



MAINE REVENUE SERVICES SALES, FUEL & SPECIAL TAX DIVISION INSTRUCTIONAL BULLETIN NO. 22

MANUFACTURERS

This Bulletin is intended solely as advice to assist persons in determining and complying with their obligations under Maine tax law. It is written in a relatively informal style and is intended to address issues commonly faced by manufacturers in Maine.

Taxpayers are responsible for complying with all applicable tax statutes and rules. Although bulletins issued by Maine Revenue Services ("MRS") do not have the same legal force and effect as rules, justifiable reliance upon this bulletin will be considered in mitigation of any penalties for any underpayment of tax due. This bulletin is current as of the last revision date shown at the end of the document.

The Sales and Use Tax Law is found in the Part 3 of Title 36 of the Maine Revised Statutes ("M.R.S."). Both Title 36, all MRS rules and affidavits referenced in this bulletin may be viewed on the MRS website: www.maine.gov/revenue.

For more information on manufacturers see also MRS Rule 303 ("Sales to Industrial Users").

1. "PRODUCTION" DEFINED

The term "manufacturer" means an entity that is engaged in the production of tangible personal property for later sale or lease. The question of exactly what is and what is not "production" has great importance when considering the sales and use tax exemptions available to manufacturers. The term is defined in 36 M.R.S. § 1752(9-B) as follows:

"Production" means an operation or integrated series of operations engaged in as a business or segment of a business that transforms or converts personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed. "Production" includes film production.

"Production" includes manufacturing, processing, assembling and fabricating operations that meet the definitional requisites, including biological processes that are part of an integrated process of manufacturing organisms or microorganic materials through the application of biotechnology.

"Production" does not include biological processes except as otherwise provided by this subsection, wood harvesting operations, the severance of sand, gravel, oil, gas or other natural resources produced or severed from the soil or water, or activities such as cooking or preparing drinks, meals, food or food products by a retailer for retail sale.

In summary, in order for "production" to exist, a business must be engaged, in whole or in part, in the transformation of raw materials into a new and different product. Some common examples are:

- A paper mill converting wood chips into paper;
- A wood crafter converting lumber into finished furniture; and
- A seamstress converting cloth material into a dress.

A. WHEN PRODUCTION BEGINS. The point at which production begins depends on whether or not the raw materials used in the production process are stored. If the materials are stored, production begins with the movement of the materials from storage to the first production machine. If the materials are not stored, production begins with the movement of the materials from point of delivery to the first production machine.

Examples: A manufacturer of furniture receives rough sawn lumber and stores this lumber in a warehouse. The first production machine for this manufacturer will likely be a planer. Production begins when the rough lumber is removed from storage and brought to the planer. If this movement to the planer is accomplished mechanically, the machine used to move the lumber to the planer is considered to be used in production.

A manufacturer of plastic widgets stores its plastic pellets in storage tanks. The first production machine is machinery that melts down the pellets into a liquid form. Production begins when the plastic pellets move toward the melting machine. If this is accomplished through a piping system, for instance, production begins when the pellets leave the storage tank and the piping system is considered part of production.

B. WHEN PRODUCTION ENDS. Production ends with the completion of the finished product before the product is stored for later delivery. This may include packaging operations, but only those that are part of a series of operations, within the production line and the packaging is performed before the product is stored. Packaging operations that occur after the product has been placed in storage or that occur within the storage facility are not part of production.

Example: A manufacturer of compact discs has a machine within its production line that inserts the disc into a plastic case and shrink-wraps each individual case. This packaging operation is part of production. In contrast, if the cases are instead sent to a storage room and later shrink-wrapped into packages of 10 and inserted into cardboard boxes for shipping to customers, the shrink-wrapping and packaging operation is not part of production.

C. EXCLUSIONS FROM PRODUCTION. Machinery and equipment used primarily in the following activities or operations are excluded from the definition of "production" and generally *do not* qualify for the production exemption. *The purchase of these items is taxable*

unless covered by a different exemption.

(1) Acquisition of raw materials. Machinery or equipment used in the acquisition of raw materials, including wood-harvesting operations and severing sand, gravel, or other natural resources from soil or water.

