment tax credits on any systems installed at its customers' facilities. Petitioner alleged that its customers carried these deductions and credits on their books. In all transactions, regardless of the method of purchase, petitioner's customers provided petitioner with a Capital Improvement Certificate. Following the hearing, petitioner supplied such certificates for 29 out of the 35 time-based transactions at issue herein.

13. Petitioner paid sales tax on the purchases of materials used in its systems.

14. Petitioner requested and was granted a period of time following the hearing to submit evidence substantiating certain alleged errors in the calculation of the deficiency. Petitioner submitted such evidence, the result of which is summarized as follows:

a) assessed sales tax of $21,986.24, relating to the time-based transactions at issue, should be reduced by $9,644.61, thus leaving $12,341.63 at issue;

b) assessed use tax of $327.26, relating to miscellaneous purchases, should be reduced by $203.34, thus leaving $123.92 at issue.

The net result of these adjustments is to reduce the deficiency from $22,323.50 to $12,465.55.

CONCLUSIONS OF LAW

A. That petitioner has not challenged the amount of assessed use tax on miscellaneous purchases which remains outstanding after the adjustment detailed in Finding of Fact "14" ($123.92). Accordingly, this portion of the assessment is sustained.

B. That the determination of whether an agreement is a true lease turns on the substance and not merely the form of the transaction(s); that is, one must examine both the intention of the parties and the underlying nature of the transaction. In re Sherwood Diversified Services, Inc., 382 F. Supp. 1359 [S.D.N.Y. 1974]; Matter of Petrolane Northeast Gas Service, Inc. v. State Tax Comm., 79 A.D.2d 1043, mot. for lv. to app. den. 53 N.Y.2d 601.

C. That while there are terms used and certain factors present which, upon surface examination, tend to indicate that leases rather than time-based (i.e., installment) sales occurred (see e.g. Finding of Fact "4"), the evidence produced by petitioner supports the conclusion that, in fact, sales were taking place. The use of the special conditions section with the terms contained therein, as well as the nature of the transactions and the systems, underscores this conclusion. We emphasize particularly, without restating all of the facts, that interest was charged each month on the remaining unamortized

purchase price, that "rent" was based on the system's effectiveness, that the customers' obligation to make monthly payments terminated when the full purchase price was paid (i.e., total "rent" equalled purchase price) and that there was a purchase option exercisable at any time at a price equal to the remaining unamortized balance of the purchase price. Although title remained with petitioner until payment of the purchase price, it was held only for security purposes as in a conditional sale. 20 NYCRR §526.7(c)(3); cf. Matter of The Bank of California, N.A., State Tax Comm., April 27, 1983; see also N.Y. U.C.C. Section 1-201 (37). Each of petitioner's energy control systems sold under a time-based agreement would, in effect, pay for itself, undoubtedly a feature of convenience to petitioner's customers as well as a selling point in petitioner's favor. Once the purchase price (plus interest) was paid via the purchasers' monthly fuel savings, the benefit of lower fuel payments afforded by the system (the reason for buying the system) went directly to the customer. Accordingly, based on the facts presented in this case, the time-based transactions at issue were sales and not true leases.

D. That section 1115(a)(17) of the Tax Law exempts from sales and use taxes "tangible personal property sold by a contractor...to a person...for whom he is adding to, or improving real property...by a capital improvement...if such tangible personal property is to become an integral component part of such structure, building, or real property". In view of the Audit Division's treatment of petitioner's systems as capital improvements when sold to customers outright rather than over time, together with the issuance, in good faith, of capital improvement certificates to petitioner, the systems sold by petitioner under the fuel savings participation plan were exempt from sales tax as they constituted sales of capital improvements. Tax Law §1101(b)(9); Safe-Tee Plumbing

Corp. v. Tully, 77 A.D.2d 1, (3rd Dep't., 1980); Matter of The Ralph M. Parsons Company, State Tax Comm., April 15, 1983.

E. That the petition of Hershey Enterprises, Inc. is granted to the extent that the portion of the deficiency relating to sales tax assessed on time-based transactions is cancelled. However, the portion of the deficiency relating to use tax assessed on miscellaneous purchases, as revised in accordance herewith ($123.92; see Finding of Fact "14"), is sustained.

DATED: Albany, New York

APR 29 1985

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER

P 693 169 761

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to Hershey Entertainment Inc	
Street and No. 642 Hoag Dr	
P.O., State and ZIP Code Pittsford NY 14534	
Postage	$
Certified Fee	
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	
Return receipt showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	$
Postmark or Date	

★ U.S.G.P.O. 1983-403-517

PS Form 3800, Feb. 1982

P 693 169 762

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to Thomas E Willett	
Street and No. Parks Beach Water House	
P.O., State and ZIP Code 2 State St Rochester NY 14614	
Postage	$
Certified Fee	
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	
Return receipt showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	$
Postmark or Date	

★ U.S.G.P.O. 1983-403-517

PS Form 3800, Feb. 1982