

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. (This is a GIL.)

August 23, 2011

Dear Xxxxx:

This letter is in response to your letter dated August 4, 2010, 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 Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). The Department declines to issue a Private Letter Ruling. We are responding instead with this General Information Letter that we hope will assist you.

In your letter you have stated and made inquiry as follows:

On behalf of COMPANY, we submit this Private Letter Ruling Request pursuant to 2 Ill. Admin.Code §1200.110. We have enclosed a copy of Illinois Form 2848, Power of Attorney, authorizing this firm to submit this request on behalf of COMPANY.

General Information

1. This Private Letter Ruling ('PLR') is not requested for hypothetical or alternative proposed transactions, but rather to determine the taxability for ROT/UT purposes of actual transactions engaged in by COMPANY, as described below. This ruling is sought for all tax periods during which the related purchases will occur.
2. COMPANY is not currently under audit by or engaged in litigation with the Department with regard to this or any other tax matter.

3. The Department has not previously ruled regarding this matter for COMPANY. COMPANY has not submitted the same or similar issue to the Department and withdrew it before the Department issued its ruling.
4. We are aware of no authority contrary to the authorities referred to and cited below.

Statement of Facts

COMPANY is a commercial construction company operating from its corporate offices located in CITY, Illinois. COMPANY has a contract with a customer, CUSTOMER to construct a tightly sealed, fully refrigerated and insulated meat processing facility within an already existing building located in CITY2, Illinois.

The processing facility will be designed to process meat products that will be sold to various grocers and retailers throughout the Midwest. The products will be packaged for retail sale at the processing facility and available for customer pick up in fresh or frozen condition.

COMPANY will construct a meat processing facility within the shell of an already existing building. In order to maintain compliance with USDA food processing and sanitary working condition standards, the processing facility will be a self-contained manufacturing plant, consisting of specially designed and installed USDA approved components.

Specially insulated stainless steel walls, doors and silicone-coated ceiling structures will be built within the shell of the existing building. These specially insulated items are essential to the manufacturing process in order to maintain proper temperature control and assist in meeting required sanitation standards and requirements. Structural steel framing must be added to the existing building shell to support the insulated stainless steel walls and silicone-coated ceiling as well as the production processing equipment.

A specially designed exhaust system must be installed in order to provide positive air pressure to all production areas and rooms in order to avoid foreign particles entering and possibly contaminating the food products. Separate Roof Top Units (RTUs) must be installed to provide fresh air and cooling service separately to the employees working in the raw product production area and to the cooking/processing areas of the facility. A third RTU must be installed to service the thawing room in order to maintain precise temperatures for meat thawing purposes.

Water supply lines must be installed throughout the processing facility for equipment functionality and sanitation purposes. Water supply is an absolute necessity for both of these purposes and as such must be considered a component of the manufacturing process. Heating units must also be installed to temper the air between the external roof of the existing building shell and the suspended ceiling structure of the interior processing facility in order to prevent the waterlines located in that space from freezing. Compressed air lines must also be installed for production processing and sanitation purposes as well.

A sprinkler system must be installed within the processing facility to meet local safety standards and building code requirements. However, the sprinkler system to be installed within the production processing area must consist of freeze-proof sprinkler

heads and must be specially designed to prevent product contamination. Although a sprinkler system may not generally seem to be part of the manufacturing process, in this case it is. The system is so significantly integrated with the manufacturing facility itself that it must be considered a component of the manufacturing system. Any piece of manufacturing equipment typically includes various safety devices to prevent electrical circuit overload, overheating and fire. To isolate that safety component of a piece of equipment as being non-manufacturing related would be improper since that component is an integral part of the overall piece of machinery. Likewise, in this case, the facility itself represents an integrated piece of manufacturing equipment and the sprinkler system is an integral safety device within it. Without such a device, the system itself could not function in accordance with federal, state and local codes and requirements.

The standard concrete floor of the original building will be removed and a specially insulated and sealed polyurethane flooring system will be constructed in its place. The flooring system will consist of an intricate and extensive drainage system required to maintain the highest sanitary standards and avoid the risk of product contamination. The flooring system must be insulated and designed to ensure that the floor does not heave and/or crack which often occurs in commercial building construction. Any cracks in the floor of the facility are considered unacceptable as the risk of product contamination from such breaches could be significant and are completely unacceptable within food processing standards. Without the specialized flooring system, the production and processing facility would not function acceptably under the USDA sanitary requirements. The flooring system is an integral part of the overall production processing facility.

Specialized lighting must be installed meeting certain USDA foot candle requirements as well as being water-proof and having the ability to be washed down as part of the sanitation process. The canopy or shell covering the light must have certain water shed capabilities so that moisture is not retained and contamination avoided.

The production area employee locker room includes a sanitation facility which every employee must pass through before they enter the production areas of the building. This level of employee sanitation is required in order to prevent food product contamination. Without such sanitation system, the employees could not enter the production area of the building and as such, the production facility itself would not be operational. Therefore, the sanitation system and production processing employee locker room should be considered an integral part of the production and manufacturing process.