Examples: Cameras used by newspaper photographers to record images on film for later selection and use in newspaper production; chain saws used to harvest wood for subsequent milling; excavation equipment used to extract clay from which bricks are later formed.

(2) Storage and handling (pre- and post-production). Machinery or equipment used in the storage or handling of exempt material prior to the movement of the materials between the point of receipt or storage area and the first production operation, or after the completion of any in-line packaging operation.

Examples: A crane used primarily to unload logs from trucks into storage piles, prior to movement of the logs to a debarker or pulp grinder; an ice machine used primarily to keep fresh food cold during delivery, rather than to chill or freeze food as a step in the processing; a forklift used primarily to move palletized product from the palletizer to a warehouse pending shipment.

(3) Product transportation and distribution. Machinery or equipment used in the transportation of product on public ways between different production sites, or in the distribution of product to customers.

Example: A truck used to carry packaged product to customers.

(4) Biological processes. Machinery or equipment used in connection with biological processes. A biological process is a natural process that occurs with little or no intervention from humans or machinery.

Examples: Equipment used in the hatching of eggs or in the growing of crops. (See Section 2, subsection I for information on an exception to this rule in the case of biotechnology.)

(5) Activities by a retailer in connection with the preparation of food to be sold by the retailer. Machinery or equipment used by a retailer in the preparation of food to be sold by the retailer.

Examples: Refrigerators, ovens, and blenders used by a restaurant in the preparation of meals.

(6) Administrative functions. Machinery or equipment used in administrative, personnel, security, inventory control, administrative record keeping, ordering, billing, or

similar support functions.

Examples: Computers used primarily for billing, payroll and business correspondence; telephone systems; security cameras.

(7) Quality control. Machinery or equipment used for quality control purposes (other than as described in Section 2, subsection A).

(8) Maintenance and cleaning. Machinery or equipment used to clean, repair, or maintain real or personal property in the manufacturing facility (other than attachments to exempt machinery and equipment described in Section 2, subsection A(4)(e) below).

Examples: A floor polishing machine; welding equipment used to repair production piping; equipment used to sharpen the blades of saws used at a lumber mill; brooms and other cleaning supplies.

(9) Safety and fire protection. Machinery or equipment used for fire protection or the protection and safety of workers or other persons (unless the equipment is attached to or incorporated into exempt machinery and equipment).

Examples: A plexiglass screen (not attached to exempt equipment) used to protect passing workers and visitors from flying debris; fire extinguishers and fire sprinkler systems; an emergency shower and eyewash station; security systems; standard safety clothing and other standard safety items worn by employees.

(10) Non-specialized environmental controls (lighting, HVAC, etc.). General plant lighting, heating, ventilation, air conditioning, or similar environmental control designed for the comfort or convenience of employees. (See Section 2, subsection A(4)(i) below regarding specialized environmental control items essential to a particular production process).

Examples: A general building HVAC system used to cool and ventilate a room where wood workers assemble furniture; an office humidifier; thermostats used to control a boiler used primarily to heat a building.

(11) Certain electrical equipment. Electrical equipment located prior to the last transformer at the manufacturing facility that steps electricity up or down to the voltage at which the electricity is primarily used by other exempt machinery and equipment, when the electricity has been purchased from or supplied by another person, except as provided in Section 2, subsection (A)(4)(j) below.

Examples: In a meat packing plant that receives 34.5KV electricity from the grid and steps the electricity down with its own transformer to 12KV, then transmits the electricity with its own wires to a second transformer that reduces the voltage to 480 volts for use at that voltage by its production

machinery, the first transformer would be taxable (the second transformer would be exempt).

2. EXEMPTIONS

The Maine Sales and Use Tax Law provides the following categories of exemptions to manufacturers:

- A. Machinery and Equipment Used in Production
- B. Ingredients (Raw Materials) or Component Parts
- C. Items that are Consumed or Destroyed in Production
- D. Fuel and Electricity
- E. Water Pollution Control Facilities
- F. Air Pollution Control Facilities
- G. Machinery and Equipment Used in Research and Development
- H. Contracts with U.S. Government
- I. Biotechnology
- J. Fuel Oil and Coal

Each of these exemptions has detailed and specific requirements in order for the purchase or use of an item to qualify for the exemption.

