

This letter explains the applicability of the manufacturing machinery and equipment exemption to various aspects of the blasting process used in quarrying. See 86 Ill. Adm. Code 130.330. (This is a PLR.)

August 18, 2011

Dear Xxxxx:

This letter is in response to your letter dated March 22, 2011, in which you requested a Private Letter Ruling. 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.

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 BUSINESS 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 BUSINESS, 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:

FIRM has been engaged by BUSINESS to assist it with obtaining a Private Letter Ruling. A Declaration of Tax Representative authorizing FIRM to act on behalf of BUSINESS as Taxpayer's Representative is enclosed as Exhibit A.

On behalf of our client, BUSINESS, we respectfully request that the Illinois Department of Revenue ('Department') issue a Private Letter Ruling pursuant to Ill. Adm. Code 2 § 1200.110 with respect to the following factual situation.

GENERAL INFORMATION:

1. This Private Letter Ruling ('PLR') is not being requested with regard to a hypothetical or alternative proposed transactions [sic].

2. This PLR is being requested to determine the Retailers' Occupation Tax ('ROT'), Use Tax ('UT'), Service Occupation Tax ('SOT'), and Service Use Tax ('SUT') consequences of the actual business practices of BUSINESS.
3. BUSINESS is not currently engaged in litigation or an audit with the Department concerning this or any other tax matter.
4. To the best of the knowledge of BUSINESS's personnel and FIRM's personnel, the Department has not previously ruled regarding this matter for BUSINESS, nor has BUSINESS submitted a request for a ruling on the same or similar issues to the Department.
5. BUSINESS requests that its name and address be deleted from the PLR prior to publication or dissemination to others.

STATEMENT OF FACTS:

BUSINESS operates numerous quarrying sites throughout the State of Illinois. At the quarry sites, BUSINESS primarily extracts and produces items such as stone, sand and gravel. These materials are extracted, crushed, washed, sized and blended into a final product, based on customer specifications. The following is a series of facts, issues, findings and analysis, based on BUSINESS' Illinois quarry operations with respect to explosive devices.

Explosive Devices

1. Explosives are used in the mining process to fragment the rock mass into a size that can be handled by equipment. This fragmentation is called blasting. This first step in the manufacturing process facilitates additional processing of the rock mass into a manufactured product based on specifications from the customer.
2. The largest component of the blasting process is a blasting agent. Blasting agents (ammonium nitrate and fuel oil or ANFO) are loaded into the rock mass. Each type of blasting agent is incorporated into the process via a bulk delivery system, a truck, or in a package. Some explosive products are delivered to the quarry as an oxidizer and are sensitized into a blasting agent at the time of loading the borehole. Blasting agents are not sensitive to detonation by means of a detonator or blasting cap.
3. Due to the extreme stability of the blasting agent, high explosives are used to initialize the detonation process. High explosives are set off with the use of a detonator. These are commonly referred to as boosters. Boosters come in a variety of sizes and shapes based upon the configuration. Other high explosives are used in a blast, based upon various geologic conditions.
4. Detonators come in a variety of delivery systems. These include electric, shock tube, electronic, fuse and detonating cord. A detonator is designed to provide the detonation of the booster. Some blasting utilizes very short split second periods and some use longer periods, which separate the individual charges by second intervals.

5. The entire blast is connected to a lead-in line, which sends a signal to the individual charges. This lead-in line is connected to a blasting machine, which programs the predetermined timing of the explosive charges.

REQUEST FOR RULING

Based on the material facts discussed in the prior section, we respectfully request a response to the following questions:

1. Are blasting agents, high explosives, detonators, lead-in lines and blasting machine component parts of an integrated manufacturing process exempt from sales and use tax?
2. Since this equipment produces a direct and immediate change on the quarry rock, does this equipment qualify under the manufacturing exemption?
- 2.[sic] Although these items are separate from machinery, are they considered to be equipment that is essential to an integrated manufacturing process exempt from sales and use tax?

