ST 04-0007-PLR 01/23/2004 MANUFACTURING MACHINERY & EQUIPMENT

This letter discusses specific equipment used to mine coal and whether that equipment qualifies for the exemption under 86 Ill. Adm. Code 130.330 and *Nokomis Quarry Co. v. Department of Revenue,* 295 Ill. App. 3d 264, 692 N.E. 2d 855 (1998). (This is a PLR.)

January 23, 2004

Dear Xxxxx:

This letter is in response to your letter dated December 1, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to ABC for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither ABC nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

> ABC hereby respectfully requests a Private Letter Ruling regarding eligibility for the manufacturing machinery and equipment exemption ('MMEE') authorized under Section 2-5 of the Retailers Occupation Tax Act (35 ILCS 120/2-5), Section 2 of the Service Occupation Tax Act (ILCS 115/2), Section 2 of the Service Use Tax Act (35 ILCS 110/2), and Sections 3-5 and 3-50 of the Use Tax Act (35 ILCS 105/3-5 and 3-50). Together, these Acts are referred to as the 'Sales Tax Acts.' Department Regulations relating to the exemption include Section 130.330, Manufacturing Machinery and Equipment (86 Ill. Adm. Cd. 130.330). ABC is requesting the ruling to confirm its understanding that the manufacturing process at its coal mining operation begins with the extraction of the coal product from the underground coal deposit in accordance with the decision by the Illinois Court of Appeal, Fifth District, in *Nokomis Quarry Co. v. Department of Revenue*, 295 Ill. App. 3d 264, 692 N.E.2d 855 (1998). This request is

made in accordance with Section 1200.110 of Title 2 of the Illinois Administrative Code, and includes the information required pursuant to Section 1200.110, subsections (b)(1) through (b)(7).

Statement of Facts

ABC operates a coal mine.

The coal deposit being extracted is approximately # underground and has an average thickness of # feet. ABC currently operates EQUIPMENT.

After the coal is sorted by the feeder breaker, it is placed on the coal handling system. This coal handling system transports coal out of the mine to a silo or stockpile located near the wash plant.

The ABC preparation plant has a capacity of # ton per hour

Washing the coal is a vital process in keeping ABC' coal quality competitive.

Documents Relevant to the Request

ABC is enclosing copies of the quality, sizing, and penalty sections of two major Agreements currently in effect to demonstrate the different shipped coal product size and quality requirements for each customer.

Tax Period at Issue

The ruling request is for tax periods after June 30, 2003. There is no audit or litigation pending with the Department for this tax period.

Previous Ruling on the Same or Similar Issue

To the best of our knowledge, the Department has previously ruled on the same or a similar issue for XYZ. ABC has not previously submitted the same or a similar issue to the Department. However, we understand the Department has previously ruled on the same or a similar issue for XYZ.

Authorities Supporting ABC' Views

The extraction of the coal deposit by the continuous miners begins the transformation of the coal deposit .

ABC' understanding is supported by the following authorities:

In *Van's Material Co. v. Department of Revenue*, 131 Ill.2d 196, 545 N.E.2d 695 (1989), the Illinois Supreme Court noted:

> 'In interpreting the term 'commonly regarded' it seems evident that application of the terms of the statute is not to be guided by some hyperbolic definition of manufacture but rather is subject to commonsense interpretations based on past and current understanding. [Citations.]***

> ***
>
> The issue of defining the word and process of manufacturing was addressed a second time in 1912; this court determined that '[w]henever labor is bestowed upon an article which results in its assuming a new form, possessing new qualities or new combinations, the process of manufacturing has taken place.' *Dolese & Shepard Co. v. O'Connell* (1912), 257 Ill. 43, 45.' *Van's Material Co. v. Department of Revenue*, 131 Ill.2d 207-08, 545 N.E.2d at 701.

In *Nokomis Quarry Co. v. Department of Revenue*, 295 Ill. App. 3d 264, 692 N.E.2d 855 (1998), the Illinois Court of Appeals, relying upon the decision in *Van's Material Co.*, noted:

> '*** The record demonstrates that the blasting either completely changes or begins the transformation of a limestone deposit with no apparent use into various sizes of limestone products with different uses.
>
> *** Rather under the particular circumstances before us, we view plaintiff's calculated blasting method as synonymous with manufacturing.
>
> The blasting technique plaintiff utilizes is much more complicated than mere digging or haphazard rock removal. Plaintiff deliberately puts a sufficient amount of explosives in systematically placed holes in order to achieve an intended result, particularly, the production of shot rock which may be immediately marketed or further processed. This blasting method does more than simply separate the rock from the ground; it does so with specific desired results. Clearly, plaintiff bestows labor upon a limestone deposit, resulting in the limestone's assumption of new forms possessing new qualities or new combinations.' *Nokomis Quarry Co. v. Department of Revenue*, 295 Ill.App. 3d at 270, 692 N.E.2d at 859-60.