A. MACHINERY AND EQUIPMENT USED IN PRODUCTION. The exemption for production machinery and equipment found in 36 M.R.S. § 1760(31) sets forth a number of requirements. First, the item purchased must fall within the statutory definition of "machinery and equipment." Second, the machinery or equipment in question must be: (1) purchased for use by the purchaser; (2) purchased for use *primarily in production*; (3) purchased for use *directly in production*; and (4) purchased for use in producing *tangible personal property* that is (5) *intended to be sold or leased* ultimately for final use or consumption.

(1) Machinery and equipment. The term "machinery and equipment" is defined in 36 M.R.S. § 1752(7-B) and includes both new and used machinery and equipment and parts and attachments for the machinery and equipment, including repair and replacement parts.

The statutory definition excludes foundations for machinery and equipment that are permanent supports, such as most foundations composed of concrete. Foundations that can be dismantled and moved, such as many steel supports, are considered part of the machinery and equipment that they support. Also excluded from "machinery and equipment" are so-called "special purpose buildings" used to house or support machinery and equipment.

Examples of exempt foundations and supports:

- Angle iron used to construct a support frame, provided the machinery or equipment it supports qualifies as production machinery or equipment.
- A movable concrete base, provided the machinery or equipment it supports qualifies as production machinery or equipment.

Examples of taxable foundations or buildings:

- Permanently affixed concrete pillars on which a piece of production machinery sits.
- A kiln that houses machinery and equipment used in the drying of finished lumber is a special purpose building. The piping, controls and other equipment within the walls of the kiln qualify as exempt machinery and equipment.

(2) Use by the purchaser. The purchaser of the machinery and equipment must also be the *user of machinery and equipment in the production process* in order to qualify for the exemption. Lessors of machinery and equipment under a true lease are not entitled to an exemption even though the lessee is using the machinery and equipment in production. The taxable "use" by the purchaser/lessor in this situation is the derivation of income through the leasing of the equipment. (See the exception for "sale/leaseback" transactions, explained in Section 3, subsection A(1) of this bulletin.)

If a subsidiary of the manufacturer purchases equipment and allows the parent manufacturer to use it in the manufacturer's own production, the subsidiary may not purchase the equipment exempt since, as the purchaser, the subsidiary is not the user of the equipment in production.

(3) Use primarily in production. "Primarily" is defined in 36 M.R.S. § 1752(9-A) to mean more than 50% of the time during the period that begins on the date the machinery or equipment is first placed in service by the purchaser and ends either two years from that date or at the time that the machinery or equipment is sold, scrapped, destroyed or otherwise permanently removed from service by the taxpayer, whichever occurs first. Thus, if an item of machinery or equipment has multiple uses, it must be used in an exempt activity more than 50% of its time in operation (during the relevant time window) to qualify as exempt production machinery. For instance, a forklift may be used to move work in process between production machines, but also to load delivery vehicles, or to move raw material from one storage location to another. Only the time used in moving the "work in process" would qualify as "use in production." The amount of time in this function would need to exceed 50% of its total use in order for the forklift to be exempt as "primarily" used in production.

(4) Use directly in production. "Directly" is defined in 36 M.R.S. § 1752(2-A) to be operations that are "an integral and essential part of production," as contrasted with activities that are "simply incidental, convenient or remote to production." A wood planer in a furniture manufacturer's facility is clearly essential to the production of the

finished furniture, while items in a machine shop used to maintain and repair production machinery are only "incidental" to production and are therefore not exempt.

The term "directly" does not include support operations. Machinery and equipment used in the following operations are taxable:

- Administrative operations;
- Storage and warehouse operations;
- Maintenance operations (including maintenance activities occurring in the production area itself);
- Receiving and shipping operations;
- Heating and lighting, including in production areas (except as provided in (i) below;)
- Safety and fire protection (including those activities required by state or federal agencies); and
- Transportation on public ways between production sites.

The following is a non-exclusive list of activities considered to be use "directly" in production:

(a) Acting on raw materials. The processing of raw material at the production site, or the holding of raw material as it is being processed.

