

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition
of
T.V. DATA, 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, 1981 through May 31, 1984.

DECISION
DTA NO. 803016

Petitioner, T.V. Data, Inc., Northway Plaza, Glens Falls, New York 12801, filed an exception to the determination of the Administrative Law Judge issued on July 8, 1988 with respect to its 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, 1981 through May 31, 1984 (File No. 803016). Petitioner appeared by Baker and Hostetler (Christopher J. Swift, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Arnold Glass, Esq., of counsel).

Neither party submitted a brief on exception. The Division submitted a letter in opposition to the exception. Oral argument was not requested by either party.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

- I. Whether purchases made by petitioner were exempt from the imposition of sales and use tax because they were used or consumed directly and predominantly in the production for sale of tangible personal property.
- II. Whether petitioner has established that its failure to pay sales and use taxes due was due to reasonable cause and not due to willful neglect.

FINDINGS OF FACT

We find the facts as stated in the Administrative Law Judge's determination and such facts

are incorporated herein by this reference except that we modify findings of fact “5(a)”, “5(b)” and “6” to reflect a written stipulation reducing tax due on sales to \$1,362.80. In addition, we modify findings of fact “12(a)” and “12(d)” as indicated below. The remaining facts found by the Administrative Law Judge are summarized as follows.

Petitioner, T.V. Data, Inc., is in the business of providing television program listings to newspapers. On November 22, 1985, the Division of Taxation (the “Division”) issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1981 through May 31, 1984, assessing tax of \$93,689.95 plus penalty and interest. The assessment resulted from an audit of petitioner's books and records. The Division informed petitioner that its books were adequate and sufficient to warrant a complete audit of all its records. In lieu of such an audit, petitioner elected to allow the Division to conduct a representative test period audit. Its consent to this audit method was executed on August 23, 1985. Petitioner executed three consent forms which, taken together, extended the period of limitation for assessment of sales and use taxes for the period December 1, 1981 through August 31, 1982 to December 20, 1985.

The auditor analyzed petitioner's records in three areas.

Finding of fact “5(a)” is modified to read as follows:

(1) Sales. The auditor examined all sales for the period January 1, 1984 through June 30, 1984. This resulted in a determination that petitioner had failed to charge or collect tax from two vendors for whom no tax exemption certificates were on file. Petitioner's accounts receivable system disclosed that sales to these vendors were the same in each quarter; consequently, the results of the test period audit were used to determine additional taxable sales for the audit period of \$34,237.00 with a tax due on that amount of \$2,725.60. By written stipulation, the Division and petitioner agreed that the tax should be reduced to \$1,362.80, and petitioner conceded that this amount was due.

Finding of fact “5(b)” is modified to read as follows:

(2) Purchases. Purchase invoices for the year 1983 were analyzed to determine whether petitioner had paid tax on all of its taxable purchases. This resulted in a tax assessment of \$13,768.70 for the audit period.

Petitioner conceded this portion of the assessment.

Petitioner disputed the Division's assessment of an additional tax of \$4,838.48 on the ground that those purchases were exempt from sales and use taxes. The disputed purchases consisted of repair and maintenance contracts on petitioner's computer and typesetting equipment.

(3) Capital assets. Petitioner's records disclosed that petitioner had acquired capital assets during the audit period totalling \$1,033,673.89 on which no tax had been paid. At the time of audit, petitioner conceded that assets amounting to \$167,347.38 were taxable at the time of purchase and agreed to tax due on these assets of \$11,714.31. Petitioner contended that the remaining purchases of \$866,326.51 were not subject to sales tax on the ground that those assets consisted of machinery and equipment used directly and predominantly in the production of tangible personal property for sale. By a stipulation, the parties agreed that disputed purchases for the period ended February 28, 1982 should be reduced by a total of \$345,480.00 reducing the total amount of asserted tax due on capital assets to \$48,173.57 plus penalty and interest.

