

ST 17-0031-GIL 09/19/2017 MANUFACTURING MACHINERY & EQUIPMENT

Under the Retailers' Occupation Tax Act, the manufacturing machinery and equipment exemption is available for 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. Machinery and equipment used to manufacture compressed natural gas can qualify for the exemption. See 86 Ill. Adm. Code 130.330. (This is a GIL.)

September 19, 2017

Re: Private Letter Ruling Request/COMPANY.

Dear Xxxxx:

This letter is in response to your letter dated June 28, 2017 in which you requested information. 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 to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

This request is filed on behalf of our client, COMPANY (the Company"). Ruling is requested to determine the Retailers' Occupation Tax and Use Tax obligations of Company related to the purchase of exempt manufacturing machinery and equipment. Specifically, rulings are requested regarding whether: (i) the Company's purchase of machinery and equipment is deemed qualified manufacturing machinery and equipment under 86 Ill. Admin Code §130.330(c) and (ii) that its primary use could satisfy the requirement under 86 Ill. Admin Code §130.330(d) to be used greater than 50% in the manufacturing process given the facts presented.

A. General Information

1. This Private Letter Ruling ('PLR') is not requested for hypothetical or alternative proposed transactions, but rather to determine the taxability for ROT/UT

purposes of an actual transaction engaged in by the Company, as described below.

2. The Company is not currently under audit by or engaged in litigation with the Department with regard to this or any other tax matter.
3. The Department has not previously ruled regarding this matter for the Company. The Company has not submitted the same or similar issue to the Department and withdrew it before the Department issued its ruling.
4. We are aware of no authority contrary to the authorities referred to and cited below.

B. Description of Company Business Operations

The Company is a biotechnology company focusing specifically on gene therapy; the company's gene therapy candidate drug is in the process of completing its Phase 1 clinical trial and about to initiate multiple additional clinical trials in 2017. The company's gene therapy candidate drug has been granted DRUG DESIGNATION and DRUG DESIGNATION 1 for the treatment of CONDITION. The drug, once in production, will be a one-time intravenous treatment for CONDITION. The client's activity conducted within Illinois related to the aforementioned clinical phase of the drug's development would be considered research and development as currently constituted.

The Company is currently conducting a Phase 1 clinical trial and will be conducting further clinical trials. The Company is also developing the manufacturing process for the production of the drug. A manufacturing facility has been constructed in CITY, Illinois

C. Statement of Relevant Facts

In order to develop and manufacture the drug the Company requires prefabricated and autonomous cleanrooms (the "CLEAN ROOMS"). The Company recently purchased the aforementioned CLEAN ROOMS from a non-Illinois company which did not charge sales tax on the purchase.

These mobile CLEAN ROOMS are necessary to manufacture the Company's drug and provide all necessary environments. By establishing a controlled setting via the CLEAN ROOMS mechanical and sensor systems, the Company can create the environment necessary for drug production. The CLEAN ROOMS establish and maintain the appropriate temperature, humidity, sterility and asepticity to produce the drug.

The CLEAN ROOMS are prefabricated, mobile, reusable and have separate mechanical and sensor systems; the CLEAN ROOMS only require power to become operational. The CLEAN ROOMS have been placed in service within the Company's CITY, IL manufacturing facility.

The drug development effort involves the creation of a costly manufacturing process, which includes the purchase of the CLEAN ROOMS. Once the research and development phase is complete, the CLEAN ROOMS will not be discarded, but rather will be used in the final process to produce this new drug for human clinical trial purposes and, ultimately if the drug receives regulatory approval, for commercial manufacturing purposes. The CLEAN ROOMS will initially be used in a non-exempt manner (i.e., the research and development of a new production technique). However, subsequent to this initial non-exempt use, the CLEAN ROOMS will be used 100% of the time in the manufacturing of a product subject to the laws applicable to the Retailer's Occupation and Use Tax – the Company's new drug. It is anticipated that these CLEAN ROOMS will be used in the actual manufacturing process for more than 50% of the assets' useful and/or economic life.