STATEMENT OF SUPPORTING AUTHORITIES

Explosives and related equipment used for quarry blasting should be exempt from sales and use tax under the manufacturing exemption set forth in the Illinois Revenue Code. First, the blasting agent chemicals used for quarry blasting should be exempt as manufacturing equipment. Pursuant to 35 Ill. Comp. Stat. Ann. 105/3-50(4) and 120/2-45(4):

Equipment includes chemicals or chemicals acting as catalysts but only if the chemicals or chemicals acting as catalysts effect a direct and immediate change upon a product being manufactured or assembled for wholesale or retail sale or lease.

Blasting agents are chemicals that act as catalysts to make the first direct and immediate physical change to the aggregate being manufactured. The manufacturing of crushed stone, cannot occur without the use of these chemicals. Second, the equipment used to ignite these blasting agents (high explosives, detonators, lead-in lines and blasting machines) should also be exempt as essential, necessary and integrated manufacturing equipment. The statute above further states the following:

Equipment includes an independent device or tool separate from machinery, but essential to an integrated manufacturing or assembly process; including computers used primarily in a manufacturer's computer assisted design, computer assisted manufacturing (CAD/CAM) system; any subunit or assembly comprising a component of any machinery or auxiliary, adjunct, or attachment parts of machinery, such as tools, dies, jigs, fixtures, patterns, and molds; and any parts that require periodic replacement in the course of normal operation; but does not include hand tools.

Each independent piece of equipment or subunit used to ignite the blasting agent is essential to quarry blasting. The blasting agent chemicals will not ignite and fracture the

stone without the use of high explosives, detonators, lead-in lines and blasting machines, which are all considered to be related equipment and are used in an integrated manufacturing process.

The catalyst chemicals make direct and immediate changes to the aggregate material being manufactured and the other items are used to ignite the catalyst chemicals, which are necessary for the process to occur. This direct and immediate change is both substantial and significant. Although these explosives, detonators, lead lines and blasting machines are independent devices, they are also essential for the manufacturing process to continue.

As further support of our position, we referred to General Information Release [sic] ST-09-0149 issued on November 9, 2009. In this letter, the Department ruled that explosive devices used by members of the ORGANIZATION in their quarry operations were exempt from sales and use tax, since the items produced a direct and immediate change on the quarry rock, which makes the equipment essential to an integrated manufacturing process.

STATEMENT OF CONTRARY AUTHORITIES

While we believe that the aforementioned authorities and explanations allows [sic] for an exemption for explosive devices, there is a contrary statement found in the statutes, which is the reason behind this private letter ruling request. As such, pursuant to Ill. Adm. Code 130.330.b.4:

Manufacturing does not include extractive industrial activities. Mining, logging, and drilling for oil, gas, and water neither produce articles of tangible personal property nor effect any significant or substantial change in the form, use or name of the materials or resources upon which they operate. The extractive process of quarrying does not constitute manufacturing. However, 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.

Although this regulation seemingly contradicts the General Information Release [sic] ST-09-0149 issued on November 9, 2009 we believe that explosive devices are not listed as being part of the extraction process, since extraction involves removing top layers of rock and overburden. The extraction process is in a sense a preliminary activity and does not cause a direct an [sic] immediate change upon the actual product that will be manufactured through the next series of states [sic].

Explosive devices cause the first direct and immediate change upon the product that is being manufactured for sale. These independent devices are essential and directly linked to the beginning of the manufacturing process.

SUMMARY

If the Department cannot conclude the proper tax treatment for the above services, we request that the Department contact us to determine what additional information is required. If you have any questions, please contact the undersigned.

DEPARTMENT'S RULING:

The Retailers' Occupation Tax ("Act") does not apply to sales of machinery and equipment used primarily (over 50%) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease. See 86 Ill. Adm. Code 130.330. When determining whether a piece of equipment qualifies for the manufacturing machinery and equipment exemption, all of the requirements of the Department's rules regarding the manufacturing machinery and equipment exemption (86 Ill. Adm. Code 130.330) must be met.

