

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

TSB-A-89(11)S  
Sales Tax  
April 27, 1989

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S890104E

On January 4, 1989, a Petition for Advisory Opinion was received from Barrister Information Systems, 45 Oak Street, Buffalo, New York 14203.

The issues raised are as follows:

1. When Petitioner converts a minicomputer central processing unit, (minicomputer CPU) which Petitioner has manufactured, to Petitioner's own use, what is the proper basis for use tax: the cost of the individual parts that comprise the minicomputer's central process unit (e.g. the various circuit boards, resistors, capacitors, cables, etc.) or the petitioner's sales price of the assembled minicomputer CPU?

2. When a microcomputer or a "stand-alone" computer component which Petitioner purchased for resale from a third party manufacturer is converted to Petitioner's own use, what is the proper basis for the use tax: the cost of the microcomputer or "stand-alone" component or the "marked-up" price at which Petitioner sells these microcomputers and components to its customers?

3. Are Petitioner's purchases of replacement or spare parts which are transferred to customers in conjunction with Petitioner's computer component maintenance and repair service excluded from sales tax as purchases for resale? Are third party charges to Petitioner for the repair of defective parts acquired from customers by Petitioner's maintenance and repair service and then placed into Petitioner's replacement or spare parts inventory after such repairs have been performed, also excluded from tax as a purchase for resale?

The facts are as follows:

I. One of Petitioner's business activities is the production and sale of minicomputer central processing units (minicomputer CPUs).

Petitioner's production process entails assembling an aluminum case into which various sub-components and circuit board sub-assemblies are placed.

The sub-assemblies are designed and produced by Petitioner. Production of a sub-assembly involves placing a blank circuit board in a machine which places (populates) certain standard integrated circuits (chips) in the correct location on the board. The board is then passed through a soldering machine and through an ultrasonic degreaser. Subsequently it is taken to a hand-assembly area where specialized integrated circuits, resistors and capacitors are added, resulting in a completed sub-assembly.

The completed sub-assemblies are connected by wires or integrated plugs to other sub-components which include main power supplies, supplementary power supplies, etc. The sub-components are either produced by Petitioner or purchased from outside vendors.

The minicomputer CPUs are sold by Petitioner, either individually or with various other components. Occasionally, Petitioner may remove a completed minicomputer CPU from inventory for use in Petitioner's own operations.

II. Petitioner also purchases microcomputer central processing units (fully manufactured and functional IBM-AT or XT clones) plus various stand-alone computer components (peripheral equipment) such as keyboards, video display terminals (VDT), modems, and printers, all of which are manufactured by other vendors and purchased by Petitioner for resale purposes. Petitioner sells these items individually and also as a group. A typical grouping would include a keyboard, a VDT, a printer and either a microcomputer or a Petitioner produced minicomputer.

Upon receipt of the microcomputers and the peripheral equipment, Petitioner tests each item to insure it is operating properly. Testing merely involves connecting the item with the same type of equipment it will encounter when the component is located at a client's place of business.

After testing, some of the large components are relabeled. Relabeling merely involves taking Petitioner's logo, which has been embossed on plastic or silk screened on vinyl, and gluing it over the actual manufacturer's logo. Petitioner has entered into licensing agreements with the manufacturers which allow the relabeling of the components. Smaller components (e.g. modems) are not relabeled.

Petitioner also purchases software and supplies, for resale purposes, from other manufacturers.

Occasionally, some of the microcomputers, components (peripherals), software or supplies are converted to Petitioner's own use and not resold to customers.

A portion of the microcomputers sold by Petitioner often require some form of reconciliation (upgrading) due to customer desire for enhancement of the capabilities inherent in the basic model microcomputer. Reconciliation may result in options such as increasing the amount of memory or storage capacity and the addition of color graphics capabilities.

Reconciliation of microcomputers is a simple process. The microcomputer interior is accessed by removing four screws which attach the outer cover to the chassis. Exposure of the interior allows clear visibility of and access to the mother board of the microcomputer.

