

**New York State Department of Taxation and Finance  
Office of Counsel  
Advisory Opinion Unit**

TSB-A-14(14)S  
Sales Tax  
July 2, 2014

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION      PETITION NO. S121022A

The Department of Taxation and Finance received a Petition for Advisory Opinion from [REDACTED]. Petitioner asks whether: (1) Petitioner is a person engaged in the production for sale of tangible personal property for purposes of § 1115(a)(12) of the Tax Law; and (2) Petitioner's purchase of machinery, equipment, tools, materials, supplies, and utilities used to apply coatings to its customers' property qualify for exemption from sales and use tax.

We conclude that Petitioner's purchases of machinery and equipment described below, and the parts, tools and supplies used in conjunction with such machinery and equipment, will be exempt from sales and use tax pursuant to § 1115(a)(12) of the Tax Law if used directly and predominantly in the production process and if the property on which the coatings are applied is, or becomes a component part of, property sold by its customer. We further conclude that Petitioner's purchase of fuel and utilities to power exempt production equipment will be exempt from sales tax under § 1115(c)(1) of the Tax Law if used directly and exclusively in the production process.

**Facts**

Petitioner applies coatings that improve the performance of equipment and precision component parts. The coatings provide corrosion, temperature, and chemical resistance to the items to which they are applied. In addition, the coatings help to reduce friction and wear on the parts to which they are applied. The coating process involves the use of various types of coatings depending on the specifications of the customer. Some examples include: specialty paint, ceramic lining and metal coatings. Petitioner prepares its customers' manufactured items to accept the coatings and performs the coating process according to the manufacturer's specifications and the Petitioner's trade secret coating application process. Petitioner prepares the coatings, develops the coating processes, and provides the coating processes to its customers' manufactured items at Petitioner's operating facility in New York State.

Petitioner's customers typically are manufacturers of equipment and precision component parts. Petitioner applies the coatings to equipment and precision component parts (tangible personal property) that are being manufactured by Petitioner's customers. Tangible personal property that is to be processed is picked up from the customer's manufacturing facility in one of Petitioner's vehicles used only for that purpose. Once the tangible personal property is received at Petitioner's plant, it is reviewed to verify that it matches the shipping

documentation in type and quantity prior to being unloaded by forklift to a lay down area. When the tangible personal property is ready to be worked on, it will be moved from the lay down area to the mineral abrasive or grit blasting plants, where it will be placed on stable structures to allow access to the pieces so that they can be inspected and surface preparation can begin.

Hardened edges & welds will have grinding performed on them and corners receive a radius. This is performed so the coatings to be applied will bond properly around sharp edges. Metal preparation by blasting will then begin. The preparation of the surface typically involves the use of various blasting media (i.e. mineral abrasives, steel grit, glass bead, etc.). The purpose of using the blasting media is to change the texture and composition of the surface area of the tangible personal property in order for the coating application to bond properly. During this process, some of the blasting media permanently remains a part of the tangible personal property.

After the preparation process is complete and quality control approves that the work specification is met, the material will be moved from the blasting plant to one of four paint bays. The tangible personal property will be cleaned using compressed air or by vacuuming to remove any remaining dust or other media. Masking and protection of surfaces that will not be coated is also performed. Once the property is cleaned, masked and approved by quality control, the application of the customers' material specification begins. Examples include but are not limited to metalizing with 99.9% zinc, inorganic and organic zincs, epoxies and polyurethanes. Depending on the specifications of the particular project, multiple coatings may be applied. After each coating, an inspection is performed for quality assurance.

After all applications are complete and final approval is given by quality control, the pieces are placed back on the original shipping structures and stored until final delivery to the customer. Each group is then protected with foam and shrink wrap for undamaged delivery to the customer in one of Petitioner's vehicles, for the continuation of the customer's production process.

Petitioner provided a detailed list of machinery and equipment that is used in the various stages of the process described above. For purposes of brevity, this equipment generally falls into the following categories:

- Vehicles used for product transportation.
- Cranes, forklifts, magnets, steel beams.
- Mobile carts.
- Pallets and skids, and skid steer for material handling.
- Air compressor system and dryer to remove moisture from air supply. All moisture must be removed to prevent corrosion of steel. This is very critical to the production process.
- Grinders, needle guns, roto-peaners; bristle blasters for steel preparation.
- Dust collectors, fans and filters.

- Reclaimer, vacuum, and storage drums for grit recycling system (allows grit to be used multiple times in the coating process).
- Air hoses, hoppers, blast pots, blast cradles and blast hoses for blasting operations.
- Liquid metal and paint spraying equipment.