Without the CLEAN ROOM the Company would not be able to establish the environment necessary to manufacture the drug and obtain United States Food and Drug Administration approval for the drug. The CLEAN ROOMS provide a controlled environment which enables the Company to produce the drug; without the CLEAN ROOMS the production process would be compromised and the drug potentially contaminated.

The anticipated drug production start date is July XXXX; the useful life of the CLEAN ROOMS is estimated to be XX years. Assuming the aforementioned production and estimated useful life timelines are accurate the CLEAN ROOM will have been used greater than 50% of the time in the drug manufacturing process.

D. Statement of Law

The Illinois Retailer's Occupation Tax [35 ILCS 120/1 et seq.] and Use Tax [35 ILCS 105 et seq.] are assessed on the sale or use by Illinois residents of tangible personal property within the State of Illinois. Each Act provides, however, that the sales or use of certain tangible personal property may be exempt; one such exemption applies to manufacturing and assembling machinery and equipment used primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease. 35 ILCS 105/3-(18)5 [sic].

Under the exemption, manufacturing and assembling machinery and equipment used primarily in the process of manufacturing are exempt from the imposition of Illinois Sales/Use Taxes. 35 ILCS 105/3-5; 35 ILCS 120/2-45. Machinery and equipment must be used primarily in the manufacturing or assembling process; this is defined as use over 50% in an exempt manner in order to qualify as exempt. 86 Ill. Admin. Code §130.330(d). The following activities are generally considered to be an exempt use of machinery and equipment:

1. The use of machinery or equipment to effect a direct and immediate physical change upon tangible personal property to be sold;

2. The use of machinery or equipment to guide or measure a direct and immediate physical change upon tangible personal property, provided such function is an integral and essential part of tuning, verifying, or aligning the component parts of such property;
3. The use of machinery or equipment to inspect, test or measure the tangible personal property to be sold where such function is an integral part of the production flow;
4. The use of machinery and equipment to convey, handle, or transport the tangible personal property within production stations on the production line: and
5. The use of machinery or equipment to place the tangible personal property to be sold into the container, package, or wrapping in which such property is normally sold where such machinery or equipment is used as part of an integrated manufacturing process.

[86 Ill. Admin. Code §130.330(d)(3).]

Certain activities are generally considered to not be manufacturing in nature:

1. The use of machinery or equipment to store, convey, handle or transport materials or parts or sub-assemblies prior to their entrance into the production cycle;
2. The use of machinery or equipment to store, convey, handle or transport finished articles of tangible personal property to be sold or leased after completion of the production cycle;
3. The use of machinery or equipment in the disposal of waste, scrap or residue; and
4. The use of machinery or equipment for general ventilation, heating, cooling climate control or general elimination, not required by the manufacturing process.

[86 Ill. Admin. Code §130.330(d)(4).]

E. Company Position

It is the taxpayer's position that each Pod utilized in the production processing facility will be treated as exempt from ROT/UT pursuant to 86 Ill. Admin. Code §130.330 because the CLEAN ROOMS are a required component of the overall manufacturing process and are used to create, maintain, and monitor the appropriate condition of the manufacturing process. The CLEAN ROOMS provide the necessary, temperature, sanitation and contamination prevention to produce the drug for research and development, the conduct of human clinical trials and ultimately for the commercial manufacture of the approved drug.

It would also appear that pursuant to 86 Ill. Admin. Code §130.330, the purchase of the machinery and equipment initially used in a non-exempt manner, as described above, will qualify for the exemption, provided that the purchaser can establish that the machinery and equipment was used in an exempt manner for more than 50% of the assets' useful and/or economic life.

We believe that the property in question will qualify for the machinery and equipment exemption provided that the asset is used (or will be used) in an exempt manner for more than 50% of the assets' economic or useful life. The initial non-exempt use of machinery and equipment will not in itself preclude a purchaser from taking the exemption for otherwise qualified manufacturing machinery and equipment.

