

This letter describes the Manufacturing Machinery and Equipment Exemption and the Manufacturer's Purchase Credit. See 86 Ill. Adm. Code 130.330 and 130.331. (This is a GIL.)

October 24, 2012

Dear:

This General Information Letter is in response to your letter dated April 10, 2012, in which you request a Private Letter Ruling. 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](http://www.tax.illinois.gov) to review regulations, letter rulings and other types of information relevant to your inquiry.

This letter is in response to your letter dated April 10, 2012, in which you request information. Whether to issue a Private Letter Ruling in response to a request for such a ruling is within the discretion of the Department. See subpart (a)(2) of 2 Ill. Adm. Code 120.110. The Department has decided that it will not issue a Private Letter Ruling in regards to your request and instead is providing you with a General Information Letter.

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

COMPANY1, acting on behalf of our client, COMPANY2, respectfully requests a private letter ruling pursuant to Ill. Adm. Code 1200. A properly executed IL 2848 Power of Attorney form is included in this package authorizing COMPANY1 to request this ruling.

### **General Statement**

This private letter ruling is not requested for hypothetical or alternative proposed transactions, but rather to determine the taxability for Retailer's [sic] Occupation Tax or Use Tax purposes of actual transactions engaged in by COMPANY2 as described below. This ruling is sought for all tax periods during which the related purchases will occur.

### **Facts**

COMPANY2 is not currently under audit by the Illinois Department of Revenue and has not received notice of an impending sales and use tax audit from the same. The sales/use tax issues in this request are not a part of current or pending litigation involving this taxpayer or a related taxpayer and the equipment underlying these issues has been a part of COMPANY2's production process since the inception of the business. The requesting parties have been unable to locate any case law, regulations, or prior rulings dispositive of the issues within this request and neither this taxpayer nor

its representative has previously requested a ruling from the Department regarding the issues contained within this request.

### **Business Description**

COMPANY2 manufactures electronic control units (ECU's) which are embedded systems that control an electronic system or subsystem of an automobile such as sunroofs, power sliding door systems, smart key systems, etc. (electronic parts) at its location: ADDRESS, IL. These components are sold to customers in the automotive industry to be further assembled into automobiles. The first shipment of parts to customers occurred in September 20XX with the plant in uninterrupted operation since that time.

### **Issue No. 1**

The components produced by COMPANY2 contain embedded software, microprocessors, as well as myriad other small and delicate electronic components that are precisely affixed to a circuit board to operate load drivers and actuating relays. The high-speed multi-purpose mounting machines that perform these operations require considerable programming code to pickup [sic], place, and affix the components that comprise COMPANY2's products. This programming code is resident within this manufacturing machinery when it is purchased and is an integral component of that machinery.

In addition to the mounting machines, COMPANY2 uses assembly machines that require significant programming code to pickup [sic], move, judge quality, heat, and coat its products. As with the mounting machines, the code is an integral component of the machinery.

Periodically, this code must be altered, added to, or reworked in order to adjust the machinery to perform correctly or repurpose the equipment to produce a new and distinct product. This software modification, code addition, or replacement must be performed by highly skilled electrical engineers with the work frequently being outsourced to a vendor that performs equipment repairs. These software changes and code alterations are typically billed as "Service: Engineering Fee" on invoices (typical invoice copy is included with this request) from the vendor even though the code segments are prewritten or canned pieces of code which are merely inserted on the appropriate line by the engineers.

### **Taxpayer's Position-Issue No. 1**

It is COMPANY2's position that these programming "repairs" are analogous to retooling presses or other types of manufacturing equipment that require replacement of parts or tooling to better function or to perform a new function. The retooling of presses or replacement of parts to improve functioning of manufacturing machinery employing much lower technology in the performance of manufacturing processes are inarguably considered to be repairs of manufacturing machinery and are exempt from the Retailers [sic] Occupation Tax under Illinois law therefore making these types of purchases

eligible to earn the Manufacturer's Purchase Credit. It is also COMPANY2's position that the engineering fees for programming changes to its equipment (both mounting and assembly machines) should earn the Manufacturer's Purchase Credit. Alternatively, since the invoices do not segregate the charges for the code and the engineer's placement of the code into the correct programming line, the engineering fees should earn Manufacturer's Purchase Credit at ½ the regular rate under 86ILAC140.106(a)(2).

**Question No. 1**

Do the engineering service fees for software changes to mounting and assembly machines earn the Manufacturer's Purchase Credit and if so, at what rate do they earn the credit?

**Issue No. 2**

COMPANY2's customers have very high quality standards and an extremely low tolerance for imperfections in the components they purchase. COMPANY2's products are highly technical electrical components that absolutely cannot be exposed to static electricity which would compromise the product integrity and render the product unsalable.

