

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-98(24)C
Corporation Tax
December 2, 1998

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C970630A

On June 30, 1997, a Petition for Advisory Opinion was received from Xerox Corporation, c/o Mark S. Klein, Esq., Hodgson, Russ, Andrews, Woods & Goodyear LLP, 1800 One M&T Plaza, Buffalo, New York 14203-2391.

The issue raised by Petitioner, Xerox Corporation, is whether its purchase of certain tooling equipment is eligible for the investment tax credit under section 210.12 of the Tax Law.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner is a New York corporation primarily engaged in the production of office equipment, most notably copiers. Petitioner sometimes subcontracts the production of certain component parts of its copier machines and other equipment. In these circumstances, Petitioner provides tooling (dies and molds) to the subcontractors to help ensure that the component parts produced meet the Petitioner's manufacturing specifications. In addition, in all cases:

- the subcontractors are located in New York and the component parts are produced in New York;
- the tooling is provided to subcontractors without charge;
- the tooling may be used only in the manufacture of components for Petitioner or its subsidiaries or affiliates;
- all parts produced using the tooling are sold to Petitioner or related corporations that are identified in Petitioner's standard master purchase agreement;
- the tooling is returned to Petitioner when the particular work order is completed;
- Petitioner owns the tooling;
- Petitioner acquires the tooling by purchase under section 179 of the Internal Revenue Code ("IRC");
- Petitioner claims a depreciation deduction pursuant to section 167 of the IRC;
- the useful life of the tooling is greater than four years.

Petitioner relies upon the subcontractors' expertise in providing technical support as requested by Petitioner to ensure manufacturability, cost effectiveness, quality and reliability of the component parts made. The component parts made are to be produced subject to Petitioner's specifications and quality standards. Petitioner may authorize a subcontractor to purchase raw materials for the production of the component parts and no substitution of materials shall be permitted unless previously agreed to by Petitioner. The component parts produced by the subcontractors are subject to satisfactory completion of qualification tests by Petitioner prior to any release of production quantities to Petitioner.

Petitioner specifically states that:

1. Although Petitioner owns tooling in many parts of the United States, 100 percent of the tooling on which the New York investment tax credit will be claimed is located in New York State.
2. The tooling in the hands of the subcontractors is used principally (more than 50 percent of the time of use of the tooling) in producing components that are transferred to Petitioner (as opposed to affiliates or anyone else) for the purpose of producing (as opposed to servicing) office equipment in New York State.
3. There is no lease of Petitioner's tooling to subcontractors or anyone else. Petitioner owns and controls the use, maintenance, storage and possession of all of the tooling. Petitioner uses the tooling, although it hires the efforts of subcontractors to operate the tooling in fulfillment of their production contract with Petitioner. The following represents some specific examples of the nature and extent of Petitioner's control of the tooling while in the hands of the subcontractors:
 - a. All tools are purchased by Petitioner and are manufactured to Petitioner's exacting tolerances.
 - b. All tools are tagged with Petitioner identification tags and inventory control numbers to reflect that Petitioner is the owner of the tooling.
 - c. Petitioner owns the tooling for its entire useful life, and the tools are listed on Petitioner's books as Petitioner's assets.
 - d. Petitioner maintains detailed records concerning the whereabouts of each and every piece of tooling located on a subcontractor's premises.
 - e. Petitioner's personnel periodically conduct asset verification of the tooling that is located on the subcontractors' premises.

f. Petitioner representatives visit the subcontractors' sites to insure that the equipment is being used properly and to insure the quality control of the parts produced by the subcontractors.

g. The subcontractors are explicitly forbidden from using Petitioner's equipment on behalf of anyone other than Petitioner. Any other use of the tooling by the subcontractors is strictly prohibited.

h. At the conclusion of a subcontractor's contract, the tooling is returned to Petitioner, or it might be forwarded to another subcontractor pursuant to Petitioner's instructions.

i. At any time, at Petitioner's request, the tooling must be returned to Petitioner. The subcontractors cannot impose any charge or penalty for this.

j. The tooling cannot be removed from a subcontractor's premises without the approval of Petitioner.

k. If the tooling becomes unusable and must be disposed of, Petitioner pays for the disposal and is considered the "generator" of the waste for waste removal purposes.