## Analysis

Tax Law § 1115(a)(12) provides an exemption from sales and use tax for “machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property, gas, electricity, refrigeration or steam for sale, by manufacturing, processing, generating, assembling, refining, mining, or extracting . . . .” Parts with a useful life of one year or less, and tools and supplies used in connection with such machinery or equipment are exempt under § 1105-B of the Tax Law. An exemption is also allowed for “[f]uel, gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature for use or consumption directly and exclusively in the production of tangible personal property, gas, electricity, refrigeration or steam, for sale, by manufacturing, processing, assembling, generating, refining, mining or extracting . . . .” Tax Law § 1115(c)(1).

“Processing is 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.” 20 NYCRR § 527.4(d). Petitioner’s application of its coatings to its customers’ tangible personal property effects a change in the nature of the tangible personal property by providing corrosion, temperature and chemical resistance, and by reducing friction and wear on the parts to which they are applied. Petitioner’s services to its customers’ tangible personal property fall within the meaning of “processing” as provided in Regulation § 527.4(d).

Petitioner is not selling the tangible personal property on which the processing is performed to its customer. However, if tangible personal property processed by Petitioner is, or becomes a component part of, property sold by Petitioner’s customer, Petitioner would be “performing a part of a production process for its customer and its services are, in effect, performed as part of a continuous production line which is an extension of its customer’s manufacturing process.” TSB-A-04(22)S. Petitioner would, therefore, be engaged in the production for sale of tangible personal property for purposes of Tax Law § 1115(a)(12).

In order to qualify for exemption, Petitioner’s machinery and equipment described above, and the parts, tools and supplies used in conjunction with such machinery and equipment, must be used “directly and predominantly” in the production of tangible personal property for sale.

“Predominantly” means more than 50%. Sales and Use Tax Regulations § 528.13 describes the three stages of manufacturing as administration, production, and distribution. Only machinery and equipment used directly and predominantly in the production phase of

manufacturing is exempt from sales tax under Tax Law § 1115(a)(12). Section 528.13 (b) provides in part:

The determination of when production begins is dependent upon the procedure used in a plant. If on receiving raw materials, the purchaser weighs, inspects, measures, or tests the material prior to placement into storage, production begins with placement into storage, and the prior activities are administrative. If the materials are unloaded and placed in storage for production without such activities, the unloading is the beginning of production.

Petitioner picks up the customer's tangible personal property in its own trucks used specifically for that purpose. When the customer's incoming tangible personal property is received at Petitioner's facility, it is checked against shipping documents, unloaded, and stored in a lay down area until it is ready to be worked on. At that point it is moved to the mineral abrasive or grit blasting plant, where the property is inspected and surface preparation can begin.

We conclude that the production phase begins when the customer's equipment is placed in the lay down area and concludes when the final inspection is completed. In order to satisfy the "directly" requirement of the exemption, Petitioner's machinery and equipment, and any parts and supplies used in conjunction with such machinery and equipment, must be used during this phase. The vehicles used to transport the tangible personal property to and from Petitioner's facility are not used in the production process and, therefore, do not qualify for exemption. However, the equipment used to place the tangible personal property in the laydown area (such as forklifts) would be used during the production process. See 20 NYCRR § 528.13(b)(3) example 1.

In order to satisfy the "predominantly" requirement, the machinery or equipment must be used more than 50% during the production process. If machinery or equipment that is used in the production process is also used 50% or more in the administrative or distribution phase, it would not qualify for the production exemption. See 20 NYCRR § 528.13(c)(4).

Similarly, the utilities used to power the machinery and equipment exempt under § 1115(a)(12) are also exempt from tax. However, while machinery and equipment is exempt if it is used predominantly for production, § 1115(c)(1) exempts "fuel, gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature for use or consumption *directly and exclusively* in the production of tangible personal property . . . ." Petitioner may claim an exemption for the portion of the fuel, electricity, gas, refrigeration or steam used to power exempt machinery and equipment during the production process. Petitioner must maintain adequate records with respect to the allocation of such fuel, electricity, gas, refrigeration or steam used for exempt and non-exempt purposes, and must provide an engineering study or the formula used to substantiate that allocation. See 20 NYCRR § 528.22(c)(3); Publication 852, *Sales Tax Information For: Manufacturers*,

*Processors, Generators, Assemblers, Refiners, Miners and Extractors, and Other Producers of Goods and Merchandise.*

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