NOTICE OF INTENT

Department of Revenue
Policy Services Division

Sales and Use Tax Exclusion for Manufacturing Machinery and Equipment (LAC 61:I.4301)

Under the authority of R.S. 47:301 and R.S. 47:1511 and in accordance with the provisions of the Administrative Procedure Act, R.S. 49:950 et seq., the Department of Revenue, Policy Services Division, proposes to amend LAC 61:I.4301 relative to the definitions of *cost price, lease or rental,* and *sales price* for sales tax purposes.

Act 1 of the 2004 First Extraordinary Session provides exclusions from state sales and use tax for the purchase, lease or rental, and use of machinery and equipment used predominately and directly to manufacture *tangible personal property* or produce, process, and store food, fiber, or timber for sale. These amendments provide guidance regarding the definition of *cost price* under R.S. 47:301(3)(i), *lease* or *rental* under R.S. 47:301(28)(a), and *sales price* under R.S. 47:301(13)(k) as those terms relate to the purchase of machinery and equipment used predominantly and directly in the manufacturing of *tangible personal property* for sale or the production, processing, and storing of food, fiber, or timber for sale.

Title 61
REVENUE AND TAXATION
Part I. Taxes Collected and Administered by the Secretary of Revenue
Chapter 43. Sales and Use Tax
§4301. Definitions

A. - C. …

* * *

Cost Price

a. - g. …

h. Under R.S. 47:301(3)(i), machinery and equipment is excluded from *cost price* if the property is used to manufacture *tangible personal property* for sale to another or is used directly in the production, processing, and storing of food, fiber, or timber for sale; is used predominantly and directly in the manufacturing process or in the actual manufacturing for agricultural purposes; and is eligible for depreciation for federal income tax purposes. The exclusion is subject to a phase-in between July 1, 2004, and June 30, 2010. The exclusion applies only to manufacturing businesses that have been assigned, by the Louisiana Department of Labor, North American Industrial Classification System (NAICS) codes within the agricultural, forestry, fishing, and hunting Sector 11 or the manufacturing Sectors 31 through 33 as they existed in 2002. Businesses that are not registered with the Louisiana Department of Labor or that have not been assigned these NAICS codes are not eligible to claim this exclusion. The exclusion applies to *state sales or use tax and local sales or use tax* if the political subdivision has adopted this exclusion by ordinance.

i.(a). *Manufacturing*—putting raw materials through a series of steps that brings about a change in their composition or physical nature in order to make a new and different item of *tangible personal property* that will be sold to another. The manufacturing process begins when a raw material is introduced into the first machine or item of equipment that begins the change of the composition or physical nature of the raw materials into another product. The manufacturing process ends when the final product for sale has been placed into the packaging that will normally be delivered to the final consumer.

(b). *Manufacturing for Agricultural Purposes*—the activities involved in the production, processing, and storing of food, fiber and timber for sale. Manufacturing for agricultural purposes begins when the soil or field is prepared for planting and ends when the harvested product is removed from the farm.

ii.(a). For machinery or equipment used to manufacture tangible personal property for sale, *used predominantly* means that more than 50 percent of the property's use is in the process of causing a change in the composition or physical nature of the raw materials that are to become a final product for sale.

(b). For machinery or equipment used to produce, process, and store food, fiber, or timber for sale, *used predominantly* means the property is used more than 50 percent of the time in the production, processing, and storing of food, fiber, or timber for sale. Equipment that remains idle between growing seasons is considered used for the production, processing, and storing of food, fiber, or timber during that time.

iii.(a). For a manufacturer of tangible personal property for sale, *used directly* describes the manner in which the machinery or equipment used in a plant facility alters the physical characteristics of the product during the manufacturing process. *Used directly* means that the machinery and equipment must have an immediate effect upon those products manufactured for ultimate sale to another person. Machinery and equipment used to manufacture intermediate products for internal use, such as manufacturing tools, internally consumed energy, and processing chemicals do not qualify for the exclusion.

(b). For a manufacturer of food, fiber, or timber for sale, *used directly* describes the manner in which the machinery or equipment is involved in the manufacturing for agricultural purposes. *Used directly* means that the machinery and equipment must have an immediate effect upon the production, processing, or storing of food, fiber, or timber. Examples of machinery and equipment *used directly* in manufacturing for agricultural purposes include machinery and equipment for planting, cultivating, fertilizing, spraying, harvesting, producing, processing, and storing of food, fiber, or timber for sale. This exclusion includes materials used in the construction of facilities used to store the food, fiber, or timber for sale. Machinery and equipment *used directly* in manufacturing for agricultural purposes does not include facilities used to store equipment.

