

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-03(2)M
Miscellaneous Tax
November 18, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M030129A

On February 24, 2003, the Department of Taxation and Finance received a Petition for Advisory Opinion from Ernst & Young, 1400 Key Tower, 50 Fountain Plaza, Buffalo, New York 14202.

The issue raised by Petitioner, Ernst & Young, on behalf of its client, ABC Company (ABC), is whether, under the circumstances presented, ABC is eligible for reimbursement or credit of Article 13-A tax paid on the purchase of kerosene and No. 2 fuel oil from ABC's distributor.

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

ABC, with headquarters outside of New York State, is a global leader in the design and manufacture of diesel engines, with various business units that design, manufacture, distribute and service engines and related products. ABC operates a manufacturing plant in New York. This plant manufactures heavy-duty diesel engines used in the automotive industry.

The New York plant purchases kerosene and No. 2 fuel oil (collectively "fuels") from a registered distributor which delivers these fuels directly to the plant and charges various taxes, including the New York petroleum business tax imposed under Article 13-A. The fuels are dispensed directly into two aboveground 20,000-gallon storage tanks from the distributor's delivery truck via a 3-inch pipe connection. These storage tanks are located outside, in the rear of the manufacturing plant, in an area commonly referred to as the "tank farm." These storage tanks have no nozzles to dispense the fuels directly from the tanks.

After delivery into the storage tanks, the fuels are then pumped into the plant via two dedicated in-line pumps. These pumps continuously operate to circulate the fuels from the storage tanks to a fuel header located above the test cells. Once the fuels are transported to the fuel headers located above each test cell area, they are measured and dispensed directly to engines via a hose.

The fuels are used exclusively to operate the engines produced at the manufacturing plant. The engines are started in one of the 17 test stands, and then tested to make sure they operate within various standards established by ABC. None of the fuels are used to operate motor vehicles over the road.

Applicable law and regulations

Section 282 of the Tax Law provides, in part:

1. (b) With respect to Diesel motor fuel, “distributor” means any person, firm, association or corporation (i) who or which imports or causes to be imported into the state, for use, distribution, storage or sale within the state, any Diesel motor fuel; (ii) who or which produces, refines, manufactures or compounds Diesel motor fuel within the state; (iii) *who or which engages in the enhancement of Diesel motor fuel in this state . . .* (Emphasis added)

* * *

16. “Enhancement” when used in this article with respect to Diesel motor fuel shall mean *the addition or blending of kerosene or any other substance . . . to or with fuel oil or other middle distillate which improves or enhances such middle distillate's performance in the operation of a motor vehicle engine of the diesel type . . . “Enhanced Diesel motor fuel” shall mean the combined or blended product which has resulted from the act of enhancement (not the purchase of the ingredients to make the blend) and any product specifically designated “Diesel fuel” or “No. 1 Diesel fuel” or “No. 2 Diesel fuel” or any like industry designation commonly used to refer to a fuel used in the operation of a motor vehicle engine of the Diesel type which meets standard industry specifications. . . .* (Emphasis added)

Section 282-a of the Tax Law provides, in part:

2. No person shall engage within this state in the enhancement of Diesel motor fuel, make a sale or use of Diesel motor fuel . . . or produce, refine, manufacture or compound Diesel motor fuel within the state *unless such person shall be registered* by the department of taxation and finance as a distributor of Diesel Motor fuel. . . . (Emphasis added)

* * *

3. (b) The tax on the incident of sale or use imposed by subdivision one of this section shall *not apply to:*

(i) the sale to or use by the consumer of previously untaxed Diesel motor fuel which is not enhanced Diesel motor fuel and which is used . . . for the purpose of *use or consumption directly and exclusively in the production of tangible personal property, gas, electricity, refrigeration or steam, for sale, but only if all of such fuel is consumed other than on the highways of this state;* provided, however, this exemption shall in no event apply to a sale of Diesel motor fuel which involves a delivery at a filling station or into a repository which is equipped with a hose or other apparatus by which such fuel can be dispensed into the fuel tank of a motor vehicle.

. . .

