STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PHILIPP BROTHERS, INC.	:	DETERMINATION DTA NO. 805485
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, 1980 through May 31, 1985.	:	

Petitioner, Philipp Brothers, Inc., 1221 Avenue of the Americas, New York, New York 10020, filed a petition for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1980 through May 31, 1985.

A hearing was held before Marilyn Mann Faulkner, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on November 28, 1990 at 2:45 P.M., with all briefs to be submitted by March 18, 1991. Petitioner submitted a brief on February 7, 1991. The Division submitted its brief on February 27, 1991 and petitioner filed a reply letter on March 4, 1991. Petitioner appeared by Cunningham & Lee, Esqs. (Gerard W. Cunningham, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Peter J. Martinelli, Esq., of counsel).

ISSUES

I. Whether petitioner may amend its petition to conform to the evidence presented at hearing.

II. Whether petitioner was entitled to credit for sales tax already paid on certain purchases and for purchases installed out of state.

III. Whether the three-year period of limitations for assessment had expired for one quarter of the audit period.

IV. Whether certain software computer programs were intangible personal property exempt

from sales tax.

FINDINGS OF FACT

Petitioner, Philipp Brothers, Inc., is a commodity brokerage firm in Manhattan involved in the purchase and sale of precious metals and other commodities.

The Division of Taxation ("Division") performed an audit of petitioner's books and records for the period in question. Petitioner signed consent forms extending the period of limitation for assessment for the taxable period September 1, 1980 through August 31, 1982 until December 20, 1985.

The auditor determined that petitioner maintained a complete set of books and records; however, on November 7, 1983, petitioner's vice-president of taxes signed a consent agreement permitting the auditor to use the test period audit method in determining sales and recurring expense purchases. The month of May 1983 was selected as the test period for all sales, operating expenses and certain purchases. The Division performed a full audit with regard to the fixed asset acquisitions.

The auditor disallowed certain purchases with a New York City destination in the amount of $60,589.38, operating expenses in the amount of $999,436.35 and fixed asset acquisitions in the amount of $2,496,534.50.

The Division issued to petitioner two notices and demands for payment of sales and use taxes due, dated October 15, 1985. The notices assessed a use tax liability for the audit period in the amount of $643,391.46, plus interest, for a total due of $907,471.03.

Petitioner executed a "Consent to Fixing of Tax Not Previously Determined and Assessed" and, on October 22, 1985, paid the total amount of $907,471.03 to the Division in satisfaction of the use taxes due.

Petitioner submitted an "Application for Credit or Refund of State and Local Sales or Use Tax", dated November 18, 1985, requesting a refund in the amount of $907,471.03.

After a series of conferences between petitioner and the Division, the Division notified petitioner on January 22, 1988 that it would receive a refund of $537,304.65. The notification

letter stated that the determination denying the claim in part would be final and irrevocable unless petitioner completed the attached TA-9.1 (notification of right to protest) and submitted that form within 90 days from the date of the letter.

Thereafter, by letter dated April 21, 1988, petitioner confirmed that it conceded that tax was due in the amount of $299,521.39, but disputed the denial of refund in the amount of $68,118.27. According to an affidavit submitted by Anna Bloodworth, the team leader who supervises the audit unit which conducted the audit,[1] the items remaining in controversy involved taxable expense items and fixed asset acquisitions by petitioner from Cullinane Datable Systems,[2] Raid Systems and DBMS involving

total taxable transactions in the amount of $582,348.20. The sales tax generated by these items was $47,403.90, plus interest, which increased the total amount to $68,118.27.

By petition, dated April 20, 1988, petitioner challenged the denial of its refund claim in the amount of $68,118.27 asserting the following errors:

"1. Improperly conducted a test period audit.
2. Improperly assessed sales tax on capital improvement work.
3. Improperly assessed sales tax on the purchase of materials, goods and services that were not subject to the sales tax.
4. Refused to grant credits against the assessment for taxes previously paid.
5. Taxpayer properly paid sales and/or use tax on any transactions that were taxable and is entitled to a refund of the tax improperly assessed and paid, with interest."

