

MINNESOTA DEPARTMENT OF REVENUE

Modification of Revenue Notice #97-05

Revenue Notice #97-05: Sales and Use Tax - Integrated Production Process for Tangible Personal Property*

*With modifications shown (see “Key” below).

Introduction

Minnesota Statutes, section 297A.6825, subdivision 542, provides an exemption from sales and use tax for sales of capital equipment. Procedures for obtaining a refund of taxes paid on capital equipment and replacement capital equipment are found in Minnesota Statutes, section 297A.7545, subdivision 5. Minnesota Statutes, section 297A.6804, subdivision 546(a) and (b), defines capital equipment to include all machinery and equipment that is essential to the integrated production process. However, not all activities in the integrated production process qualify under the capital equipment provisions because of statutory restrictions.

The purpose of this revenue notice is to differentiate between qualifying and non-qualifying activities within the integrated production process as they relate to capital equipment and replacement capital equipment refunds used to produce tangible personal property to be sold ultimately at retail. This revenue notice does not apply to the generation of electricity or steam, or to electronically transmitting results retrieved by a customer of an on-line computerized data retrieval system.

General Requirements

“**Essential**” means that the machinery or equipment must perform a necessary or indispensable step in the production process.

“**Integrated production process**” means the series of activities that result in the production of tangible personal property to be sold ultimately at retail, including the actual production process. The production process begins with the removal of raw materials from inventory and ends when the last process prior to loading for shipment has been completed, and also includes research and development and design of the tangible personal property.

Qualifying Activities. Equipment and machinery used primarily (50 percent or more of its operating time) in the following activities qualify for the capital equipment or replacement capital equipment refund:

1. Research, development and design of tangible personal property intended to be sold ultimately at retail, whether or not such activities actually result in the production of property. (Refer to Revenue Notice #96-14, “Research, Development, and Design”, for more information.)
2. Constructing, cleaning, maintaining, and repairing equipment, tools, or repair parts for equipment to be used in a qualifying activity.
3. Removal of materials from beginning inventory or temporary storage to begin the actual production process.
4. Direct production of the tangible personal property. This includes machinery and equipment that operate, control, or regulate production equipment.
5. Outside fabrication services contracted for by a manufacturer if those services are essential to the production of tangible personal property to be sold ultimately at retail.
6. Maintaining conditions such as temperature, humidity, light, or air pressure when those conditions are essential to and a special requirement of the production process. This also includes maintaining finished goods inventory, but does not include general space heating or lighting.
7. Temporary storage of work-in-process, but not including temporary storage of raw materials on the production floor.
8. Quality control and testing activities done on the tangible personal property.
9. Packaging of the completed tangible personal property. This includes all packaging done prior to loading the completed tangible personal property for shipping, but does not include returnable items such as pallets used in shipping. Equipment used in activities such as addressing, applying postage, invoicing, etc., does not qualify as capital equipment.

Non-qualifying activities. Minnesota Statutes, section 297A.6804, subdivision 546(e), provides that equipment and machinery used in the following activities does not qualify for the capital equipment or replacement capital equipment refund:

1. Receiving or storing raw materials.
2. Plant security, fire prevention, first aid, and hospital stations.
3. Pollution control, prevention, or abatement.
4. Plant cleaning, disposal of scrap and waste, plant communications, space heating, lighting, or safety.
5. Any other activity that is not essential to the integrated production process of manufacturing, fabricating, mining, or refining.
6. Support operations or administrative purposes. “Support operations and administrative purposes” mean activities used to keep up or maintain the integrated production process including management, direction, and overseeing of a business. These activities, although essential to the business, are not actual production activities. Examples are:
 - Cleaning, repair, or maintenance of the plant facilities
 - General janitorial activities
 - Inventory management, warehousing, internal product tracking, and sales and distribution activities
 - Construction, maintenance, or alteration of real property

- Providing a safe work environment for employees
- General office administration including clerical, personnel, and accounting activities
- Customer service activities
- Managerial functions such as business and production analysis, and supervision

Examples

A newspaper publisher purchases a computer system to permanently store completed news stories for future reference. The publisher also adds a number of devices that it considers to be used in quality control. Some of the devices are used to measure the quality of the ink flow and its color, while other devices are used for employee and job scheduling. The computer system and the devices used to measure the quality of the actual product qualify as capital equipment. The other devices used for employee and job scheduling do not qualify because they do not control or regulate the production equipment and do not have an affect on the product being produced.

A wood products fabricator uses equipment to package their wood products prior to placing them into finished goods inventory. The company also has boxing, shrink-wrapping, and palletizing equipment used by the shipping department to prepare products taken out of finished goods inventory. All of the equipment used to package the products qualifies as capital equipment.

A meat packer builds a new plant. Environmental control systems are installed throughout the plant, including beginning and finished goods inventory areas. These systems are used to maintain very cold temperatures to ensure that the meat products are not contaminated by bacteria. The system used for storage of the raw meat product does not qualify since capital equipment does not include machinery and equipment used to receive or store raw materials. However, the environmental control systems for actual production areas and for storage of the completed meat products qualify as capital equipment. The systems for support and administrative areas do not qualify.

A paper producer adds a lubrication system to existing production equipment. Previously, the lubrication was done manually. The lubrication systems qualifies for the ~~replacement~~ capital equipment ~~reduction~~ exemption because it is an accessory to the production equipment, ~~added after the equipment was placed into production.~~

A bakery installs a washing system to clean and sterilize baking pans and the production equipment. They also purchase pressure washers used to clean the floors and walls. The washing system to clean and sterilize baking pans qualifies as capital equipment because it affects the quality of the baked product. The pressure washers do not qualify since they are used in support operations for general plant maintenance and cleaning.

A foundry adds equipment used to construct and maintain special tooling. The equipment is used to assemble and maintain the production equipment, non-production equipment and general building repairs. Equipment used primarily (50 percent or more of its operating time) to create and maintain special tooling and production equipment qualifies as capital equipment. However, if the equipment is used more that 50 percent of its operating time for work on non-production equipment or in other non-qualifying activities, it does not qualify as capital equipment.

A plastics manufacturer adds heaters to the molding equipment on a production line currently in service. The primary function of the heaters is to maintain constant temperatures in the molding equipment; a function that will extend the life of the molding equipment. The heaters are accessories to the manufacturing equipment and qualify as ~~replacement~~ capital equipment since they are used to maintain the molds.

An industrial machinery manufacturer adds several pieces of equipment to its research and development shop. The equipment includes additional computer aided design (CAD) and computer aided manufacturing (CAM) systems, a blueprint machine, and an integrated communication system. The blueprint machine prepares blueprints for use by employees during the assembly process. The integrated communication system keeps track of costs and labor hours for each piece of machinery during the assembly process. The CAD system, the CAM system and the blueprint machine qualifies as capital equipment. ~~The CAM system qualifies as replacement capital equipment, unless it was placed into service to operate and control new production equipment.~~ The communication system does not qualify as capital equipment since it is used for plant communications.

A candy wholesaler buys bulk candies from manufacturers, blends various candies together, and packages the assortment into individual bags. The equipment used to package the candy into individual bags qualifies for the capital equipment exemption.

A wood products manufacturer expands operations by adding collection systems for wood waste, conveyors, a boiler, and equipment to generate electricity. This equipment is used collectively to generate electricity that powers the facility and the production equipment. The equipment qualifies for the capital equipment exemption.

An equipment manufacturer out-sources portions of their production process. The manufacturer contracts with separate companies to heat treat parts that become a part of the equipment and to paint the final product. While the outside companies do not produce a tangible product for sale at retail, the activities they perform are essential to the integrated production process for the manufacturer. Equipment and machinery used 50 percent or more of its operating time by the outside companies to fabricate tangible personal property for manufacturers is eligible for a refund. (Refer to Revenue Notice #96-15, "Capital Equipment and Replacement Capital Equipment - What Activities Qualify".)

Effective Date

This notice is effective for all periods open under the statute of limitations for purchases or leases of equipment that qualify as capital equipment under laws in effect prior to July 1, 1994. For purchases or leases of replacement capital equipment and certain capital equipment, this notice is effective July 1, 1994.

Dated: ~~April 14, 1997~~
September 20, 2004

Jennifer L. Engh

Assistant Commissioner for Tax Policy

***Key:** Underlining indicates additions to existing Revenue Notice language. Strikeouts indicate deletions from existing Revenue Notice language.

Please see next page for a clean, printable copy of this notice as modified.

MINNESOTA DEPARTMENT OF REVENUE

Modification of Revenue Notice #97-05

Revenue Notice #97-05: Sales and Use Tax - Integrated Production Process for Tangible Personal Property**

**As modified

Introduction

Minnesota Statutes, section 297A.68, subdivision 5, provides an exemption from sales and use tax for sales of capital equipment. Procedures for obtaining a refund of taxes paid on capital equipment and replacement capital equipment are found in *Minnesota Statutes*, section 297A.75. *Minnesota Statutes*, section 297A.68, subdivision 5 defines capital equipment to include all machinery and equipment that is essential to the integrated production process. However, not all activities in the integrated production process qualify under the capital equipment provisions because of statutory restrictions.

The purpose of this revenue notice is to differentiate between qualifying and non-qualifying activities within the integrated production process as they relate to capital equipment refunds used to produce tangible personal property to be sold ultimately at retail. This revenue notice does not apply to electronically transmitting results retrieved by a customer of an on-line computerized data retrieval system.

General Requirements

"Essential" means that the machinery or equipment must perform a necessary or indispensable step in the production process.

"Integrated production process" means the series of activities that result in the production of tangible personal property to be sold ultimately at retail, including the actual production process. The production process begins with the removal of raw materials from inventory and ends when the last process prior to loading for shipment has been completed, and also includes research and development and design of the tangible personal property.

Qualifying activities. Equipment and machinery used primarily (50 percent or more of its operating time) in the following activities qualify for the capital equipment refund:

1. Research, development and design of tangible personal property intended to be sold ultimately at retail, whether or not such activities actually result in the production of property. (Refer to Revenue Notice #96-14: Research, Development, and Design, for more information.)
2. Constructing, cleaning, maintaining, and repairing equipment, tools, or repair parts for equipment to be used in a qualifying activity.
3. Removal of materials from beginning inventory or temporary storage to begin the actual production process.
4. Direct production of the tangible personal property. This includes machinery and equipment that operate, control, or regulate production equipment.
5. Outside fabrication services contracted for by a manufacturer if those services are essential to the production of tangible personal property to be sold ultimately at retail.
6. Maintaining conditions such as temperature, humidity, light, or air pressure when those conditions are essential to and a special requirement of the production process. This also includes maintaining finished goods inventory, but does not include general space heating or lighting.
7. Temporary storage of work-in-process, but not including temporary storage of raw materials on the production floor.
8. Quality control and testing activities done on the tangible personal property.
9. Packaging of the completed tangible personal property. This includes all packaging done prior to loading the completed tangible personal property for shipping, but does not include returnable items such as pallets used in shipping. Equipment used in activities such as addressing, applying postage, invoicing, etc., does not qualify as capital equipment.

Non-qualifying activities. *Minnesota Statutes*, section 297A.68, subdivision 5, provides that equipment and machinery used in the following activities does not qualify for the capital equipment or replacement capital equipment refund:

1. Receiving or storing raw materials.
2. Plant security, fire prevention, first aid, and hospital stations.
3. Pollution control, prevention, or abatement.
4. Plant cleaning, disposal of scrap and waste, plant communications, space heating, lighting, or safety.
5. Any other activity that is not essential to the integrated production process of manufacturing, fabricating, mining, or refining.
6. Support operations or administrative purposes. "Support operations and administrative purposes" mean activities used to keep up or maintain the integrated production process including management, direction, and overseeing of a business. These activities, although essential to the business, are not actual production activities. Examples are:
 - Cleaning, repair, or maintenance of the plant facilities
 - General janitorial activities
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 - Construction, maintenance, or alteration of real property
 - Providing a safe work environment for employees
 - General office administration including clerical, personnel, and accounting activities

- Customer service activities
- Managerial functions such as business and production analysis, and supervision

Examples

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A plastics manufacturer adds heaters to the molding equipment on a production line currently in service. The primary function of the heaters is to maintain constant temperatures in the molding equipment; a function that will extend the life of the molding equipment. The heaters are accessories to the manufacturing equipment and qualify as capital equipment since they are used to maintain the molds.

An industrial machinery manufacturer adds several pieces of equipment to its research and development shop. The equipment includes additional computer aided design (CAD) and computer aided manufacturing (CAM) systems, a blueprint machine, and an integrated communication system. The blueprint machine prepares blueprints for use by employees during the assembly process. The integrated communication system keeps track of costs and labor hours for each piece of machinery during the assembly process. The CAD system, the CAM system and the blueprint machine qualify as capital equipment. The communication system does not qualify as capital equipment since it is used for plant communications.

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 Appeals and Legal Services Division
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