



North Carolina Department of Revenue

Pat McCrory
Governor

Lyons Gray
Secretary

April 26, 2013

Account ID: [REDACTED]
FEIN: [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Re: [REDACTED]

Dear Mr. [REDACTED]

We are in receipt of your letter dated May 14, 2012 requesting a private letter ruling on behalf of [REDACTED] regarding the application of North Carolina sales and use taxes and the certain machinery privilege tax to purchases of nitrogen used by its subsidiaries, [REDACTED] and [REDACTED] in the roller bearing manufacturing process. As communicated to you and your associate, [REDACTED] based on the Department's Private Letter Rulings and Letters of General Applicability Policy, the Department only issues a private letter ruling to a taxpayer that inquires about matters affecting its own tax liability or reporting requirements. Based on direction received earlier today from Mr. [REDACTED] this ruling is issued to [REDACTED], hereinafter referred to as, "[REDACTED]." Also as communicated to you, in the event you wish to receive a private letter ruling on behalf of [REDACTED] that operates a manufacturing facility in [REDACTED] North Carolina, a separate private letter ruling request must be submitted along with payment of the required fee.

Overview

[REDACTED] operates a plant in [REDACTED] North Carolina where it "manufactures various types of anti-friction bearings including: ball bearings, cylindrical bearings, tapered bearings, thrust bearings, rolling mill bearings and other custom bearings. Although the company manufactures many different types of bearings, the manufacturing process remains relatively similar for all bearing types. The following describes the relevant aspects of bearing manufacturing . . . [r]aw material stainless steel and other metals are purchased from various suppliers and stored on site until they are needed to manufacture the desired product within specifications as set forth by [REDACTED] customers. From on site storage, the raw materials are brought into the manufacturing processing area by forklifts and are placed on various types of machinery and

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equipment to cut, bend and shape the roller bearing assemblies into the desired product. Once the roller bearing assembly has been fabricated, but before it is finished and ready for sale, the products are subjected to a hardening process involving intense heat treatment and severe freezing which involves the use of nitrogen." You also advise, "[n]itrogen is essentially used in three separate but fully integrated and related functions in the continuous manufacturing process of metal bearings: heat treatment, freezing and elemental separation."

Per your correspondence, "[h]eat treatment is the process in bearing manufacturing where a significant amount of heat (1,750°F) is applied to the metal bearings [REDACTED]

[REDACTED]". You advise, "nitrogen is used as an atmospheric carrier gas to deliver a mix of methanol and natural gas in order to create a carbon rich environment within the pit furnaces." You further advise, [REDACTED] gas are the primary sources of energy used in the pit furnace to heat and temper the bearings, nitrogen is considered an essential atmospheric carrier gas [in the heat treatment process] to deliver a mix of [REDACTED] gas in order to create a carbon rich environment within the pit furnaces. Inevitably, the nitrogen gas mixed with the [REDACTED] gas is consumed or otherwise dissipated during the tempering of the bearings. As the nitrogen combines with the [REDACTED] gas, the combined fuels (i.e. nitrogen, [REDACTED] [REDACTED]) are jointly burned together."

[REDACTED], nitrogen is used in the cryogenic treatment of carburized steel which is an essential aspect to the bearing manufacturing process whereby the tempered parts are exposed to raw nitrogen at extremely low temperatures [REDACTED]). This freezing process accompanied by its sudden and drastic change in temperature refines the [REDACTED] and produces [REDACTED] each bearing, allowing it to fulfill its necessary function under high stress environments without the risks of cracking or becoming otherwise dysfunctional. The freezer is used several times a day, 7 days a week." You further advise, for the freezing process, nitrogen is used "as a chilling substance in the freezer structure. [REDACTED]

Your correspondence also indicates that "nitrogen is also used in extremely low pressure as a protective layer in the liquid [REDACTED] storage tank to prevent any possible explosions." Additionally, you state, the use of "nitrogen as a protective element within the [REDACTED] tank is seldom replaced as it consistently maintains a low volume."

Statutory Authority and Other References

N.C. Gen. Stat. § 105-164.13(5a) provides that the sale at retail and the use, storage, or consumption in this State of "[p]roducts that are subject to tax under Article 5F" are specifically exempted from the tax imposed by Article 5 of Chapter 105. N. C. Gen. Stat. § 105-164.13(57) provides that the sale at retail and the use, storage, or consumption in this State of "[f]uel . . . sold to a manufacturer for use in connection with the operation of a manufacturing facility" is specifically exempted from sales and use taxes. N.C. Gen. Stat. § 105-187.51(a) provides "[a] privilege tax is imposed on . . . [a] manufacturing industry or plant that purchases mill machinery or mill machinery parts or accessories for storage, use, or consumption in this State. . . ." N.C. Gen. Stat. § 105-187.51(b) provides "[t]he tax is one percent (1%) of the sales price of the machinery, part, or accessory purchased. The maximum tax is eighty dollars (\$80.00) per article. As used in this section, the term 'accessories' does not include electricity."