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[1]According to the Division's counsel and Ms. Bloodworth's affidavit, the auditor who conducted the audit had left the Division's employment and was not available. The information provided in the affidavit was based on Ms. Bloodworth's review of the auditor's workpapers and file concerning the audit in question as well as discussions within the audit unit and with petitioner's representative. Ms. Bloodworth's affidavit was submitted subsequent to the November 28, 1990 hearing with the permission of the Administrative Law Judge.

[2]Although the affidavit refers to taxable fixed asset acquisitions in the amount of $242,800.00 by "Cullimore" Datable Systems, the workpapers attached to the affidavit have the handwritten notation of "Cullinane" Datable Systems next to amounts that total $242,800.00. Therefore, I assume that the affidavit mistakenly referred to Cullinane as Cullimore.

A formal hearing was held on November 28, 1990 at which time petitioner's counsel argued that, inasmuch as petitioner was challenging the test period, the amount it was contesting could exceed the $68,118.27 that was initially protested in the petition. Petitioner's counsel initially argued at hearing that the test period agreement was invalid because it was not filled out properly; that the consents to extend the three-year statute of limitations did not cover one of the quarters in question; and that purchases of computer software programs were not subject to sales tax.[3]

At the hearing, petitioner's counsel was advised by the Administrative Law Judge that because the amount contested at hearing exceeded the $68,118.27 contested in the petition, the parties should address whether the statute of limitations barred recovery with regard to issues that were not part of the initial $68,118.27 claim.

At hearing, petitioner's counsel submitted various documents into evidence. Petitioner's Exhibit "1" consisted of invoices and an affidavit by John Gerace, petitioner's employee, concerning petitioner's purchases of computer programs. In the affidavit, Mr. Gerace explained that the invoices attached to the affidavit all involved purchases of computer software. Also attached to the affidavit was an agreement between Cullinane Corporation and petitioner concerning the purchase of computer software products.

Petitioner's Exhibit "2" consisted of an invoice to petitioner from Jackson Communications indicating the purchase of telephones in the amount of $23,890.00 and sales tax of 8% in the amount of $1,911.20. At hearing, petitioner's counsel cross-referenced this amount to the auditor's workpapers wherein there was a handwritten notation "no bill" next to a

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[3]Petitioner's counsel stated that these arguments would be explained in his subsequent brief to the Administrative Law Judge; however, the letter briefs that were subsequently submitted by petitioner did not even mention the statute of limitations argument or explain why software purchases were not subject to sales tax. However, petitioner did state in brief that it withdrew its allegation that the test period audit was improper. Thus, it appears that petitioner also has abandoned its argument that the test period agreement was invalid.

purchase from Jackson Communications in the amount of $25,801.20. The Division's counsel questioned petitioner's counsel with regard to petitioner's Exhibit "2" as follows:

"Mr. Martinelli: Was this submitted during the time of negotiations?

Mr. Cunningham: It is very difficult to be certain, and I really cannot say. All of these -- there was meeting after meeting with boxes full of documentation. I just do not know.

Mr. Martinelli: With the understanding --

Mr. Cunningham: It was not refunded, that we do know." (Transcript 47.)

Petitioner's Exhibit "3" consisted of invoices from Allwin Office Furniture Co., Inc. totalling $130,672.39 which indicated that an 8% sales tax had been included in that amount. Again, petitioner's counsel cross-referenced this amount with a corresponding entry in the auditor's workpapers that contained the handwritten notation "no bill". The Division's counsel again stated his objection that there was no proof offered as to whether these invoices were presented to the auditor during the course of the refund negotiations.

Petitioner's Exhibit "4" consisted of invoices and a letter from Avanti Communication Corp. to petitioner indicating tax due in the amount of $112.00 with regard to $1,402.76 worth of purchases. Again, petitioner's counsel cross-referenced this amount with a comparable entry in the auditor's workpapers with the handwritten notation "no bill" and, again, the Division's counsel objected that no proof was offered that these invoices were not offered to the auditor for correction during the refund negotiations.

