

Under the Retailers' Occupation Tax Act, the manufacturing machinery and equipment exemption extends to machinery and equipment that is 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. (This is a GIL.)

April 1, 2011

Dear Xxxxx:

This letter is in response to your letter dated January 29, 2011, 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.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

We are requesting a letter ruling on the following issue.

COMPANY is a manufacturer and processor of steel. In addition, we are a secondary provider of manufacturing services & equipment rental. We have production facilities in Illinois in which our operations include the following.

- Steel and Blast Furnace Slag Removal
- Reclamation of Metallics
- Scrap Recycling
- Revert Scrap Collection / Processing
- Mill Scale Removal, Screening, and Recycling
- Refractory Segregation and Recycling

- Alloy Handling & Iron Breaking
 - Equipment Rental

We have three questions pertaining to the applicability of sales tax.

1. We are purchasing a number of repair parts for cranes, excavators, loaders. The equipment is used directly to move product and process scrap. (I've attached a more detailed description of production operations.) We had contacted your sales tax division to inquire as to whether the equipment repair parts i.e. motors , bearings , etc. purchased for the material handling equipment would be taxable or exempt. We were advised that based on the information, it would appear that the repair parts would qualify for exemption. The equipment is used primarily to take materials between production stations. (over 50%) The equipment is also used to a lesser degree to unload raw materials and take such materials to the first production stationand [sic] to take the finished product away from the last production station. It was suggested that we may want to contact Legal Services for a more definitive answer. Can you advise us on the above?

2. We are purchasing Dyed diesel fuel from ABC for the material handling equipment listed in question 1. The material handling equipment is entirely off highway and used in the matter described above. ABC has asked if we are exempt from sales tax. We are unsure and are asking for your opinion.

3. We have also purchased an excavator that is used as a rental at XYZ. The machine was purchased by us to use as a rental unit to XYZ. The machine sits on their property and is used only for them.

We send an operator to their facility daily to dig out what they call a coke quenching pit. When they cool their coke products (burnt coal basically) some of the finer particulate materials wash into the quenching pit. All we do is dig that material out of their 3 stage cooling pit and place it on concrete pads to drain and solidify. This process takes between 4 and 8 hours per day and other than those hours the machine is just staged.

The company we had purchased this excavator from has asked if we were taxable or exempt. We were hoping you could offer us some direction on this matter.

If you need any clarification, I can be reached at #

Please issue any response to our tax office:

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. 35 ILCS 120/2; 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. 35 ILCS 105/3; 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the

purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department.

Manufacturing and Assembly Exemption

Under the Retailers' Occupation Tax Act and Use Tax Act, machinery and equipment that will be used by the purchaser primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease, whether the sale or lease is made directly by the manufacturer or by some other person, whether the materials used in the process are owned by the manufacturer or some other person, is exempt from Retailers' Occupation Tax and Use Tax. 35 ILCS 120/2-10(14); 105 ILCS 3-5(1). The exemption is also available if the machinery and equipment that will be used by the purchaser primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease is made apart from or as an incident to the seller engaging in a service occupation. See 86 Ill. Adm. Code 140.125(o), which can be found on the Department's website. When a person manufacturing or assembling tangible personal property for wholesale or retail sale or lease is manufacturing or assembling materials owned by some other person, the manufacturer or assembler should obtain a certificate from the owner of the materials that certifies that the manufactured or assembled tangible personal property will be sold or leased, and not used or consumed, by the owner.

The manufacturing machinery and equipment exemption is extended to machinery and equipment that is 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 manufacturing process is 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, processing, fabricating, or refining that changes some existing material or materials into a material with a different form, use, or name. These changes must result from the process in question and be substantial and significant. See Section 130.330(b)(2). A certificate of exemption must be presented to the seller for each transaction where exempt machinery or equipment is purchased. See Section 130.330(g).

"Machinery" means major mechanical machines or major components of such machines contributing to a manufacturing or assembling process. Machinery includes machinery and equipment used in the general maintenance or repair of such exempt machinery and equipment or for in-house manufacture of exempt machinery and equipment. See Section 130.330(c)(2). Further, repair and replacement parts for exempt machinery or equipment are exempt when purchased by the owner of the exempt machinery and equipment, as long as the parts are incorporated into the exempt machinery and equipment. See Section 130.330(c)(2). Servicemen making repairs are governed by the Service Occupation Tax Act, which provides an exemption for repair and replacement parts when such parts are incorporated into the exempt machinery and equipment by the servicemen. See 35 ILCS 115/2 and P.A. 87-876 eff. January 1, 1993. The exemption is also available where manufacturers build their own production machinery. Any machine parts purchased to be incorporated into a machine which qualifies for the Manufacturing Machinery and Equipment Exemption will also qualify for the exemption. See Section 130.330(c)(2) and (c)(4).