The computers memory is increased by installing additional memory chips on the mother board. Likewise, monochrome or color graphics are obtainable by installing a monochrome or color graphics board on the mother board. Each of these items are installed by placing the memory chip or the graphics board over the proper receptacle on the mother board and applying downward pressure.

Petitioner does not manufacture any of the chips or boards used in reconciliation activities. These items are purchased from other manufacturers.

Other components such as hard disk drives (ready-made and factory sealed) are also purchased from another manufacturer. The installation of a hard disk drive requires attaching the drive (with four screws) to the chassis of the microcomputer. The hard disk drive also comes equipped with a controller board that is plugged into the mother board.

After the chips, boards and/or hard disk drive have been added, the outside cover is refastened and the microcomputer is tested.

It is Petitioner's contention that reconciliations performed on a microcomputer are analogous to a car dealer adding customer requested options, such as air conditioning, an upgraded stereo system, cruise control or a rear window defogger, to a base-model car purchased "off-the-lot" from the dealer's inventory by such customer.

Other manufacturer's computer components (peripherals) sometime require reconciliation before being used with certain types of hardware. Reconciliation of a component usually involves flipping various switches, located on the component, to insure that the component has the ability to interface (communicate) with other components.

Some printers need to be "told" about the typeface requirements of a particular customer. This usually involves flipping certain on-off or "dip" switches located on the chassis of the printer. Although the switches are preset by the manufacturer, Petitioner's employees may have to reverse some of the switches in order to insure that the printer's output matches the customer's requirements.

Other components purchased by Petitioner, such as laser printers, may require the substitution of one type of computer chip for another. Upon locating the chip which is to be replaced, removal is accomplished by grasping the chip and applying upward pressure. Installation of the substitute chip is performed by positioning the chip over the spot vacated by the original chip and exerting downward pressure until the chip is secured to the mother board.

Petitioner does not produce any of these chips but purchases them from a third-party supplier.

Petitioner also sells "groupings" that include the minicomputer central processing units which are assembled by Petitioner along with various "stand-alone equipment produced by other manufacturers. A typical "grouping" of this nature would include a minicomputer central processing unit produced by Petitioner, and a video display terminal, keyboard, printer, modem and other equipment produced by third-party manufacturers. Some minor reconciliation of the components from the other manufacturers may be required to insure that they properly interface with the other computer components.

Where the contract between Petitioner and the customer requires that Petitioner install the computer system on the customer's premises, Petitioner will connect the computer and the various components by use of applicable cables and plugs, as well as plugging the various components into an electrical power source.

III. Petitioner also contracts to provide maintenance and repair services to certain customers. Under the terms of the service contracts, clients pay a fixed maintenance/service fee in return for Petitioner's obligation to maintain the computer and computer components and to replace old and defective parts at no additional charge. Petitioner collects sales tax on these maintenance fees.

Because Petitioner sells computers and computer components nationwide, Petitioner has over 30 service centers located throughout North America. Each service center has at least one service technician and a local replacement or "spare" parts inventory. Petitioner's service headquarters and main replacement parts inventory are located in Buffalo, N.Y..

Petitioner maintains both the main and the local replacement parts inventories to insure parts availability resulting in prompt repair service. Parts which are not available locally must be shipped by overnight express mail from the main parts inventory at Buffalo.

Petitioner obtains the parts comprising the replacement parts inventories from several sources. Some parts are purchased directly from parts suppliers, while other parts are obtained by purchasing complete components from other manufacturers and "cannibalizing" or breaking down the components into their various "parts" such as circuit boards, mother boards, cases, switches, power supplies, cables, video display terminal picture tubes, etc. Petitioner also acquires parts by retaining defective parts from customers equipment, where such parts are replaced in accordance with the terms of the service contracts between Petitioner and Petitioner's customer.

Pursuant to the service contracts, title and possession of the replacement parts transfers to the customer at the time the service is performed, with Petitioner being granted the right to retain the defective parts.

The defective parts are forwarded to Petitioner's Buffalo location for repair (when possible) by Petitioner or by a third party repair service, and for subsequent transfer into the replacement parts inventory.

