

NO. CV 06 4009194

SIKORSKY AIRCRAFT CORPORATION : SUPERIOR COURT

: TAX SESSION

v.

: JUDICIAL DISTRICT OF

: NEW BRITAIN

PAMELA LAW, COMMISSIONER OF
REVENUE SERVICES

: MAY 16, 2007

MEMORANDUM OF DECISION

In this tax appeal, the plaintiff, Sikorsky Aircraft Corporation (Sikorsky) challenges the commissioner of revenue services' (commissioner) denial of a refund of sales and use taxes previously paid for the period of April 1, 1995 through December 31, 2002. During this period of time, Sikorsky claims that it purchased various aircraft manufacturing personal property for use in its Stratford facility and either paid sales tax to its vendors upon the purchase of such property, or self-assessed and paid use tax upon the purchase of such property.

The issue in this case is whether the purchase of materials, tools, fuel, machinery and equipment used for research and development (R & D) by an aircraft manufacturer, as part of the manufacturing of aircraft, parts and components in an aircraft manufacturing facility, qualify for exemption from sales and use taxes pursuant to the aircraft exemption, General Statutes § 12-412 (78).

The facts in this case, as recited by the commissioner, are as follows:

“Sikorsky, which is a wholly-owned subsidiary of United Technologies Corporation (‘UTC’), is a Delaware corporation with a principal place of business in Stratford, Connecticut. In addition to manufacturing aircraft, specifically helicopters, and aircraft parts, Sikorsky also overhauls and repairs aircraft and aircraft parts and conducts research and development in connection therewith. Sikorsky performs these activities at a variety of locations . . . in Connecticut The Department of Revenue Services (‘Department’) conducted a Sales and Use Tax audit of Sikorsky for the period April 1, 1995 through December 31, 2002 (‘Audit Period’). The audit resulted in a net refund being issued to Sikorsky in the amount of approximately \$1,900,000.

“Throughout the Audit Period . . . Sikorsky purchased *materials, tools, fuel, machinery and equipment for use in conducting research and development*. In connection with its purchases of these items, Sikorsky contends that it either paid sales tax and/or accrued use tax thereon.” (Emphasis added; footnotes omitted.) (Defendant’s memorandum of law, dated February 23, 2007 (hereinafter defendant’s 2/23/07 MOL), pp. 2-3.)

The issue revolves around the commissioner’s construction of the words “materials, tools, fuel, machinery and equipment for use in conducting research and development” used in her memorandum of law. The commissioner contends that Sikorsky’s use of materials, tools, fuel, machinery and equipment for R & D does not

qualify for the aircraft exemption from the sales and use tax because the property is not used for manufacturing aircraft, parts or components.

The commissioner and Sikorsky take distinct positions with regard to what activities constitute R & D and manufacturing. The commissioner separates and compartmentalizes materials, tools, fuel, machinery and equipment used in R & D from the manufacturing side of aircraft, parts or components. On the other hand, Sikorsky contends that R & D is wholly integrated within the process of manufacturing helicopters, their parts and components.

Marc Poland, Sikorsky's vice president of commercial programs, described the process Sikorsky used in manufacturing helicopters, parts and components. Mr. Poland testified that the research and engineering operations unit provides technical service to a variety of company pursuits including "new product development, support of manufacturing operations, support of aircraft in the field, customer support in general, in terms of technical inquiries[,] as well as basic research which would go to advancing . . . the state of the art in a variety [of] disciplines." (Transcript of December 13, 2006 (hereinafter Tr.), p. 9.)

Mr. Poland testified credibly that Sikorsky implemented "integrated product teams" (IPTs) for product development¹ in the mid-1980's and, as a result, Sikorsky does

¹

Mr. Poland described product development as "[involving] the creation of new products and very typically [involving] more than just the research and engineering department. It also involves product support, specialists, financial analyst, commercial or procurement expertise and manufacturing or production expertise." (Tr., p. 12.)

not have a separate R & D unit that is solely responsible for researching new products and then passing the research results to Sikorsky's manufacturing side.²

Sikorsky found that the production and support of the helicopters could be manufactured more efficiently through the use of the IPTs because the production of helicopters is interdependent and interrelated, not as the commissioner contends, separate and distinct functions. Poland explained that the IPT process uses multi-disciplinary teams, composed of personnel from engineering, production, procurement, finance and customer support to manage segments of the aircraft, such as rotor systems, propulsion systems, and fuselage, throughout the entire life cycle of the aircraft. In other words, the manufacturing of helicopters, parts and components is accomplished by integrating R & D into the "fabric" of producing the aircraft.

