

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

TSB-A-84(30)S
 Sales Tax
 October 15, 1984

STATE OF NEW YORK
 STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. S820902B

On September 2, 1982 a Petition for Advisory Opinion was received from Graham Manufacturing Co., Inc., 20 Florence Avenue, Batavia, New York 14020.

The issue raised is whether receipts from the sale of certain equipment qualifies for the "production exemption" from New York State and local sales and use taxes.

Petitioner, a manufacturer, purchased equipment consisting of a computer, disc drive, tape punch unit, plotter and a terminal, the latter including a line printer. This system is used to produce punched NC tapes used in the guidance of manufacturing equipment including Moline and other drills, turret latches, a milling machine and burning machines. These machines are, in turn, used directly and predominantly in the production of tangible personal property for sale in such a manner as to render their purchase and use exempt from sales and use taxes.

The following chart indicates the various phases of this system's use, and the approximate number of minutes of use on each phase, in producing an NC tape. The system is used exclusively for the production of such tapes, in the manner shown below.

Phase	<u>Computer</u>	<u>Disc Drive</u>	<u>Tape Punch Unit</u>	<u>Plotter</u>	<u>Terminal/Line Printer</u>	<u>Minutes of Use</u>
1. Key code sheet information into computer	X	X			X	20
2. Perform checks for format errors	X	X			X	10
3. Plot tool path	X	X		X		30
4. Print out of special instructions for production machine operators	X	X			X	30
5. Punch NC tape	X	X	X			30
6. Storage of information for possible future duplication of job	X	X				15

Phase 1. Information from a previously prepared code sheet is keyed directly into the computer.

Phase 2. Petitioner runs checks for errors in format. This phase is devoted primarily to correcting errors in the program to be encoded on the NC tape. Most of the time taken up by this phase is spent in program correction.

Phase 3. Based on the information previously keyed into the computer, the computer directs the plotter in plotting the tool path. This provides a visual display of the product which will be produced by using the NC tape, and the motion the tool must take to reach and operate on this part. The plot is then checked for errors and adjusted appropriately.

Phase 4. The computer and line printer produce a printout of special instructions for use by the production machine operators in setting up the production machinery. The computer and line printer also produce a printout, during this phase, indicating at which stage in production certain equipment, such as drill spindles, should be replaced.

Phase 5. The computer directs the tape punch unit in the punching of the NC tapes.

Phase 6. Information from a particular job is stored on a floppy disk for retrieval in the event of a production duplication at a later date.

Section 1115(a)(12) of the Tax Law provides for an exemption from sales and use taxes with respect to:

"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, . . . "

Section 528.13(c)(3) of the Sales and Use Tax Regulations provides as follows:

"Machinery used to produce other machinery or equipment or parts for self use in production is considered to be used directly in production."

Section 528.13(e)(1) of the Sales and Use Tax Regulations provides, in part, as follows:

(i) The term 'part' means a replacement for any portion of a machine or piece of equipment, and any device actually attached to the machinery or equipment and used in connection with the performance of its function.

(ii) A part cannot accomplish the work for which it was designed independent of the machine for which it is intended to be a component.

The NC tapes are used to guide the Petitioner's exempt manufacturing equipment; they have no utility beyond or independent of this function. Thus, the NC tapes themselves serve as parts for Petitioner's exempt manufacturing equipment, 20 NYCRR 528.13(e)(1), and any machinery used directly and predominantly in the production of the NC tapes would itself be considered to be used directly and predominantly in production for purposes of the production exemption described supra. 20 NYCRR 528.13(c)(3).

For equipment to be used directly in production there must exist an intimate nexus with the actual production operation; that is, there must be a bond or union between production and the equipment such that the equipment performs a necessary and essential function in the course of the actual production process. Rochester Independent Packer, Inc. v Heckelman, 83 Misc. 2d 1064 (1975). However, the fact that equipment is essential to production is not itself determinative of whether such equipment qualifies for the exemption provided for in Section 1115(a)(12) of the Tax Law. Cole Sand and Gravel Corp., State Tax Commission Decision, January 10, 1983, TSB-H-83(44)S. The equipment must perform a continuous, synchronized operation that is necessary and integral to the production process. (emphasis added). International Salt Co. v New York State Tax Commission, 79 A.D.2d 343 (3d Dept. 1981); Niagara Mohawk Power Corp. v Wanamaker, 286 A.D. 446 (4th Dept. 1955). In the latter case, coal and ash handling equipment was exempt from sales and use taxes not only because it was essential to the production process, but also because it was used during the course of a harmonious and integrated system to produce electricity.

In the present case, although phase (1) may be necessary to the production of the NC tapes, it is not an integral part of the continuous and vital production process (viz., the creation of NC tapes by the tape punch unit). Niagara Mohawk Power Corp. v. Wanamaker, 286 A.D. 446 (4th Dept. 1955). That is, phase (1) constitutes a function which, while admittedly essential, is part of the preparation for production, rather than occurring during and in necessary connection with the creation of the NC tapes themselves. Similarly, phases (2) and (3) are merely incidental to phase (1); their main function is to provide information or direction to the workers to enable verification of the initial input. The Sales and Use Tax Regulations specifically provide that, "[u]sage in activities collateral to the actual production process is not deemed to be used directly in production." 20 NYCRR 528.13(c)(2). Accordingly, the equipment used during phases (1) through (3) is not being used, during such phase, directly in production. Phase (4) does not represent direct use in production, as its function is merely to provide direction to workers, Moog Inc., State Tax Commission Decision, June 2, 1982, TSB-H-82(96)S, while phase (6) represents merely the storage of information.

Section 1115(a)(12) of the Tax Law provides an exemption only for machinery used directly and predominantly in production (emphasis added). The Sales and Use Tax Regulations further provide that "[m]achinery or equipment is used predominantly in production if over 50 percent of its use is directly in the production phase of a process." 20 NYCRR 528.13(c)(4).

Since phase (5) is the only phase in which the equipment is used directly in the production process, the computer and disc drive are not used predominantly in production because their use in phase (5) alone does not represent more than 50 percent of the computer and disc drive's usage. Further, the plotter and terminal/line printer are employed only during phases (1) through (4) and are, therefore, not used directly in production at all. Accordingly, the computer, disc drive, plotter, and

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terminal/line printer are subject to the applicable sales and use taxes. The tape punch unit, however, is used exclusively in phase (5); that is, it is used both directly and predominantly in production. Accordingly, the tape punch unit is exempt from New York State sales and use taxes pursuant to Section 1115(a)(12) of the Tax Law. Similar exemptions apply with respect to all other State and locally imposed Sales and use taxes except for those imposed in New York City under Section 1107 of the Tax Law.

DATED: July 10, 1984

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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