

STATE OF NEW YORK  
DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
DELTA SONIC CAR WASH SYSTEMS, INC.	:	DETERMINATION
for Redetermination of Deficiencies or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Fiscal Years	:	
Ended April 30, 1984, April 26, 1985, May 2,	:	
1986 and May 1, 1987.	:	

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Petitioner, Delta Sonic Car Wash Systems, Inc., 570 Delaware Avenue, Buffalo, New York 14202, filed a petition for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended April 30, 1984, April 26, 1985, May 2, 1986 and May 1, 1987 (File No. 807399).

On July 16, 1990 and August 16, 1990, respectively, the Division of Taxation by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel) and petitioner by its representative, Hodgson, Russ, Andrews, Wood & Goodyear (Mark S. Klein, Esq., of counsel) agreed to have the controversy determined on submission without hearing, with all documents and briefs to be submitted by December 27, 1990. After due consideration of the record, Daniel J. Ranalli, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioner's purchase of certain machinery and equipment qualifies for the investment tax credit under Tax Law § 210.12.

FINDINGS OF FACT

Petitioner, Delta Sonic Car Wash Systems, Inc. ("Delta Sonic"), filed New York State corporation franchise tax reports for the following periods claiming thereon net investment tax credits in the following amounts:

<u>Period</u>	<u>Net Investment Tax Credit Claimed</u>
5/1/83-4/30/84	\$ 3,345.00
5/1/84-4/26/85	6,339.00
4/27/85-5/2/86	21,253.00
5/3/86-5/1/87	22,605.00

On May 18, 1988, the Division of Taxation ("Division") issued to Delta Sonic a separate Statement of Audit Adjustment for each of the periods at issue herein disallowing in full the net investment tax credit claimed by petitioner. All four of the statements of audit adjustment contained the same explanation:

"In accordance with New York State Law, Section 210.12 of Article 9A of the Corporation Tax Law, in order for property to qualify for investment tax credit, the property must principally be used by the taxpayer in the production of goods by manufacturing, which means the process of working raw materials into wares suitable for use or which give new shapes, new quality or new combination to matter which already has gone through some artificial process by use of machinery, tools, appliances, or other similar equipment. Production of goods (wares) means to produce a produce [sic] for sale. Since your principal business activity is 'car wash', a service and not manufacturing, the investment tax credits claimed for this property have been disallowed."

Based on the statements of audit adjustment, the Division, on July 5, 1988, issued separate notices of deficiency to petitioner for each period at issue for the following amounts:

<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Total</u>
5/1/83-4/30/84 <sup>1</sup>	\$ 3,345.00	\$1,583.75	\$ 4,928.75
5/1/84-4/26/85	6,339.00	2,003.43	8,342.43
4/27/85-5/2/86	21,253.00	3,819.79	25,072.79
5/3/86-5/1/87	22,606.00	1,829.09	24,435.09

Petitioner and the Division entered into a Stipulation of Facts which provided, in part, as follows:

"Both the Petitioner and the Audit Division agree that the facts of this case are identical to those found by the State Tax Commission in the decision of Delta Sonic Car Wash Systems, Inc. TSB-H-87(48)S and agree to accept findings of fact 5 through 11, inclusive as the facts in this matter."

Findings of Fact "5" through "11" in the Matter of Delta Sonic Car Wash Systems, Inc. (State Tax Commn., January 9, 1987) are hereby incorporated verbatim in this determination, also as

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<sup>1</sup>The Notice of Deficiency dated July 5, 1988 for the fiscal year ended April 30, 1984 was timely issued inasmuch as petitioner consented to extend the statute of limitation for assessment for said period to any time on or before January 16, 1989.

Findings of Fact "5" through "11".

As part of its business operation, petitioner purchased water and also purchased certain raw materials, consisting of concentrated chemicals, in bulk. Petitioner established that the chemical concentrates were sold to its customers and the Audit Division excluded these purchases as purchases for resale.

Petitioner maintains facilities at several different locations in the greater Buffalo area. The overall process performed by petitioner is initiated by placing vehicles on a conveyor system, after which the vehicles are passed through various integrated and automated treatment stations where certain products, some of which are optional to the customer, are delivered to the said vehicles. The overall process lasts between one to three minutes, depending upon how quickly the vehicles are passed through the process. The customer chooses which of the various optional products he wishes to have applied to his vehicle and the selected products are delivered and applied to his vehicle during the process. Some of petitioner's products are included in its base price and are applied to every customer's vehicle. During the audit period, the base price for petitioner's process was approximately \$2.80 and a customer's selection to have all of the products applied to his vehicle increased the total cost to approximately \$4.30. The process was almost completely automated with persons employed only at the beginning to accept payment and to record the customer's purchase in the computer and at the end to assist in the drying process.