Examples: A wood planer acting on rough lumber to plane and reduce thickness; machinery that mixes raw materials before the raw material is added to the production line; a printing press that acts upon paper and ink in producing a printed product for sale; a rock crusher that crushes rock which is then further processed in a kiln as a part of the manufacture of cement for sale; a freezer used to flash-freeze vegetables in the production of frozen vegetables for sale.

(b) Processing or holding "exempt materials." The processing of exempt materials, or holding of such materials as they are being processed, so that they or the materials resulting from the processing can be used or reused in a production process or in connection with the operation of exempt machinery or equipment. As used in this Bulletin, "exempt materials" means works in process and materials purchased by the taxpayer that would be exempt in whole or in part under 36 M.R.S. § 1760(9-D) (fuel and electricity used at a manufacturing facility), 36 M.R.S. § 1760(9-G) (fuel oil or coal, the by-products from the burning of which become an ingredient or component part of tangible personal property for later sale), or 36 M.R.S. § 1760(74) (property that becomes an ingredient or component part of, or that is consumed or destroyed or loses its identity in production of, tangible personal property). "Exempt materials" may include raw materials, electricity, fuel, water, ice, steam, air, oil, gas, chemicals, gases, catalysts, grinding or blasting materials, reagents, lubricants, solvents, acids, printing plates, color separations, tagging materials, and other substances and materials used in connection with the operation of exempt machinery and equipment.

Examples: A lime kiln that prepares chemicals for use in a kraft pulping process at a paper manufacturing facility; equipment that deionizes or demineralizes water for use by other exempt machinery and equipment; a chipper for wood used to fuel a boiler used to supply steam or electricity to saws and planers at a lumber mill.

(c) Handling or moving exempt materials. The handling, moving or transmitting of exempt materials from one production machine to another; or between a storage area (or point of receipt if there is no storage) and the first production operation; or between a production operation and a temporary holding area prior to further production operations. However, transportation of raw materials or work in process on public ways between different production sites is not considered an activity "directly" in production.

Examples: A forklift used to move lumber from a planer to a sanding machine; a conveyor system that moves work in process from one production machine to another, or from a storage pile at the point of receipt to the first production machine; piping used to move oil from a storage tank to a boiler used to generate electricity to power the other exempt machinery and equipment at a potato processing plant; conveyors used to move lime from storage at the point of receipt to a lime kiln used to prepare chemicals for use in a kraft pulping process at a paper manufacturing facility.

(d) Protection or temporary holding of exempt materials or work in process. Machinery and equipment that preserves, protects, or temporarily holds exempt materials (including work in process) between different production operations or that is used to temporarily hold exempt materials. "Temporary holding" as used in this Bulletin includes (1) equipment or functions designed to avoid delays in production resulting from reasonably anticipated fluctuations in the rate of supply or use of the stored items, and (2) equipment such as a tank, chest or tower used to hold exempt material previously processed and awaiting delivery to other production equipment for further processing or use. An item of equipment is presumed to be for "temporary holding" if it holds work in process or exempt material only for periods of less than 24 hours.

Examples: Steel racks used in temporary holding of finished lumber that is to be sized and cut; a holding tank used in temporary holding of raw material between two production machines; racks or "skids" used by a printer in the temporary holding of pages of printed material pending printing of additional pages, inserts or covers needed to produce the final product; bins used in sorting and temporary holding of yarns produced by a fabric manufacturer for subsequent use in weaving fabric; a tank used to hold a 12-hour supply of an exempt process chemical for use in the event of an interruption of supply.

(e) Removal of waste products from production machinery. Removal of waste or by-products from the immediate vicinity of exempt machinery and equipment, for the purpose of permitting that machinery and equipment to operate continuously.

Examples: A conveyor used to remove chips and sawdust from the planer; an ash grate for a boiler used to produce steam and electricity to power manufacturing equipment at the same facility; a blanket wash application system for a printing press; a dryer hood and exhaust fan used to remove excessive moisture from a production machine.

(f) Control of exempt production machinery. Manually or automatically controlling, or monitoring for the purpose of manually or automatically adjusting or controlling, the operation of exempt production machinery.