These issues mandate that COMPANY2 have policies in place to require workers and visitors in the production room to wear anti-static boots and anti-static clothing. These apparel items serve no safety or comfort purposes for the wearer; they only prevent static electricity buildup or discharge. COMPANY2 has equipment to test persons entering the production area for a static charge. COMPANY2 has also put special flooring in place to prevent static electricity buildup,

Additional measures employed by COMPANY2 to maintain the static-free environment include humidity and temperature control which necessitates the purchase of equipment to achieve the environmental control parameters required for static elimination. The relative humidity must stay within a range of 30% to 60% and the temperature must stay within a range of 22°C to 28°C.

**Taxpayer's Position-Issue No. 2**

It is COMPANY2's Position that the static control issues are analogous to the bacteria control issues in meat processing and food manufacturing industries which are afforded an exemption from tax on cooling equipment to maintain a precise temperature in processing areas. COMPANY2 is required to control static electricity in the manufacturing room just as meat/food processors must control bacterial growth with cooling equipment. The equipment and apparel at issue are used exclusively to control static electricity buildup. It is COMPANY2's position that the static electricity control apparel and boots, flooring, humidity control equipment, heating/cooling control equipment, and static electricity testing equipment are exempt manufacturing equipment under Illinois law.

**Question No. 2**

Are the static control boots, apparel, flooring, temperature control equipment, humidity control equipment, and testing equipment exempt from Illinois ROT/UT? If so, do they therefore earn the Manufacturer's Purchase Credit?

**Requested Ruling Issue No. 1**

COMPANY2 respectfully requests that the Department issue a Private Letter Ruling that specifies the engineering fees listed in Issue No. 1 are considered to be equipment such as parts that require replacement in the normal course of operation and would therefore earn the Manufacturer's Purchase Credit.

**Requested Ruling Issue No. 2**

COMPANY2 also respectfully requests that the Department issue a Private Letter Ruling that specifies the components listed in Issue No. 2 are integral parts of the manufacturing process and are exempt from Illinois Retail [sic] Occupation tax and Illinois Use tax and, as a corollary, earn Manufacturer's Purchase Credit.

**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 on the issues.

Thank you in advance for your consideration of this request.

**DEPARTMENT'S RESPONSE:**

**Manufacturing Machinery and Equipment exemption & computer software**

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 are exempt from Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.330. The manufacturing process is the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining that 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.

Machinery or equipment 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, and the purchaser would not earn MPC. See Section 130.330(d)(4)(H). Machinery and equipment of this type only qualifies if required by the manufacturing process.

Manufacturing equipment does not include foundations for, or special purpose buildings to house or support, machinery and equipment. See Section 130.330(b)(5).

Section 130.330(c)(3) describes the application of the manufacturing machinery and equipment exemption to computer-assisted manufacturing systems. The exemption applies to equipment, "including computers used primarily in operating exempt machinery and equipment in a computer-assisted design, computer-assisted manufacturing (CAD/CAM) system." See 86 Ill. Adm. Code 130.330(c)(3). If manufacturing machinery and equipment qualifies for the exemption, any computer software contained in the machinery or equipment at the time of purchase will also qualify for the exemption.

The Retailers' Occupation Tax Act is imposed upon persons engaged in the business of selling at retail tangible personal property, including computer software. 35 ILCS 120/2. Computer software is defined in Section 2-25 of the Retailers' Occupation Tax Act and is considered tangible personal property for purposes of the Act. The definition specifically excludes software used to operate exempt machinery and equipment used in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease. Although computer software generally is not exempt under the manufacturing machinery and equipment exemption since computer software is neither machinery nor equipment, computer software used to operate exempt machinery and equipment that used in the process of manufacturing or assembling tangible personal property is not subject to Retailers' Occupation Tax. See 35 ILCS 120/2-25; 86 Ill. Adm. Code 1935(d). Computer software exempt under Section 2-25 does not earn MPC.

#### Manufacturer's Purchase Credit

As noted above, the Retailers' Occupation Tax does not apply to sales of 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. 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). The exemption does *not* apply to "hand tools, supplies (such as rags, sweeping or cleaning compounds), coolants, lubricants, adhesives, or solvents, items of personal apparel (such as gloves, shoes, glasses, goggles, coveralls, aprons, masks, mask air filters, belts, harnesses, or holsters), coal, fuel oil, electricity, natural gas, artificial gas, steam, refrigerants or water." See Section 130.330(c)(3).

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 a fixed percentage 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.

In addition, MPC may also 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. 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 (similar to the tangible personal property about which you inquire in your letter) that will be considered production related (e.g., 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).

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

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