Petitioner's Exhibit "5" consisted of an invoice for the amount of $10,368.00 from C.E.D. Communications to petitioner and attached to the invoice was petitioner's interoffice memo requesting that payment be made in the amount of $10,368.00 for two mobile phones which were "installed for W. Harris and B. Lavinia, both of our Houston office." Petitioner's counsel argued that no tax was due on purchases installed in offices outside of New York State. Petitioner's counsel cross-referenced this amount with a comparable entry in the auditor's workpapers accompanied by the handwritten notation "no tax paid". Again, the Division's counsel objected that there was no proof offered that these documents were not presented to the

auditor for consideration in the refund negotiations.

Finally, petitioner's Exhibit "6" consisted of invoices from ABC Trading Co. to petitioner indicating that $96.64 represented an 8% sales tax on purchases that totalled $1,208.00. Petitioner's counsel cross-referenced the total amount of $1,304.64 to a comparable entry in the auditor's workpapers which also contained the handwritten notation "no bill". Again, the Division's counsel made the same objection as he did with petitioner's Exhibits "2" through "5".

In its letter brief, dated February 7, 1991, petitioner stated that in order to clarify the issue, it "hereby withdraws its allegation that the test period audit was improper" and "requests a decision awarding a refund of the sales tax improperly collected on the items presented at the November 28, 1990 hearing." With regard to the jurisdictional issue, petitioner asserted that it timely filed a petition on April 20, 1988 protesting the denial on January 22, 1988 of that portion of the refund claim in the amount of $68,118.27.

In the Division's letter brief, dated February 27, 1991, it claimed that the 90-day period, within which to file a petition, commenced in June of 1987. In support of its argument, the Division referred to petitioner's letter dated April 21, 1988 which stated that, after a series of conferences, the parties agreed that:

> "1. The taxpayer should receive a refund of $537,304.65;
> 2. The taxpayer conceded tax was due in the amount of $299,521.39; and
> 3. The taxpayer would have a hearing on the balance of the assessment in the sum of $68,118.27."

The letter also stated the following:

> "It took many months from the date of the agreement for the taxpayer to receive payment. In fact, it took from June of 1987 to February of 1988 to receive payment."

Apparently relying on these statements, the Division assumes that an agreement as to the amount owed and the amount in dispute was reached in June 1987 and, therefore, the statute of limitations commenced as of the June 1987 agreement.

Subsequent to the filing of briefs, the Division, by letter dated August 27, 1991, conceded the timeliness of the petition.

CONCLUSIONS OF LAW

A. The jurisdictional issue that arose during the course of the November 28, 1990 hearing resulted from petitioner's counsel's request that petitioner was seeking a refund in excess of the $68,118.27 asserted in the petition. The question was whether the 90-day statute of limitations barred petitioner's request for refund of amounts greater than the $68,118.27 protested inasmuch as petitioner previously had conceded that tax was owing in the amount of $299,521.39 (see Findings of Fact "9" and "20"). This issue was further aggravated by the fact that at hearing neither party could identify which items were the source for the $68,118.27 in dispute, the $299,521.39 previously conceded as tax owed or the $537,304.65 refund already granted by the Division after negotiations.

Subsequent to the hearing, the Division submitted an affidavit by Anna Bloodworth identifying the items in dispute with regard to the $68,118.27 (Finding of Fact "9"). The content of this affidavit has not been refuted by petitioner. Thus, in accordance with the information provided in this affidavit, the $68,118.27 initially disputed in the petition involved only purchases by petitioner from Cullinane Datable Systems, Raid Systems and DBMS.

At hearing, petitioner's counsel appeared to argue that because the test period was challenged in the petition, the requested refund would exceed the $68,118.27 stated in the petition and that the amount stated represented a computational error on his part. In its brief, however, petitioner affirmatively withdrew its challenge to the test period and requested relief only on the items presented at hearing (see Finding of Fact "11", footnote 2). Notwithstanding the withdrawal of the test period claim, however, petitioner would still need permission to amend the petition in order to include its claim that the three-year statute of limitations had run on one quarter of the audit period and that a refund was due regarding purchases from vendors other than Cullinane Datable Systems, Raid Systems and DBMS.[4]

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[4]Although petitioner's counsel did not formally request permission to amend the petition to assert the greater amount, his statements at hearing will be treated as a request to amend the pleadings to conform to the proof.