iv. *Eligible for Depreciation*—the machinery or equipment is a principle component of the manufacturing process and has a substantially useful life beyond the taxable year as described in Treas. Reg. §1.263(a)-2, although it does not have to be capitalized and depreciated to qualify for exclusion. Examples of property considered eligible for depreciation are robotic welding machines in a vehicle manufacturing plant; pumps, valves, and compressors in a petrochemical plant; and tractors, trailers, and harvesting equipment on a commercial farm. Examples of items that do not qualify include nuts, bolts, gaskets, lubricants, filters, and fuel.

v. The following also qualify for exclusion as manufacturing machinery and equipment:

(a). computers and software that control, communicate with or control other computer systems that control, or control heating or cooling systems for machinery or equipment that manufactures *tangible personal property* for sale. Computers and software used for inventory and accounting systems or that control non-qualifying machinery and equipment do not qualify for the exclusion;

(b). machinery and equipment necessary to control pollution at a plant facility where pollution is produced by the manufacturing operation. For purposes of this exclusion, machinery and equipment necessary to control pollution includes equipment that reduces the volume, toxicity, or potential hazards of the waste products generated by the manufacturing process or transforms the waste product for reuse in the manufacturing process or use in another process; and

(c). machinery and equipment used to test or measure raw materials, the property undergoing manufacturing, or the finished product, when such test or measurement is a necessary part of the manufacturing process. This includes machinery and equipment used to test the quality or quantity of the product for sale before, during, or after the manufacturing process.

vi. Persons acting as mandataries (agents) of manufacturers can claim the exclusion on purchases of qualifying machinery and equipment that will ultimately be used by a business assigned an eligible NAICS code by the Department of Labor. The mandatary must obtain the manufacturer's exclusion Form R-1071 and provide it, with a copy of the contract of mandate or the Department's Form R-1072 (Manufacturer's Designation of Mandate), to the seller at the time of purchase.

vii. Repairs to manufacturing machinery and equipment to keep the property in an ordinarily efficient working order generally do not qualify for exclusion under R.S. 47:301(3)(i) because neither the labor nor the materials used in these repairs are eligible for depreciation for federal income tax purposes. However, the purchase of *tangible personal property* used in the repair would qualify for the exclusion provided the property is a major component of the manufacturing process and has a substantially useful life beyond the current period.

viii. Charges for labor and materials that are classified as capital improvements under Internal Revenue Service Regulations may be excluded as follows.

(a). Charges for labor are excluded from tax when performed on qualifying manufacturing machinery and equipment that is movable property at the time of the capital improvement. The vendor that provides the labor is allowed to treat the materials used as purchased for resale. All materials that are incorporated into qualifying machinery and equipment during the capital improvement qualify for exclusion from tax.

(b). Materials incorporated into qualifying manufacturing machinery and equipment that is immovable property at the time of the capital improvement are eligible for exclusion as follows:

(i). In instances when a manufacturer purchases materials that will become a component part of qualifying machinery or equipment, the materials are excluded from tax.

(ii). A repair vendor's purchases of materials that will become component parts of qualifying machinery or equipment are excluded from tax if the vendor has been designated as a mandatary of a manufacturer. The vendor must obtain the manufacturer's exclusion Form R-1071 and provide it, with a copy of the contract of mandate or the Department's Form R-1072, to the seller at the time of purchase. Manufacturers that supply this form to their mandataries must maintain a schedule of the *tangible personal property* used in these capital improvements.

(c). Purchases of spare machinery and equipment, such as compressors, pumps, and valves, qualify for the exclusion provided these items satisfy the definition of machinery and equipment provided in R.S. 47:301(3)(i). Spare machinery and equipment, such as bolts, nuts, gaskets, oil, etc., which cannot be depreciated for federal income tax purposes, do not qualify for the exclusion.

* * *

Lease or Rental—

a. - b.vii. …

viii. the *lease or rental* of machinery and equipment used predominantly and directly in the process of manufacturing *tangible personal property* for sale or used directly in the production, processing, and storing of food, fiber, or timber for sale. The meanings of *manufacturing*, *used predominantly*, and *used directly* provided in LAC 61:I.4301.C.*Cost Price*.h apply. This exclusion applies to *state sales or use tax and local sales or use taxes* if the political subdivision has adopted this exclusion by ordinance.

c. - d. …

* * *

Sales Price—

a.i. - ix.(b).

x. R.S. 47:301(13)(k) excludes machinery and equipment used predominantly and directly in the process of manufacturing *tangible personal property* for sale or used directly in the production, processing, and storing of food, fiber, or timber for sale from the *sales price*. For purposes of *sales price*, the interpretations provided under LAC 61:I.4301.C.*Cost Price*.h will apply. This exclusion applies to state sales tax and local sales taxes if the political subdivision has adopted this exclusion by ordinance. To determine *sales price* subject to tax, this exclusion is deducted from the total amount charged to the customer after allowances for trade-ins and before any exemptions provided elsewhere in the law.

b.i. - ii. …

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AUTHORITY NOTE: Promulgated in Accordance with R.S. 47:301 and R.S. 47:1511.