Examples: Process control computers, such as a computer that controls the cuts of a band saw; a temperature gauge for a boiler that produces steam or electricity used by other exempt equipment; a valve used to control the flow of gas used in welding; a camera used to monitor the shape of the plume of flame in a kiln used in a production operation to ensure that the kiln is functioning properly.

(g) Testing or monitoring. Testing or monitoring exempt materials (including work in process) if the equipment used for this purpose is physically attached to exempt machinery and equipment, or is used to test every item or batch of product or exempt material.

Examples: A moisture meter that verifies the moisture content of 100% of the lumber used in making furniture; a chart recorder used to monitor the pH of water to be used in process or work in process held within a tank; a color density meter used to determine whether each batch of product meets color specifications for top grade product; a full volume detector used to ensure that the product container is properly filled and sealed.

(h) In-line packaging operations (pre-storage). Packaging operations that are part of a series of operations within the production line and that are performed before the final product is stored. Packaging operations that occur after the product has been placed in storage or that occur within a separate storage facility are not part of production.

Examples: Machinery and equipment used to insert a compact disc into a cardboard sleeve and shrink-wrap it; equipment used to sort and count product for packaging; equipment used to box, bottle, can, or label product.

(i) Machinery and equipment that controls the production environment. Controlling the production environment by means of specialized plant lighting, ventilation, air purification or prevention of contamination, humidity or temperature regulation, or similar environmental control essential to a particular production process.

Examples: Air handling equipment used for a "clean room" in a computer chip manufacturing facility; equipment used to reduce contamination or to

control temperature and humidity in a clean room; equipment used to monitor air quality in a clean room; air conditioning equipment connected or otherwise directed to computers used to control a manufacturing process; thermometers and humidity meters used to monitor the environment for process control computers or exempt electrical equipment.

(j) Certain electrical equipment. The last transformer at the manufacturing facility that steps electricity up or down to the voltage at which the electricity is primarily used by other exempt machinery and equipment, and wiring, switches and other electrical equipment between that transformer and other exempt machinery and equipment; and machinery and equipment used to avoid electrical damage to such transformer or other exempt machinery and equipment or to ensure uninterrupted power supply to exempt machinery and equipment, including by means of providing back-up or emergency power or surge protection.

Examples: In a meat packing plant that receives 34.5KV electricity from the grid and steps the electricity down with its own transformer to 12KV, then transmits the electricity with its own wires to a second transformer that reduces the voltage to 480 volts for use at that voltage by its production machinery, the second transformer would be exempt.

(5) Tangible personal property intended for sale or lease. To be eligible for exemption, machinery or equipment must be used in the production of tangible personal property that is intended to be sold or leased ultimately for final use or consumption. "Tangible personal property" is defined in 36 M.R.S. § 1752(17) as something that can be seen, touched or perceived by the senses. The definition specifically includes electricity.

The product being produced must also be sold or leased as *tangible personal property*. Machinery and equipment used to produce property that will be sold as *real property*, or that will be used by the producer rather than sold, does *not* qualify for exemption. For more on this topic, see Instructional Bulletin No. 4 ("Contractors and Subcontractors").

Examples:

- A cabinetmaker who produces and installs kitchen cabinets and passes title to the cabinets after installation is selling real property, not tangible personal property. The cabinetmaker's purchase of machinery and equipment does not qualify for exemption.
- A cabinetmaker who produces and installs kitchen cabinets and passes title to the cabinets before installation is engaged in selling tangible personal property. The cabinetmaker's purchase of machinery and equipment would qualify for exemption.
- A retailer that manufactures free-standing shelving units for its own use is not selling the shelves. The retailer's purchase of machinery and equipment to build the shelves does not qualify for exemption.

B. INGREDIENTS (RAW MATERIALS) OR COMPONENT PARTS. 36 M.R.S. § 1760(74) provides an exemption for tangible personal property that becomes an ingredient or component part of the item being produced. This category includes all raw materials that get physically converted into, or physically attached to the finished product, including tags and labels.

