

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

TSB-A-93 (11) S
Sales Tax
TSB-A-93 (6) C
Corporation Tax
February 4, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. Z920828A

On August 28, 1992 a Petition for Advisory Opinion was received from Professional Transmission & Truck Service, East Broad Street, Frankfort, NY 13340.

The issue raised by Petitioner, Professional Transmission & Truck Service, is whether the purchase of a torque converter production machine qualifies for the exemption from sales tax under Section 1115(a)(12) of the Tax Law and the investment tax credit under Section 210.12 of Article 9-A of the Tax Law.

Petitioner owns and operates a transmission repair shop. All types of transmissions both manual and automatic are repaired for the automotive, trucking and construction industries. Automatic transmissions represent about 80% of all work performed by Petitioner. As part of rebuilding an automatic transmission a major component piece replaced is the torque converter. The torque converter acts as the link between the vehicle engine and transmission. Petitioner currently purchases these converters from an outside supplier.

Due to the cost of torque converters, Petitioner has explored ways to find lower cost alternatives to purchasing them. Petitioner has contacted a specialized machinery manufacturer in order to purchase a torque converter production machine. This machine is capable of producing a torque converter by assembling internal parts such as clutches, bearings and washers. The machine then welds the outer casings together and balances the unit.

Petitioner will use the machinery to produce new torque converters by using new outer casings and new internal parts. Petitioner will also use old outer casings and new internal parts to produce torque converters. Petitioner estimates that the torque converter production machine will be used 75% of the time to manufacture new converters. It is important to note that there are no differences between old and new casings. In both situations, new internal parts are used in the manufacture of the torque converter. The assembly process of welding, alignment and balancing is identical.

Petitioner plans to sell the torque converters to other transmission shops and suppliers as well as use the torque converters in Petitioner's own business.

Section 1115 of the Tax Law states, in part:

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 ... for sale by manufacturing, processing ... assembling

Section 528.13 of the New York State Sales and Use Tax Regulations states,' in part:

Machinery and equipment used in production; telephone and telegraph equipment; parts, tools and supplies. [Tax Law, §1115(a)(12)] (a) Exemption.

(1) Exemption from statewide tax. An exemption is allowed from the tax imposed under subdivision (a) and (c) of section 11105 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 ... by manufacturing, processing assembling

...

(iii)(a) Parts with a useful life of one year or less, tools or supplies for use or consumption directly and predominantly in the production of tangible personal property, ... for sale by manufacturing, processing assembling

...

(2) Exemption from taxes imposed by localities other than New York City.

(i) There is an exemption from all sales and use taxes, other than the taxes imposed in New York City, for all sales and uses of:

(a) tangible personal property used or consumed directly and predominantly in the production for sale of tangible personal property by manufacturing, processing, ... assembling

...

(3) Exemption from New York City local tax. (i) There is an exemption from the sales and use tax imposed in New York City under section 1107 of the Tax Law for sales and uses of the following:

(a) 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, ... by manufacturing, processing, ... assembling

(b) Production. (1) The activities listed in paragraph (a)(1) of this section are classified as administration, production or distribution.

(ii) Production includes the production line of the plant starting with the handling and storage of raw materials at the plant site and continuing through the last step of production where the product is finished and packaged for sale.

(2) The exemption applies only to machinery and equipment used directly and predominantly in the production phase.

. . .

(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) to 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.

. . .

Example 13: A company purchases a machine to produce new paper machine rolls and to recondition old paper machine rolls for its customers. The machine is to be used for production 70 percent of the time and for reconditioning 30 percent of the time. Reconditioning is a repair service to tangible personal property. However, as the machine in this example will be used directly in production over 50 percent of the time, it qualifies for exemption.

In the instant case, the torque converter production machine will be used by Petitioner to produce torque converters by means of a process in which the machine will be used to assemble internal parts such as clutches, bearings and washers, weld the outer casings together and balance the unit. The activities of the torque converter production machine will fall within the description of production as provided under Section 528.13(b)(1)(ii) of the Sales and Use Tax Regulations.

Petitioner's purchase of the torque converter production machine will qualify for the exemption from sales and use tax under Section 1115(a)(12) of the Tax Law and Section 528.13 of the Sales and Use Tax Regulations provided it is used directly and predominantly, as defined in Section 528.13(c) of the Regulations, to produce torque converters for sale. (Also, see illustration in Section 528.13(c)(4), Example 13 of the Regulations.)