The machinery and equipment employed by petitioner in its process can be categorized as follows:

a. The first category of machinery and equipment used by petitioner includes those which dilute chemical concentrates to desired formulations, treat water with various chemicals, mix, pressurize, heat and purify the mixtures and those which pump and convey the mixtures to other locations for further mixing and/or conversion to foam;

b. The second category includes the cloth machinery, hydraulic systems and attendant items which produce foam from the mixtures of various chemicals and those which mix and

distribute waxes and conditioners. The cloth machinery serves to agitate the foam which results from the entrainment of air into the various liquid solutions;

c. The third category includes primarily the blow dryers which smooth and distribute the waxes and other materials and which also serve to dry the vehicles; and

d. The fourth category of machinery and equipment is that which initiates, regulates and controls the overall process. Included within this category are the computer, electric eye, conveyor system and other switching and regulatory devices which record the customers' purchases, regulate the flow of the materials dispensed to the vehicles, regulate the speed of the vehicles through the process and turn each machine on and off.

Traces of petitioner's chemical mixtures, foam and water remain on the vehicles of its customers after the completion of the process, most of which can be found in recessed or concealed areas of the vehicle and also on the undercarriage. A substantial portion of the waxes which are dispensed by petitioner's machinery and equipment remain on the vehicles' surfaces.

Petitioner did not offer for sale to its customers any of the chemical mixtures, foam, water or waxes which were mixed, treated or dispensed by its machinery and equipment. None of its customers have expressed a desire to purchase petitioner's products, but rather have requested that petitioner perform the service of washing, waxing or, in some other manner, applying certain products such as whitewall cleaner, chassis bath and rust inhibitor in conjunction with the basic service.

Petitioner contends that its machinery and equipment, as set forth in Finding of Fact "7", supra, were purchased for use directly and predominantly in the production by processing or manufacturing of various chemicals. It contends that it purchases raw materials, i.e., chemicals and water and converts them into different products which are sold to customers and carried out by the customers on their vehicles.

Petitioner purchases approximately six million gallons of water per year for each of its car wash locations. All of the water which is used in its process is chemically treated by petitioner. This water is dispensed to its customers' vehicles through pipes. Some of this water

remains on the customers' vehicles after completion of petitioner's process.

The record on submission contains a copy of the transcript of the hearing held on February 26, 1986, which hearing developed the record upon which the former State Tax Commission issued its decision dated January 9, 1987. Pursuant to a letter dated September 18, 1990 from petitioner's representative to the Division's attorney, the transcript of the February 26, 1986 hearing was submitted only in the event that "If the administrative law judge has any questions concerning the stipulated facts, reference to the transcript below would be very helpful." Accordingly, the transcript of the February 26, 1986 hearing was utilized only if the stipulated facts needed clarification and was not used to find facts in addition to the stipulated facts.

#### SUMMARY OF THE PARTIES' POSITIONS

Petitioner asserts that the machinery and equipment in question transform various raw materials, primarily highly concentrated liquid chemicals, into a different form, e.g., a foam, through, inter alia, the addition of water, pressurization, heat and the entrainment of air. Delta Sonic maintains that this process clearly qualifies as the manufacturing or processing of a good as contemplated in Tax Law § 210.12 and that, unlike the exemption contained in Tax Law § 1115(a)(12) with respect to sales and use taxes, Tax Law § 210.12 does not require that the goods produced be for sale.

The Division argues that the machinery and equipment in question are not involved in a manufacturing or processing function since the change in the raw material was, at best, superficial. Alternatively, the Division asserts that if the machinery and equipment is found to be utilized in a manufacturing or processing function, that said machinery and equipment was not "principally engaged" in manufacturing or processing and therefore can not qualify for the investment tax credit.

#### CONCLUSIONS OF LAW

A. Tax Law § 210.12(b)(i) provides for an investment tax credit with respect to tangible personal property and other tangible property, including buildings and structural components of

buildings, which are depreciable pursuant to section 167 of the Internal Revenue Code, have a useful life of four years or longer, are acquired by purchase as defined in section 179(d) of the Code, have a situs in New York and are principally used by the taxpayer in the production of goods by, inter alia, manufacturing, processing, assembling or refining.

B. Since the machinery and equipment in question constitute tangible personal property depreciable pursuant to section 167 of the Internal Revenue Code, have a useful life of four years or longer, were acquired by purchase as defined in section 179(d) of the Code and have a situs in New York, the determination in this matter turns solely on whether or not the equipment was principally used by petitioner in the production of goods by manufacturing, processing, assembling or refining.

C. Tax Law § 210.12(b)(ii)(A) defines manufacturing as follows:

"the process of working raw materials into wares suitable for use or which gives new shapes, new quality or new combinations to matter which already has gone through some artificial process by the use of machinery, tools, appliances and other similar equipment."

Processing is an operation whereby raw material is subjected to some special treatment, either artificially or naturally, which results in a transformation or alteration of the raw material's form, state or condition (Matter of Hudson Cold Storage & Freezer Corp., State Tax Commn., September 9, 1983.)