Finding of fact "6" is modified to read as follows:

The following schedule summarizes the status of taxes assessed after stipulation by the parties:

<u>Category</u>	<u>Tax Assessed</u>	<u>Revised Assessment</u>
Sales	\$ 2,725.60	\$ 1,362.80
Purchases	18,607.18	18,607.18
Capital assets	<u>72,357.17</u>	<u>48,173.57</u>
Totals	\$93,689.95	\$68,143.55

Newspaper readers are familiar with the television program listings found in most newspapers. Typically, these consist of a log or grid divided by time slots listing programs and the television channels on which these programs are broadcast. Petitioner provided these listings to newspapers in three different forms: camera-ready copy (also known as photocompositions); wire delivery (electronic impulses transmitted over telephone wires); and newspaper inserts. In order to produce the listings, petitioner first gathered information from television broadcasters regarding the programs they offered in various time spots. This information was entered into petitioner's

computers where it was stored in a program information file. Approximately nine percent of petitioner's operating expenses were attributable to the information gathering function.

Slightly less than 80 percent of petitioner's customers elected to receive the television listings in the form of camera-ready copy. This was a photo composition which the newspapers pasted on a board, either alone or with other copy. A photograph was taken of the paste-up to produce a mechanical which was used in the printing process. The production of the final camera-ready copy required a detailed process.

Newspapers were able to select a program listing format which conformed to their own style and needs. Petitioner's employees met with a newspaper's representatives to determine that newspaper's specific formatting requirements. The customer was given a wide variety of logos (or type styles), type sizes, layout styles, and other information to choose from.

Information regarding each customer's format specifications was stored in a separate computer file. The computer manipulated the data stored in each of the files (the program information file and the customer specifications file) to generate the television listings. This included merging of the files, editing of the listings, and justification of margins. A computer relayed commands to the typesetting (or photocomposition) equipment.

The typesetters produced television program listings on photographic paper which could be pasted up by the newspaper.

Approximately 20 percent of petitioner's customers received the television listings through wire delivery. An electronic device called an Atlas or "BSD" was placed at the customer's location. Through telephone wires, petitioner transmitted information from its files to the Atlas or BSD which stored it until it was transferred to the newspaper's computers. The information transmitted included the newspaper's format specifications as well as television program information, i.e., the two files were merged before being transmitted. Less than five percent of petitioner's customers elected to receive newspaper supplements. These consisted of small booklets containing articles, advertisements and television program listings. Petitioner produced the camera-ready copy for these

inserts. They were printed by a subcontractor.

Petitioner consistently filed sales tax returns throughout the audit period, showing no tax due on its own purchases. The Division assessed tax on all capital assets acquired during the audit period, including equipment associated with gathering and storing information, manipulating information and conveying information to the customer, whether in the form of camera-ready copy, electronic impulses or paper inserts. Petitioner provided a listing of each item which it believed to be exempt from tax and a brief summary of that item's function. It appears, with omission of references to audit periods and workpapers, as Appendix A.¹ A description of the items petitioner claimed to be exempt from sales and use tax follows.

Finding of fact "12(a)" is modified to read as follows:

(a) System C computer. The petitioner's computer equipment consisted of five computers (or "systems"), each interconnected to the others in a network. The computer network created the commands to drive the typesetting equipment, and together with the typesetting equipment functioned as a unit. The physical limitation on the number of electrical connections that could be joined to a single system prevented each of them from being linked without interruption to the typesetting equipment, but all were connected to that equipment. Each of the individual systems could be used to create the commands to drive the typesetter. Specifically, System C's function within the computer network was primarily to create the camera-ready copy. System C produced commands which drove the typesetting equipment through the linkage of System D.

(b) Typesetting machines and photocomposition equipment. This was the equipment which actually produced the camera-ready copy. It included: a disc drive containing the fonts or typefaces which were exposed by a cathode ray tube to produce print on photographic paper; the cathode ray tube; cassettes to hold rolls of photographic paper; and a water-saving device connected to the Logetronic ("Log-e"), the machine that developed the photographic paper.