Through the integration of each of these disciplines with the teams responsible for each major component, at each stage of the process, Sikorsky ultimately develops a helicopter that can be manufactured and operated efficiently and cost-effectively. Poland testified that IPTs allow design and process engineers³ to work side-by-side and share common hardware, design tools, files and software. See Tr., pp. 30-32. He also stated that

²

See Tr., pp. 41-43.

³

Mr. Poland testified that "[t]he task of process engineering is to take that starting point of a product design and to define exactly what those tools, steps and so forth will be in the manufacturing process in order to create that physical product." (Tr., pp. 10-11.)

process engineers from the research and engineering operations unit are located throughout the manufacturing facility in order to support the production of aircraft. The interplay between R & D and manufacturing can be shown in one of Poland's remarks that a production machine operator, suggesting a change in the ongoing process, does not have the authority to make the change. The appropriate personnel in the research and engineering operations unit ultimately would analyze and approve any change. See Tr., pp. 27-30.

As discussed above, the use of the IPTs in the development of helicopters brings together numerous disciplines that are necessary to ensure that, from start to finish, the final product meets Sikorsky's goal of producing and supporting a commercially viable and safe helicopter. For example, the development process in manufacturing a helicopter consists of: design, prototyping, testing and assembling of subunits into larger units, and then into an entire aircraft, testing the entire aircraft on the ground, testing the entire aircraft in flight, production start-up, actual fabrication, and support and design improvements during field operation.

General Statutes § 12-412 recites, in relevant part, as follows:

“Exemptions. Taxes imposed by this chapter shall not apply to the gross receipts from the sale of and the storage, use or other consumption in this state with respect to the following items:

“(78) Materials, tools, fuel, machinery and equipment in an aircraft manufacturing facility. On or after July 1, 1993, sales of and the storage, use or other consumption by an aircraft manufacturer operating an aircraft

manufacturing facility in this state of materials, tools, fuel, machinery and equipment used in such facility. For purposes of this subsection, (A) machinery and equipment' means tangible personal property (i) which is installed in an aircraft manufacturing facility operated by an aircraft manufacturer and (ii) the predominate use of which is for the manufacturing of aircraft or aircraft parts or components or for the significant overhauling or rebuilding of aircraft or aircraft parts or components on a factory basis and (B) 'aircraft manufacturing facility' means that portion of a plant, building or other real property improvement used for the manufacturing of aircraft or aircraft parts or components or for the significant overhauling or rebuilding of aircraft or aircraft parts or components on a factory basis."

As this court noted in the consolidated cases Pratt & Whitney v. Commissioner of Revenue and Hamilton Standard v. Commissioner of Revenue, Superior Court, judicial district of New Britain, Docket Nos. CV 010509576 & CV 010509577 (July 3, 2002, *Aronson, JTR*), "in 1992, the aircraft industry [had] been singled out by the legislature for sales and use tax exemptions with respect to aviation fuel; General Statutes § 12-412 (75); aircraft repair or replacement parts; General Statutes § 12-412 (76); aircraft repair services; General Statutes § 12-412 (77); as well as the exemption already described in General Statutes § 12-412 (78)."

There are two key components to the aircraft exemption that the legislature granted to the manufacturers of aircraft, parts and components: (1) an aircraft manufacturer operates an aircraft manufacturing facility in this state and (2) the manufacturer uses materials, tools, fuel, machinery and equipment in this aircraft manufacturing facility or for the significant overhauling or rebuilding of aircraft, parts and components. See General Statutes § 12-412 (78). There is nothing in this statutory

exemption that precludes the use of materials, tools, fuel, machinery and equipment as part of an integrated research and development process, as long as the use is made within an aircraft manufacturing facility in this state.

General Statutes § 1-2z⁴ directs the court not to read language into a statute if the statute is clear on its face. Although the commissioner agrees that § 12-412 (78) is clear on its face, the commissioner would have the court add language to this statutory exemption in order to exclude the use of materials, tools, fuel, machinery and equipment in an aircraft manufacturing facility that are also used in R & D. However, as discussed above, Sikorsky's use of materials, tools, fuel, machinery and equipment for R & D purposes is not conducted in isolation.

As the plaintiff notes, all aircraft manufacturing property qualified for a partial exemption of 50% from sales and use tax under the Manufacturing Recovery Act (MRA), General Statutes § 12-412i.⁵ Therefore, the issue of whether the aircraft exemption,

4

General Statutes § 1-2z provides as follows: "The meaning of a statute shall, in the first instance, be ascertained from the text of the statute itself and its relationship to other statutes. If, after examining such text and considering such relationship, the meaning of such text is plain and unambiguous and does not yield absurd or unworkable results, extratextual evidence of the meaning of the statute shall not be considered."

