

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

TSB-A-99(21)S
Sales Tax
April 8, 1999

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S990114C

On January 14, 1999, the Department of Taxation and Finance received a Petition for Advisory Opinion from The Sherwin-Williams Company, 101 Prospect Avenue, N.W., Cleveland, Ohio 44115-1075.

The issue raised by Petitioner, The Sherwin-Williams Company, is whether mixing and blending machinery and equipment, and related computer equipment, used in the paint tinting process in Petitioner's New York retail stores are used directly and predominantly in the production of tangible personal property for sale and are exempt from the 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 manufacturer of paint and paint related products. In addition to selling its products in the wholesale market, Petitioner sells a portion of its products in its company owned retail stores. Each retail store contains machinery and equipment that blends and mixes paint. The product that is shipped to the retail stores is a white base, a raw material used in the production of paint. The white base is produced at one of Petitioner's various primary production facilities located throughout the United States.

When customers enter one of Petitioner's stores, they are able to select the exact color of paint desired by examining color cards. Alternatively, the customer may bring in a color sample to be custom matched. Once the customer selects the desired color, an employee of Petitioner blends the proper amount of colorant in the can of white base and properly mixes the colored paint. Petitioner manufactures various types of white base that have differing chemical qualities that relate to the colorants that will be added. The blending and mixing are accomplished in three independent steps. The steps are accomplished by using machines called Color Matching Systems, Automatic Colorant Dispensers, Shakers and related computer equipment (CPU, monitor, keyboard and printer).

In order for the customer to obtain the desired can of colored paint, an employee of Petitioner must determine the proper formula or recipe to produce the desired color. For a color selected from the over one thousand color chips on display in the store, the employee enters the proper color identification number into the computer that controls either the Color Matching System or the Automatic Colorant Dispenser. The employee then enters information specific to the type of paint required. If the color needs to be custom matched, the customer's sample is first measured by a

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spectrophotometer or other color sensing device of the Color Matching System. Numerical representations of the color are processed by sophisticated color matching algorithms and a special color formula is created on the spot. The formula is then sent to the Dispenser through associated computer software. The Dispenser contains a pump system, which dispenses a varied number of colors from canisters housed inside it, and is connected to a computer system, which provides an electronic message regarding the proper amount of colorant to dispense. The color retrieval information is supplied to the Dispenser through the use of a computer keyboard and monitor.

The processor on the Dispenser sends signals to the pumps and valves to meter out the proper amounts of the individual colorants that make up the formula into the can of white base. The liquid colorant travels through plastic tubes housed within the machine and are dispensed into the can through nozzles. The Printer attached to either the Color Matching System or the Automatic Colorant Dispenser is used to produce a small label, which contains the color identification and the formula ingredients. This label is affixed to each can of tinted paint. This procedure is essential to completing the product labeling process, as the label on the white base at the primary production facility only lists the ingredients prior to colorant addition.

Once the proper amount of colorant is added to the white base, the can of paint is placed inside the Shaker, in which, the paint is properly mixed. If the paint is not thoroughly and mechanically mixed by Petitioner at the point of sale, the colorant added into the white base by the Dispenser would not be properly dispersed throughout the can.

Applicable Law and Regulations

Section 1105 of the Tax Law provides, in part:

Imposition of sales tax. On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax of four percent upon:

(a) 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.

(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.

(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.

(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.

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

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Example 3: A food processor sells canned food in cases of 48 cans. The canned food is stacked for later labeling and casing. The line of production is deemed to extend through the labeling and casing operation.

(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.

* * *

(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

Petitioner manufactures paint and paint related products including paint which is customized to the color selected by the particular customer. In order to produce this customized paint, Petitioner combines a certain colorant or colorants with a particular white base depending on the desired color. The selection of the colorants and the white base, blending and mixing activities and printing of labels, which result in the final product being processed and ready to be sold are accomplished by using the Color Matching Systems, the Automatic Colorant Dispensers, the Shakers and the related computer equipment.

New York Department of Taxation and Finance Publication 852 (2/96), Sales Tax Information for Producers at page 3, describes "production" as "[t]he process by which products

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are created using one or more of the following operations: manufacturing; processing; fabricating; generating; assembling; refining; mining; or extracting." Such publication describes "processing" as "[a]n operation that changes the nature, shape or form of tangible personal property."

The production process for manufacturing, processing and assembling operations ends when the product is completed, packaged and ready to enter the stream of commerce. See Section 528.13(b) of the Sales and Use Tax Regulations. An interruption in the production cycle before the product is finished and ready for sale does not terminate the production process. See the above mentioned Publication 852 at page 7.

Based on the foregoing, the Color Matching Systems, Automatic Colorant Dispensers, Shakers and related computer equipment are used directly in the production of paint for sale, under Section 1115(a)(12) of the Tax Law and Section 528.13 of the Sales and Use Tax Regulations. These items will be exempt from sales and compensating use tax provided that over 50% of their use is directly in the production of paint for sale as described above. See Section 528.13(c)(4) of the Sales and Use Tax Regulations.

DATED: April 8, 1999

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

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