C. ITEMS THAT ARE CONSUMED OR DESTROYED IN PRODUCTION. 36 M.R.S. § 1760(74) provides an exemption for tangible personal property, other than fuel or electricity, that is consumed or destroyed or loses its identity in the production process. These are items that have a normal life expectancy of less than one year in the use to which they are applied. Rule 303 ("Sales to Industrial Users") provides additional guidance on this topic.

Examples of items that are consumed or destroyed in the production process:

- Items that are essential to the operation of production machinery and equipment, such as lubricants;
- Items that come in contact with raw material but does not become part of the finished product, such as solvents.
- Items that come in contact with raw material and are no longer of use afterwards, such as sandpaper.

Examples of items that are *not* consumed or destroyed in the production process:

- Items that are consumed or destroyed before production begins, such as lubricants for a chain saw used to harvest trees to be manufactured into lumber;
- Items that are consumed or destroyed after production ends, such as lubricants for a forklift used primarily to move finished product from storage to trucks for shipment to customers.
- Items that are not used "directly" in production.

D. FUEL AND ELECTRICITY. 36 M.R.S. § 1760(9-D) provides a partial exemption for fuel and electricity used at a "manufacturing facility." 95% of the cost of the fuel and electricity is exempt, while the remaining 5% is subject to the general sales tax rate. This partial sales tax exemption applies to all types of fuel, including #2 heating fuel, diesel fuel, oxygen, acetylene, and wood chips.

A manufacturing facility is defined in 36 M.R.S. § 1752(6-A) as a site where production machinery is located. This includes all machinery, equipment, structures and facilities located at the site and used in support of production or associated with the production. If a site includes production machinery, all fuel and electricity used at that site is eligible for the partial exemption. Separate electric meters, fuel tanks or heating systems need not be maintained for the purpose of separating production areas from non-production areas.

A site at which mobile production equipment is temporarily located may also constitute a "manufacturing facility." The 95% energy exemption applies to fuel used in qualifying mobile production equipment used at this type of temporary site, such as certain wood chippers, rock crushers, cement mixers, firewood processors, and soil screening equipment. The partial exemption would also extend to fuel used in equipment that loads a piece of mobile production equipment that otherwise qualifies for exemption – for instance, fuel used by a machine that loads a wood chipper temporarily located in the yard. The partial exemption does not extend to fuel used in transportation or other non-production activities – for instance, fuel used in a skidder moving logs from the woods to the yard would not qualify.

A manufacturing facility does not include a site at which a retailer is primarily engaged in making retail sales of items that it does not produce itself. Thus, for example, a hardware store is not a "manufacturing facility," and is not entitled to the 95% energy exemption, merely because it has a key cutting machine on the premises.

E. WATER POLLUTION CONTROL FACILITIES. 36 M.R.S. § 1760(29) provides an exemption for water pollution control facilities. In order to qualify for this exemption, a facility must be certified by the Commissioner of Environmental Protection ("DEP") as a facility that is engaged in disposing, isolating or treating of water-borne industrial or other waste. Once a facility has been certified by DEP, an exemption is allowed for any materials used in the construction, repair or maintenance of the facility, as well as for any machinery and equipment used primarily for reducing, controlling or eliminating water pollution. This includes, but is not limited to, thickeners, incinerators, pipelines or conduits, pumping stations, force mains and all other constructions, devices, appurtenances and facilities used for collecting or conducting water borne industrial or other waste. It does not include supplies other than maintenance materials and pollution control chemicals. It does not include septic tanks and the pipelines and leach fields connected to septic tanks.

F. AIR POLLUTION CONTROL FACILITIES. 36 M.R.S. § 1760(30) provides an exemption for air pollution control facilities. In order to qualify for this exemption, a facility must be certified by DEP as a facility that is engaged in reducing, controlling, eliminating or disposing of industrial or other air pollutants. Once a facility has been certified by DEP, an

exemption is allowed for any materials used in the construction, repair or maintenance of the facility as well as for any machinery and equipment used primarily for reducing, controlling or eliminating air pollutants. This does not include machinery or equipment installed for the benefit of people, such as air conditioners, dust collectors, fans and similar items; nor does it include facilities designed or installed for the reduction or control of automobile exhaust emissions.