Section 289-c. 3. (a) of the Tax Law provides, in part:

Except as otherwise provided in paragraph (b) of this section, any person who shall buy any motor fuel or diesel motor fuel, on which the tax imposed by this article shall have been paid, and shall consume the same in any manner except in the operation of a motor vehicle upon or over the highways of this state, or in the operation of a pleasure or recreational motor boat upon or over the waterways of the state including waterways bordering on the state, *shall be reimbursed the amount of such tax* in the manner and subject to the conditions herein provided except that there shall be no reimbursement of tax paid on motor fuel or diesel motor fuel taken out of this state in a fuel tank connected with the engine of a motor vehicle and consumed outside of this state. (Emphasis added)

Section 300 of the Tax Law provides, in part:

(c)(1) The term (A) “diesel motor fuel” means such term as defined in subdivision fourteen of section two hundred eighty-two of this chapter and regulations thereunder including any regulations relating to product specifically designated “No. 4 diesel fuel” and not suitable as a fuel used in the operation of a motor vehicle engine, and

(B) “*enhanced diesel motor fuel*” means such term as defined in subdivision sixteen of section two hundred eighty-two of this chapter . . . (Emphasis added)

(C) (i) “nonautomotive type diesel motor fuel” as used in relation to the rates of the tax imposed by section three hundred one-a of this article means any diesel motor fuel, as described in subparagraph (A) of this paragraph, which would be excluded from the diesel motor fuel excise tax imposed by section two hundred eighty-two-a of this chapter solely by reason of the enumerated exclusions based on ultimate use of the product set forth in paragraph (b) of subdivision three of such section, and (ii) “automotive-type diesel motor fuel” as used in relation to the rates of tax imposed by such section three hundred one-a means diesel motor fuel which is not nonautomotive-type diesel motor fuel.

* * *

(m) “Manufacturing gallonage” means residual petroleum product or *diesel motor fuel (which is not enhanced diesel motor fuel)* used and consumed directly and exclusively in the production of tangible personal property for sale by manufacturing, processing or assembly, but only if all of such fuel or product is delivered on the manufacturing site and is consumed other than on the highways of this state. “Manufacturing gallonage” shall in *no event include diesel motor fuel delivered at a filling station or into a repository which is equipped with a hose or other apparatus by which such fuel can be dispensed into the fuel tank of a motor vehicle.* The commissioner shall require such documentary proof *to substantiate the classification of product as “manufacturing gallonage” as the commissioner deems appropriate.* (Emphasis added)

Section 301-a of the Tax Law provides, in part:

(a) General. Notwithstanding any other provision of this chapter . . . there is hereby imposed upon every petroleum business for the privilege of engaging in business, doing business, employing capital, owning or leasing property, or maintaining an office in this state, a monthly tax for each or any part of a taxable month equal to the sum of the motor fuel component determined pursuant to subdivision (b) of this section, the automotive-type diesel motor fuel component determined pursuant to paragraph one of subdivision (c) of this section, the nonautomotive-type diesel motor fuel component determined pursuant to paragraph two of subdivision (c) of this section and the residual petroleum product component determined pursuant to subdivision (d) of this section.

* * *

(f)(4) Notwithstanding any other provision of this article, commencing January first, nineteen hundred ninety-eight, nonautomotive-type diesel motor fuel which is “*manufacturing gallonage*,” as such term is defined in subdivision (m) of section three hundred of this article, *shall be exempt* from the measure of the nonautomotive-type diesel motor fuel component of the tax imposed under this section. (Emphasis added)

Section 301-b. (a)(1) provides an exemption for gallonage otherwise includable in the measure of the tax imposed by Article 13-A of the Tax Law for:

Kerosene sold or used by a petroleum business which is registered under article twelve-A of this chapter as a distributor of diesel motor fuel so long as (i) such product has not been blended or mixed with any other product constituting diesel motor fuel or motor fuel or a residual petroleum product and (ii) such product is not used by the petroleum business as fuel to operate a motor vehicle or sold by such petroleum business to a consumer for use as fuel to operate a motor vehicle.

Section 301-c (j) of the Tax Law provides:

Reimbursement for manufacturing gallonage. Commencing January first, nineteen hundred ninety-eight, *a subsequent purchaser shall be eligible for reimbursement* of any taxes imposed under this article with respect to gallonage of residual petroleum product and *diesel motor fuel (which is not enhanced diesel motor fuel), subsequently sold by such purchaser to a consumer as “manufacturing gallonage.”* This reimbursement may be claimed only where (1) any tax imposed pursuant to this article has been paid with respect to such gallonage and the entire amount of such tax has been absorbed by such purchaser, and (2) such purchaser possesses documentary proof satisfactory to the commissioner evidencing the absorption by it of the entire amount of such tax. Provided, however, that the commissioner shall require such documentary proof to qualify for any reimbursement of tax

provided by this subdivision as the commissioner deems appropriate including a certificate by the consumer that such product is to be used and consumed exclusively as “manufacturing gallonage”. (Emphasis added)