It is noted that when Petitioner is repairing or rebuilding a torque converter for a customer's vehicle and Petitioner uses the torque converter production machine for such purpose, that particular use will not be considered to be for exempt production purposes.

If Petitioner uses the torque converter production machine directly and predominantly to produce torque converter's for sale rather than predominantly to repair or rebuild customers' existing torque converters, Petitioner's purchase will qualify for the exemption provided under Section 1115(a)(12) of the Tax Law and Section 528.13 of the Regulations. If Petitioner's purchase qualifies for the exemption from Sales Tax, Petitioner should give the seller of the torque converter production machine a properly completed form ST-121, Exempt Use Certificate, in order to substantiate that the transaction is not subject to sales tax.

For taxable years beginning after 1990, section 210.12 of the Tax Law allows an investment tax credit against the tax imposed under Article 9-A of the Tax Law equal to five percent with respect to the first \$350 million of the investment credit base. The investment credit base is the cost or other basis for federal income tax purposes of qualified tangible personal property and other tangible property, including buildings and structural components of buildings.

Section 5-2.1 of the Business Corporation Franchise Tax Regulations (hereinafter "Corporation Regulations") provides that the taxpayer must claim the investment tax credit for the first taxable year in which the property becomes qualified property.

The term "qualified property" means tangible personal property and other tangible property, including buildings and structural components of buildings, which:

- (1) are acquired, constructed, reconstructed or erected after 1990;
- (2) are depreciable pursuant to section 167 of the Internal Revenue Code;
- (3) have a useful life of four years or more;
- (4) are acquired by purchase as defined in section 179(d) of the Internal Revenue Code;
- (5) have a situs in New York State, and
- (6) are 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 210.12(b)(ii)(A) 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." Additionally, section 210.12(b)(ii)(A) provides that "[p]roperty used in the production of goods shall include machinery, equipment or other tangible property which is principally used in the repair and service of other machinery, equipment or other tangible property used principally in the production of goods and shall include all facilities used in the production operation, including storage of material to be used in production and of the products that are produced." Section 5-2.4(c) of the Corporation Regulations provides that the term "principally used" means more than 50 percent.

In deciding whether Petitioner's activities of producing new torque converters and rebuilding old torque converters constitutes manufacturing, consideration must be given to the extensiveness of the activities performed on the articles and whether the end products are equivalent in usefulness and treated as freshly and newly produced articles. The court in United States v. J Leslie Morris Co., 124 F2d 371 (9th Cir 1941), with respect to the Federal manufacturers excise tax, observed:

"[T]he question whether the process is essentially one of production or merely of repair is to be resolved by an over-all view of taxpayer's activities, beginning with its acquisition of discarded parts and ending when a useful article of commerce emerges ... ". Id. at 372.

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In Western Electric Co., Inc., Dec St Tx Comm, November 6, 1981, TSB-H-81(60)C, the disassembling, reconditioning and reassembling of telephone sets qualified as manufacturing for purposes of the investment tax credit under section 210.12 of the Tax Law.

In addition, section 606(a) of Article 22 of the Tax Law is substantially similar to section 210.12 of the Tax Law. In John Panos, Adv Op Comm T & F, April 29, 1991, TSB-A-91(6)I it was held that under section 606(a), the extensive activities performed on old non-working starters and alternators went beyond mere repair and qualified as manufacturing, where the old starter or alternator was dismantled, all defective components were removed and replaced and the set was reassembled with some of its original parts and some brand new parts.

In the instant case in accordance with consideration of the factors, decisions and opinions discussed above and the language of section 210.12(b)(ii) of the Tax Law, the extensive activities performed by Petitioner on the old torque converters as well as the production of new torque converters qualifies as manufacturing for purposes of the investment tax credit. The old torque converters are given new quality and Petitioner's activities go beyond mere repair: the old torque converter is dismantled, all defective components are removed and replaced and the set is reassembled with some of its original parts and some brand new parts.

Accordingly, both processes of Petitioner's operations constitute manufacturing for purposes of section 210.12(b)(ii) of the Tax Law. If Petitioner's equipment is principally used in such manufacturing and the equipment meets all of the other requirements contained in section 210.12 of the Tax Law, Petitioner will be allowed an investment tax credit for such property for the taxable year during which such property became qualifying property.

DATED: February 4, 1993

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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