Section 531.2(b) of the Sales and Use Tax Regulations defines manufacturing as:

[T]he production of tangible personal property that has a different identity from its ingredients. Manufacturing includes the production of standardized items as well as the production of items to a customer's specifications.

Example 5: Company E combines metal, wood, glass, and other component parts into structural panel sections which are joined to form the bearing walls of a building. These panels are manufactured products.

Section 531.2(c) of the Sales and Use Tax Regulations defines assembling as:

[T]he coupling or the uniting of parts or materials as a manufacturing process or as a step in the manufacturing process which results in a new product.

Example 1: Company A purchases drilled angle iron from Company B and steel shelving from Company C. Company A then bolts the shelving to the angle iron, to produce bookcases by assembly.

Section 1110 of the Tax Law states:

Imposition of compensating use tax.

Except to the extent that property or services have already or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state ... except as otherwise exempted under this article, ... (B) of any tangible personal property manufactured, processed or assembled by the user, if items of the same kind of tangible personal property are offered for sale by him in the regular course of business ...

Section 531.1 of the Sales and Use Tax Regulations states:

Imposition of compensating use tax. (Tax Law § 1110.)

(b) Taxable uses. The uses enumerated herein are subject to tax.

(2) Tangible personal property manufactured, processed or assembled by the user if items of the same kind are offered for sale by him in the regular course of business.

Section 531.3 of the Sales and Use Tax Regulations states:

Basis of tax.

(a) Tangible personal property purchased at retail.

(2) The compensating use tax is due upon the use of tangible personal property, which was purchased for resale or an exempt use and is subsequently withdrawn from or diverted to a taxable use by the purchaser.

Example 2: A retail store purchased a dozen desks at \$75 each for sale to its customers at \$125 each. It subsequently withdrew one of the desks from inventory to be used in its office. A compensating use tax is due for the desk withdrawn from inventory. The tax is computed on the \$75.00 the store paid.

(b) Tangible personal property manufactured, processed or assembled by the user.

(1) A compensating use tax is imposed on the use of any tangible personal property which was manufactured, processed or assembled by the user, if items of the same kind of tangible personal property are offered for sale by him in the regular course of business.

(i) Items of the same kind mean that items belong to an identifiable class, but need not be identical.

(ii) Offered for sale in the regular course of business means that a person sells in excess of 10 percent of his product for each 12 month period beginning December 1st .... When it is determined that a person is selling in excess of 10 percent of his product in the regular course of business ..., he will be considered a person required to pay compensating use tax on the basis set forth in paragraph (3) of this subdivision ...

\* \* \*

(3) Where the user sells items of the same kind to other persons in the regular course of business, the basis of tax on the use of tangible personal property which is manufactured, processed or assembled by the user is the price at which such items are sold as evidenced by a price list, catalog price or record of sales. In the absence of a catalog price or price list, the average of the prices charged various customers will be deemed the price which the user would sell such item to the persons during the regular course of business.

Example 6: A desk manufacturer withdraws desks from its inventory for use in its executive office. In the regular course of business it sells the desk for \$150. It pays a compensating use tax on \$150, the price at which it sells such desks.

Section 532.4 of the Sales and Use Tax Regulations states:

Presumption of taxability.

(a) General. It shall be presumed that all receipts from sales of property or service of any type mentioned in subdivisions (a) ... (c) ... of section 1105 of the Tax Law ... are subject to tax until the contrary is established.

\* \* \*

(d) Resale certificate. (1) A resale certificate is used to claim exemption from tax on purchases of tangible personal property or services which will be resold or transferred to a customer when the:

(i) tangible personal property is for resale as such or as a physical component part of tangible personal property;

(ii) tangible personal property is for use in performing taxable services under paragraph ... (3) ... of subdivision (c) of section 1105 of the Tax Law where such property becomes a physical component part of the tangible personal property upon which the services are performed or will be actually transferred to the purchaser of the service in conjunction with the performance of the service; or

(iii) service is for resale.

Example 1: A retail shoe store vendor will give his supplier a resale certificate when he purchases shoes from him for resale.