G. MACHINERY AND EQUIPMENT USED IN RESEARCH AND DEVELOPMENT. 36 M.R.S. § 1760(32) provides an exemption for machinery and equipment used in research and development. As with the exemption for production machinery, several requirements must be satisfied:

- The item being purchased must be machinery and equipment;
- It must be used by the purchaser in research and development;
- It must be used directly in research and development; and
- The machinery or equipment must be used *exclusively* in research and development.

"Research and development" for the purposes of this exemption is limited to the experimental and laboratory sense of that term. It does not include the ordinary testing or inspecting of materials or products for quality control, efficiency surveys, management studies, consumer surveys, advertising, or promotions. It also does not include research done in connection with literary, historical or similar projects.

H. CONTRACTS WITH U.S. GOVERNMENT. The exemptions mentioned in paragraphs A through D also apply to those entities engaged in the production of tangible personal property pursuant to a contract with the United States Government or any agency thereof.

I. BIOTECHNOLOGY. Although the term "production" as defined in 36 M.R.S. § 1752(9-B) excludes biological processes generally, it does include "biological processes that are part of an integrated process of manufacturing organisms or microorganic materials through the application of biotechnology." As a result, the exemptions mentioned in paragraphs A through D also apply to entities engaged in biotechnological applications.

These applications include recombinant DNA techniques, biochemistry, molecular and cellular biology, immunology, genetics and genetic engineering, biological cell fusion techniques and new bioprocesses using living organisms or parts of organisms to produce or modify products, improve plants or animals, develop microorganisms for specific uses, identify targets for small-molecule pharmaceutical development, transform biological systems and useful processes and products or to develop microorganisms for specific uses.

With respect to research and development in biotechnological applications, the exemption for machinery and equipment includes instruments and supplies, such as microscopes and diagnostic testing materials. See 36 M.R.S. § 1760(32) for more detail.

J. FUEL OIL AND COAL. 36 M.R.S. § 1760(9-G) provides an exemption for the use of fuel oil or coal in those situations where the by-products that result from the burning of the fuel or coal become an ingredient of tangible personal property being produced for sale.

3. OTHER IMPORTANT CONSIDERATIONS

A. LEASING. Generally speaking, the exemption for production machinery and equipment does not apply to machinery and equipment being leased. The exemption provided to a manufacturer does not extend to the lessor of equipment even though the equipment will be used in production. The lessor is generally liable for use tax on the cost of the equipment being leased.

The following are exceptions to this general application:

(1) Sale/leaseback transactions. If machinery and equipment that qualifies for exemption is purchased by a manufacturer and subsequently sold to and leased back from a lessor, the sales/use tax exemption still applies. It is immaterial whether the original purchase and subsequent sale/leaseback transaction occur simultaneously or at some time in the future or whether actual use of the machinery and equipment is made by the manufacturer before the sale/leaseback transaction occurs.

(2) Lease "in lieu of purchase." A lease that is determined by the State Tax Assessor to be a lease "in lieu of purchase" is a "sale" as defined in 36 M.R.S. § 1752(13). Machinery and equipment being purchased pursuant to a lease in lieu of purchase meets the requirement of "use by the purchaser" and would be exempt provided it meets the other requirements of exemption. For more on this topic, see Instructional Bulletin No. 20 ("Lease and Rental Transactions").

(3) Interim rentals. Machinery and equipment being rented under the "interim rental" provision of the statute (36 M.R.S. § 1758) is treated as a sale, with the lessor being the retailer, the rental payment being the sale price and lessee being the purchaser/consumer. An interim rental, therefore, meets the requirement of "purchase by the user" and is exempt provided it meets the other applicable requirements of the law.

B. TRANSPORTATION. As noted above, machinery and equipment must be used "directly" in production in order to qualify for exemption. Moving work in process between production machines is a qualifying activity. Transportation of raw material to the production site, transportation of work in process on public ways between production sites and transportation of finished products to customers are all non-qualifying activities.

Certain vehicles used in interstate or foreign commerce may be exempt pursuant to 36 M.R.S. § 1760(41-A), depending upon the circumstances. For more information on this subject, see MRS Rule 318 ("Instrumentalities of Interstate or Foreign Commerce").