The manufacturing machinery and equipment exemption does not apply to machinery or equipment used primarily in pre-production activities. Machinery or equipment used primarily to store, convey, handle, or transport materials or parts or sub-assemblies prior to their entrance into the production cycle do not qualify for the manufacturing machinery and equipment exemption. See part (4)(C) of subsection (d) of Section 130.330.

In addition, the manufacturing machinery and equipment exemption does not apply to machinery or equipment used primarily in post-production activities. Machinery and equipment used primarily to store, convey, handle, or transport finished articles of tangible personal property to be sold or leased after the production cycle do not qualify for the manufacturing machinery and equipment exemption. Machinery and equipment, such as loaders, conveyors, and transport vehicles used primarily to move finished a product do not qualify for the manufacturing machinery and equipment exemption.

Generally, hand tools do not qualify for the exemption afforded manufacturing machinery and equipment. Hand tools include, but are not limited to, wrenches, pliers, hammers, chisels, sanding blocks, and screwdrivers. See 86 Ill. Adm. Code 130.330(c)(3). However, pneumatic hand tools or electric powered hand tools used primarily in manufacturing or assembling may qualify for the exemption. Router bits, drill bits, sand paper, and screw tips can also qualify as long as they are incorporated into manufacturing machinery and equipment that is exempt under the regulation.

Consumable materials, in general, do not qualify for the manufacturing machinery and equipment exemption. See Section 130.330(c)(3). These items, such as maintenance oils, grease, adhesives, cleaning solutions or compounds, and antifreeze, are considered consumable items and would be subject to Retailers' Occupation Tax and Use Tax. The rules specifically exclude items of personal apparel such as goggles, aprons, and masks from the exemption. Items used to protect employees, such as protective face masks or helmets, gloves, coveralls, and protective goggles are excluded from the exemption even if they are required by law. See Section 130.330(d)(4)(G). Please note that the rules also specifically exempt gases that are consumed in a manufacturing process. See Section 130.330(c)(3). Consumable supplies used in a welding process are subject to tax. For example, flux is generally considered to be a consumable manufacturing supply and is fully taxable. However, to the extent that an item, such as solder or welding wire, physically becomes a part of the product being manufactured for sale, it can be purchased for resale.

Manufacturer's Purchase Credit

The State of Illinois provides a manufacturer's purchase credit in addition to the exemption for manufacturing machinery and equipment. See 86 Ill. Adm. Code 130.331. Purchasers of manufacturing machinery and equipment that qualifies for the manufacturing machinery and equipment exemption earn a credit in an amount equal to a fixed percentage of the tax which would have been incurred under the Use Tax or Service Use Tax. 35 ILCS 105/3-85; 35 ILCS 110/3-70.

The credit may be used to satisfy Use Tax or Service Use Tax liability that is incurred on the purchase of production related tangible personal property that does not qualify for the manufacturing machinery and equipment exemption. Please note that the amount of manufacturer's purchase credit that can be applied to a purchase of production related tangible personal property is limited to the State rate of tax incurred on that property (6.25%). Any local taxes incurred on the purchase of production related tangible personal property remain the responsibility of the purchaser.

"Production related tangible personal property" includes all tangible personal property used or consumed in a production related process by a manufacturer in a manufacturing facility in which a manufacturing process described in Section 2-45 of the Retailers' Occupation Tax Act takes place, and all tangible personal property used or consumed by a manufacturer or graphic arts producer in research and development regardless of use within or without a manufacturing or graphic arts production facility. See 35 ILCS 105/3-85. The Department's regulation for the credit provides examples of tangible personal property that will be considered production related: supplies and consumables used in a manufacturing facility, including fuels, coolants, solvents, oils, lubricants, cleaners, adhesives, and hand tools, protective apparel, and fire and safety equipment used or

consumed in a manufacturing facility. See 86 Ill. Adm. Code 130.331(b)(4). This means that the credit may be applied to the State tax due for purchases of these items. See 86 Ill. Adm. Code 130.331(b)(1).