1. The initial non-exempt use of manufacturing machinery and equipment, as provided under 86 Ill. Admin. Code §130.330(d)(4)(B) will not in itself void the exemption provided for otherwise qualified manufacturing machinery and equipment.
2. The exemption provided for manufacturing machinery and equipment under Chapter 120.44(2) of the Illinois Revised Statutes will apply provided that the equipment is used for more than 50% of the time in an exempt manner. Accordingly, provided that the machinery and equipment is otherwise qualified as exempt manufacturing machinery and equipment under 86 Ill. Admin Code §130.330, the exemption will apply when the asset is used in an exempt manner for more than 50% of the assets' economic or useful life.

Applicable Rulings: Private Letter Ruling ST 90-0457-PLR; General Information Letter ST 00-0255-GIL.

F. Ruling Requested

Company respectfully requests the Department issue a Private Letter Ruling that specifies whether (i) the Company's purchase of machinery and equipment is deemed qualified manufacturing machinery and equipment under 86 Ill. Admin. Code §130.330(c) and (ii) that its primary use could satisfy the requirement under 86 Ill. Admin. Code §130.330(d) to be used greater than 50% in the manufacturing process given the facts presented.

G. Signature

Under penalties of perjury, I declare that I have examined this request, including the accompanying documents, and to best of my knowledge and belief the facts presented in support of the requested ruling are true correct and complete

Please send all questions or requests for additional information to me via email, by phone, or by mail.

DEPARTMENT'S RESPONSE:

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). The Department recently met and determined that it would decline to issue a Private Letter Ruling in response to your request. We hope, however, the following General Information Letter will be helpful in addressing your questions.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property at retail to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales tax" in Illinois.

Retailers' Occupation Tax, however, does not apply to sales of machinery and equipment used primarily 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).

Machinery means major mechanical machines or major components of such machines contributing to a manufacturing or assembling process, including machinery and equipment used in the general maintenance or repair of such exempt machinery and equipment or for in-house manufacture of exempt machinery and equipment. See Section 130.330(c)(2).

The law requires that machinery and equipment be used primarily in manufacturing or assembling. Therefore, machinery that 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 of its useful life in an exempt manner in order to claim the deduction. 86 Ill. Adm. Code 130.330(d)(1)

The use of machinery or equipment to guide or measure a direct and immediate physical change upon the tangible personal property to be sold, provided this function is an integral and essential part of tuning, verifying, or aligning the component parts of such property; and the use of machinery or equipment to inspect, test or measure the tangible personal property to be sold where the function is an integral part of the production flow; will generally be considered to constitute an exempt use Section 130.330(d)(3)(B)-(C). The use of machinery or equipment in research and development of new products or production techniques, machinery or equipment will generally not be considered manufacturing. Section 130.330(d)(4)(B). The product produced as a result of the manufacturing or assembling process also must be for sale or lease. Section 130.330(c)(1).

For purposes of determining whether machinery or equipment is used over 50 percent of its useful life in an exempt manner, the Department looks at the period during which the asset is depreciated, not the period the equipment may ultimately be used in the manufacturing process.

Based on your letter, it is the Department's opinion the CLEAN ROOMS are machinery or equipment that may be eligible for the manufacturing machinery and equipment exemption. However, without knowing the period of time over which the CLEAN ROOMS will be depreciated and the actual date the machinery begins manufacturing drugs for sale or lease, the Department cannot render an opinion whether the CLEAN ROOMS qualify for the exemption.

Under the circumstances described in your letter, the best course of action was for the Company to self-assess Use Tax at the time the CLEAN ROOMS were purchased to avoid penalties and interest in the event the CLEAN ROOMS do not meet all the requirements for claiming the exemption. The Company could file a claim for credit if it determines the CLEAN ROOMS will be used over 50 percent of their useful life in an exempt manner, assuming that at the time of the determination the claim would be within the statute of limitations.

If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Associate Counsel

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