HISTORICAL NOTE: Promulgated by the Department of Revenue and Taxation, Sales Tax Section, LR 13:107 (February 1987), amended by the Department of Revenue and Taxation, Sales Tax Division, LR 21:957 (September 1995), LR 22:855 (September 1996), amended by the Department of Revenue, Policy Services Division, LR 27:1703 (October 2001), LR 28:348 (February 2002), LR 28:1488 (June 2002), LR 28:2554 (December 2002), LR 28:2556 (December 2002), LR 29:186 (February 2003), LR 30:1306 (June 2004), LR 31:

Family Impact Statement

As required by Act 1183 of the 1999 Regular Session of the Louisiana Legislature the following Family Impact Statement is submitted to be published with the Notice of

Intent in the Louisiana Register. A copy of this statement will also be provided to our legislative oversight committees.

1. The Effect on the Stability of the Family. Implementation of these proposed amendments will have no effect on the stability of the family.

2. The Effect on the Authority and Rights of Parents Regarding the Education and Supervision of Their Children. Implementation of these proposed amendments will have no effect on the authority and rights of parents regarding the education and supervision of their children.

3. The Effect on the Functioning of the Family. Implementation of these proposed amendments will have no effect on the functioning of the family.

4. The Effect on Family Earnings and Family Budget. Implementation of these proposed amendments will have no effect on family earnings and family budget.

5. The Effect on the Behavior and Personal Responsibility of Children. Implementation of these proposed amendments will have no effect on the behavior and personal responsibility of children.

6. The Ability of the Family or a Local Government to Perform the Function as Contained in the Proposed Rule. Implementation of these proposed amendments will have no effect on the ability of the family or a local government to perform this function.

Interested persons may submit data, views, or arguments, in writing to Raymond E. Tangney, Senior Policy Consultant, Policy Services Division, P.O. Box 44098, Baton Rouge, LA 70804-4098 or by fax to (225) 219-2759. All comments must be submitted by 4:30 p.m., Tuesday, January 25, 2005. A public hearing will be held on Wednesday, January 26, 2005, at 1:30 p.m. at the Department of Revenue Headquarters Building, 617 North Third Street, Baton Rouge, LA.

Raymond E. Tangney
Senior Policy Consultant

FISCAL AND ECONOMIC IMPACT STATEMENT FOR ADMINISTRATIVE RULES
RULE TITLE: Sales and Use Tax Exclusion for Manufacturing Machinery and Equipment

I. ESTIMATED IMPLEMENTATION COSTS (SAVINGS) TO STATE OR LOCAL GOVERNMENT UNITS (Summary)

Implementation costs to administer the sales tax exclusion for manufacturing machinery and equipment enacted by Acts 2004 1st Ex. Sess., No. 1, for the Department of Revenue are approximately $190,000 for fiscal year 2004-2005, $198,000 for fiscal year 2005-2006, and $206,000 for fiscal year 2006-2007. The costs are to hire two Revenue Accounts Auditors and three Revenue Agents and to purchase the office equipment needed to administer the exclusion. These proposed amendments to LAC 61:I.4301 will not affect those costs. Implementation will have no impact on local governments' costs or savings because no local government has adopted this exclusion.

II. ESTIMATED EFFECT ON REVENUE COLLECTIONS OF STATE OR LOCAL GOVERNMENTAL UNITS (Summary)

The phase-in of the sales tax exclusion for manufacturing machinery and equipment enacted by Acts 2004 1st Ex. Sess., No. 1, would reduce state sales tax revenues by $5 million for fiscal year 2004-2005; $20 million for fiscal year 2005-2006; $40 million for fiscal year 2007-2008; $76 million for fiscal year 2008-2009; $96 million for fiscal year 2009-2010; $121 million for fiscal year 2010-2011; and $125 million annually when fully implemented in fiscal year 2011-2012. The Act allows local governments to adopt the exclusion by ordinance, and since no local government has adopted the exclusion, there will be no effect on local sales tax revenues.

III. ESTIMATED COSTS AND/OR ECONOMIC BENEFITS TO DIRECTLY AFFECTED PERSONS OR NONGOVERNMENTAL GROUPS (Summary)

These proposed amendments establish procedures for applying for the manufacturing machinery and equipment exclusion enacted by Acts 2004 1st Ex. Sess., No. 1, and provide guidance to taxpayers on what transactions qualify for the exclusion. It is estimated that the exclusion provided by the Act will save Louisiana manufacturers over $120 million per year in state sales taxes when fully implemented in fiscal year 2011-12.

IV. ESTIMATED EFFECT ON COMPETITION AND EMPLOYMENT (Summary)

These proposed amendments should have no effect on competition or employment.

Cynthia Bridges	Robert E. Hosse
Secretary	General Government Section Director
0412#052	Legislative Fiscal Office