STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. S990713A

On July 13, 1999, the Department of Taxation and Finance received a Petition for Advisory Opinion from Lowe's Home Centers, Inc., PO Box 1111, Tax Dept., N. Wilkesboro, NC 28656.

The issue raised by Petitioner, Lowe's Home Centers, Inc., is whether the types of equipment described below are used directly and predominantly in the production of tangible personal property for sale and are exempt from sales and compensating use tax under Section 1115(a)(12) of the Tax Law.

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

Petitioner is a national company that operates "Big Box" home improvement centers across the country. Petitioner provides the following descriptions of four types of equipment that are used in retail locations in New York State:

1. Cardboard baler/compactor: This equipment is used to compact and bale scrap cardboard. Petitioner pays a commercial hauler to remove the scrap cardboard from its stores, and the scrap cardboard is later sold by the hauler to recycling companies.

2. Panel and cross cut saws: These saws are used to cut lumber and plywood sheeting to sizes that are specified by the customer prior to the sale being finalized.

3. Pipe cutting/threading equipment: This piece of equipment cuts and threads plumbing and electrical conduits as required by the customer prior to the sale being finalized.

4. Carpet and vinyl floor cutting equipment: Each machine holds 10 plus rolls of flooring that rotates each roll to a cutting station where the flooring is measured and cut to the specifications of the customer. The cutting equipment is invoiced as separate line items, but is assembled into one piece of equipment before it goes into service. Once assembled, this equipment cuts carpet and vinyl flooring to meet the requirements of the customer prior to the sale being finalized.

Petitioner furnished photographs of the four types of equipment described above and the invoices for the purchase of such equipment as part of its Petition for Advisory Opinion.

Applicable Law and Regulations

Section 1105(a) of the Tax Law imposes sales tax on the receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

Section 1115(a) of the Tax Law provides, in part:

> 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:
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> * * *
>
> (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....

Subdivisions (b) and (c) of Section 528.13 of the Sales and Use Tax Regulations provide, in part:

> (b) Production. (1) The activities listed in paragraph (a)(1) of this section are classified as administration, production or distribution.
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> (i) Administration includes activities such as sales promotion, general office work, credit and collection, purchasing, maintenance, transporting, receiving and testing of raw materials and clerical work in production such as preparation of work, production and time records.
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> (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.
>
> (iii) Distribution includes all operations subsequent to production, such as storing, displaying, selling, loading and shipping finished products.
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> (2) The exemption applies only to machinery and equipment used directly and predominantly in the production phase. Machinery and equipment partly used

in the administration and distribution phases does not qualify for the exemption, unless it is used directly and predominantly in the production phase.

(3) 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.

*   *   *

(4) Production ends when the product is ready to be sold.

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(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.

(2) Usage in activities collateral to the actual production process is not deemed to be used directly in production.

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

Opinion

In this case, the cardboard baler/compactor is used by Petitioner to compact and bale scrap cardboard. Petitioner pays a commercial hauler to remove the cardboard scrap from its stores. Under these circumstances, the cardboard baler/compactor does not qualify as machinery and equipment used or consumed directly and predominantly in the production of tangible personal property for sale. In order to qualify for the exemption as production equipment under Section 1115(a)(12) of the Tax Law, the machinery or equipment must be used to produce tangible personal property for sale. Petitioner is not producing tangible personal property for sale. Instead, it pays a commercial hauler to remove the crushed cardboard.

As for the panel and cross cut saw, pipe cutting/threading equipment and carpet and vinyl floor cutting equipment, used to cut, or in some cases thread, products to customers' specifications, pursuant to Sections 528.13(b) and (c) of the Sales and Use Tax Regulations this equipment is not used directly in the production of tangible personal property for sale. Petitioner's materials have already left the production line and have entered into the retail distribution chain which cannot be construed to be a continuation of the production process. The materials may already be on display for sale. Thus, the equipment and tools used to size, cut or thread the materials to customers' specifications do not meet the requirement for the production exemption.

The facts in this Advisory Opinion are distinguishable from Sherwin-Williams Company, Adv Op Comm T & F, April 8, 1999, TSB-A-99(21)S, which held that mixing and blending machinery and equipment, and related computer equipment, used in the paint tinting process in a retail store were used directly and predominantly in the production of tangible personal property for sale. The machinery and equipment were used to tint a white base, to produce the colored paint selected by a customer. Unlike the present case, the machinery and equipment in Sherwin-Williams Company were used to process raw material with an additive (tint), which would result in a finished product that was sold as paint. At such time the production process was deemed to have ended.

DATED: November 30, 2000

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