Section 302(a) of the Tax Law provides, in part:

Registration required. Each petroleum business with respect to motor fuel must be registered with the department of taxation and finance as a distributor of motor fuel under article twelve-A of this chapter. *Each petroleum business with respect to diesel motor fuel must be registered with the department of taxation and finance as a distributor of diesel motor fuel under article twelve-A of this chapter. . . .* (Emphasis added)

Section 315(b) of the Tax Law provides, in part:

Joint administration of taxes. In addition to the powers granted to the commissioner in this chapter, *the commissioner is hereby authorized to make provisions for the joint administration, in whole or in part, of the taxes imposed by articles twelve-A and twenty-eight and pursuant to the authority of article twenty-nine of this chapter upon automotive fuel and the taxes imposed by this article, including the joint reporting, assessment, collection, determination and refund of such taxes, and for that purpose to prescribe that any of the commissioner's functions under such articles, and any returns, forms, statements, documents or information to be submitted to the commissioner under such articles, any books and records to be kept for purposes of the taxes imposed or authorized to be imposed by such articles, any schedules of amounts to be collected under such articles, any registration required under such articles, and the payment of taxes under such articles, shall be on a joint basis with respect to the taxes imposed by or pursuant to such articles. Provided, notwithstanding any provision of this article to the contrary, in the furtherance of joint administration, the provisions of subdivision one of section two hundred eighty-five-a and subdivision one of section two hundred eighty-nine-c of this chapter shall apply to the taxes imposed under this article with the same force and effect as if those provisions specifically referred to the taxes imposed hereunder and all the products with respect to which the taxes are imposed under this article. . . .* (Emphasis added)

Section 1105-B of the Tax Law provides, in part:

(a) Receipts from the retail sales of parts with a useful life of one year or less, *tools and supplies for use or consumption directly and predominantly in the production of tangible personal property . . . for sale by manufacturing, processing, generating, assembling, refining, mining or extracting shall be exempt from the tax imposed by subdivision (a) of section eleven hundred five of this article.* (Emphasis added)

Section 1115(c)(1) of the Tax Law provides, in part:

Fuel, gas, electricity, refrigeration and steam, and gas, electric, refrigeration and steam service of whatever nature for use or consumption directly and exclusively in the production of tangible personal property, gas, electricity, refrigeration or steam, for sale, by manufacturing, processing, assembling, generating, refining, mining or extracting shall be exempt from the taxes imposed under subdivisions (a) and (b) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten of this article.

Section 528.13(b) of the Sales and Use Tax Regulations provides:

(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.

Example 1: A crane is used to unload raw materials, which are immediately placed in storage at a plant. From the storage site, the material is placed on an assembly line without testing. The crane is being used in production.

Example 2: Testing equipment used to test incoming materials is not used in production and is subject to tax.

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

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.

Section 528.22(c) of the Sales and Use Tax Regulations provides, in part:

(1) *Directly* means the fuel, gas, electricity, refrigeration and steam and like services, and must during the production phase of a process, either:

- (i) operate exempt production machinery or equipment; or
- (ii) create conditions necessary for production; or
- (iii) perform an actual part of the production process. (Emphasis added)

* * *

(3) (i) *Exclusively* means that the fuel, gas, electricity, refrigeration and steam and like services are used in total (100%) in the production process. (Emphasis added)

(ii) Because fuel, gas, electricity, refrigeration and steam when purchased by the user are normally received in bulk or in a continuous flow and a portion thereof is used for purposes which would make the exemption inapplicable to such purchases, the user may claim a refund or credit for the tax paid only on that portion used or consumed directly and exclusively in production.

* * *

(iv) The user must maintain adequate records with respect to the allocation of fuel, gas, electricity, refrigeration and steam used directly and exclusively in production and for nonexempt purposes.

(v) For the purpose of substantiating the allocation of fuel, gas, electricity, refrigeration and steam and like services used directly and exclusively in production from that used for nonexempt purposes, the user must, when claiming a refund or credit, submit an engineering survey or the formulae used in arriving at the amounts used in an exempt manner.