5

General Statutes § 12-412i provides, in relevant part, as follows: **Partial exemption for materials, tools, fuels, machinery and equipment used in manufacturing.**

"(a) The taxes imposed by this chapter shall not apply to the percentage set forth in subsection (c) of this section of the gross receipts from the sale of and the storage, use and consumption in this state of the following items: (1) Materials, tools and fuels or any substitute therefor which become an ingredient or component part of tangible personal

property to be sold or which are used or consumed in an industrial plant in the manufacturing, processing or fabricating of products to be sold, in any process preparatory or related thereto or in the measuring or testing of such products or (2) machinery and equipment which will be used primarily in the process of manufacturing, processing or fabricating tangible personal property if: (A) The machinery or equipment is used for research and development, measuring or testing with respect to or in furtherance of the manufacturing, processing or fabricating of tangible personal property; (B) the machinery or equipment is used at any stage of the manufacturing, processing or fabricating process from the time any raw materials are received to the time the product is ready for delivery or storage, including overpacking and crating; (C) the machinery or equipment is used primarily to maintain or repair any machinery or equipment described in subparagraph (A) or (B) of this subdivision, or (D) the machinery or equipment is used primarily for metal finishing, provided this exemption shall not apply to any materials, tools, fuels, machinery or equipment which is used primarily in administration, general management, sales or any other activity which does not constitute manufacturing, processing or fabricating. The exemption under this subsection shall not apply to any materials, tools, fuels, machinery or equipment which is exempt under any other provision of this chapter.

“(b) As used in this section: (1) ‘Manufacturing’ means the activity of converting or conditioning tangible personal property by changing the form, composition, quality or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Changing the quality of property shall include any substantial overhaul of the property that results in a significantly greater service life than such property would have had in the absence of such overhaul or with significantly greater functionality within the original service life of the property . . . ; (2) ‘fabricating’ means to make, build, create, produce or assemble components or tangible personal property so that they work in a new or different manner; (3) ‘processing’ means the physical application of the materials and labor necessary to modify or change the characteristics of tangible personal property; (4) ‘machinery’ means the basic machine itself, including all of its component parts and contrivances . . . and all equipment or devices used or required to control, regulate or operate the machinery, including . . . computers and data processing equipment, together with all replacement and repair parts . . . ; (5) ‘equipment’ means any device separate from machinery but essential to a manufacturing, processing or fabricating process; and (6) ‘measuring or testing’ includes both nondestructive and destructive measuring or testing, and the alignment and calibration of machinery, equipment and tools, in the furtherance of the manufacturing, processing or fabricating of tangible personal property.

“(c) The gross receipts from the sale of and the storage, use and consumption in this state of the items set forth in subsection (a) of this section shall be exempt from the taxes imposed

General Statutes § 12-412 (78), exempts the remaining 50% of the purchase price of the aircraft manufacturing property remains outstanding. See Plaintiff's post-trial brief, p. 4.

Notably, the language in § 12-412i (a) (2), which the commissioner conceded includes the present property under review, exempts "machinery and equipment which will be used primarily in the process of *manufacturing, processing or fabricating tangible personal property* if: (A) The machinery or equipment is used for research and development, measuring or testing with respect to or in furtherance of the *manufacturing, processing or fabricating of tangible personal property*; (B) the machinery or equipment is used at any stage of the *manufacturing, processing or fabricating process* from the time any raw materials are received to the time the product is ready for delivery or storage" (Emphasis added.) The exemption deals with the manufacturing, processing or

by this chapter, to the following extent: (1) For sales made on or after January 1, 1993, and prior to July 1, 1993, ten per cent of the gross receipts from such items; (2) for sales made on or after July 1, 1993, and prior to July 1, 1994, twenty per cent of the gross receipts from such items; (3) for sales made on or after July 1, 1994, and prior to July 1, 1995, thirty per cent of the gross receipts from such items; (4) for sales made on or after July 1, 1995, and prior to July 1, 1996, forty per cent of the gross receipts from such items; and (5) for sales made on or after July 1, 1996, fifty per cent of the gross receipts from such items.

"(d) The burden of proving that an item is subject to the exemption . . . is upon the person who makes the sale unless he takes from the purchaser a certificate to the effect that the property is subject to such exemption. The certificate relieves the seller from the burden of proof only if taken in good faith by the seller. . . .

"(e) If a purchaser who gives a certificate makes any use of the property other than the purposes set forth in this section, the use shall be deemed a use by the purchaser in accordance with this chapter, as of the time the property is first used by him, and the property shall be taxable to such purchaser in accordance with this chapter."

fabricating stage, not as expressly stated in 12-412i (a) (2) (D), “to any materials, tools, fuels, machinery or equipment which is used primarily in administration, general management, sales or any other activity which does not constitute manufacturing, processing or fabricating.”

