

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

TSB-A-96 (56)S
Sales Tax
September 23, 1996

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO.S950913C

On September 13, 1995, the Department of Taxation and Finance received a Petition for Advisory Opinion from David Berdon & Co. LLP, 415 Madison Avenue, New York, New York 10017-1178.

The issue raised by Petitioner, David Berdon & Co. LLP, is whether the purchase of "artwork", as described herein, used ultimately in the manufacturing of upholstery fabric is exempt from New York State sales and use taxes imposed under Sections 1105(a) and 1110 of the Tax Law.

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

Petitioner states that the beginning of the design process for manufacturing an upholstery fabric is the purchase of an item of artwork. This artwork is very often a painting or drawing from which an idea or concept evolves, initiating the creative process. The artwork may also be an antique fabric swatch, the carved molding on an old picture frame, or the grain pattern in a slab of polished stone.

The artwork is run through an optical scanner that converts the visual material into a digital image, which in turn is transposed onto a computer screen. Frequently, a color photocopy, or sometimes even a professional color enlargement photograph, must be made for the scanner in order to capture or omit some details from the source material. After some technical decisions are made regarding the structure of the fabric to be manufactured, weaves are then chosen to formulate the visual and textural character of each area of the fabric which the designer is seeking to create.

Next, the image (geometry) of the pattern will be brought up onto the computer screen to begin the editing process. If there are many colors in the image, they may have to be combined or condensed into a practical and workable number. At this point in the process, color represents nothing but the demarcation of an area of weave structure that differs in form from those areas adjacent to it, and entire areas may be manipulated (i.e., moved, reduced, enlarged or eliminated entirely), if it is to the aesthetic advantage of the resulting fabric. At times, if the artwork is too large, or cumbersome, or if only portions are actually required, it may be cut up and reassembled prior to being input onto the computer.

Once all the areas of the design are oriented into desired locations and manipulated to their correct proportions, weave instructions are assigned to each of these differently colored areas on the computer image. When this is done, a disc is encoded that will instruct a Jacquard card punch to cut a series of instructions that enable a loom to produce a woven image of the computer blueprint. A first sample is woven to determine if the instructions were encoded

correctly and that all estimates of threads per inch, both vertical and horizontal, are in the appropriate proportions and densities for the chosen weave structures.

If all is technically correct, color choice comes into play for the first time as it relates to making the design a saleable product. At this point, the process of playing with multitudes of color possibilities to find the few probable best combinations to offer to customers begins. After completion of the design process, which takes place in New York City, the resulting blueprint is then used at the taxpayer's out-of-state plant site to produce upholstery fabric for sale. The end result of this process is a manufactured item of tangible personal property with a design developed from the initial artwork purchased.

Section 1105-B(a) of the Tax Law provides as follows:

(a) Notwithstanding any other provisions of this article, but not for purposes of the taxes imposed by section eleven hundred seven or eleven hundred eight or authorized pursuant to the authority of article twenty-nine of this chapter, the taxes imposed by subdivision (a) of section eleven hundred five on the receipts from the retail sales of parts with a useful life of one year or less, tools and supplies 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 or for use directly and predominantly in or on telephone central office equipment or station apparatus or comparable telegraph equipment where such equipment or apparatus is used directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication shall be paid at the rate of two percent for the period commencing September first, nineteen hundred eighty and ending February twenty-eighth, nineteen hundred eighty-one, and such retail sales shall be exempt from such tax on and after March first, nineteen hundred eighty-one.

Chapter 366 of the Laws of 1996 amended subdivision (d) of Section 1105-B, effective September 1, 1996, to provide as follows:

Notwithstanding any other provisions of this section or this article to the contrary, on and after September first, nineteen hundred ninety-six, the exemptions provided by subdivisions (a), (b) and (c) of this section shall apply for purposes of the sales and compensating use taxes imposed by section eleven hundred seven of this article.

Section 1115 of the Tax Law provides, in part, as follows:

Sec. 1115. Exemptions from sales and use taxes.--(a) Receipts from the following shall be exempt from the tax on retail sales

imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten:

* * *

(12) 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, or telephone central office equipment or station apparatus or comparable telegraph equipment for use directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication, but not including parts with a useful life of one year or less or tools or supplies used in connection with such machinery, equipment or apparatus. This exemption shall include all pipe, pipeline, drilling rigs, service rigs, vehicles and associated equipment used in the drilling, production and operation of oil, gas, and solution mining activities to the point of sale to the first commercial purchaser.

Section 528.13 of the Sales and Use Tax Regulations provides in part:

Sec. 528.13. Machinery and equipment used in production; telephone and telegraph equipment; parts, tools and supplies--(Tax Law, Sec. 1115(a)(12)). (a) Exemption. (1) Exemption from statewide tax. An exemption is allowed from the tax imposed under subdivisions (a) and (c) of section 1105 of the Tax Law, and from the compensating use tax imposed under section 1110 of the Tax Law, for receipts from sales of the following:

(i) Machinery or equipment (including parts with a useful life of more than one year) used or consumed directly and predominantly in the production for sale of tangible personal property, gas, electricity, refrigeration or steam, by manufacturing, processing, generating, assembling, refining, mining or extracting. (This exemption includes all pipe, pipeline, drilling rigs, service rigs, vehicles and associated equipment used in the drilling, production and operation of oil, gas and solution-mining activities to the point of sale to the first commercial purchaser.)

* * *

(c) Directly and predominantly. (1) "Directly" means the machinery or equipment must, during the production phase of a process:

(i) act upon or effect a change in material to form the product to be sold,
or

(ii) have an active causal relationship in the production of the product to be sold, or

(iii) be used in the handling, storage, or conveyance of materials or the product to be sold, or

(iv) be used to place the product to be sold in the package in which it will enter the stream of commerce.

* * *

(4) Machinery or equipment is used predominantly in production, if over 50 percent of its use is directly in the production phase of a process.

In this case, the artwork being purchased will be used in the process of designing a computer image and computer blueprint necessary for printing the designs on upholstery fabric produced for sale. In accordance with New York State Department of Taxation and Finance Publication 842 (12/93), New York State and Local Sales Tax Information for Printers, at page 27, purchases of artwork, illustrations, layouts, drawings, paintings, mechanicals, overlays, designs, photographs, pasteups and onionskin by a printing company and used or consumed directly and predominantly to produce printed material for sale qualify for the production exemption. Accordingly, while the purchaser is not a printing company per se, the printing process and Petitioner's manufacturing process are similar and the artwork is deemed to be used or consumed by the purchaser directly and predominantly to produce the upholstery fabric for sale. See The Design Council. Ltd., Adv Op Comm T&F, June 28, 1995, TSB-A-95(23)S. Therefore, the purchase by Petitioner of the artwork described above would be exempt from the Statewide sales and use taxes imposed under Sections 1105(a) and 1110 of the Tax Law.

It should be noted that the right to reproduce a photograph, painting, sketch, or illustration is not a sale of tangible personal property, and the receipts from the sale of this right are not subject to tax, where the payment made is in the nature of a royalty to the grantor under the laws relating to artistic and literary property. A right to reproduce exists only if there is a written agreement between the artist and client setting forth the conditions to reproduce. Temporary possession by the client for the sole purpose of making the reproduction is not considered to be a transfer of possession which would convert the reproduction right into a taxable use. See Section 526.7(f) of the Sales and Use Tax Regulations.

DATED: September 23, 1996

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

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