Separate lunchroom and restroom facilities must be constructed for the sole use of the production process employees in order to further eliminate the risk of product contamination. Employees must go through a sanitation process before entering the production processing areas of the facility. Separate lunchroom and restroom facilities are necessary in order to avoid requiring employees to re-sanitize each time they visit the lunchroom or restroom. As a result, processing and production efficiency is maintained at a higher level. A 'test' lunchroom will be separately constructed and used for product presentation and sales purposes. The test lunchroom is not considered part of the manufacturing facility.

The electrical service provided to the building will consist of two # amp panels, of which only ## amps will be used to provide electrical service to the administrative area of the facility.

There are various stages in the manufacturing process from the time the meat products are unloaded from the delivery trucks until the processed products are ready to be picked up by various grocers and retailers. Immediately after the raw products are unloaded from the delivery trucks, they are moved to a refrigerated cooler until the products enter the manufacturing process. At the beginning of the manufacturing process, the products are moved from the cooler to the processing tables via hand cart or forklift where they are then processed into fresh or frozen consumable food products. Again, hand carts or forklift will be used to transport the products between processing stations, such as into and out of searing stations, chillers, and freezers, before the product is vacuum packed for temporary storage and final delivery.

After the products are processed into a consumable form, they are either packaged for fresh shipping or are packaged for freezing. Once the products are packaged for frozen shipment, they are transported by hand cart or forklift to the freezer and slowly moved through a process that cools the product from approximately 40° to 0° to preserve the products and to prevent spoilage. After the products reach the appropriate freezing temperature, the frozen packages are stored in specially equipped deep freezers to continue preservation of the products until they are loaded by hand or forklift onto each customer's freezer trucks for transportation.

Pertinent Law and Regulations

The Illinois Retailer's [sic] Occupation Tax [35 ILCS 120/1 et seq.] and Use Tax [35 ILCS 105 et seq.] are assessed on the sale or use by Illinois residents of tangible personal property within the State of Illinois. Each Act provides, however, that the sales or use of certain tangible personal property may be exempt; one such exemption applies to manufacturing and assembling machinery and equipment used primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease. 35 ILCS 105/3-(18)5.

Under the exemption, manufacturing and assembling machinery and equipment used primarily in the process of manufacturing are exempt from the imposition of Illinois Sales/Use Taxes. 35 ILCS 105/3-5; 35 ILCS 120/2-45. Machinery and equipment must be used primarily in the manufacturing or assembling process; this is defined as use over 50% in an exempt manner in order to qualify as exempt. 86 Ill. Admin.Code §130.330(d). The following activities are generally considered to be an exempt use of machinery and equipment:

1. The use of machinery or equipment to effect a direct and immediate physical change upon tangible personal property to be sold;
2. The use of machinery or equipment to guide or measure a direct and immediate physical change upon tangible personal property, provided such function is an integral and essential part of tuning, verifying, or aligning the component parts of such property;
3. The use of machinery or equipment to inspect, test or measure the tangible personal property to be sold where such function is an integral part of the production flow;
4. The use of machinery and equipment to convey, handle, or transport the tangible personal property within production stations on the production line; and
5. The use of machinery or equipment to place the tangible personal property to be sold into the container, package, or wrapping in which such property is normally

sold where such machinery or equipment is used as part of an integrated manufacturing process.

[86 Ill. Admin. Code §130.330(d)(3).]

Certain activities are generally considered to not be manufacturing in nature:

1. The use of machinery or equipment to store, convey, handle or transport materials or parts or sub-assemblies prior to their entrance into the production cycle;
2. The use of machinery or equipment to store, convey, handle or transport finished articles of tangible personal property to be sold or leased after completion of the production cycle;
3. The use of machinery or equipment in the disposal of waste, scrap or residue; and
4. The use of machinery or equipment for general ventilation, heating, cooling, climate control or general elimination, not required by the manufacturing process.

[86 Ill. Admin. Code §130.330(d)(4).]

Several General Information Letters also address the taxpayer's position and are referenced below.

ST 99-0139-GIL – As a general rule, under the manufacturing Machinery and Equipment exemption, pre-production and post production storage facilities do not qualify for exemption. However, refrigeration or freezer facilities maintained at a specific temperature which is required in order to preserve a post-production manufactured product, can qualify for MM&E exemption. We have extended the regulation in the cases due to the requirements of the industry (the need to prevent contamination of the product).

ST 98-0193-GIL – Essentially the same ruling.

ST 01-0192-GIL – Essentially the same ruling with the added line ... Independent devices, separate from machinery but essential to the manufacturing or assembly process can qualify, including parts which require periodic replacement in the normal course of operation.

ST 01-0162-GIL – Essentially the same ruling with the line regarding periodic maintenance.

