STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I971103A

On November 3, 1997, a Petition for Advisory Opinion was received from Gordon S. Bagwell & Sandra R. Sunday, 529 W 42nd Street, #2-V, New York, New York 10036.

The issue raised by Petitioners, Gordon S. Bagwell & Sandra R. Sunday, is whether the Docutech Publishing System is eligible for the investment tax credit under section 606 of Article 22 of the Tax Law.

Petitioners submit the following facts as the basis for this Advisory Opinion.

Petitioners state that a Xerox Docutech is a high volume xerographic copier. It is different from conventional copiers in that it accepts originals electronically (via magnetic media) in addition to accepting originals in the conventional "light lens" method. It can run copy jobs as large as one million plus and as small as one. Petitioners do not have percentages based on job size or usage. Long print runs are the norm.

A Docutech Publishing System is capable of accepting previously unrelated materials: photographs, charts, spread sheets, pre-printed inserts, electronic media, et al. Utilizing a computer-based interface, these materials are integrated, edited, cropped, re-sized, merged, and printed, often-times using a glue bind to assemble the finished work in book form.

Petitioners state that the Docutech Publishing System takes four raw ingredients: paper, toner (plastic), developer (magnetic material), and spool-fed binding tape. Pages are printed according to digitized optical input, and these materials are then collated on-line, and are often bound on-line, to create a variety of end-user applications. Among these applications are paperback books, manuals, magazines, sales guides and legal briefs.

Petitioners operate Kinko's of Manhattan and many of Kinko's professional clients rely on these products for their final product, whether it be for an internal or external customer. Customers for the Docutech often require the integration of previously unrelated materials such as computer disks, transparencies, photographs, linotronic output, etc. Whereas in the past Kinko's customers were required to create their documents using non-photocopying machine equipment, the Docutech is a technological break-through that allows this work to be done in an integrated fashion, electronically.

Kinko's houses the Docutech in a non-retail portion of its location. The machine is in a separate part of the store reserved for corporate customers requiring the features described above. It is organized in a fashion distinctly different from the retail photocopying store. The machine is operated only by highly-trained technicians, and is in operation during a normal production schedule Monday through Friday.

In contrast, customers that require "photocopying" at Kinko's are traditionally steered toward traditional "photocopying machines" that produce faithful duplicates of the originals supplied. There is no reason to incur the additional cost of Docutech production for this business.

Section 606(a) of the Tax Law allows an investment tax credit against the tax imposed under Article 22 of the Tax Law. For taxable years beginning after 1986, section 606(a) allows an investment tax credit equal to four percent of the investment credit base. The investment credit base is the cost or other basis, for federal income tax purposes, of qualified property.

The term "qualified property", under section 606(a)(2)(A) of the Tax Law and section 106.1(c)(1) of the Personal Income Tax Regulations, means tangible personal property and other tangible property, including buildings and structural components of buildings, which:

(1) is acquired, constructed, reconstructed or erected after December 31, 1986;

(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 606(a)(2)(B)(i) of the Tax Law provides that the term "manufacturing" shall mean "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 has been defined, by the former New York State Tax Commission, as 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 Continental Terminals, Inc., Dec St Tax Commn, March 5, 1982, TSB-H-82(4)C.) Section 106.1(d)(3) of the Personal Income Tax Regulations provides that the term "principally used" means 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.

For purposes of the investment tax credit, section 606(a) of Article 22 is substantially similar to section 210.12 of Article 9-A. Under Article 9-A, investment tax credit for computers and computer-related equipment was addressed in Technical Services Bureau Memorandum TSB-M-87(5)C, May 15, 1987. It concluded that computers and computer-related equipment used by taxpayers will qualify for the investment tax credit if the 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. The memorandum’s general guidelines provide that 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. The memorandum includes the following as 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.
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> Corporation B is a newspaper publisher that used 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).
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> 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.

In the Matter of Multimode, Inc, Dec St Tax Commn, May 20, 1983, TSB-H-83(23)C, the company was entitled to take an investment tax credit on its purchase of a computer since the computer was principally used in the production of goods by processing. About 70 percent of the company's business was comprised of transferring names and addresses from "hard copy", including order blanks and shipping invoices, into a list in the form of magnetic tape according to criteria such as income or geography and used in printing mailing labels. The printing of the mailing labels by using a computer printer which was hooked into the computer was considered to be processing.

In the Matter of Reader's Digest Assoc v State Tax Commn, 103 AD2d 926, computer-printed personalization on promotional literature did change the literature and constituted processing, however, it was denied an investment tax credit for the cost of two computers because they were used in the production of goods by processing less than 50 percent of the time.

In the Matter of Super Data Systems, Inc, Dec St Tax Commn, June 1, 1984, TSB-H-84(26)C, the petitioner was denied an investment tax credit on the purchase of data processing equipment because the equipment was not used in the production of goods by processing, but was used merely to transfer its customer's information into a more compact form, such as cards, diskettes or tapes, for later use by the customer for various purposes.

A taxpayer that was engaged in the business of preparing publications for mailing was not entitled to an investment tax credit for its acquisition of labeling and addressing machines, a typing machine, and a mail inserting machine because the equipment used to affix the mailing labels on catalogs, magazines, newspapers and other publications it received from its clients was not used in the production of goods by processing or assembling. Matter of Brigar, Inc v Chu, 105 AD2d 587.

In this case, the Docutech Publishing System takes previously unrelated materials such as photographs, charts, spread sheets, preprinted inserts and electronic media and integrates, edits, crops, re-sizes, merges and prints the new material, sometimes also binding the material into books, manuals, magazines, sales guides and legal briefs. This operation of the Docutech Publishing System is similar to the activities performed by Corporation D in the general examples in TSB-M-87(5)C, supra, and Multimode, supra, and constitutes the production of goods by processing. However, the mere copying of a customer's material without the integrating, editing, cropping, re-sizing, and merging aspects of the operation is the provision of a service and does not constitute the production of goods.

Accordingly, if Petitioners' operation of the Docutech Publishing System is used more than 50 percent of its operating time in integrating, editing, cropping, re-sizing and merging their customers' materials as well as printing the material, the Docutech Publishing System is principally used in the production of goods by processing and will qualify for the investment tax credit if the property also meets all of the other requirements contained in section

606(a) of the Tax Law. If the Docutech is used 50 percent or more of its operating time to photocopy customers' materials without integrating, editing, cropping, re-sizing or merging the material before printing, the Docutech Publishing System is not principally used in the production of goods and will not qualify for the investment tax credit under section 606(a) of the Tax Law.

DATED: February 25, 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.