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Minnesota revenue notice, number 96-17

Sales and Use Tax: Determination of Capital Equipment vs. Replacement Capital Equipment

Introduction

Minnesota Statutes, section 297A.25, subdivision 42 provides an exemption from sales and use tax for purchases of capital equipment. Minnesota Statutes, section 297A.02, subdivision 5 sets reduced rates of tax on replacement capital equipment. However, Minnesota Statutes, section 297A.15, subdivision 5 requires that the sales or use tax must first be paid on purchases of capital equipment and replacement capital equipment and the purchaser must apply for a refund of the tax paid.

Purchases of qualifying capital equipment are eligible for a full refund of the sales or use tax paid. Minnesota Statutes, section 297A.01, subdivisions 16 and 20, define capital equipment as machinery and equipment used by the purchaser or lessee primarily for manufacturing, fabricating, mining, or refining tangible personal property to be sold ultimately at retail, and for electronically transmitting results retrieved by a customer of an on-line computerized data retrieval system.

Purchases of replacement capital equipment are eligible for a partial refund of the sales or use tax paid. Replacement capital equipment is defined in Minnesota Statutes, section 297A.01, subdivision 20 as machinery and equipment that serves fundamentally or essentially the same purpose or function or that produces the same or similar end product as did the old equipment, even though it may increase speed, efficiency, or production capacity.

General Requirements

If any of the following three statements is true, the equipment is replacement capital equipment eligible for a partial refund of the tax paid. If none of the three parts is true, the equipment is capital equipment eligible for a full refund of the tax paid.

- 1. Same or similar.** The new equipment is only capable of making the same or similar tangible personal property that was produced by the old equipment. For this revenue notice, "same or similar" is defined to mean that property produced by the new equipment is like the property produced by the old equipment. The factors to consider are size, shape, composition, and make up of the product.
- 2. Purpose.** The new equipment serves the same purpose as the old equipment. For this revenue notice, "purpose" is defined as the end result to be achieved. If the new equipment is being used to make tangible personal property that could not have been made by the old equipment, the new equipment serves a new purpose and qualifies as capital equipment, even if it also makes the same property made by the old equipment.
- 3. Function.** The new equipment serves the same function as the old equipment. For this revenue notice, "function" is defined to mean the normal capabilities or actions performed by an individual piece of equipment. If the new equipment performs only the same capabilities or actions as the old equipment, the new machine serves the same function and qualifies as replacement capital equipment. However, if the new equipment has additional capabilities or actions that are necessary to produce specific tangible personal property, the new machine serves a different function and qualifies as capital equipment, even if it also performs the same capabilities or actions as the old equipment.

Examples

A printer trades in a black and white press for a press capable of printing multiple colors. The printer intends to use the new press to print newspapers in color. The press qualifies for the full refund as capital equipment because the product produced is not the same as the old product, and the press performs

functions that the old press could not.

A printer trades in a four color press for a press capable of printing eight colors. Now the printer plans to offer new products such as calendars, posters, multiple colored brochures, and newspapers with full color graphic reproductions. The new press qualifies for the full refund as capital equipment since the new end products are not the same as the product previously produced.

A machine shop trades in a drill press on the purchase of a new machining center that is capable of drilling holes to a higher tolerance. The new machining center makes the production process more efficient by reducing the number of rejects and thereby ensuring a higher degree of quality. The end product is the same, so the new machining center qualifies only as replacement capital equipment.

A cosmetics manufacturer changes their shampoo production line to manufacture an alcohol free shampoo. New equipment is required to produce this particular type of shampoo. The new equipment qualifies as capital equipment.

A juice manufacturer bottles their product in small glass containers. The manufacturer decides to enter the drink box market by packaging their juice in plastic pouches. The new equipment purchased to package the juice in pouches qualifies as capital equipment.

A woodworking shop disposed of a lathe that used two foot stock lengths to make lamp bases and small tables. The new lathe can use up to six foot stock lengths that allows production of additional products. Using the new lathe the shop will make baseball bats, hat trees, and umbrella stands. The new lathe qualifies as capital equipment.

A computer software manufacturer purchases canned software programmed in another computer language to produce their product in a format that is compatible with other operating systems. Their old software programs did not allow for this computer language. The software program purchased qualifies as capital equipment.

A plastics manufacturer produces coffee cups in batches of four. In order to expand their market, they trade in two of their old molding presses on the purchase of two new presses. One of the new presses allows for the production of coffee cups in batches of eight. This press qualifies only as replacement capital equipment because it only increases production capacity. The other press allows them to make insulated coffee mugs. This press qualifies as capital equipment because it allows them to manufacture a new product.

A window and door manufacturer retools a basic window production line to manufacture higher quality wood and vinyl windows. The basic window line is then discontinued. The new windows have the added features of triple pane glass, removable panels, and weather resistance. Equipment purchased that performs functions to produce the new features qualify as capital equipment.

Effective Date

This notice is effective for purchases or leases of capital equipment or replacement capital equipment made on or after July 1, 1994.

Dated: November 12, 1996

Don Trimble
Assistant Commissioner