



TAXPAYER INFORMATION RULING LR13-008

Janice K. Brewer
Governor

John A. Greene
Director

July 15, 2013

This taxpayer information ruling is in response to your written request dated December 26, 2012, and the additional information provided in your letter dated February 7, 2013 on behalf of your unidentified client ("Taxpayer") regarding whether your client's purchases of lubricants used in manufacturing equipment are subject to Arizona tax. Because your client is not the taxpayer in regard to purchases of lubricants from an Arizona seller that is subject to the transaction privilege tax, this taxpayer information ruling is limited to Arizona use tax implications because the use tax is imposed on the purchaser. However, the use tax statutory provisions addressed in this ruling are identical to corresponding transaction privilege tax statutory provisions. Pursuant to Arizona Revised Statutes ("A.R.S.") § 42-2101, the Department may issue a taxpayer information ruling to a representative of an unidentified taxpayer.

Issue:

Whether Taxpayer's purchase of gear oil used in the main drive gear box of machinery or equipment that bends, shapes and cuts metal bars as part of a manufacturing process, is subject to Arizona use tax.

Ruling

The Department rules as follows:

Taxpayer's purchase of gear oil used in the main drive gear box of machinery or equipment that bends, shapes and cuts metal bars as part of a manufacturing process, is subject to use tax. (An Arizona vendor that sells gear oil that is used by the purchaser in this function is subject to transaction privilege tax on the income derived from these sales.)

Statement of Facts:

The following is excerpted from your December 26, 2012:

Taxpayer is an Arizona facility that manufactures tangible personal property. Taxpayer's machinery and equipment requires large amounts of special lubricants to keep the machinery and equipment operating properly. These lubricants are

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purchased solely for use in machinery and equipment used directly in the manufacturing process. The machinery and equipment will not function without the lubricants and are therefore a critical component of the machinery and equipment and essential to the operation of the manufacturing facility.

The following is excerpted from your letter dated February 7, 2013:

The machinery and equipment are directly used in a production line operation and are in direct contact with the raw materials and finished product. . . .

The lubricants used in the above machinery and equipment, include:

- [X] gear oil;
- [Y] gear oil; and
- [Z] gear oil.

These lubricants are used in the main drive gear box of the above listed equipment. These lubricants are specifically designed for use in industrial gearing for conveyers, agitators, dryers, extruders, fans, mixers, presses, pulpers, pumps (including oil well pumps), screens, extruders and other heavy duty applications. The lubricants are necessary for the gears, bearings and seals in the equipment to operate properly and also help maintain gearbox seal integrity thereby preventing oil leaks and keeping contamination out. By protecting the gears, bearings and seals, the lubricants improve equipment reliability and increase productivity.

Like any other major component of the above machinery and equipment, the machinery and equipment will not operate properly without the lubricants. The same as any motor, hose, belt, etc., without the lubricants, the Taxpayer's manufacturing line will cease to function and the integrated system will fail.

Discussion and Legal Analysis:

A.R.S. § 42-5155(A) imposes Arizona's 5.6% use tax on purchases of tangible personal property from an out-of-state retailer, job printer, or utility business that are used, stored, or consumed in Arizona. A.R.S. § 42-5159 provides specific exemptions from the use tax.

A.R.S. § 42-5159(B)(1) provides an exemption from the transaction privilege tax for sales of machinery or equipment used directly in manufacturing, processing, fabricating, job printing, refining or metallurgical operations. The key phrase in the exemption (and

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in other similar exemptions) is “used directly.” [A.R.S. § 42-5061(B)(1) provides an identical tax base deduction for retailers that are subject to the transaction privilege tax.]

A.R.S. § 42-5159(C)(1) excludes “expendable materials” from the exemptions provided by subsection (B) of the statute (which includes machinery and equipment used directly in manufacturing), as follows:

C. The deductions provided by subsection B of this section do not include sales of:

1. Expendable materials. For purposes of this paragraph, expendable materials do not include any of the categories of tangible personal property specified in subsection B of this section regardless of the cost or useful life of that property.

[Emphasis added]

The underlined portion of this subparagraph was added by Laws 1999, Chapter 153. As an example of the application of this change, prior to this amendment an item such as a drill bit (on a stationary drill used in a manufacturing process) was considered a taxable expendable item because it had to be replaced so frequently. After the 1999 amendment, this drill bit is considered a replacement part rather than an expendable item. The effect of the 1999 amendment is that items that perform a function as machinery or equipment qualify for exemption under A.R.S. § 42-5159(B)(1) (and other subsection B exemptions) regardless of their useful life.

The 1999 Legislature did not remove the exclusion for expendables. Therefore, while repair parts and other physical components of exempt machinery and equipment are not considered “expendable materials” despite the frequency of replacing the parts and components; all lubricants and other necessary fluids that do not themselves function as machinery and equipment are considered taxable expendable materials. While machinery or equipment may not function properly without the necessary lubricants or fluids, this does not negate their characterization as expendable materials.

This response is a taxpayer information ruling (TIR) and the determination herein is based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the Department's making of an accurate determination, this taxpayer information ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law, or notification of a different Department position.