

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

TSB-A-85(62)S  
Sales Tax  
December 4, 1985

STATE OF NEW YORK  
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. S830412A

On April 12, 1983 a Petition for Advisory Opinion was received from Chrysler Corporation, New Process Gear Division, PO Box 1919, Detroit, Michigan 48288.

The issue raised is whether coolant/chip handling systems used by Petitioner in conjunction with metal cutting machines are exempt articles of machinery or equipment used directly and predominantly in the production of tangible personal property for sale.

Petitioner utilizes metal cutting machines to cut metal surfaces on automotive parts, such parts being in various stages of production. The production exemption afforded to the metal cutting machines is not an issue in this Advisory Opinion.

The metal cutting machines must utilize a coolant/chip handling system to function properly. In the past, coolant/chip handling systems were designed into individual machines and were therefore self-contained and an integral part of each machine. The system designed for Petitioner's New Process Gear Plant eliminates the requirement for individual coolant/chip handling systems through the use of a central system which is attached to a group of machines which are using the same coolant, machining the same metal and generating the same type of metal chips.

The coolant performs two primary functions: It cools the metal at the point where it is being cut and it lubricates the metal to reduce the adhesion between the metal and the cutting tool face. In addition, the coolant washes away metal chips, improves the surface finish, increases tool life, reduces power requirements and prevents or reduces possible corrosion on both the work and the machine.

The coolant is delivered under controlled temperature and pressure to the point of contact between the cutting edge and the part being machined where it performs the cooling, lubricating, and related functions and flushes the chips through an opening in the cutting machine to a central tank. At the central tank, the coolant and chips are separated and the coolant is filtered and monitored for deterioration and returned through a closed loop system under controlled temperature and pressure to the cutting machines to repeat the process. The metal chips are mechanically crushed to reduce the volume and then introduced into a wringer which extracts residual coolant and produces a dry by-product which is subsequently sold.

Petitioner contends that the exempt cutting machines could not operate without the coolant/chip removal systems, and that the systems are physically annexed to the cutting machines, specially designed therefor, and necessary to the proper functioning of the cutting machines.

Further, it is Petitioner's contention that the coolant/chip handling system is interrelated with the production cutting machines in a manner which exempts the system from sales and use tax both in the production of automotive parts and also in the production of a saleable by-product.

It is Petitioner's concluding contention that since the coolant/chip handling systems consist of both tangible personal property and real property elements which required the application of labor to place them within the plant, the sales tax should be applied as follows:

1. The contractor's labor to install the foundations and other articles of real property should be exempt from tax under the capital improvement provisions of Section 1105(c)(3).
2. The materials in the foundation or other articles which become real property should be exempt as manufacturing equipment under Section 1115(a)(12), based upon direct and predominant use in the manufacturing process.
3. The articles which make up the coolant/chip handling systems such as the piping, tanks, filters, separators and dryers should be exempt equipment under Section 1115(a)(12) of the Tax Law.
4. Labor charges for on-site assembly of the articles indicated in Paragraph 3, above, should be considered manufacturer's or assembly labor of the components and therefore exempt under Section 1115(a)(12) of the Tax Law.

Section 1101(b)(9) of the New York State Sales and Use Tax Law defines a capital improvement as ". . . An addition or alteration to real property which: (i) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and (ii) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and (iii) Is intended to become a permanent installation."

Section 1105 of the Tax Law states, in part: ". . . there is hereby imposed and there shall be paid a tax . . . upon: . . . (c) The receipts from every sale . . . except: . . . (iii) for installing property which, when installed, will constitute an addition or capital improvement to real property, property or land, as the terms real property, property or land are defined in the real property tax law as such term capital improvement is defined in paragraph nine of subdivision (b) of section eleven hundred one of this chapter . . .".

Accordingly, Petitioner's contention that the contractor's charges for labor to install the foundations and other articles of real property are exempt from sales tax as a capital improvement is correct since such installations meet the three conditions stated in section 1101(b)(9) of the Tax Law.

However, in the Matter of Slattery Associates, Inc., v. Tully, 79 AD 2d 761, affd. 54 NY2d 711, it was held under similar circumstances that materials used to construct the foundation for production machinery did not qualify for the production exemption under section 1115(a)(12) of the Tax Law because the materials incorporated into the foundation did not possess the requisite "identifiable character" as machinery or equipment at the time of their purchase at retail.

Accordingly, in the instant case, the materials in the foundation or other such articles which become real property are not exempt as manufacturing equipment under Section 1115(a)(12) but rather are taxable at the time of purchase as purchases of tangible personal property.

Section 1115(a)(12) of the Tax Law provides an exemption from sales and use tax on the receipts from retail sales of "machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property. . . for sale, by manufacturing. . .".

Section 528.13(c) of the New York State Sales and Use Tax Regulations states, in part: "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. . . .

(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. . . ."

The coolant/chip handling system acts upon the metal being cut to cool and lubricate the metal to enable it to be cut. Additionally, the system is used to reclaim and process metal chips which are, in turn, sold.

Accordingly, the items which make up the coolant/chip handling system qualify as machinery or equipment used directly in the production of tangible personal property for sale by manufacturing. (International Salt Co., v. New York State Tax Commission, 79 AD 2d 343 (1981); Cummins Engine Co., Inc., State Tax Commission Advisory Opinion, TSB-A-81(34)S). Since these items are used more than fifty percent of the time in such production, they qualify for the exemption provided by section 1115(a)(12) of the Tax Law.

Section 1105-B(b) of the Tax Law states, in part: "Notwithstanding any other provisions of this article, but not for the purposes of the taxes imposed by section eleven hundred seven or eleven hundred eight or authorized pursuant to the authority of article twenty-nine of this chapter, the taxes imposed by subdivision (c) of section eleven hundred five on receipts from every sale of the services of installing, repairing, maintaining or servicing the tangible personal property described in paragraph twelve of subdivision (a) section eleven hundred fifteen, including the parts with a useful life of one year or less, . . . to the extent subject to such tax, shall be paid at the rate of two percent for the period commencing September first, nineteen hundred eighty and ending February twenty-eighth, nineteen hundred eighty-one and such receipts shall be exempt from the tax on sales imposed under subdivision (c) of section eleven hundred five on and after March first, nineteen hundred eighty-one."

As the piping, tanks, filters, separators and dryers are not sold as a completely assembled unit, the assembling of the unit for installation at the job site is not considered to be on-site assembly.

Accordingly, the labor charges for such assembly do not qualify for exemption under Section 1115(a)(12) of the Tax Law, but rather, are afforded the exemption provided under Section 1105-B(b) of the Tax Law.

The installation labor charges for attaching the assembly to the foundations and floor, and to the production cutting machines are also afforded the exemption provided under Section 1105-B(b) of the Tax Law.

If the labor charges in either of the above instances were for labor performed prior to September 1, 1980, the applicable statewide sales tax rate was 4%; for labor performed during the period September 1, 1980 through February 28, 1981 the applicable statewide tax rate was reduced to 2%; for labor performed on or after March 1, 1981 the statewide tax was reduced to 0%. In each instance the labor charges were subject to the New York City tax of 4%, if performed within New York City and were also subject to any applicable local sales or use tax, regardless of when performed.

DATED: November 14, 1985

s/ANDREW F. MARCHESE  
Chief of Advisory Opinions

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