



COLORADO
Department of Revenue
Taxation Division

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GIL-15-004

January 30, 2015

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Re: Contract Manufacturing

Dear XXXXXXXXXXXXX,

You submitted on behalf of your client ("Company") a request for guidance to determine whether equipment used in manufacturing and contract manufacturing is eligible for the manufacturing machinery exemption pursuant to §39-26-709, C.R.S.

The Colorado Department of Revenue ("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 Rule 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 Department Rule 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

1. Is contract manufacturing a service?
2. If it is a service, how does it affect the manufacturing machinery exemption set forth in §39-26-709, C.R.S?

Background

Company uses its machinery and machine tools to manufacture tangible personal property from raw materials that are either purchased by the Company or supplied by customers. When the customer supplies the raw materials, the customer will receive the product manufactured from their raw materials. Customer will own and retain title to, and security interest in, all raw materials necessary to manufacture its products. Company predominantly uses its machinery and machine tools to manufacture goods from its own raw materials and that it subsequently resells.

Discussion

1.) *Contract manufacturing*

In general, Colorado does not levy sales or use tax on services. However, sales tax on manufactured goods includes any charge by a manufacturer for the labor used to produce a product.¹ For example, a retail manufacturer of tangible personal property cannot separately state a charge for the "service" of manufacturing its product and, thereby, exclude that cost from the sales tax calculation. However, when a customer supplies all the raw materials used by the manufacturer to manufacture the product, then there is no transfer of tangible personal property from the manufacturer to the customer and therefore no taxable sale between the manufacturer and customer. In such cases, the transaction is solely one for services and sales and use tax does not apply to that service transaction.²

2.) *Manufacturing machinery exemption.*

Purchases of machinery or machine tools and parts thereof are exempt from state sales and use tax when the machinery is used in manufacturing.³ In addition to other qualifications, the machinery or machine tools must be used directly and predominantly to manufacture tangible personal property for sale or profit.⁴ The question posed in this general information letter is whether the manufacturing machinery exemption applies if the manufacturer does not sell the manufactured product but, rather, performs the service of manufacturing for a customer who owns all the materials used to manufacture the product and the customer either uses or sells

¹ §39-26-102(12), C.R.S. "...sales tax is imposed on the full purchase price of articles sold after manufacture ... and includes the full purchase price for materials used and service performed in connection therewith... sales price is the gross value of all materials, labor, and service, and the profit thereon, included in the price charged to the user or consumer."

² See, also, Colorado General Information Letter No. GIL-12-005, 04/04/2012.

³ §39-26-709, C.R.S

⁴ To qualify, the machinery must:

- 1) Be used in Colorado,
- 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. 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) Be included on a purchase order or invoice totaling more than \$500,
- 5) Be capitalized.

(For machinery used solely and exclusively in an enterprise zone see §39-30-106, C.R.S.)

the manufactured product.⁵ We think it is unnecessary to reach this question because Company predominantly uses its own raw ingredients to manufacture products that it subsequently sells. The manufacturing machinery exemption does not require the machinery or machine tools to be used exclusively in an exempt manner - the exemption applies when the machine and machine tools are predominantly used in an exempt manner. Therefore, Company's purchase of manufacturing machinery appears to be exempt from sales or use tax.

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

⁵ The language used in the manufacturing machinery exemption is notably similar to the language for the exemption for ingredients and components used to manufacture products. The latter exemption applies to avoid pyramiding of sales tax in the manufacturing process and, therefore, applies only if the manufactured good is subject to a retail sale. That pyramiding arguably does not occur for contract manufacturing because the manufacturer does not sell the manufactured good. However, the manufactured machinery exemption may simply be an exemption to reduce the tax burden on manufacturing and allowed even in the absence of pyramiding taxes.