C. BY-PRODUCTS AND RECOVERED RAW MATERIALS. The manufacturing process generally results in a certain amount of waste. In many situations this waste must be disposed of. In certain manufacturing environments it can be recycled, sold as a by-product or used as an ingredient of another product. Removing waste from a production machine is an activity that is considered "directly" in production. Machinery and equipment that handles or processes the product after that point may or may not qualify for exemption.

Examples of *exempt* activities involving by-products and recovered raw materials:

- Recycling the by-product or recovered raw material back into production. This activity is "directly" in production and machinery and equipment used primarily for this purpose is exempt.
- Using the by-product or recovered raw material as an ingredient in the production of another product. This activity is also considered "directly" in production and machinery and equipment used primarily for this purpose is exempt.

An example of a *taxable* activity involving by-products would be selling the by-product "as is." In this case, removing the waste from the production machine is "directly" used in production, but machinery and equipment used after this point is *not* used directly in production since nothing more is done to the by-product to change its form, character, or composition.

D. TANGIBLE PERSONAL PROPERTY VS. REAL PROPERTY. The purchase by a construction contractor of materials for the construction of real property (buildings, fixtures attached to buildings, etc.) or for incorporation into real property does not qualify for the machinery and equipment exemption.

Examples of such items are:

- Wires, conduits, outlets and other electrical items installed to facilitate the use of the building as a building rather than for purposes of a particular production process;
- Heating and air conditioning units (including ductwork) installed to facilitate the use of the building as a building, rather than for purposes of a particular production process such as that described in Section 2, subsection A(4)(i);
- Special purpose buildings;
- Permanent foundations composed of concrete.

If machinery and equipment is purchased as tangible personal property *before* being incorporated into realty and, as tangible personal property, meets all of the other requirements of exemption, the machinery and equipment would qualify for exemption. Since this type of arrangement between the contractor and the purchaser is the exception, rather than the norm, manufacturers are cautioned that proper contractual terms are necessary for correct application of the exemption. For more information on this topic, see Instructional Bulletin No. 4 ("Contractors and Subcontractors").

E. EXEMPT PURCHASE DOCUMENTATION. A manufacturer claiming that the purchase of tangible personal property qualifies for exemption must provide its vendor a "Industrial Users Blanket Certificate of Exemption" (form ST-A-117) . The certificate can be found on the MRS website: www.maine.gov/revenue/forms/sales/salesforms.htm. The manufacturer should indicate on this certificate the grounds for exemption by checking off the appropriate category. The vendor should retain this certificate in its file to document the exempt sale. If multiple purchases are made from one vendor, the certificate may act as a "blanket" certificate, covering all subsequent purchases of like items. It is the *responsibility of the purchaser* to understand all requirements of the law before claiming any exemption. The purchaser must also be able to prove that a purchase meets the qualifications of the exemption.

F. DIRECT PAY PERMIT. Pursuant to Rule 308 ("Direct Pay Permits"), certain manufacturers and utilities that commonly acquire a substantial amount of tangible personal property under circumstances making it impractical to determine at the time of purchase whether the use will be taxable or exempt, may qualify for a "direct payment permit" issued by MRS. This permit allows the manufacturer to purchase most items of tangible personal property without paying tax but -- the purchaser then becomes accountable directly to the State for payment of appropriate use tax. The direct pay permit must be provided to the vendor at the time of purchase to document the exempt sale and, as with the blanket certificate of exemption, need only be provided once to cover subsequent purchases of like items. See Rule 308 for more information and qualifications.

4. ADDITIONAL INFORMATION

The information in this bulletin addresses some of the more common questions regarding the Sales and Use Tax Law faced by manufacturers. It is not intended to be all-inclusive. Requests for information on specific situations must be in writing, must contain full information as to the transaction in question, and must be directed to:

MAINE REVENUE SERVICES
SALES, FUEL & SPECIAL TAX DIVISION
P.O. BOX 1060
AUGUSTA, ME 04332-1060
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First Issued: November 1, 1964
Re-issued: October 15, 2000
Amended: April 29, 2016
Last Revised: **August 16, 2019**

(Published under Appropriation 010-18F-0002-07)