Investment Tax Credit for Computers and Computer-Related Equipment

General

Taxpayers have asked whether computers and computer-related equipment principally used in the production of goods qualify for the investment tax credit (ITC). Section 210.12 of Article 9-A of the Tax Law says:

> "(b) A credit shall be allowed under this section with respect to tangible personal property and other tangible property, including buildings and structural components of buildings which are: depreciable pursuant to Section 167 and 168 of the Internal Revenue Code, have a useful life of four years or more, are acquired by purchase as defined in Section 179(d) of the Internal Revenue Code, have a situs in New York State and are 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."

Thus, if a taxpayer produces goods, the ITC is allowed on property principally used in the production of such goods if the property meets the qualifications set forth in Section 210.12. In addition, where tangible personal property and other tangible property is purchased by a taxpayer providing a service to another business, the taxpayer will be entitled to the ITC only if the other business would have been entitled to the credit had it purchased the property and used it in a manner identical to its use by the taxpayer.

Determination of Property Eligibility

In determining whether the investment tax credit is allowed or disallowed on computers and/or computer-related equipment the facts in each case must be considered for consistent allowance or disallowance of the credit. A primary consideration is how the property is used in the production of goods. The term "manufacturing" is generally defined for tax purposes as the production, by hand or machinery, of a new or different article from raw or prepared materials (See 20 NYCRR 5-2.4(a)). A particular process must bring about a substantial or significant change in the basic material in order to constitute manufacturing; a superficial change in the basic material does not amount to manufacturing. Further, "processing" has been defined as the performance of any service on tangible personal property for the owner which effects a change in the nature, shape or form of the property.

A second consideration is to what extent the computer and/or computer-related equipment is used in the production process, including all applications handled by the computer and/or the computer-related equipment and the percentage of operating time devoted to each application. The term "principally used" means more than 50 percent. Dual purpose machinery and equipment is principally used in production when it is used in production more than 50 percent of its operating time.

Background Decisions

In the Matter of Multimode, Inc. (TSB-H-83(23)C), the taxpayer's computer was used to make a list of names and addresses in the form of magnetic tape. The names and addresses on the magnetic tape were printed in various formats, including mailing labels, by using a computer printer which was hooked into the computer. The State Tax Commission found that the computer qualified for the credit since its use by the taxpayer in its printing activities constituted processing.

In the Matter of Epic Chemicals, Inc. (TSB-H-81(59)C), the taxpayer's computers were used to make mathematical calculations relating to alterations of chemical formulae based upon inventory and cost factors to keep manufactured products within quality and profitability parameters. The computers were primarily used to aid in the making of management decisions. They did not physically act upon any raw materials and did not constitute part of the manufacturing process. The State Tax Commission found that the computers were not used in manufacturing and therefore did not qualify for the investment tax credit.

In the Matter of the Reader's Digest Association, Inc. (TSB-H-83(24)C), the taxpayer's computer equipment was used to maintain and update their customer list and match customers to promotional offers; the computer also performed regression analyses (statistical affinity tests), which ranked names in the order of likelihood of response to a product offer. Once the names were selected, the computers matched them to various promotional offers and printed on the offers various "personalized" items such as "Dear Mr. and Mrs. Doe" and the address of the Doe's residence. Collation and mailing were performed both by the petitioner and/or the independent contractor.

Upon petitioner's receipt of a positive customer response, the computer matched the customer's order with the product inventory and printed out a mailing label via the printing subsystem.

The computers also executed various accounting functions, including maintenance and updating of inventories, production of general ledgers and customer billing. Approximately 43 percent of computer time was devoted to promotion and personalization, 16 percent to master file updating and approximately 6 percent to matching orders and producing labels for magazines and other publications.

In this decision, the State Tax Commission found that computer-printed personalization on the promotional literature did change the literature and constituted processing. However, the petitioner failed to establish that the printing activities (performed on the literature and mailing labels) occupied over 50 percent of computer time and therefore that the computer equipment was "principally" used in processing. In this instance, the investment tax credit was disallowed, not because of the nature of the property, but rather because the property was not principally used in the production of goods.

General Examples

Corporation A operates a data processing service bureau. It receives information from its customers in the form of voluminous records and transfers this information onto diskettes and computer tapes. A's customers have various uses for the information on the tapes depending on what type of business they are in, such as printing mailing labels or making printouts of inventories, payrolls, credit reports, etc. Computers and related equipment would not qualify for the investment tax credit since no change is effected on A's property.

Corporation B is a newspaper publisher that uses computerized equipment exclusively for automatic typesetting. This equipment qualifies for the investment tax credit since it is directly used by the taxpayer in the production of goods (newspapers).

Corporation C is an electronics manufacturer that makes printed circuit boards. A computer is used to run the drill press that plots the points to be drilled for insertion of the various electronic components of the board. After the board is wave-soldered, another computer, using a test pin fixture, checks each component on the board and prints out locations of faulty components. Both computers would qualify for the investment tax credit.

Corporation D is a printer of mailing labels for various publishers and advertisers. Data is supplied to Corporation D by its customers in various forms, some of which must be keyed into the computer prior to processing various mailing lists and labels, including packaging labels. Corporation D processes the mailing lists and prints mailing labels, which are returned to its customers who affix the labels to the product and use the list as a check-off for their mailing. Approximately 70 percent of total computer operating time is used for list processing and printing of labels. The computer and related equipment qualify for the investment tax credit since Corporation D produces goods by processing the data onto blank labels.

General Guidelines

Computers used by the printing industry qualify for the investment tax credit if they are principally used in the production of newspapers, magazines or periodicals beginning at the inputting of printed or graphic material and continuing through various processes such as printing, cutting, insertion and bailing if such processes are in an assembly line set-up.

Related equipment used in the news gathering and storage processes also qualifies if it is part of the assembly line process that produces newspapers, magazines, periodicals, etc. Such equipment includes video setters, UTS controllers, mini disk terminals and modems.

Equipment used at loading docks does not qualify for the investment tax credit since it is considered part of the distribution process and not the manufacturing process.

Capital expenditures for modernization of building interiors qualify for investment tax credit if the production facilities constitute the principal use of the building and the capital expenditures have a useful life of four or more years; however, capital expenditures which can be identified as being applicable only to a nonproduction area are not allowable.

Equipment purchased for the advertising offices, business offices, sales offices and distribution offices does not generally qualify for the investment tax credit since equipment is not principally used in the production process.

Conclusion

Computers and computer-related equipment used by taxpayers will qualify for the investment tax credit if such property is principally used in the production of goods or if it effects a substantial or significant change in the nature, shape or form of tangible personal property. Property which only superficially changes the basic materials will not qualify for the credit. Such property includes data processing, keypunching equipment, photocopying machines and other similar office equipment.