Discussion

Section 210.12 of the Tax Law allows an investment tax credit against the tax imposed under Article 9-A of the Tax Law. For taxable years beginning after 1990, section 210.12 allows an investment tax credit equal to five percent with respect to the first \$350 million of the investment credit base and four percent with respect to the investment credit base in excess of \$350 million. The investment credit base is the cost or other basis for federal income tax purposes of qualified tangible personal property and other tangible property, including buildings and structural components of buildings.

Under section 210.12(b) of the Tax Law and section 5-2.2 of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations"), the term "qualified property" means tangible personal property and other tangible property, including buildings and structural components of buildings, which:

- (1) is acquired, constructed, reconstructed or erected by the taxpayer after December 31, 1968;
- (2) is depreciable pursuant to section 167 of the Internal Revenue Code;
- (3) has a useful life of four years or more;

- (4) is acquired by the taxpayer by purchase as defined in section 179(d) of the Internal Revenue Code;
- (5) has a situs in New York State; and
- (6) is principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing.

Section 210.12(d) of the Tax Law and section 5-2.3 of the Article 9-A Regulations provide that tangible personal property which a taxpayer leases to any other person or corporation does not qualify for the investment tax credit. For purposes of the preceding sentence, any contract or agreement to lease or rent or for a license to use such property will be considered a lease. However, in cases where production property is leased in form and the lessee is, in fact, the beneficial owner and entitled to take Federal depreciation of the property and the property otherwise qualifies, the lessee may be entitled to take the investment tax credit.

In this case, Petitioner states that it owns the tooling, the tooling is acquired by purchase pursuant to section 179(d) of the IRC, Petitioner is entitled to a depreciation deduction under section 167 of the IRC and the tooling has a useful life of more than four years. These facts are assumed for purposes of the opinion. Therefore, the questions remaining are whether the tooling (1) is principally used by Petitioner in the production of goods by manufacturing and (2) is not leased.

Petitioner enters into an agreement with subcontractors whereby the subcontractors use the tooling, in New York State, to manufacture the component parts for Petitioner for use in the production of Petitioner's office equipment. The tooling is purchased by Petitioner and is manufactured to Petitioner's exacting tolerances, and is provided to subcontractors without charge. The tooling may only be used by the subcontractors in the manufacture of the components for Petitioner, and when the work order is completed, the tooling is returned to Petitioner. Petitioner authorizes the subcontractors to purchase the raw materials to be used in the production of the component parts. The component parts are produced pursuant to Petitioner's specifications and quality standards, and after the component parts are produced, they are subject to qualification tests by Petitioner. The tooling is principally used (more than 50 percent of the use of the tooling) by the subcontractors in producing components that are transferred to Petitioner (as opposed to affiliates) for the purpose of producing (as opposed to servicing) office equipment. This satisfies the principal use requirement.

Petitioner describes various examples of its control over the use, maintenance, storage and possession of all of the tooling, such as maintaining detailed records concerning the location of the tooling which is periodically verified; controlling the movement of the tooling; monitoring the tooling for proper usage and quality control of components; and being responsible for the proper disposal of the tooling. Those facts indicate that the tooling is not leased, but is used by the

subcontractors under Petitioner's supervision. Thus, the tooling is not leased within the meaning of section 210.12(d) of the Tax Law and section 5-2.3 of the Article 9-A Regulations.

Since the tooling is principally used, in New York State, in producing the component parts used in the production of Petitioner's office equipment in New York State, Petitioner is using the tooling in the production of its office equipment by manufacturing, processing or assembling. Accordingly, Petitioner's tooling equipment used by the subcontractors to manufacture the component parts for Petitioner's office equipment qualifies for the investment tax credit pursuant to section 210.12 of the Tax Law and Subpart 5-2 of the Article 9-A Regulations.

DATED: December 2, 1998

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.