(c) The Atlas and BSD units described above.

¹Included on this schedule were assets which petitioner agreed to as taxable at the time of audit, as shown in the auditor's workpapers.

Finding of fact “12(d)” is modified to read as follows:

(d) Video terminals and keyboards, used to input information into the computer network.

(e) Silver recovery unit. This device retrieved silver from the photocomposition fluids. The silver was sold to a film supplier who resold it.

(f) Raised floor tiling. A raised floor was installed in the computer room to allow electrical cables, pipefittings and air conditioning equipment to be installed under the floor.

(g) Miscellaneous. Other equipment included an electrical converter which prevented surges in electricity from damaging the electronic equipment, a bandprinter which printed the television listing information in draft form on regular paper, and electronic cables and devices linking the equipment.

OPINION

In the decision below the Administrative Law Judge concluded that petitioner did not qualify for the Tax Law section 1115(a)(12) exemption for certain equipment and machinery. Specifically, it was determined that the equipment and machinery at issue were not used directly and predominantly in the production of tangible personal property.

On exception petitioner contends that such equipment did have an active causal relationship in the production of tangible personal property. Further, petitioner argues that the items at issue were used directly and predominantly in the production of tangible personal property within the meaning of Tax Law section 1115(a)(12). As a result, petitioner claims the exemptions provided by Tax Law sections 1115(a)(12) and 1105-B(b) are applicable.

In response the Division contends that petitioner’s exception is not supported by the facts while the determination of the Administrative Law Judge is.

We affirm in part and reverse in part.

Tax Law section 1115(a)(12) provides an exemption from sales and use taxes for machinery and equipment with a useful life of more than one year that is used or consumed directly and

predominantly in the production of tangible personal property. We will address petitioner's exceptions on an item by item basis.

The first item to be examined is the System C computer. The facts indicate that the System C computer's function within the network was to create camera-ready copy by performing the bulk of the editing function. Specifically, it was used for inputting new information, updating the information, merging files and justifying files. It produced commands which drove the typesetting equipment through the linkage of System D.

The Administrative Law Judge determined that the System C computer did not qualify for the Tax Law section 1115(a)(12) exemption because it did not act upon or effect a change in tangible materials which became the final tangible product and because it did not direct the operations of the typesetters directly, i.e., by direct connection. While neither of these facts is in dispute, we do not agree that they prevent the System C computer from qualifying for the exemption. In order for machinery or equipment to be considered as used "directly" in production, 20 NYCRR 528.13(c)(1) provides that it must:

- “(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”

We agree that the System C computer does not fall within 20 NYCRR 528.13(c)(1)(i) since it does not effect a change in material to form the product to be sold. However, we find that the System C computer does have an active causal relationship in the production of the product to be sold within the meaning of 20 NYCRR 528.13(c)(1)(ii). It was one of five interconnected computers which formed the network that produced the commands to drive the typesetting equipment. The fact that the System C computer itself was not directly connected to the typesetting equipment does not

negate its role in the production of the camera-ready copy. The merging, justifying and updating of data done by the System C is a direct, necessary and integral part of the production of camera-ready copy. Without the processes provided by the System C the overall production process of the camera-ready copy would be incomplete. We find that it does have an active causal relationship in the production process as it updates, merges and justifies the information to make the camera-ready copy possible.

We also find that the System C computer was used predominantly in production since over 50% of its use was directly in the production phase (20 NYCRR 528.13[c][4]).