The term "principally used" as set forth in Tax Law § 210.12(b) is defined in 20 NYCRR 5-2.4(c) to mean "more than 50 percent.... Dual purpose machinery is principally used in production when it is used in production more than 50 percent of its operating time."

D. In a previous matter wherein petitioner claimed an exemption from sales and use taxes under Tax Law § 1115(a)(12) on identical machinery and equipment, the Appellate Division, Third Dept., found that "petitioner's facilities provide a taxable service to vehicles (citations omitted). As part of this service, tangible personal property in the form of water, foam and wax are applied to customers' vehicles by the machinery and equipment at issue." (Delta Sonic Car Wash Systems, Inc. v. Chu, 142 AD2d 828, 530 NYS2d 341 [emphasis added]). Petitioner was denied an exemption from sales and use taxes on the machinery and

equipment since the tangible personal property it produced was not for sale as required by Tax Law § 1115(a)(12). However, in determining whether the machinery and equipment qualify for the investment tax credit, Tax Law § 210.12(b) does not require that the goods produced be for sale.

E. The machinery and equipment at issue is clearly engaged in a manufacturing and/or processing function when it is transforming the various concentrated liquid chemicals into foam or diluted wax by the addition of water and air and through pressurization and heat. (See Matter of Niagara Frontier Services, Inc., Tax Appeals Tribunal, August 9, 1990; Matter of Nesbitt, Tax Appeals Tribunal, October 4, 1989; Matter of Plattekill Mountain Ski Center, Inc., State Tax Commn., March 9, 1984.) However, the manufacturing and/or processing function stops at the point that the various foams and waxes are produced and the same equipment and machinery is thereafter utilized in a service capacity, i.e., to apply the manufactured or processed good to the customer's automobile during the service of washing and waxing the automobile. In other words, a considerable portion of the machinery and equipment constitute "dual purpose machinery".

F. In a recent decision (Matter of National Fuel Gas Distribution Corporation, Tax Appeals Tribunal, March 14, 1991) the Tribunal concluded that gas compressors used both to remove water from natural gas and to increase pressure for distribution purposes qualified for exemption from sales and use taxes under Tax Law § 1115(a)(12). The Tribunal found that:

"the compressors were used predominantly in production because all of the time that they were operating to increase the pressure of the gas, the compressors would reduce the amount of water that could be carried by the gas. We conclude that it is immaterial that the water removal may not have been the primary purpose of the compressors. The regulatory requirement is clearly satisfied if the equipment is used 100% of its time directly in production. We see no basis for an additional rule that would require that the primary function of the equipment be in production."

The same rationale applied by the Tribunal above is equally applicable to the matter at hand. A considerable portion of the machinery and equipment in dispute is used all of the time in a qualifying function (to mix the various concentrated chemicals with water and to heat and/or pressurize); while at the same time this same equipment is used in a nonqualifying

function (to apply the manufactured and/or processed good to the customer's vehicle while performing a service). Since there is no requirement that the primary function of the machinery and equipment be in production and since a portion of the machinery and equipment in this proceeding was essential to the production of a good by manufacturing and/or processing, the provisions of Tax Law § 210.12(b) have been met.

G. As noted in Conclusion of Law "E", supra, petitioner's qualifying manufacturing and/or processing function stops at the point that the various foams and waxes are produced, i.e., at the point that these goods are ejected under pressure from a spray nozzle. As also noted earlier, a considerable portion of the machinery and equipment is used in this qualifying process. What is equally clear, however, is that some of the machinery and equipment, for instance the conveyor system used to bring vehicles through the washing and waxing process and the blow dryers, are not used at all in the manufacturing and/or processing function, but instead, are utilized entirely in the service aspect of petitioner's operation. Unfortunately, the record herein does not contain a breakdown of each specific piece of machinery and equipment, its cost and its function. Although some of the machinery and equipment at issue is eligible for the investment tax credit, the record contains insufficient detail to determine which machinery and equipment qualify. Accordingly, since the burden of proof rests with petitioner (Tax Law § 1089[e]), this record does not support a conclusion that petitioner has met its burden of proof.<sup>2</sup> (See Matter of John Grace & Co., Inc., Tax Appeals Tribunal, September 13, 1990.)

H. The petition of Delta Sonic Car Wash Systems, Inc. is denied and

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<sup>2</sup>As noted in Finding of Fact "12", supra, the transcript of the February 26, 1986 hearing before the former State Tax Commission was not used to find any new facts, but only to clarify the stipulated facts. There are not sufficient facts contained in said transcript to change or alter the conclusions reached in this determination, even if utilized to find facts in addition to the stipulated facts.



the four notices of deficiency dated July 5, 1988 are hereby sustained in their entirety.

DATED: Troy, New York  
April 18, 1991

ADMINISTRATIVE LAW JUDGE