<u>Authorities Contrary to ABC' Views</u>

The only authority contrary to ABC' view that we are aware of is in 86 Ill Adm. Code 130.330(b)(4) that states 'Generally, manufacturing does not include extractive industrial activities. Mining *** neither produce articles of tangible personal property nor effect any significant substantial change in the form, use or name of the materials or resources upon which they operate. However, pursuant to *Nokomis Quarry v. Department of Revenue*, the extractive process of quarrying does constitute manufacturing. In addition, the activities subsequent to quarrying such as crushing, washing, sizing and blending will constitute manufacturing, and machinery and equipment used primarily, therefore will qualify for the exemption, if the process results in the assembling of an article of tangible personal property with a different form, use or name than the material extracted.'

However, in *Nokomis, supra*, the Illinois Appellate Court rejected the Department's reliance on similar regulatory language and stated:

> 'We reject that part of the Department's regulation that states, 'The extractive process of quarrying does not constitute manufacturing.' 86 Ill. Adm. Code § 130.330(b)(4) (1994). It is clear that '[a]dministrative rules can neither limit nor extend the scope of a statute.' *Du-Mont Ventilating Co. v. Department of Revenue*, 73 Ill. 2d 243, 247-48, 383 N.E.2d 197, 200 (1978). This portion of the regulation unduly restricts the scope of the statute. The statute's language draws no such distinction between quarrying and manufacturing. We cannot accept that which is not contemplated by the legislature.' *Nokomis Quarry Co. v. Department of Revenue*, 295 Ill. App. 3d at 270-71, 692 N.E.2d at 859-60.

It is ABC' belief that there is also no distinction between mining and manufacturing in the statute's language, that 86 Ill. Adm. Code 130.330(b)(4) is inconsistent with the statute, and that pursuant to *Nokomis,* should likewise be rejected.

Specific Trade Secret Information

ABC identifies the enclosed Agreements and all specific references to coal seam depth, average seam thickness, percentage of coal product washed, preparation plant hourly rating, customer coal size specifications, equipment manufacturer and number of units, belt width, drive horsepower, and stockpile and clean coal storage capacity as trade secret information to be deleted from the publicly disseminated version of the private letter ruling.

Because of the complexities of the extraction and subsequent activities associated with the transformation of the coal deposit into marketable coal products, ABC will make available to you and your staff a mine tour to observe the actual extraction and coal preparation processes to enable you to better understand our operation.

ABC has attempted to include all relevant information with this request for ruling. If additional information is required, please contact me.

Under the Retailers' Occupation Tax Act, the manufacturing machinery and equipment exemption is available for machinery and equipment used primarily (over 50% of the time) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease. See 86 Ill. Adm. Code 130.330. The exemption also extends to repair and replacement parts as long as the parts are incorporated into machinery and equipment that is exempt under the regulation.

"Manufacturing" is defined as the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, which changes some existing material or materials into a material with a different use, form, or name. These changes must result from the process in question and be substantial and significant.

The use of machinery and equipment to convey, handle, or transport tangible personal property to be sold within production stations on production lines or directly between such production stations or buildings within the same plant qualifies for the manufacturing machinery and equipment exemption. See 86 Ill. Adm. Code 130.330(d)(3)(D).

The Department has reviewed the machinery in your letter ruling request on an item by item basis in light of the decision of the Illinois Court of Appeals, Fifth District, in *Nokomis Quarry Co. v. Department of Revenue,* 295 Ill. App. 3d 264, 692 N.E. 2d 855 (1998). Based upon the representation in your letter, the continuous miner machines begin the manufacturing process in that they start the transformation of the product into a different form. Because the continuous miner machines break the coal into a useful size, the machines qualify for the manufacturing machinery and equipment exemption. The battery ramcars act as transportation of the product between production stations within the coal mine when they take the coal to the feeder breaker. These battery ramcars qualify for the manufacturing machinery and equipment exemption. The feeder breaker is used to sort the product into the correct sizes to further the manufacturing process. The feeder breaker qualifies for the manufacturing machinery and equipment exemption. The battery scoops are used to collect dropped product at the coal face and place it into the manufacturing process. The battery scoops qualify for the manufacturing machinery and equipment exemption. The roof bolter and wet duster are equipment that are used as a part of an integrated manufacturing process. See 86 Ill. Adm. Code 130.330(a)(3). As a part of the integrated manufacturing process, the roof bolter and wet duster do qualify for the manufacturing machinery and equipment exemption. Generally ventilation systems do not qualify for the manufacturing machinery and equipment exemption. You represent that the equipment could not be used without the system and that the product could not be mined. In this case, the ventilation system is a part of the integrated manufacturing process and qualifies for the exemption.

It is our understanding that at this point the coal is transported out of the mine on a coal handling system and sent to the wash plant for further processing. The coal handling system allows for the transportation of product between production stations, feeder breaker and wash plant, and therefore qualifies for the manufacturing machinery and equipment exemption.

The machinery in the wash or preparation plant prepares the coal to meet the specification of the individual customers. Specifically, the washers and crushers change the coal to the specifications of the customer. These specifications include calorific value, moisture content, size, ash burden, sulfur content and foreign material content. This machinery qualifies for the manufacturing machinery and equipment exemption.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter ruling, you may contact me at 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Melanie A. Jarvis
Associate Counsel

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