Taxpayer's position

It is the taxpayer's position that each component in the production processing facility, as noted below, will be treated as exempt from Illinois ROT/UT, because each of the items is a required component of the overall manufacturing process and are used to create and maintain the appropriate condition, including temperature, sanitation and contamination prevention, of the product from the time of raw product receipt, through processing, packaging and temporary storage for customer pick-up. As such, each of the components listed below are integral to the food manufacturing process and therefore qualify for the tax exemption. The components that should be treated as exempt from Illinois ROT/UT are as follows:

1. stainless steel insulated walls,
2. interior insulated doors located within the production processing areas,

3. exterior insulated doors located within the production processing areas,
4. silicone-coated ceiling,
5. structural steel framing to support processing area equipment, walls, and ceiling,
6. Exhaust and HVAC systems,
7. production processing water lines, boilers and heat exchangers,
8. compressed air lines,
9. production processing area sprinkler system,
10. production processing area flooring and drainage systems
11. production processing area lighting systems,
12. production processing area [sic] employee locker room,
13. production processing area employee lunchroom,
14. production processing area employee restroom,
15. production processing electrical systems

Requested Ruling

COMPANY respectfully requests that the Department issue a Private Letter Ruling that specifies that the components listed above are integral parts of the manufacturing process and are exempt from Illinois Retailers [sic] Occupation Tax and Illinois Use Tax; and that COMPANY will be issued a sales and use tax exemption certificate to that effect.

Request for a Conference

We respectfully request a personal conference to discuss these matters orally, if the Department believes that such a discussion may be helpful or if the Department may otherwise intend to render a ruling contrary to the taxpayer's position.

DEPARTMENT'S RESPONSE:

Manufacturing Machinery and Equipment

In general, Retailers' Occupation Tax does not apply to sales of machinery and equipment used primarily 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 articles of tangible personal property 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 Section 130.330(b)(2).

Machinery means major mechanical machines or major components of such machines contributing to a manufacturing or assembling process, including 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). However, Machinery and equipment does not include foundations for, or special purpose buildings to house or support, machinery and equipment. See Section 130.330(c)(5). Generally, items such as the framing for a building and its walls, ceilings, floors, and doors would not qualify for the exemption.

The fact that particular machinery or equipment may be considered essential to the conduct of the business of manufacturing or assembling because its use is required by law or practical necessity does not, of itself, mean that machinery or equipment is used primarily in manufacturing or assembling. See Section 130.330(d)(2). In addition, machinery or equipment that is used for general

ventilation, heating, cooling, climate control or general illumination, not required by the manufacturing process would not qualify for the manufacturing machinery and equipment exemption. See Section 130.330(d)(4)(H). Generally, items such as sprinkler systems and employee facilities such as lunchrooms, restrooms, and locker rooms would not qualify for the exemption.

Machinery or equipment that is required for meat processing, such as cooling equipment that maintains a precise temperature as part of the processing, could qualify for the exemption if used primarily for that purpose.

Manufacturer's Purchase Credit:

Even if an item does not qualify for the Manufacturing Machinery and Equipment exemption, in some instances it may be purchased using Manufacturer's Purchase Credit if it qualifies as "production related tangible personal property."

When a manufacturer purchases manufacturing machinery and equipment, the State of Illinois provides a Manufacturer's Purchase Credit (MPC) in addition to the exemption for manufacturing machinery and equipment. See 86 Ill. Adm. Code 130.331. A purchaser of manufacturing machinery and equipment that is exempt under the manufacturing machinery and equipment exemption also earns MPC in an amount equal to 50% 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.

MPC 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 MPC 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%). MPC cannot be used to satisfy any local taxes incurred on the purchase of production related tangible personal property.

"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 MPC provides examples of tangible personal property that will be considered production related (e.g., tangible personal property purchased by a manufacturer for incorporation into real estate within a manufacturing facility for use in a production related process, and supplies and consumables used in a manufacturing facility, including fuels, coolants, solvents, oils, lubricants, cleaners, adhesives, as well as 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 MPC may be applied to the State 6.25% tax due for purchases of these items. See 86 Ill. Adm. Code 130.331(b)(1).

A manufacturer or graphic arts producer must provide a Manufacturer's Purchase Credit Certificate (ST-16-C or purchaser's own form) when using 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. 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 servicemen may require that separate MPC certificates be provided for each invoice or purchase in order to properly document those sales.

In order to validate credit earned as the result of a qualifying purchase of exempt manufacturing machinery and equipment or exempt graphic arts machinery and equipment, however, the manufacturer or graphic arts producer must report credit earned to the Department by signing and filing an Annual Report of Manufacturer's Purchase Credit Earned (ST-16) for each calendar year no later than the last day of the sixth month following the calendar year in which the Manufacturer's Purchase Credit is earned. See Section 130.331(e)(1). A purchaser that fails to properly file an Annual Report of Manufacturer's Purchase Credit Earned (ST-16) or an Annual Report of Manufacturer's Purchase Credit Used (ST-17) with the Department by the last day of the sixth month following the end of the calendar year forfeits all Manufacturer's Purchase Credit earned or used for that calendar year, unless the purchaser establishes that the purchaser's failure to file was due to reasonable cause. See Section 130.331(e)(6).

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.

Sincerely,

Samuel J. Moore
Associate Counsel

SJM:msk