

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

TSB-A-83(46)S
Sales Tax
November 29, 1983

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. S821012B

On October 12, 1982 a Petition for Advisory Opinion was received from Ebenezer Oil Co., Inc., 85 Main Street, Wellsville, New York 14895.

The issue raised, within the context of the oil extraction industry, is whether sales or use tax is due with respect to 1) certain "subcontracted expertise and labor," 2) certain bulldozers and snowmobiles, and 3) diesel fuel used in such vehicles. This issue has arisen in the course of an audit covering the period June 1, 1978 to May 31, 1981.

Petitioner is engaged in the oil extraction industry. According to Petitioner, as part of the extraction process, the well pipes and pumps are removed from the earth (pulled) and inspected a number of times over the life of a working well. The operation in question is often subcontracted out to a company with expertise in this area. Machinery commonly called a pulling rig is brought to the well site by truck and set up over the well. The pipe, joints and pumps are then removed from the well by mechanically pulling them upward. The inner-workings of the well are then inspected and a decision is made to continue the extraction process at the particular well or to cap the well. If the decision to continue the extraction process is made, worn twenty-foot sections of pipe, Joints and pumps will be replaced as required. The pipe, joints and pumps are placed into the well system by the pulling rig.

The services performed by the subcontractor described above fall within the category of "installing, . . . maintaining, servicing or repairing . . . tangible personal property . . . not held for sale in the regular course of business." The receipts from the provision of such service are subject to the tax imposed under section 1105(c)(3) of the Tax Law, as well as any similar applicable locally imposed sales taxes. Use tax would be due where sales tax was not paid at the time of purchase. Tax Law, § 1110. However, section 1105-B of the Tax Law provides that where such service is rendered with respect to machinery or equipment used "directly and predominantly in the production of tangible personal property . . . by . . . extracting," as is the case herein, the State sales tax rate was reduced from 4% to 2% as of September 1, 1980, and such receipts became exempt from the State tax as of March 1, 1981. These provisions have no bearing on locally imposed sales taxes.

Petitioner next inquires as to the applicability of sales and use taxes to its bulldozers and snowmobiles. The bulldozers are utilized to prepare drilling sites, clear terrain and create roads in order to enable drilling equipment to reach and operate on drilling sites. The bulldozers are not licensed for over the road use. They are transported to the sites by tractor trailers which are licensed for over the road use. The snowmobiles are utilized in the transportation of employees and equipment from well to well. The snowmobiles are not licensed for over the road use and are transported to the property edge by pick-up trucks.

The wells are virtually inaccessible by any other means during the winter months.

Section 1115(a)(12) of the Tax Law provides for an exemption from sales and use taxes with respect to machinery and equipment used "directly and predominantly in the production of tangible personal property . . . for sale, by . . . extracting." The term "directly" is explicated in the Sales and Use Tax Regulations, as follows:

- (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 . . . 20 NYCRR § 528.13(c).

While the vehicles in question are indubitably used in connection with the production of oil, and may even be considered essential thereto, their causal role in the actual process of oil production is not sufficiently proximate to render their use "direct," within the meaning of the portion of section 1115(a)(12) of the Tax Law quoted above. Cole Sand and Gravel Corp., State Tax Commission, January 10, 1983, TSB-H-83(44)S; Rochester Independent Packer, Inc. v. Heckelman, 83 Misc. 2d 1064. Their purchase and use, accordingly, do not come within the ambit of the exemption described above, as it existed during the audit period at issue. It is to be noted, however, that section 1115(a)(12) of the Tax Law was amended, in 1981, by the addition of the following sentence: "This exemption shall include all pipe, pipeline, drilling rigs, service rigs, vehicles and associated equipment used in the drilling, production and operation of oil, gas and solution mining activities to the point of sale to the first commercial user." L. 1981, c. 846. Such amendment took effect on August 26, 1981, and is applicable to both State and local sales and use taxes (other than in New York City). Accordingly, any purchase by Petitioner of vehicles to be used as described above, as well as such use, on or after August 26, 1981 would not be subject to sales or use tax.

Petitioner inquires, finally, as to the sales and use tax status of diesel fuel used in the vehicles described above. Section 1115(c) of the Tax Law provides for an exemption from sales tax with respect to "fuel . . . for use or consumption directly and exclusively in the production of tangible personal property, gas . . . for sale, by . . . extracting" The vehicles in question are not used "directly" in production, and it is for this reason that their purchase and use prior to August 26, 1981 was not exempt from tax. It follows, accordingly, that fuel used to power such vehicles during such

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period was not used directly in production, and was therefore subject to tax. However the statutory amendment described above carved out an exemption for a variety of equipment used in the gas, oil and solution mining industries, including the subject vehicles, in effect statutorily deeming them to be "used directly" in production. Accordingly, on or after August 26, 1981, where vehicles referred to in the second sentence of section 1115(a)(12) are used predominantly in the activities there described, they are, within the present meaning of the Tax Law, "directly and predominantly" used in the production of gas or other tangible personal property for sale by extracting. The fuel used to power such vehicles during such activities would thus come within the purview of the exemption provided for in section 1115(c) of the Tax Law.

DATED: October 26, 1983

s/FRANK J. PUCCIA
Director
Technical Services Bureau