

STATE OF COLORADO

DEPARTMENT OF REVENUE
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John W. Hickenlooper
Governor

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GIL-12-015

December 31, 2012

XXXXXXXXXXXXXXXXXX
ATTN: XXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX

Re: Manufacturing Equipment Exemption for Bakeries

Dear XXXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXXXXXXX ("Company") a request for guidance to determine whether equipment used in bakeries to "manufacture" goods qualify for the manufacturing equipment exemption.

The Department issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues and is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department regulation 24-35-103.5 at www.colorado.gov/revenue/tax > Tax Library > Rulings.

The Department initially treats your request as one of a general information letter. If you would like the Department to issue a private letter ruling on the issues you raise, you can resubmit a request and fee in compliance with regulation 24-35-103.5. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not a determination of the tax consequence of any particular action or inaction.

Issue

Does equipment used in bakeries to "manufacture" goods qualify for the manufacturing equipment exemption?

Background

Company is building a bakery and inquires whether equipment used to manufacture baked goods, such as silos, scale hoppers, syrup tanks with meters, oil tanks, freezer/freezer construction, racks, plastic trays and baskets on which buns will be packaged and the

washing system, qualify for the manufacturing machine exemption. We understand that Company is not a restaurant and does not sell bakery goods directly to consumers. Rather, Company is large-scale wholesale producer of bakery items which are purchased by restaurants and other retailers.

Discussion

The following is a general discussion of the tax issues surrounding your request. If you would like a specific ruling on the issues you raise, you can request a private letter ruling by submitting a request and fee in compliance with Department Regulation 24-35-103.5.

We note at the outset that there is no publication that defines cooking or baking as manufacturing. Many states, including Colorado, do not characterize cooking by restaurants as manufacturing because restaurants are not commonly understood as the sort of industrial enterprise normally associated with manufacturing.¹ However, several states have treated large-scale wholesale bakeries as manufacturers.² Although the Department has not addressed this distinction in any publication and cannot make such a ruling in the context of a general information letter, this distinction appears to be a reasonable approach to the issue.

If the Department determines that Company is engaged in manufacturing, then its purchases of machinery or machine tools and parts thereof are exempt from state sales and use tax when the machinery is used in manufacturing. §39-26-709, C.R.S. In order to qualify for this exemption, the machinery, machine tools, and parts must meet the definition of machinery in §39-26-709(c)(II), C.R.S:

Any apparatus consisting of interrelated parts used to produce an article of tangible personal property. The term includes both the basic unit and any adjunct or attachment necessary for the basic unit to accomplish its intended function.

To qualify the machinery must:

1. Be used in Colorado,

¹ *Golden Skillet Corporation v. Commonwealth of Virginia*, 199 S.E.2d 511 (1973); *Brinker Missouri v. Department of Revenue*, 319 S.E.3d 433 (MO. 2010).

² Georgia Department of Revenue Regulation 560-12-2-.62(2)(i)(2), (Businesses that are primarily engaged in providing personal or professional services, or in the operation of retail outlets, generally including, but not limited to, grocery stores, pharmacies, bakeries, or restaurants, are not considered manufacturers.); Iowa Letter of Finding , 12/17/1985 (bakery in a grocery store is not manufacturing, but bakery selling to retailers is manufacturing); South Carolina Department of Revenue Regulation 117-302.5(B)(1)(A), ("For example, machines used by a large industrial baker in manufacturing breads, cakes, and pies for sale may be purchased tax free; however, similar machines used by a "Ma & Pa" bakery on Main Street may not be purchased tax free since they are used at a facility whose purpose is retailing."); Cases: *Stop 'N Save, Inc., et al. v. Department of Revenue Services*, 212 Conn 454 562 A2d 512, 08/08/1989, (an establishment must have manufacturing as its main purpose and be generally recognized to be an industrial plant in order to qualify for the manufacturing equipment exemption. baking of products on the premises of the supermarkets did not change the primary purposes of the stores from retail establishments to industrial plants and that, therefore, the manufacturing aspect of the baking did not qualify for the exemption.)