Example 3: An auto service station operator will give his parts supplier a resale certificate covering the purchase of repair parts incorporated into customer's cars.

\* \* \*

(3) When property or services are intended for resale and purchased tax exempt with a resale certificate, but later are used or consumed rather than resold, the purchaser must pay a tax on the purchase price.

Section 527.5 of the Sales and Use Tax Regulations states:

Installing, repairing, servicing and maintaining tangible personal property. (Tax Law, § 1105[c][3])

\* \* \*

(c) Maintenance and service contracts.

(1) The purchase of a maintenance or service contract is a taxable transaction.

(2) The vendor making sales of such contracts may purchase for resale any tangible personal property which is transferred to his customer in connection with the services rendered.

Section 527.5(b) of the Sales and Use Tax Regulations provides:

Exceptions. (1) The services of installing, maintaining, servicing or repairing tangible personal property are not taxable if the services were performed for resale ....

### Conclusions

The activities performed by Petitioner in producing minicomputer central processing units for sale fall within the meaning of manufacturing and assembling as respectively defined in Section 531.2(b) and 531.2(c) of the Sales and Use Tax Regulations.

Petitioner's sales of minicomputer central processing units are in excess of 10% of the units produced. Therefore, whenever a minicomputer central processing unit is withdrawn from inventory for Petitioner's own use, Petitioner, in accordance with Section 531.3(b)(1) of the Sales and Use Tax Regulations, is considered to be using an item of the same kind as offered for sale in Petitioner's regular course of business. Accordingly, at that time, Petitioner is liable for a use tax as imposed under Section 1110 of the Tax Law and Section 531.1 of the Sales and Use Tax Regulations. The basis for computing the use tax due, in accordance with Section 531.3(b)(3) of the Sales and Use Tax Regulations, will be the price at which such item is sold by Petitioner as substantiated by record of sale, price list or catalog price.

Microcomputers, "stand alone" computer components, software and supplies which Petitioner purchases from other manufacturers, are considered to be purchased for the purpose of resale. When any of these items are withdrawn from inventory for use by Petitioner, Petitioner will incur a use tax liability as imposed under Section 1110 of the Tax Law. The basis for the compensating use tax in these instances, in accordance with Sections 531.3(a)(2) and 532.4(d)(3) of the Sales and Use Tax Regulations, will be the purchase price of the item as paid to the manufacturer by Petitioner. The fact that Petitioner relabels the microcomputers and components; performs reconciliations (upgradings) of the microcomputers or components upon customer request, such as installing memory chips, color graphic boards, hard disk drives, etc.; insures that all the components of a system (grouping) have the ability to interface with each other; sells "groupings" made up of the microcomputer or the Petitioner assembled minicomputer and other components; and, installs the systems on the customer's premises, does not effect the basis on which Petitioner computes the use tax liability for self-use of the microcomputers or components. The activities performed by Petitioner involving the microcomputer and components are not to be construed as production by manufacturing, processing or assembling, nor as fabricating.

In accordance with Section 527.5(c) of the Sales and Use Tax Regulations, Petitioner's purchases of replacement or spare parts which are transferred to customers in conjunction with Petitioner's maintenance and repair service and under the terms of the service contracts between Petitioner and such customers, are considered to be purchases for resale. Petitioner's purchases of components from other manufacturers are also considered to be purchases for resale. Petitioner's "cannibalizing" of some of these components for the purpose of increasing the parts inventory will not affect the resale status of the "cannibalized" items.



TSB-A-89(11)S  
Sales Tax  
April 27, 1989

In accordance with Section 527.5(b)(1) of the Sales and Use Tax Regulations, Petitioner's purchases of third party repair services for the repair of defective parts are considered to be the purchase of services performed for resale. The facts, that such defective parts are obtained by Petitioner as a result of repairing a customer's equipment and that upon being repaired, by a third party repair service or Petitioner, such parts are placed into Petitioner's parts inventory, have no effect upon the sales tax status of the third party repair services or upon the defective parts.

DATED: April 27, 1989

s/FRANK J. PUCCIA  
Director  
Technical Services

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