The next items to be examined are the video terminals and keyboards. We disagree with the Administrative Law Judge that the description offered by petitioner of such equipment was too vague to determine whether they were exempt. While the petitioner's description was brief, this was the case because the functions of the video terminals and keyboards do not require a prolonged explanation. Simply put, these items are the means by which information is entered into the computer network. Similar to the System C computer, these items do not act upon anything tangible, yet they play a direct, necessary and integral role in the production of the final tangible personal property that is produced. Without the video terminals and keyboards, the production process could never be completed. We find that the video terminals and keyboards do fall within the meaning of 20 NYCRR 528.13(c)(1)(ii) as having an active causal relationship in the product to be sold as they are responsible for entering information into the computer network.²

The next issue raised by petitioner is whether sales tax was properly imposed on petitioner's purchases of certain repair and maintenance services. Tax Law section 1105-B(b) and 20 NYCRR 527.14 exempt from the State sales tax the receipts from the sale of the services of installing, repairing, maintaining or servicing tangible personal property that is used directly and predominantly in the production of tangible personal property pursuant to Tax Law section

²It should be noted that the granting of the exemption for the System C computer, keyboards and video terminals seems to be in accord with the Division's interpretation as stated in TSB-M-79(7.1)5.

1115(a)(12). The record indicates that the repair and maintenance contracts at issue were for services performed on petitioner's computers and typesetting equipment. Since we have already determined that such equipment is used in production under Tax Law section 1115(a)(12), it follows that the repair and maintenance contracts are exempt from the State sales tax pursuant to Tax Law section 1105-B(b). Thus, we modify the determination of the Administrative Law Judge further in that we allow the section 1105-B(b) exemption for the contracts at issue.

The next items at issue are the equipment connecting the computers to the typesetters and the cable assembly. After reviewing the record, we agree that petitioner failed to show that purchases of this equipment qualified for the exemption. As a general rule, statutory exemptions from tax are strictly construed against the party claiming the exemption (Matter of Grace v. State Tax Commn., 37 NY2d 193, 196). The record indicates that petitioner's description of such equipment fails to provide enough information to precisely ascertain the function of each purchase in the production process.

We also agree that petitioner has not shown that its raised floor tiling was used directly and predominantly in the production process. While petitioner has established that the computer system was used predominantly in the production of tangible personal property, petitioner has not done so with respect to the raised floor tiling. 20 NYCRR 528.13(c)(4) provides that, "Machinery or equipment is used predominantly in production if over 50 percent of its use is directly in the production phase of the process." While petitioner has shown that the raised floor contributes to the production process, it has not been shown both that the floor was directly involved in the production process and if the floor was directly involved in the production process that it was used over 50 percent of the time in this manner.

The last issue before us concerns the imposition of penalty. The penalty for failure to timely file and pay sales taxes due may be remitted if the taxpayer establishes that the failure was due to reasonable cause and not due to willful neglect (Tax Law § 1145[a][1][ii]; 20 NYCRR 536.1[c]). The burden is on petitioner to establish the presence of reasonable cause and the absence of willful

neglect. We find that petitioner has failed to meet this burden. For example, petitioner conceded its liability for taxes on recurring purchases in the amount of \$13,768.70. However, petitioner did not present any evidence in support of its efforts to ascertain its tax liability on the recurring expenses. As a result, we sustain the imposition of penalty.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the petitioner, T.V. Data, Inc., is granted to the extent that its purchases of the System C computer and the keyboards and video terminals are held to be exempt from sales tax and to the extent the repair and maintenance service contracts for the computer system are held to be exempt from the State sales tax, but except as so granted is in all other respects denied;

2. The determination of the Administrative Law Judge is modified as indicated in paragraph "1" above, but except as so modified is in all other respects affirmed; and

3. The petition of T.V. Data, Inc. is granted to the extent indicated in paragraph "1" above and in conclusions of law "F", "K", "M" and "N" of the Administrative Law Judge's determination and the Division of Taxation is directed to modify the Notice of Determination issued on November 22, 1985 accordingly, but except as so granted is in all other respects denied.

Dated: Albany, New York
March 2, 1989

/s/John P. Dugan

John P. Dugan
President

/s/Francis R. Koenig

Francis R. Koenig
Commissioner