

Taxability of Machinery, Equipment, Supplies and Energy Sources Used
in Operating Produce Departments in Supermarkets and Grocery Stores

This memorandum sets forth the policy of the Department of Taxation and Finance with respect to the taxability of machinery, equipment, supplies, and energy sources used in the operation of a produce section of a supermarket or grocery store.

I. Machinery, equipment, and supplies typically used in produce departments do not qualify for exemption from sales and use tax.

In order for machinery, equipment, and supplies to be qualified for the production exemption provided under section 1115(a)(12) of Article 28 of the Tax Law, such machinery, equipment, and supplies must be used directly and predominantly in production of a product for sale. "Predominantly" means machinery, equipment, or supplies are used more than 50% of the time in production. Any claim for exemption for machinery and equipment used in an exempt manner in produce departments must be substantiated by maintenance of adequate records.

Typically, produce is received by supermarkets or grocery stores in cartons, crates, boxes, or bags. It may be put in refrigerated coolers until displayed for sale. Many items are simply removed from the package in which they are received and placed in display bins for sale. Some produce is repackaged in containers wrapped in plastic or placed in plastic bags. Other Produce is trimmed to make it more attractive and may be moistened before being displayed for sale. These activities do not change the nature, shape, or form of produce received by a grocery store or supermarket. These activities are not part of the production process. Rather, they are part of the process of distributing or selling produce, after production has been completed. Machinery, equipment, and supplies, therefore, mostly used in the activities described above, do not qualify for exemption from sales tax.

However, the preparation in produce departments of grocery stores and supermarkets, of raw produce to be used for salad ingredients, either for sale as such, or as part of prepared fruit and vegetable salads to be sold by the pound, constitutes production. Machinery, equipment, and supplies used predominantly in such preparation are exempt from sales tax.

- II. Packaging materials may be purchased tax exempt if used by the vendor to package tangible personal property for sale and actually transferred to the purchaser of the tangible personal property.

Packaging materials such as foam trays, plastic wrap, plastic bags, and cellophane may be purchased tax exempt by supermarkets or grocery stores by issuing a properly completed Exempt Use Certificate, Form ST-121, to the supplier.

- III. Fuel, gas, electricity, refrigeration, or steam used directly and exclusively in the exempt phase of a process is not subject to sales tax.

Other than in the production of salads (as explained above), the manner in which the produce department operates does not conform with the requirements of Sales and Use Tax Regulations 531.2(b) and (e). Accordingly, machinery and equipment used in a typical produce department does not qualify for exemption under section 1115(a)(12) of the Tax Law. For example, a refrigerated cooler does not qualify as production equipment as its only function is to maintain a constant temperature for storage prior to display for sale.

However, the above captioned energy sources are exempt when used directly and exclusively in production of tangible persons property for sale. Therefore, if machinery and equipment have both taxable and exempt use, the portion of the energy source used in the exempt phase of a process will qualify for exemption, even if the machinery does not. For purposes of such exemption, adequate records must be maintained to substantiate exempt use.