In the statutory language recited above, the legislature is clearly exempting materials, tools, fuel, machinery or equipment used primarily in the manufacturing process, while it just as clearly withholds the exemption for materials, tools, fuel, machinery or equipment used primarily for the administration of the manufacturing business.

The commissioner’s main argument is two-fold. First, the commissioner argues that procedurally, the plaintiff must prove that it is entitled to the exemption set out in § 12-412 (78) by clear and convincing evidence and second, that the materials, tools, fuel, machinery and equipment the plaintiff claims as exempt from sales and use taxes were not used in an aircraft manufacturing facility for manufacturing. The commissioner’s first claim is based on statutory construction while the second claim is based on a finding of fact.

In construing § 12-412 (78), the commissioner observes that, in order to qualify for the exemption under the statute, the materials, tools, fuel, machinery and equipment “must, at a minimum, be used by an aircraft manufacturer operating an aircraft manufacturing facility in Connecticut and the items must be used in such facility.”

(Emphasis in original; footnote omitted.) (Defendant’s 2/23/07 MOL, pp. 10-11.) In spite

of this simple interpretation of 12-412 (78), the commissioner turned to § 12-412 (78) (B) for the definition of “aircraft manufacturing facility” and noted two different parts: (1) “used for the manufacturing of aircraft or aircraft parts” or (2) “for the significant overhauling or rebuilding of aircraft or aircraft parts or components on a factory basis.” (Defendant’s 2/23/07 MOL, p. 11.) The commissioner then reasoned that “[a]s none of the items at issue in this appeal were used by Sikorsky in the ‘significant overhauling or rebuilding of aircraft parts or components,’ in order for these items to qualify for exemption, they must be used in the ‘portion of a plant, building or other real property improvement’ where ‘manufacturing of aircraft or aircraft parts’ take place.” (Defendant’s MOL, pp. 11-12.) The parties acknowledged that the issue in this case does not concern the overhauling or rebuilding of aircraft, parts or components.

Having determined factually from the presentation by Mr. Poland that the subject property was used in an integrated manufacturing process and in consideration of the commissioner’s recognition that Sikorsky used the subject property in the manufacturing process, with respect to the partial exemption granted under the MRA, the court disagrees with the commissioner’s final conclusion that the subject property was not used in the manufacturing process because it was used for R & D.

In the Pratt & Whitney and Hamilton Standard cases, discussed above, the court stated that “[i]t is not necessary for us to read into § 12-412 (78), the aircraft exemption, as to whether this subsection includes or excludes R & D machinery and equipment from the sales and use tax. We can only interpret this statutory provision as it is written. We

therefore disagree with the Commissioner that § 12-412 (78) excludes machinery and equipment used for R & D. Simply because the statute does not specifically state ‘research and development’ does not mean that materials and equipment used for research and development in relation to the manufacture of aircraft parts and components are not exempt if they otherwise meet the criteria of the exemption. The only test that we derive from the language stated in § 12-412 (78) is that the legislature granted a broad exemption from the sales and use tax to the aircraft industry in Connecticut for sales of and the storage, use or other consumption of materials, tools, fuel, machinery and equipment (1) used or consumed by an aircraft manufacturer (2) operating an aircraft manufacturing facility in Connecticut, and (3) such materials, tools, fuel, machinery and equipment are used in such facility.” (Citation omitted.)

In this appeal, the burden of proving an error in a deficiency assessment is on the taxpayer and this burden requires the taxpayer to present clear and convincing evidence that the assessment was in error. See Leonard v. Commissioner of Revenue Services, 264 Conn. 286, 302, 822 A.2d 1184 (2003). Statutory exemptions are construed strictly against the party claiming the exemption. See DaimlerChrysler Services of North America, LLC v. Commissioner of Revenue Services, 274 Conn. 196, 203, 875 A.2d 28 (2005).

As the commissioner recognized, for the plaintiff to qualify for an exemption under § 12-412 (78), “materials, tools, fuel and machinery and equipment must, at a minimum, be used by an aircraft manufacturer operating an aircraft manufacturing facility

in Connecticut and the items must be used in such facility.” (Defendant’s MOL, pp. 10-11.)

Because Sikorsky meets the above stated test, it is entitled to the benefits of the aircraft exemption as set forth in § 12-412 (78). Accordingly, judgment may enter in favor of the plaintiff, sustaining its appeal, without costs to either party.

Arnold W. Aronson
Judge Trial Referee