Re: Our file Number LR-00-043; Tax Basis for Manufactured item withdrawn for use by a manufacturer.

Dear

This is in response to your inquiry concerning the tax basis for items manufactured which are withdrawn by the manufacturer and used in completing an improvement to real property. I have set out your facts and questions below and have appended my comments and answered your questions.

FACTS
Our client manufacturers tangible personal property ("TPP"). Our client sells some "TPP" direct to customers. However, at times our client installs the items, they manufacture. When installed, the items become an improvement to real property.

Our Comments
When a manufacturer makes a withdrawal from its inventory of items that it uses in a taxable manner, such as the completion of a contract to improve real property, it is required to accrue sales tax on the sales value of the item withdrawn. Sales value is defined in Oklahoma Tax Commission Rule 710:65-1-2 as:

"Sales value" means:
(A) In the case of a manufacturer, the sum of the manufacturer's cost of raw materials and the proportionate share of both the cost of machinery and equipment used and the cost of items consumed in the direct process of the manufacturing of the product, all of which were purchased exempt from sales tax for use in the process of manufacturing;"

Questions
1. Is the basis for application of the Sales and Use Tax the cost of the tangible personal
property purchased by the contractor to fabricate into an item that will be installed?

**Answer:** No. It is the sales value of the item.

2. Often times the manufacturing operations of a contractor such as a sheet metal contractor are quite extensive. Would the manufacturing operations if segregated qualify for the manufacturing exemptions in the Oklahoma State Sales and Use Tax Law?

**Answer:** Yes. However whether an operation is or is not a manufacturing operation is a question of fact and will be dependent on the particular facts in any situation.

3. Is there a difference in the application of the manufacturing exemption if the contractor manufactures the items and sub-contracts with a third party contractor to install the items?

**Answer:** No.

4. If the sheet metal contractor's plant manufacturing the item is located outside Oklahoma does this have any bearing as to the basis for application of the Oklahoma Use Tax to the Tangible Personal Property?

**Answer:** No.

This response applies only to the circumstances set out in your request of February 9, 2000, and may not be relied upon by any entity other than the addressee. In the event of any change in the facts surrounding the transaction described, this letter ruling would no longer be applicable. You are further advised that subsequent statutory or administrative rule changes or judicial construction of the statutes or rules upon which this advice is based may yield a different result from that which is expressed here.

Sincerely,

OKLAHOMA TAX COMMISSION

Michael G. Pillow
Tax Policy Analyst