While an Administrative Law Judge may permit pleadings to be amended to conform to the evidence presented at hearing on "such terms as may be just.... No such amended pleading can revive a point of controversy which is barred by the time limitations of the Tax Law, unless the original pleading gave notice of the point of controversy to be proved under the amended pleading" (20 NYCRR 3000.4[c]).

Here, petitioner submitted a timely application on November 18, 1985 for refund of the entire $907,471.03 tax asserted in the notices and demand, dated October 15, 1985. The Division denied, in part, the refund

application in the amount of $370,166.38 by letter dated January 22, 1988. It is the Division's official denial on January 22, 1988 that commenced the 90-day statute of limitations period (see Finding of Fact "8"). Therefore, the petition, dated April 20, 1988, which was received by the Division of Tax Appeals on April 22, 1988, was timely filed.

Although the initial petition challenged only $68,118.27 of the refund denial, the original refund application challenged the entire $907,471.03 amount. The fact that petitioner apparently conceded in June of 1987 that it owed $299,521.39 of the amount requested in the refund application does not bar petitioner's request to amend the pleadings to conform to the evidence offered at hearing. Inasmuch as the Division has had adequate time to respond to the evidence and arguments offered at hearing, petitioner is granted permission to amend its petition to include claims that were not part of the $68,118.27 in dispute after negotiations (see, Matter of Diamond Terminal Corp., Tax Appeals Tribunal, September 22, 1988).

B. Although petitioner has been granted permission to amend its petition in order for me to consider evidence not associated with the $68,118.27 in dispute in the initial petition, it nonetheless has not established that this same evidence was not already considered by the Division during the refund negotiations. Indeed, petitioner's counsel admitted that he was uncertain whether the invoices presented at hearing were also presented to the Division during the months of refund negotiations (see Finding of Fact "14"). Although petitioner's counsel also

claimed that these documents were not the subject of a refund, no evidence was offered by way of affidavit, testimony or any other documentation to support this claim. Thus, with the exception of evidence involving Cullinane Datable Systems, Raid Systems and DBMS (see Finding of Fact "9"), it cannot be determined whether the Division already awarded to petitioner a refund with regard to this same evidence as part of the initial $582,348.20 refund. Therefore, although it appears that some invoices were not available during the original audit and, thus, the Division did not initially credit petitioner with the sales tax paid, petitioner has not met its burden of proof that it was entitled to a refund with respect to these items in addition to the refund already granted to petitioner.

C. At hearing, petitioner's counsel claimed that the consents signed by petitioner extending the limitations period for assessment did not cover one quarter. However, he did not identify the quarter he was referring to nor did he mention the claim in the subsequent two briefs. Thus, it appears petitioner has abandoned this claim. In any event, petitioner has not met its burden of proof on this issue.

D. The remaining issue is whether petitioner is entitled to a refund with regard to purchases from Cullinane Datable Systems, Raid Systems and DBMS. At hearing, petitioner's counsel stated that its purchase of software computer programs was not subject to sales tax. He did not state under which provision of the Tax Law the purchases of software programs were exempt from sales tax; however, it appears that petitioner is seeking to have its purchases of certain software equipment exempt from sales tax as intangible personal property.[5]

Tax Law § 1105(a) imposes sales tax on the receipts from every retail sale of tangible personal property. Tax Law § 1101(b) defines a "sale" as

"[a]ny transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume...." (Emphasis added.) However, software computer programs, if they meet certain

[5]The Division has presented no argument at hearing or in its brief in response to petitioner's claim that software was exempt from sales tax.

criteria, are considered intangible personal property and, thus, are not subject to sales tax. That criteria has been set forth in a Department of Taxation and Finance Technical Services Bureau Bulletin No. 1978-1(S), issued February 6, 1978, as follows:

> "Software [means] instructions and routines which, after analysis of the customer's specific data processing requirements, are determined necessary to program the customer's electronic data processing equipment to enable the customer to accomplish specific functions with his EDP system. To be considered exempt 'software' for purposes of this bulletin, one of the following elements must be present:
>
> A. Preparation or selection of the program for the customer's use requires an analysis of the customer's requirements by the vendor.
>
> or
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> B. The program requires adaptation, by the vendor, to be used in a specific environment i.e., a particular make and model of computer utilizing a specified output device. For example, a software vendor offers for sale a pre-written sort program which can be used in several computer models. Prior to operation, instructions must be added by the vendor which specify the particular computer model in which the program will be utilized.
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> The software may be in the form of:
>
> a. Systems programs (except for those instruction codes which are considered tangible personal property in paragraph 1 above) - programs that control the hardware itself and allow it to compile, assemble and process application programs.
>
> b. Application programs - programs that are created to perform business functions or control or monitor processes.
>
> c. Pre-written programs (canned) - programs that are either systems programs or application programs and are not written specifically for one user.
>
> d. Custom programs - programs created specifically for one user.
>
> Software meeting the above criteria, whether placed on cards, tape, disc pack or other machine readable media or entered into a computer directly, is deemed to be intangible personal property for sales tax purposes, and as such its sale is exempt from New York State and local sales and use taxes. Software or programs which do not meet the criteria are subject to tax."

In support of this contention, petitioner submitted into evidence an affidavit by an employee, John Gerace, who outlined petitioner's purchases from several vendors, including

Cullinane Corporation, Raid Systems and DBMS.[6] With regard to Cullinane Corporation,[7] Mr. Gerace stated that Cullinane installed seven separate and distinct systems that were compatible with petitioner's hardware and listed these systems as follows:

IDMS/Central Version/CMS
IDMS - DC
Integrated Data Dictionary
On Line Query
IDMS/Culprit
ADS Batch
Shared Database System

Mr. Gerace also stated that an agreement between Cullinane Corporation and petitioner granted to petitioner a license to use the software products developed by Cullinane exclusively for petitioner. Attached to the

affidavit was the agreement which set forth the terms and conditions of the agreement but which provided no further description of the products other than listing the seven systems, as stated in the affidavit, with their separate license fee and annual maintenance fee.

With regard to DBMS, Mr. Gerace stated that petitioner's licensing agreement with DBMS in the amount of $18,500.00 involved the use of DBMS's "IDMS Tool Kit Installation - DOS" which "was developed by DBMS after it analyzed Petitioner's hardware and existing software systems and was adapted by DBMS to be used by Petitioner in its financial operations with its clients and branch offices" (Pet. Exh. "1", Affidavit ¶ 10). Mr. Gerace also stated that petitioner's purchases from Raid Systems in the amount of $6,745.00 was for a unique program

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[6]As noted in Conclusion of Law "B", because the software products purchased from vendors other than Cullinane Corporation, Raid Systems and DBMS were not part of the $68,118.27 in dispute, they will not be considered inasmuch as no evidence has been submitted by petitioner that the $582,348.20 refund did not cover these purchases.

[7]From the attachments to the Gerace affidavit, it is apparent that Anna Bloodworth's reference to Cullinane Datable Systems was intended to refer to the Cullinane Database Systems, Inc. software products that were covered by an agreement between Cullinane Corporation and petitioner.

developed by Raid "to interface Petitioner's existing hardware and software with Reuters Monitor I and 4-p software systems" (Pet. Exh. "1", Affidavit ¶ 11).

Petitioner has provided no other information concerning the software purchases from Cullinane Corporation, Raid Systems or DBMS other than the bare conclusions made in Mr. Gerace's affidavit that the alleged software programs were developed by the vendors after they analyzed petitioner's existing hardware and software systems. No information was provided describing the specific functions of the purchased software programs or how those programs were individualized for petitioner's use. Thus, there are no facts in this record upon which a determination can be made that the software in question meets the criteria as intangible personal property (see, Advisory Opinions, TSB-A-90[44]S, TSB-A-90[24]S, TSB-A-89[13]S). In sum, petitioner has not met its burden of proof with regard to its software claims.

E. The petition of Philipp Brothers, Inc. is denied and the refund denial is sustained.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE