Sales Tax Issues and Exciting Exemptions for Manufacturers

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On-Demand Webinar

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Introduction

Manufacturing Exemptions

- Some states offer an exemption or a credit for machinery and equipment used to manufacture items of tangible personal property for sale or for machinery and equipment used in a specific industry.
- In addition, states may include consumable supplies in their manufacturing exemption.

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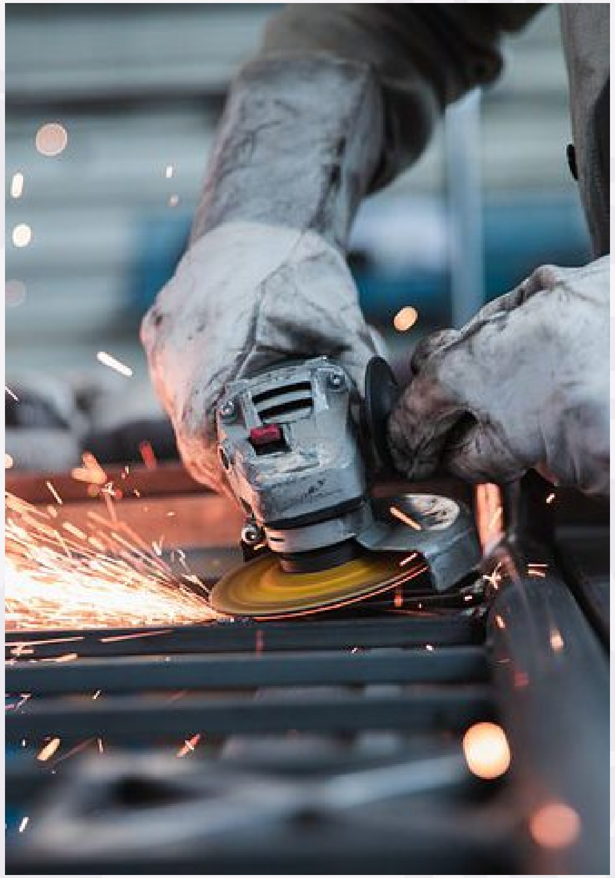
Manufacturing Exemptions (cont.)

- Repair or replacement parts for manufacturing equipment
- Utilities used to power manufacturing equipment
- Packaging supplies and equipment
- Pollution control equipment
- Research and development equipment and supplies



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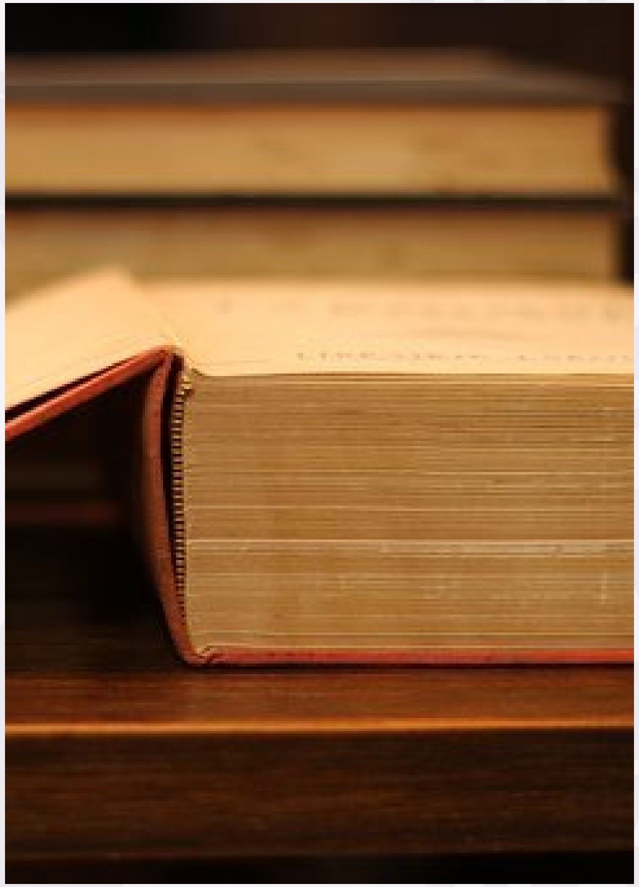
Manufacturing Exemptions (cont.)

- Computers used in the manufacturing process
- Leases of qualifying manufacturing equipment
- Repair and services to qualifying manufacturing equipment
- Other items necessary to the manufacturing process

Definition of “Manufacturing”

Varying Definitions of "Manufacturing"

- The definition of manufacturing varies from state to state and is rarely defined in the same manner as the taxpayer defines manufacturing. It is very important to determine the state's definition of the manufacturing process.



Varying Definitions of "Manufacturing" (cont.)

- Statutes and regulations define the beginning and ending point of the manufacturing process.
- Most states consider the beginning of the manufacturing process to be where the first material change occurs to the raw materials.
  - Illinois is one example
- The ending point of the process is generally when the item is complete and ready for sale.
  - Pennsylvania is one example
- This definition is interpreted differently by the states.

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Varying Definitions of "Manufacturing" (cont.)

- Is an item complete and ready for sale at the point it is packaged as the final consumer will purchase the item, or when it is packaged for shipment out of the manufacturing facility?
  - Pennsylvania considers manufacturing to end at the point where it is ready for sale to the ULTIMATE consumer
  - North Dakota includes packaging the product for sale and shipment as manufacturing
- Most items are packaged in bulk and palletized for shipment. Some states consider these activities to be part of shipping and not manufacturing.

Varying Definitions of "Manufacturing" (cont.)

- When looking at what constitutes manufacturing in a state, there are key items to research.
- What are you selling?
  - Goods for sale
  - Items for sale
  - Tangible personal property
- If you think it is tangible personal property, how do you know that it is actually classified as such? You may need to look up the state's definition of "tangible personal property."

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Terms Used in Manufacturing Exemptions

- Equipment: The actual asset being used in production
- Repair parts: Durable parts to replace a part of the machinery or equipment
- Consumable supplies: Items that are dissipated or used up during the production process
- Raw materials: Items that are incorporated into the products being produced

Terms Used in Manufacturing Exemptions (cont.)

- Equipment might not always be what you traditionally think:
  - In an Illinois case, limestone used exclusively as a filtering material in an air pollution control system was deemed to be exempt. The limestone was used by an electric utility company in its pollution control facility. The limestone, which functions like a filter, could be considered part of the utility's pollution control system. (*Columbia Quarry Co. v. Department of Revenue* (1987, App Ct) 154 IllApp3d 129)

Terms Used in Manufacturing Exemptions (cont.)

- Equipment might not always be what you traditionally think:
  - The Arkansas Supreme Court has determined that in certain circumstances, chemicals can be considered "equipment" if the chemicals are used directly in manufacturing, serve as instruments or tools with some degree of complexity, possess continuing utility, and are not fully integrated into some other object. The initial purchase of chemicals which meet these tests is exempt from sales and use tax. Purchases of replacement chemicals will be exempt if the provisions of GR-55(D)(2) are met. (*Weiss v. Chem-Fab Corporation*, 336 Ark. 21 (1999)).

Non-Traditional Manufacturing Processes

Non-Traditional Manufacturing Processes

- Some states include non-traditional processes in their definition of "manufacturing" for exemption purposes.
  - In Texas, ice used by manufacturers and processors inside or outside a package in order to shape, form, preserve, stabilize, or protect the contents of the manufactured product is exempt.
  - In Texas, a person processing food for sale is a manufacturer and can claim an exemption on purchases of equipment and other taxable items that qualify for a manufacturing exemption.
    - Under this rule, a deli or bakery in a grocery store can claim the manufacturing exemption if they are processing food for sale.

Non-Traditional Manufacturing Processes (cont.)

- Florida has extended their manufacturing exemption to printers.
- Maine's definition of manufacturing includes biological processes used in manufacturing organisms or microorganic materials.
- In New York, the creation of feature films, television films, commercials, and similar film and video productions is considered a manufacturing activity.

Non-Traditional Manufacturing Processes (cont.)

- Illinois exempts computers used in the development of canned computer software. The programming is deemed manufacturing.
- Power generation equipment used to manufacture or generate electricity that will be used in the manufacturing process may qualify for the exemption.
- Therefore, it is important to read the state's definition of manufacturing if you do any processing.

Ancillary Production Processes

- Be aware of all of the manufacturing exemptions available.
- Packaging equipment and supplies may be considered part of the manufacturing process and subject to exemptions.
- Research and development and production testing may be included in the manufacturing definition also.
    - Missouri is one example of a state that includes R&D in its manufacturing exemption

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Ancillary Production Processes (cont.)

- Other areas may be considered production because the results of the process are sold.
- This can include some waste handling functions such as baling and shredding of waste.
  - Some businesses sell the waste products. Therefore, a manufacturing process is occurring.
  - Typically for this to qualify as manufacturing, there must be a physical or chemical change to the product being sold.
- It is important to evaluate whether sales tax applies on the sales of these products.

Kentucky Enacts Manufacturing Electricity Exemption for Mining of Cryptocurrency

- On July 1, 2021, Kentucky enacted a new sales tax exemption for electricity that is used or consumed in the commercial mining of cryptocurrency.
- The new law allows for commercial cryptocurrency mining operations to apply for an exemption certificate for purchases of electricity, which can also be used for the state's local utility gross receipts license taxes.
- Cryptocurrency mining is the process by which cryptocurrency transactions are verified, and by which new cryptocurrency is created.
- The process of mining involves solving complex mathematical problems, adding these solutions to a digital leger to verify cryptocurrency transactions through a technology called blockchain, and being rewarded for these solutions with newly minted cryptocurrency.
- (Kentucky House Bill 230, Effective July 2021)

Louisiana Taxpayer's Caustic Chemicals Qualify for Pollution Control Sales Tax Exemption

- The Louisiana Board of Tax Appeals corrected the Louisiana DOR's incorrect denial of a taxpayer's refund claim for the purchase of sodium hydroxide.
- The sodium hydroxide was used by the taxpayer to reduce the toxicity of their manufacturing waste to be in compliance with state and federal pollution control laws.
- After being denied a sales tax refund for the materials, the taxpayer petitioned to appeal the refund denial.
- The board explained that the caustic materials were a pollution control device or system (PCDS) that should be eligible for the state sales tax exclusion.
- (Louisiana Board of Tax Appeals, Docket No. 11389D, April 14, 2021)

Pinnacle Polymers, LLC v. St. John the Baptist Parish

- The Louisiana Board of Tax Appeals held that a plastic polymer manufacturer's purchases of a catalyst that appeared in trace amounts in its finished products didn't qualify for the manufacturing exemption.
- The appeals court found that the catalyst didn't qualify for a "further processing exclusion" since it was primarily used to facilitate a chemical reaction rather than to be included in a final product.
- The Louisiana Supreme Court declined to review the appeal court's finding.
- *(Pinnacle Polymers, LLC v. St. John the Baptist Parish, 19-310 (La App. 5 Cir. 3/24/2021)*

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Michigan Holds that Recycling Machines Qualify for Industrial Processing Exemption

- The Michigan Supreme Court held that sales of container (bottle and can) recycling machines and repair parts qualify for the state's sales and use tax exemption on machinery used in industrial processing.
- The Michigan DOT had argued that the tasks the container-recycling machines perform occur before the industrial process begins and therefore do not qualify for the industrial processing exemption.
- The Court ruled that the time period limitation in the "general definition" section of statute could not apply to another subsection of the same statue, namely the section that identifies specific activities that qualify as industrial processing. According to the Court, the two sections of the statute are discrete inquiries.
- (TOMRA of North America v. Department of Treasury, State of Michigan Supreme Court, June 16, 2020)

Cement Company Activities Qualify as Processing Activities Under Nebraska Advantage Act, Not Manufacturing

- The Nebraska Supreme Court found that the activities of a producer of sand and gravel aggregate did not qualify as "manufacturing" under the Nebraska Advantage Act (NAA), but that the activities did qualify as "processing" activities for purposes of the NAA sales and use tax incentives.
- In Nebraska, "manufacturing" is defined as "an action or series of actions performed upon tangible personal property, either by hand or machine, which results in that tangible personal property being reduced or transformed into a different state, quality, form, property, or thing."
- Taxpayer was unable to prove that they "reduced" or "transformed" their sand and gravel aggregate. However, the Court did find that the production of aggregate qualifies as "processing" under the NAA.
- The Court stated that the meanings of "manufacturing" and "processing" are closely related but not synonymous.
- (Ash Grove Cement Company v. Department of Revenue, Nebraska Supreme Court, No. S-19-669, August 28, 2020)

Use of Equipment

Predominate vs. Exclusive Use

- In addition to defining the manufacturing process that is exempt from sales tax, the manner in which the items are used also is considered.

Predominate vs. Exclusive Use (cont.)

- Some states grant the exemption for predominate use equipment while others require exclusive use.
  - In making the determination for predominate use, the state determines whether 50 percent of more of the use of the machinery is in an exempt manner. If so, the entire item is exempt from tax. (Illinois)
  - In an exclusive use state, if any use of the equipment is in a taxable manner, the entire item is taxable. (Massachusetts)
  - Some states allow a partial exemption for the percentage of use in an exempt manner. (Indiana)

Mixed Use Equipment

- If equipment is used in both a taxable and exempt manner it is important to provide documentation on the exempt portion of the equipment if the exemption uses the predominate use test.
- Equipment that usually falls in this category includes forklifts, packaging equipment, and conveyors.

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Mixed Use Equipment (cont.)

- Different states handle mixed use equipment differently for purposes of the manufacturing exemption
- Illinois determines exemption status by the primary use:
  - The law requires that machinery and equipment be *used primarily in manufacturing or assembling*. Therefore, machinery which is used *primarily in an exempt process and partially in a nonexempt manner would qualify for exemption*. However, the purchaser must be able to establish through adequate records that the machinery or equipment is used *over 50 percent in an exempt manner* in order to claim the deduction.

Mixed Use Equipment (cont.)

- Indiana determines exemption status by the percentage use:
  - For example: A forklift is regularly, directly used 40% of the time in direct production and used 60% of the time outside the integrated production process.
  - The taxpayer is entitled to an exemption equal to 40% of the gross retail income attributable to the transaction in which the forklift was purchased.

Mixed Use Equipment (cont.)

- In Massachusetts, the manufacturing exemption requires exclusive use:
  - Sales of machinery (or replacement parts) are exempt if the machinery is used directly and exclusively in the actual manufacture, conversion, or processing in an industrial plant of tangible personal property to be sold or in the furnishing of power to an industrial manufacturing plant.

Direct vs. Indirect Use

- States also generally look to direct and indirect use of equipment to determine exemption.
- Most of the states that offer a manufacturing exemption require direct use for the exemption to apply. This generally requires that the machinery touches or has a direct impact on the item being produced for the exemption to apply.

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Sales of Coffee and Tea Brewing Equipment Qualify for Reduced Manufacturing Rate in Alabama

- A manufacturer's sales of coffee and brewing equipment were subject to Alabama's reduced sales and use tax rate since the products qualify as machines used to process TPP.
- The taxpayer manufactures coffee and tea brewers, cappuccino mixers, and frozen beverage dispensers, as well as related accessories and repair and replacement parts.
- The equipment qualified as machines used to process TPP. Specifically, the taxpayer's equipment converted dry coffee and tea, cappuccino base, and pre-mixed base concentrate into consumable drinks.
- The equipment performed "an integral function in the procedure by which the" consumable drinks were produced and played "a direct part in the processing program."
- The functioning of the equipment was not "merely incidental" to the processing of the dry and base forms of the products, because those products were not "ready for use by the consumer" prior to being acted on by the taxpayer's equipment.
- (Bunn-O-Matic Corporation v. Alabama Department of Revenue, Alabama Tax Tribunal, No. S. 17-614-JP, April 30, 2020)

Integrated Plant Theory

- A few states use an integrated plant theory. This concept doesn't require a direct test but rather whether the equipment is part of the integrated process necessary to complete manufacturing.
- Machinery and equipment that are used in Kansas as an integral or essential part of an integrated production operation by a manufacturing or processing plant or facility where integrated production operations are conducted to manufacture or process tangible personal property to be ultimately sold at retail is exempt.

Integrated Plant Theory - Kansas

Machinery & Equipment qualify for the manufacturing exemption when used to:

- *receive*, transport, convey, handle, treat, or *store* raw materials in preparation for placement on a production line;
- transport, convey, handle, or store the property undergoing manufacturing or processing at any point from the beginning of the production line through any *warehousing or distribution* of the final product that occurs at the plant or facility;
- *test or measure raw materials*, the property undergoing manufacturing or processing, or the finished product, when necessary for the manufacturer's integrated production operations;
- *plan, manage, control, or record* the receipt and flow of inventories of raw materials, consumables, and component parts; the flow of the property undergoing manufacturing or processing; and the management of inventories of the finished product;
- produce energy for, lubricate, control the operating of, or otherwise enable the functioning of other production machinery and equipment and the continuation of production operations;

Integrated Plant Theory – Kansas (cont.)

- transmit or transport electricity, coke, gas, water, steam, or similar substances used in production operations from the point of generation, if produced by the manufacturer or processor at the plant site, to that manufacturer's production operation; or, if purchased or delivered from off site, from the point where the substance enters the site of the plant or facility to that manufacturer's production operations;
- cool, heat, filter, refine, or otherwise treat water, steam, acid, oil, solvents, or other substances that are used in production operations;
- provide and control an environment required to maintain certain levels of air quality, humidity, or temperature in special and limited areas of the plant or facility, where the regulation of temperature or humidity is part of and essential to the production process. (See "Environmental control equipment" below)
- *treat, transport, or store waste* or other by-products of production operations at the plant or facility; or
- *control pollution* at the plant or facility where the pollution is produced by the manufacturing or processing operation. (Sec 79-3606(kk))

Type of Equipment

- Some states only grant the exemption to new machinery and equipment and not to replacement machinery. In these states, there is usually also a provision that exempts the machinery if there is a certain increase in productivity or if the machinery can produce a new product.
  - In North Dakota, machinery and equipment purchased for use in manufacturing are exempt if the machinery or equipment is used in a new manufacturing plant or in a physical or economic expansion of an existing plant. The purchase of replacement machinery or equipment is not exempt unless it results in a physical or economic expansion of the plant.

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Dollar Threshold

- Some states set a dollar threshold in order for the manufacturing exemption to apply
- Colorado exempts "purchases of machinery or machine tools, or parts thereof, in excess of $500 to be used in Colorado directly and predominantly in manufacturing tangible personal property, for sale or profit…"

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Useful Life

- Some states may require a capitalization amount or useful life to meet their definition of exempt manufacturing machinery and equipment.
  - Utah's states that machinery and equipment must have a useful life of *three years or more* to be exempt.
  - New York exempts "Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property, gas, electricity, refrigeration or steam for sale, by manufacturing, processing, generating, assembling, refining, mining or extracting, *but not including parts with a useful life of one year or less…*"

Arkansas Supreme Court Affirms Manufacturer’s Exemption for Steel Grit

- The Arkansas Supreme Court affirmed that a taxpayer qualified for a compensating use tax exemption on its purchases of steel grit because the grit qualified as an exempt purchase of manufacturing equipment.
- The taxpayer uses steel grit in its manufacturing process of pipes for the oil and gas industry.
- The Court held that the taxpayer was entitled to the exemption because the grit expanded an existing manufacturing facility and qualified as an “article of commerce” since taxpayer’s pipes were sold in the public market in all 50 states.
- The Court rejected that the steel grit lacked “continuing utility” to qualify as equipment because the grit was recycled and did not become a part of the pipes themselves when blasted.
- (Larry Walther, Cabinet Secretary, Arkansas Department of Finance and Administration v. Welspun Tubular, LLC, Arkansas Supreme Court, April 22, 2021)

Reduced Rate/Partial Exemptions

Reduced Rates

- Some states do not provide a full exemption from the tax but rather have a reduced rate on qualifying machinery and equipment.
- The reduced rate could be a reduced state rate with a full exemption at the local or full tax at the local levels

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Reduced Rates (cont.)

- In Alabama, certain purchases by a manufacturer are subject to tax at a reduced machine rate of 1.5%. Qualifying purchases include:
  - Machines used in mining, quarrying, compounding, processing and manufacturing
  - Packaging equipment
  - Power hand tools
  - Baking pans
  - And much more

Reduced Rates (cont.)

- In Mississippi, certain purchases by manufacturers are subject to a reduced tax rate of 1.5%. Qualifying purchases include:
  - Manufacturing machinery and machine parts
  - Motion picture production machinery and equipment
  - Refinery manufacturing machinery
  - Technology intensive enterprise machinery

Reduced Rates (cont.)

- California has a partial sales and use tax exemption on any qualified tangible personal property (TPP) purchased for use by:
  - a qualified person to be used primarily (i.e., 50% or more of the time) in any stage of the manufacturing, processing, refining, fabricating, or recycling of TPP
  - a qualified person to be used primarily in R&D;
  - a qualified person to be used primarily to maintain, repair, measure, or test any qualified TPP described above;
  - a contractor purchasing that property for use in the performance of a construction contract for the qualified person that will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, the generation or production, or storage and distribution, of electric power, or as a research or storage facility for use in connection with those processes; and
  - a qualified person to be used primarily in the generation or production, or storage and distribution, of electric power.
- The reduced state tax rate applicable to qualifying purchases and leases is 3.5625% from January 1, 2017 to June 30, 2030. The partial exemption does not apply to any local, city, county or district taxes

Refunds or Use Tax Only

- Some states require the purchaser to pay tax to the supplier and then file for a refund on a reduced rate.
- In some cases, this is due to limitations under the Streamlined Sales Tax Project which limits the number of alternative rates that a state can impose.
- Minnesota's capital equipment exemption required tax payment with a refund through June 30, 2015.

Other Manufacturing Issues

Inventory Withdrawals

- Items removed from inventory and used in a taxable manner are subject to use tax. These items were originally purchased without tax under the resale exemption.
- These types of items can easily be overlooked when preparing the tax accruals.
- If the items were self-manufactured, tax may be due on either the raw material costs, the manufactured costs including labor or the normal selling price. This varies by state.

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Non-Manufacturing Areas

- Materials and supplies used in non-manufacturing areas usually are taxable. These areas can include warehousing, shipping, receiving, plant manager and production supervisor offices, and production administration.
- However, for integrated plant theory states these are often included in the exemption.

Arkansas Discusses Application of Manufacturing Machinery and Equipment Exemption

- The Arkansas DFA issued a revenue legal counsel opinion discussing the application of the state's manufacturing machinery and equipment exemption.
- The taxpayer's use of an automated palletizer, pallet handling system, automated storage and retrieval system, automated order picking system, and customer coding equipment did not qualify for the manufacturing exemption.
- Machinery and equipment that are used for the manufacturer's own convenience to palletize or otherwise package items for warehousing or shipping purposes other than to ship the product to the purchaser do not qualify for the exemption.
- An HVAC system used to maintain product integrity in the automated storage and retrieval area is not used directly in the manufacturing process and therefore did not qualify for the exemption.
- (Revenue Legal Counsel Opinion No. 20170505-S, Arkansas Department of Finance and Administration, December 12, 2019)

In-Process Transportation

- Although intra-plant transportation can be taxable, in some cases, the intra-plant transportation equipment may be necessary and essential to the manufacturing process and qualify for the exemption.
- Examples of this concept may be a crane ladle used to move molten steel from one location to another or pipe found in a refinery used to move chemicals and the product is heating within the pipe.

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In-Process Transportation (cont.)

- Other in process transportation equipment may include conveyor belts, forklifts and trailers.
- In some instances, the original purchase may have been exempt because it was purchased as part of the overall machine without price segregation. However, repair parts may be taxable since they are sold separately.

In-Process Transportation (cont.)

- In Texas, the manufacturing exemption does not apply to the following items:
  - Intra-plant transportation equipment, including equipment used to move a product or raw material in connection with the manufacturing process and specifically including all piping and conveyor systems, except that certain piping and conveyor systems remain eligible for exemption

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Power Generation

- Equipment used to manufacture or generate electricity that will be used in the manufacturing process may qualify for the exemption. This can include self-generation equipment such as co-generation facilities.
- There can also be issues related to where power equipment is included in the manufacturing exemption. Step down equipment may not qualify as it is too far removed from the production process.

Utilities Used in Production

- Utilities used in production are sometimes included in the manufacturing exemption.
- If this is the case, make sure to find out how you claim the exemption.
  - Some states exempt if predominant use of the meter such as Texas.
  - Some states exempt the percentage use.
  - Some states require a study to verify the percentage of utilities being used in the manufacturing process.

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Utilities Used in Production (cont.)

- Examples:
  - In Maryland, if electricity, gas, or steam is sold through a single meter for both exempt and taxable uses, the purpose which consumes the majority of the electricity, gas, or steam is the basis for determining the taxability of the sale. The buyer shall determine the majority usage, considering the relative connected load for each purpose and the relative time of operation of each over a period of 1 year, unless the circumstances of a particular case require a different period.

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Utilities Used in Production (cont.)

- Examples:
  - Michigan's industrial processing exemption applies only to the extent the property is used for an exempt purpose. The exemption is limited to the exempt usage % determined by a reasonable formula or method approved by the DOR. The DOR doesn't pre-approve a % method. Taxpayers should use a reasonable method, and if questioned by the DOR, show how they arrived at it. A study is recommended to determine the exempt %. When providing an exemption % to a seller, the seller should collect tax on the taxable % that is given to them.

Taxpayer Allowed Minnesota Industrial Production Exemption on Natural Gas and Electricity Purchases

- A taxpayer's refund claim for sales tax paid for natural gas and electricity used to operate a burn-off oven was granted.
- The taxpayer's customers manufacture or produce TPP to be sold at retail. As part of their production processes, the customers use metal hooks, racks, and fixtures to support parts that must be powder coated. Powder coating accumulates on this equipment, which must then be cleaned in order to be reused in the production process.
- The customers hire the taxpayer, which operates a burn-off oven that removes the accumulated powder coating.
- The Minnesota Commissioner of Revenue had determined that the natural gas and electricity used to operate the burn-off oven were not exempt as materials consumed in the production of TPP. The Commissioner had denied the taxpayer's refund claim based on Minnesota tax law, which provides that "Industrial production does not include painting, **cleaning**, repairing or similar processing of **property** except as part of the original manufacturing process."
- The Minnesota Tax Court disagreed, finding that the taxpayer is cleaning production **equipment**, not property.
- (Inthermo, Inc. v. Commissioner of Revenue, Minnesota Tax Court, No. 9143-R, September 10, 2019, released September 2019)

Who is Considered a Manufacturer?

- Some states require you to have a certain North American Industry Classification System (NAICS) code in order to be considered a manufacturer.
  - In Louisiana, in order to qualify for the manufacturing exemption, a manufacturer must have a LA Workforce Commission assigned NAICS code in one of the following sectors: 11, 113310, 22111, 31-33, 3211-3222, 327213, 3361, 423930, or 511110.
- This can affect companies that have a different NAICS code for a separate arm of the business.

Who is Considered a Manufacturer? (cont.)

- Contract Manufacturing
  - If manufacturing is outsourced to another company, the issue is who owns the equipment vs. who does the manufacturing.
  - If the state's manufacturing definition includes equipment used to produce items that are sold, would the manufacturing exemption apply if the contract manufacturer is not the entity making the sale?

Impact of South Dakota v. Wayfair

Impact of South Dakota v. Wayfair

- Even though manufacturers may be selling for resale, they still need to evaluate if they are exceeding the threshold.
- While they are making exempt sales, they may be making taxable sales as well and they need to examine that to make sure they aren't exceeding the threshold.
- Many states use GROSS sales for determining the threshold which would require manufacturers who make minimal taxable sales to register and collect
- Collection and maintenance of exemption certificates from customers in ALL states is critical to protect against loss of the resale exemption on sales

Impact of South Dakota v. Wayfair (cont.)

- With the Wayfair decision, more sellers are collecting tax and if exemption certificates haven't been issued, this will result in overpayments by manufacturers on exempt items
- Overpayments are related to either vendor paid use tax or self-assessed use tax.
- Accrued use tax often relates to situations where the vendor never charged the tax – likely because they were not registered.
- This will likely change moving forward as more companies are registered to collect tax.

Impact of South Dakota v. Wayfair (cont.)

- Very few purchasers have a formal regular process of reviewing tax paid to vendors.
- In many cases, the tax department does a review of transactions identified for use tax accrual but no review at all of invoices where the vendor charges tax.
- You'll need to monitor for vendors that you buy exempt items from to make sure you've issued the right exemption certificates to them

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Impact of South Dakota v. Wayfair (cont.)

- Review or implement a vendor tax validation process.
- If you're using a managed compliance rate, review to see if vendors are charging you tax.
- As more suppliers start charging tax, the opportunity for reverse audits will increase. This is an area of opportunity for refunds.

Additional State Updates

Texas Provides Guidance Regarding Manufacturing Exemptions

- In March 2021, the Texas Comptroller of Public Accounts issued new guidance for manufacturing exemptions.
- The following are exempt from Texas sales and use tax:
  - TPP that is an ingredient or component of an item manufactured for sale
  - TPP that makes a chemical or physical change in the manufactured product and is essential in the manufacturing process
  - Taxable services performed on a manufactured product to make it more marketable
- The manufacturers who qualify for the exemption include those who perform any of the following activities:
  - manufacture TPP for sale
  - perform one or more of the manufacturing operations for a manufacturer
  - fabricate or assemble components into TPP for ultimate sale
  - modify or change the characteristics of the product being manufactured for ultimate sale, or its component parts
- Contractors, repair people, and service providers, such as telecommunications service providers or data processors, do not qualify for the exemption.

Iowa Enacts Change to Persons Eligible for Manufacturing Exemption

- Effective August 19, 2020, Iowa enacted legislation that narrows the limitation on persons eligible for the state's manufacturing sales tax exemption.
- The original language of the manufacturing exemption excludes persons who "are not commonly understood" to be manufacturers and excludes a person who engages in any one of five listed activities:
  - Construction contracting
  - Repairing tangible personal property or real property
  - Providing health care
  - Farming, including cultivating agricultural products and raising livestock
  - Transporting for hire
- The new legislation amends that provision to exclude persons who are "primarily engaged" in one of those five activities.
- The previous language excluded persons that performed any of the listed activities.
- (2019 Iowa Acts, House File 779, filed June 22, 2020, effective August 19, 2020 Rule 230.15(4))

Questions/Comments

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