It is the responsibility of the retailer or serviceman making the sale of production related tangible personal property to properly document the receipt of MPC on that sale through the use of MPC certificates. Retailers and servicemen are required to keep those certificates in their books and records. See subsection (f)(1) of Section 130.331. Retailers and serviceman may require that separate MPC certificates be provided for each invoice or purchase in order to properly document those sales.

A manufacturer or graphic arts producer must provide a Manufacturer's Purchase Credit Certificate (ST-16-C or purchaser's own form) when using Manufacturer's Purchase Credit (MPC) on a purchase of production related tangible personal property, unless the same information is included in the manufacturer's or graphic arts producer's purchase order. See subsection (f) of 86 Ill. Adm. Code 130.331.

The MPC was recently extended by P.A. 96-0116, through August 30, 2014.

Dyed Diesel Fuel

Section 2 of the Motor Fuel Tax Law, 35 ILCS 505/2, imposes a tax on "the privilege of operating motor vehicles upon the public highways and recreational-type watercraft upon the waters of this State." Beginning January 1, 1990, the rate of tax imposed on all motor fuel used in motor vehicles operating on the public highways and recreational type watercraft is 19 cents per gallon. The tax on the privilege of operating motor vehicles which use diesel fuel is at the rate of 19 cents per gallon plus an additional 2 ½ cents per gallon.

"Motor fuel" is defined as "all volatile and inflammable liquids produced, blended or compounded for the purpose of, or which are suitable or practicable for, operating motor vehicles. Among other things, 'Motor Fuel' includes 'Special Fuel.'" "Special fuel" is defined as "all volatile and inflammable liquids capable of being used for the generation of power in an internal combustion engine except that it does not include gasoline as defined in Section 5, example (A), of this Act, or combustible gases as defined in Section 5, example (B), of this Act. 'Special Fuel' includes diesel fuel as defined in paragraph (b) of Section 2 of this Act." "Diesel fuel" is defined as "any petroleum product intended for use or offered for sale as a fuel for engines in which the fuel is injected into the combustion chamber and ignited by pressure without electric spark."

Generally, Motor Fuel Tax is due when motor fuel is purchased. Persons other than distributors or suppliers who lose motor fuel through any cause or use motor fuel upon which the Motor Fuel Tax has been paid for any purpose other than operating a motor vehicle upon the public highways or waters, shall be reimbursed and repaid the amount so paid. See 86 Ill. Adm. Code 500.235. Distributors and suppliers may file claims for credit. See 86 Ill. Adm. Code 500.265. Section 13 of the Motor Fuel Tax Law sets forth the provisions for such reimbursement. No claims based upon idle time are allowed.

Beginning January 1, 2000, the State of Illinois implemented a dyed diesel fuel program. This program provides for tax-free purchases of dyed diesel fuel. Any special fuel sold or used for non-highway purposes must be dyed. Since the dyed diesel fuel is purchased tax-free, there is no need to apply for reimbursement of the tax. In some situations, it is not practicable for dyed diesel fuel to be used for off-road purposes. In that case, clear (undyed) diesel fuel may be purchased tax-paid for off-road use, but the purchaser must apply to the Department for a refund of the tax. Section 13 of

the Motor Fuel Tax Law sets forth the situations in which the tax paid for clear diesel fuel may be reimbursed. The Department's regulations at 86 Ill. Adm. Code 500.235 and 500.265 explain how claims for credit or refund may be made.

Although dyed diesel fuel may be purchased free of Motor Fuel Tax, it remains subject to Retailers' Occupation Tax and Use Tax. However, 100% biodiesel and certain biodiesel blends are exempt from Retailers' Occupation Tax and Use Tax. 35 ILCS 120/2-10; 35 ILCS 105/3-10.

Leases

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2010.

A true lease generally has no buy out provision at the close of the lease. If a buyout provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not "pass through" their tax obligation to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where the lessees agree to reimburse the lessors for the amount of the tax paid, then the lessees are obligated to fulfill the terms of the private contractual agreements.

As noted above, under the Retailers' Occupation Tax Act and Use Tax Act, machinery and equipment that will be used by the purchaser primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease, whether the sale or lease is made directly by the manufacturer or by some other person, whether the materials used in the process are owned by the manufacturer or some other person, is exempt from Retailers' Occupation Tax and Use Tax. Therefore, if the lessee is using the equipment primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease, the purchase by the lessor would be exempt from Use Tax.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Associate Counsel

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