2. Be used directly and predominantly to manufacture tangible personal property for sale or profit.
3. Be of a nature that would have qualified for the federal investment tax credit under the definition of section 38 property found in the Internal Revenue Code of 1954, as amended.³ This includes tangible personal property with a useful life of one year or more and limits qualifying purchases of used equipment to a maximum of \$150,000 annually.⁴
4. Be included on a purchase order or invoice totaling more than \$500,
5. Be capitalized.

Storage items generally do not qualify for the manufacturing machinery exemption. For example, bins, storage tanks, racks, fixtures, pipes, and valves do not qualify because they do not act directly in the manufacturing process. A freezer, which is generally used for storage to protect the good from loss and is not considered a machine under the machinery definition, would likely not qualify for the exemption. Conversely, ovens, mixers, scale hoppers, etc. are machines that are directly involved in the manufacturing process. Ductwork, electrical and plumbing materials are components that precede the manufacturing process and, therefore, are not exempt as manufacturing machinery.⁵ Testing and transport machines qualify only if used during the actual manufacturing process.⁶ Additionally, machines moving material through final alteration or packaging and machinery which cleans or prepares raw or prepared materials for production on the manufacturing line, after manufacturing has begun and before it has ended, qualify for the exemption. Washing systems that are used after the manufacturing has been completed do not qualify. We also note that machinery must be used "predominantly" in the manufacturing process, which means more than 50%.

Finally, equipment for which title passes to the buyer after installation and that becomes incorporated into real property as a fixture does not qualify for the exemption because the equipment is not personal property but, rather, real property.⁷ In such cases, the contractor who installed the equipment is liable for sales or use tax and is not entitled to claim a manufacturing exemption. The real property owner who purchased such equipment is not liable for sales or use tax.

When machinery is used solely and exclusively in an enterprise zone, the manufacturing machinery exemption is broader. However, the equipment that is used both within and outside an enterprise zone only qualifies for the regular statewide exemption, as does equipment used at a location prior to that location's designation as an enterprise zone. §39-30-106(1), C.R.S.

³ *Ball Corporation, v. Colorado Department of Revenue*, 51 P3d 1053, (Colo. App. 2001).

⁴ *Colorado Department of Revenue, v. Cray Computer Corporation*; 18 P3d 1277, (Colo. 2001).

⁵ Department Publication FYI Sales 10, "Sales Tax Exemption on Manufacturing Equipment."

⁶ *Coors Brewing Co. v. Fagan*, 949 P.2d 110 (Colo. App. 1997)

⁷ Department Regulation 39-26-102.15 and Special Regulation (SR) 29 "Manufacturers and Prefabricators acting as Contractors." You can find these regulations at www.Colorado.gov/revenue/tax > Tax Library > Regulations > Final Regulations > Sales

Cities, counties and special districts may or may not exempt manufacturing equipment from local sales taxes. For detailed information about local sales rates in cities and counties where the state collects the tax, refer to the Department Publication Colorado Sales and Use Tax Rates (DR 1002).⁸ The Regional Transportation District and Cultural District (RTD/CD) may impose a sales tax on machinery used in manufacturing, but may not impose a use tax on machinery used in manufacturing.⁹

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted letter.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
Tele: (303)866-5627
Email: neil.tillquist@state.co.us

⁸ You can find this publication and others on the Department's website at on-line at www.colorado.gov/revenue/tax > Forms (on the upper toolbar) > Forms by Number > DR 1002.

⁹ Local jurisdictions such as state-collected cities, counties, and special districts may specifically choose whether to adopt the state's machinery/manufacturing exemption. Most of the local jurisdictions have not adopted the exemption. See Department Publication DR 1002 for a list of cities and counties that have adopted the exemption. The RTD/CD has not adopted the state's machinery/manufacturing exemption. Thus, purchases of machinery used in manufacturing are not exempt from RTD/CD sales tax.