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As noted in your ruling request, Sales and Use Tax Technical Bulletin Section 58-3B., provides in part, "[e]ffective July 1, 2010, purchases of fuel by manufacturers are exempt. Fuels and combustibles include bottled gas, coal, coke, fuel oil, oxygen, acetylene, hydrogen, and liquefied petroleum gas." The Department has identified various items in the technical bulletin that fall within the exemption afforded per N.C. Gen. Stat. § 105-164.13(57). The term "fuel" is not defined by statute for purposes of sales and use taxes and certain machinery privilege tax. As such, the term "fuel" is therefore presumed to be used in its ordinary meaning. *Parkdale America, LLC v. Hinton*. _ N.C. App._, 684 S.E.2d 458, 461 (2009) (where words of a statute are not defined, it is presumed that the "legislature intended to give them their ordinary meaning determined according to the context in which those words are ordinarily used"). "Fuel" is defined as "something consumed to produce energy, esp.: a. A material such as wood, coal, gas, or oil burned to produce heat." The American Heritage Dictionary, Second College Edition, (1982).

"Nitrogen" is defined as "[a] nonmetallic element that constitutes nearly four-fifths of the air by volume, occurring as a colorless, odorless, almost inert diatomic gas." The American Heritage Dictionary, Second College Edition, (1982).

"Inert" is defined as "3. *Chem.* a. Exhibiting no chemical activity; totally unreactive. b. Exhibiting chemical activity under special or extreme conditions only." The American Heritage Dictionary, Second College Edition, (1982).

Issues

Question # 1:

Would the purchase of nitrogen used in the heat treatment process as described above be considered a fuel or similar substance as defined in the North Carolina Sales and Use Tax Technical Bulletin 58-3 B., thereby subjecting its purchase to the privilege tax (which is presently at a rate of 0% for manufacturing fuels)?

Response #1:

The Department acknowledges that you state in your letter, "[i]nvariably, the nitrogen gas mixed with the [REDACTED] gas is consumed or otherwise dissipated during the tempering of the bearings. As the nitrogen combines with the [REDACTED] gas, the combined fuels (i.e. nitrogen, [REDACTED] gas) are jointly burned together." Based on research, the Department has been unable to determine that nitrogen gas burns as alluded to in your letter. Additionally, in two sentences in your ruling request, you advise that the nitrogen used in the heat treatment process is an atmospheric carrier gas. It does not appear that nitrogen is "fuel" as contemplated by the ordinary meaning; therefore, nitrogen purchased by [REDACTED] for use in the heat treatment process as an atmospheric carrier gas does not fall within the exemption afforded per N.C. Gen. Stat. § 105-164.13(57). In the event your client provides additional documentation regarding the nitrogen used in the heat treatment process contrary to the Department's findings, the Department can revisit the issue.

Question #2:

Would the purchase of nitrogen used in the heat treatment process as described above, if not considered a combustible fuel type substance subject to the 0% rate as a manufacturing fuel, instead be subject to the 1% privilege tax?

Response #2:

Based on the information provided, nitrogen used in the heat treatment process during the manufacture of bearings by your client is integral to the production process. As such, nitrogen purchased for use by [REDACTED] in the heat treatment process for the purpose noted is an

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accessory to the manufacturing process; therefore, such purchases are exempt from sales and use taxes per N.C. Gen. Stat. § 105-164.13(5a). Purchases of nitrogen for such use in the heat treatment process by [REDACTED] are subject to the 1% privilege tax per N.C. Gen. Stat. § 105-187.51.

Question # 3:

Would the purchase of nitrogen used in the freezing process be considered the purchase of “mill machinery, mill machinery parts or accessories” and therefore be subject to the 1% privilege tax?

Response #3:

Based on the information provided, nitrogen used in the freezing process by [REDACTED] during the manufacture of bearings is integral to the production process. As such, nitrogen for such use by [REDACTED] is an accessory to the manufacturing process and exempt from sales and use taxes per N.C. Gen. Stat. § 105-164.13(5a). Purchases of nitrogen for such use by [REDACTED] in the freezing process are subject to the 1% privilege tax per N.C. Gen. Stat. § 105-187.51.

Question # 4:

Would the minimal purchase and use of protective nitrogen in the methanol tank be required to be separately stated by the purchaser and subject to the full rate of use tax or reduced rate privilege tax; or would the purchase be considered an inconsequential element of the total nitrogen purchased whereby its taxability will follow the taxability of nitrogen as described in the previous responses?

Response #4:

Nitrogen, as used in a function to protect the methanol tank, by [REDACTED] is subject to the general State and local sales and use tax rates. [REDACTED] advised in his email of January 2, 2013 to [REDACTED] former Departmental employee, that [REDACTED] is the only supplier of nitrogen since 1996 and that the “nitrogen is delivered by truck, pumped into a tank as a liquid. It is invoiced in CCF units, 1 CCF=100 Cubic Feet. A typical invoice would have a [u]nit [q]uantity of around 6,000 CCF delivered.” As [REDACTED] purchases nitrogen in bulk, the Department suggests that [REDACTED] issue a completed Form E-595E, Streamlined Sales and Use Tax Agreement Certificate of Exemption, to its nitrogen vendor, [REDACTED] as the vendor’s authority to exempt the sales of nitrogen to your client. [REDACTED] should calculate and remit based on the purchase price both the 1% privilege tax due on nitrogen used in the heating and freezing processes, as well as use tax due at the general State and local sales and use tax rates on any portion of the nitrogen used in a non-manufacturing function (e.g., used in a protective function for the [REDACTED] tank).

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. If the facts and circumstances given are not accurate, or if they change, then the taxpayer requesting this ruling may not rely on it. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that this document is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Sincerely,

[REDACTED]
Director – Sales and Use Tax Division

cc: [REDACTED]