"Manufacturing," as defined in Section 130.330, is the production of articles of tangible personal property, whether such articles are finished products or articles for use in the process of manufacturing or assembling different articles of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining which 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 86 Ill. Adm. Code 130.330(b)(2).

Manufacturing equipment, as noted in Section 2-45 of the Act and in Section 130.330(c)(3) of the Department's rules, includes any independent device or tool separate from any machinery but essential to an integrated manufacturing or assembling process, including any subunit or assembly comprising a component of any machinery and auxiliary, adjunct, or attachment parts of machinery, such as tools, dies, jigs, fixtures, patterns, and molds, and any parts that require periodic replacement in the course of normal operation, but not including hand tools. As Section 2-45 of the Act notes, the exemption also includes chemicals or chemicals acting as catalysts but only if the chemicals or chemicals acting as catalysts effect a direct and immediate change upon a product being manufactured or assembled for sale or lease.

Your letter explains how various explosive devices are used at quarries in the process of fragmenting rock. This process, commonly called blasting, begins with the use of a blasting agent (i.e., ammonium nitrate and fuel oil or ANFO) that is loaded into the rock mass. Because of the extreme stability of blasting agents, their detonation must be initialized by the use of high explosives, also known as boosters. Detonators are designed to detonate the boosters and come in a variety of delivery systems, including electric, shock tube, electronic, fuse and detonating cord. These detonators are utilized to activate blasts at specific intervals. Lead-in lines, connected to blasting machines, are used to send a signal to the individual charges. The blasting machine programs the predetermined timing of the explosive charges.

Provided that all the other requirements of Section 130.330 are met, we believe that the purchase by BUSINESS of the blasting agents, high explosives, detonators, lead-in line and blasting machine described in your letter would qualify for the manufacturing machinery and equipment exemption.

As you note, Section 130.330 provides that the "extractive process" of quarrying does not constitute manufacturing. It is our opinion, however, that the blasting process that you have described constitutes a process that is properly characterized as manufacturing, rather than

extraction. As Section 130.330(b)(3) explains, a manufacturing process occurs when an existing material is changed into a material with a different form, use or name by a process commonly regarded as manufacturing. The blasting process described in your letter constitutes the first step in the manufacturing process. It is purposefully engineered to change embedded quarry rock into smaller aggregate, in order to meet specific customer requirements. The rock is either initially blasted to achieve specific customer requirements, or is blasted and further finished by crushing or sizing, to meet specific customer requirements. This conclusion is reinforced by the holding in Nokomis Quarry v. Department of Revenue, 295 Ill. App.3d 264 (Fifth District, 1998)(explosives systematically placed in holes and detonated to produce shot rock which could be immediately marketed was considered the first step in the manufacturing process).

We believe that the blasting agents, high explosives, detonators, lead-in line and blasting machine are component parts of an integrated manufacturing process, the effect of which is to produce a direct and immediate change on the quarry rock. Although these items are separate from machinery, we consider them to be equipment that is essential to an integrated manufacturing process, and therefore, may be exempt. See, Section 130.330(c)(3).

We must stress that the manufacturing machinery and equipment exemption is a use-based exemption. As a result, items do not qualify in and of themselves, but only if they are used in a manner that meets all the requirements of the exemption. One of the central requirements of the exemption is that the items be used primarily (over 50%) to manufacture or assemble tangible personal property for wholesale or retail sale or lease. As a result, if the items you have described were primarily used to produce aggregate that the quarry itself consumed, e.g., in fulfilling construction contracts with customers, the items would not qualify for the exemption.

The factual representations upon which this ruling is 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 factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

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

Very truly yours,

Terry D. Charlton
Chairman, Private Letter Ruling Committee

TDC/JTG:msk