Opinion

ABC operates a manufacturing plant in New York State. This plant manufactures heavy-duty diesel engines used in the automotive industry. This plant purchases kerosene and No. 2 fuel oil from a registered distributor which delivers these fuels directly to the plant and charges various

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taxes, including the New York State petroleum business tax imposed under Article 13-A of the Tax Law. The fuels are used exclusively to operate the engines produced at the manufacturing plant. The engines are started and tested in one of ABC's 17 test stands to make sure they operate within various standards established by ABC. None of the fuel is used to operate motor vehicles over the highways of New York State.

Although Petitioner's questions relate specifically to petroleum business tax, it is necessary to include in this discussion Articles 12-A and 28 of the Tax Law (diesel motor fuel excise tax and sales and compensating use tax), because Article 13-A incorporates portions of these articles by reference. See section 315(b) of the Tax Law. While each of these taxes is imposed by a separate article of the Tax Law, these taxes are all jointly administered. Thus, it is necessary to look at the provisions of each of these taxes to better understand the application of the Tax Law to the circumstances at issue.

The definition of manufacturing gallonage under Article 13-A of the Tax Law and the exemptions provided under Articles 12-A and 28 pertain to property and fuel used and consumed "directly and exclusively" or "directly and predominantly" in the production of tangible personal property for sale by manufacturing, processing or assembly. See sections 282-a(3)(b), 300(m), 1105-B and 1115(c)(1) of the Tax Law.

Section 528.13(b) of the Sales and Use Tax Regulations provides that manufacturing activities can be classified as administration, production or distribution. In clarifying the production phase in the manufacturing process, the regulation section states that 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." The determination of when production begins and ends is dependent upon the procedure used in a plant. In the present case it is important to note that production ends when the product is ready to be sold.

Assuming the engine tests in the present case are part of the production line before packing for shipment for sale and all engines are so tested, it would appear that the testing is within the production phase. See *Al Tech Specialty Steel Corporation*, Adv Op Comm T&F, October 5, 1981, TSB-A-81(29)S. If the testing takes place prior to the completion of the engines (i.e., testing occurs within the production phase of the process), then the fuels purchased by ABC for use in such testing will be used or consumed directly in the production of tangible personal property for sale by manufacturing. In such case, the fuels will be manufacturing gallonage under section 300(m) of the Tax Law and ABC may be eligible for reimbursement of the taxes imposed by Article 13-A, provided that the diesel motor fuel purchased is not enhanced diesel motor fuel and 100% of such fuel is used or consumed in production. To claim the reimbursement, ABC must substantiate that the Article 13-A tax was paid on the fuel and absorbed by ABC. Even if the fuels are not manufacturing gallonage, and as long as they are not blended or used in a motor vehicle, ABC may claim a refund of the Article 13-A tax with respect to its purchases of kerosene. See section 301-b(a)(1) of the Tax Law and *Petro, Inc.*, Adv Op Comm T&F, July 26, 2002, TSB-A-02(1)M. As the

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fuel is not consumed on the highways of this state, and assuming that the fuel in question is used in production, ABC would also be eligible for a refund of the taxes imposed by Articles 12-A and 28. See sections 289-c (3) and 1120 of the Tax Law.

If the fuel is blended prior to delivery, or designated by the distributor as “Diesel fuel” or “No. 1 Diesel fuel” or “No. 2 Diesel fuel” or any like industry designation commonly used to refer to a fuel used in the operation of a motor vehicle engine, then the fuel meets the definition of “enhanced diesel motor fuel.” See sections 282(16) and 300(c)(1)(B) of the Tax Law. Although the enhanced diesel motor fuel may meet the refund eligibility requirements of sections 289-c (3) and 1120 of the Tax Law for automotive fuel excise and sales tax purposes, it is not eligible for refund or reimbursement of tax pursuant to section 301-b(a)(1) or section 301-c (j) of the Tax Law for petroleum business tax purposes. Also see section 300(m) of the Tax Law. Therefore, ABC would not be eligible for reimbursement or refund of petroleum business tax on its purchases of enhanced diesel motor fuel.

In addition, if ABC is itself combining or blending the kerosene with No. 2 fuel oil, ABC is considered to be “enhancing” the diesel motor fuel. This activity would require ABC to register as a distributor of diesel motor fuel under Article 12-A of the Tax Law. ABC would be required to pay the Article 13-A tax on the fuel (as noted above, there is no manufacturing gallonage exemption for enhanced diesel motor fuel). ABC would also be required to pay any appropriate Article 12-A tax, but would be eligible for a refund or credit for off-highway use. See sections 282(1)(b)(iii), 282(16), 282-a(2), 289-c(3), and 302(a) of the Tax Law.

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