



FYI Sales 10

Sales Tax Exemption on Manufacturing Equipment

GENERAL INFORMATION

Purchases of machinery or machine tools and parts thereof are exempt from state sales and use tax when the machinery will be used in manufacturing. [§39-26-709, C.R.S].

To qualify the machinery must:

- Be used in Colorado,
- Be used directly and predominantly to manufacture tangible personal property for sale or profit.
- Be of a nature that would have qualified for the federal investment tax credit under the definition of section 38 property found in the Internal Revenue Code of 1954, as amended¹. This includes tangible personal property with a useful life of one year or more and limits qualifying purchases of used equipment to a maximum of \$150,000 annually²,
- Be included on a purchase order or invoice totaling more than \$500,
- Be capitalized.

Directly

Each individual component of a system is considered to act directly on the manufacture of a product if it is a constituent part of machinery that acts upon and has a positive effect on the product. Bins, racks, fixtures, tanks, pipes, and valves do not qualify as items that act directly in the manufacturing process as they simply contain and protect the product from loss. Ductwork, electrical and plumbing materials are components that precede the manufacturing process and therefore are not exempt as manufacturing machinery. Testing and transport machines qualify only if used during the actual manufacturing process.³

Direct use also includes (1) Machinery which cleans or prepares raw or prepared materials for production on the manufacturing line, after manufacturing has begun and before it has stopped; (2) machinery which performs testing of a particular product tested during the manufacturing process, or testing as a step in a continuous manufacturing line process; and (3) loader, fork lift or conveyor belt machinery integral to the manufacturing line process, moving material from inventory on the contiguous plant site, through the manufacturing line steps, and such machines moving material through the final alteration or packaging.

Predominantly

"Predominantly" means more than 50%. All non-manufacturing use will be compared to all direct manufacturing use in determining this percentage. Maintenance and repair down time is not included in the computation. If an item is used for repair, maintenance, or research and development it does not qualify as direct manufacturing use, and if these uses prevent the machine from being predominantly used in manufacturing, the machine is disqualified from this exemption.

Example: A lathe is used to repair molds and perform other miscellaneous functions 55% of the time, while it is used in manufacturing new molds 45% of the time. The lathe would not be considered to be used predominantly in manufacturing.

Machinery

"Machinery" means any apparatus consisting of interrelated parts used to produce an article of tangible personal property. The term includes both the basic unit and any adjunct or attachment necessary for the basic unit to accomplish its intended function.

Manufacturing

"Manufacturing" means the operation of producing an item of tangible personal property different from and having a distinctive name, character, or use from raw materials. Manufacturing begins at the point raw material stored at a location contiguous to the plant site is picked up to be moved directly to the first machine, and ends at the point alteration of the product is complete. Packaging can be a completion step in the manufacturing process.

PRODUCTION OF ELECTRICITY

The exemption also applies to purchases of machinery and machine tools, or parts for such machinery, used in the production of electricity in a facility for which a long-term power purchase agreement was fully executed between February 5, 2001, and November 7, 2006. The exemption for purchases of such electricity production machinery and parts applies whether the purchases are capitalized or expensed. The exemption related to such long-term power agreements is not limited to production of electricity using a renewable energy source.

Long-term power purchase agreements means an agreement for a period of at least ten years between a provider of retail electricity and one or more independent power producers. The producer(s) must agree to sell all of the production offered for sale from a particular power generation facility for a specified price over a specified term.

Specified price means a price set by a long-term power purchase agreement that is not dependent on either the cost of production or the market price of electricity. The agreement may allow for a percentage price increase over time, so long as the increase is not dependent on the cost of production or the market price of electricity.

ENTERPRISE ZONES

When machinery is used solely and exclusively in an enterprise zone, the manufacturing/machinery exemption is broader. However, the equipment that is used both within and outside an enterprise zone only qualifies for the regular statewide exemption, as does equipment used at a location prior to that location's designation as an enterprise zone. [§39-30-106(1), C.R.S.]

- Machinery used solely and exclusively in a designated enterprise zone does not have to be capitalized to qualify for the exemption.
- Materials for construction or repair of machinery or machine tools are exempt from the state sales and use tax if the machinery is used exclusively in an enterprise zone.
- Mining operations are included in the definition of manufacturing when performed in an enterprise zone. For further information, see FYI Sales 69, Enterprise Zone Exemption for Machinery and Machine Tools used in Mining.

SPECIAL CASES

Special Mobile Equipment (SME)

SMEs usually do not qualify for the manufacturing exemption because construction activity is not manufacturing. However, if the SME is used directly and predominantly in manufacturing, state and applicable local sales and use taxes will not be collected when the SME is registered at the county Motor Vehicle office and a completed Sales Tax Exemption on Purchases of Machinery and Machine Tools (DR 1191) is presented.

Leased Equipment

The manufacturing exemption also applies to all state and applicable local sales and use taxes that would normally be charged on the lease of eligible manufacturing equipment.

LOCAL TAXES

Cities, counties and special districts may or may not exempt manufacturing equipment from local sales taxes. For detailed information about local sales rates in cities and counties where the state collects the tax, see Revenue Online, www.Colorado.gov/RevenueOnline, click the Business button, and see the listing under BusinessServices. Or refer to the publication Colorado Sales/Use Tax Rates (DR 1002). The Regional Transportation District and Cultural District (RTD/CD) may impose a sales tax on machinery used in manufacturing, but may not impose a use tax on machinery used in manufacturing.⁴

CLAIMING THE EXEMPTION

Complete a copy of Sales Tax Exemption on Purchases of Machinery and Machine Tools (DR 1191). Give one copy of the completed form to the seller of the machinery and a second copy to the Department of Revenue. The exemption can only be claimed when the purchase order/invoice totals more than \$500. Combining several invoices of less than that amount to reach the \$500 threshold is not allowed unless the items purchased were originally on one purchase order that totaled more than \$500.

If a taxpayer makes more than 100 purchases each year that qualify for the exemption, the taxpayer may complete Machine Tools State Sales Tax Exemption Agreement (DR 1192) instead of preparing a DR 1191 for each purchase.

ENDNOTES

¹ Ball Corporation, v. Colorado Department of Revenue, 51 P3d 1053, (Colo. App. 2001)

The machinery exemption is available for equipment that qualifies as recovery property as provided by section 38 of the "Internal Revenue Code of 1954" as amended. [§39-26-709, C.R.S.]

² Colorado Department of Revenue, v. Cray Computer Corporation; 18 P3d 1277, (Colo. 2001)

Confirmed that the \$150,000 limitation on a purchase of used business property is consistent with the purpose and language of the enterprise zone sales tax exemption and applies to used manufacturing equipment whether used inside or outside an enterprise zone.

³ Coors Brewing Co. v. Fagan, 949 P.2d 110 (Colo. App. 1997)

See for further information regarding the scope of the machinery exemption.

⁴ Local jurisdictions such as state-collected cities, counties, and special districts may specifically choose whether to adopt the state's machinery/manufacturing exemption. Most of the local jurisdictions have not adopted the exemption. See publication DR 1002 for a list of cities and counties that have adopted the exemption. The RTD/CD has not adopted the state's machinery/manufacturing exemption. Thus, purchases of machinery used in manufacturing are not exempt from RTD/CD sales tax. However, the Colorado Court of Appeals has ruled that purchases of machinery used in manufacturing are exempt from any RTD/CD use tax. See Ball Corporation v. Colorado Dept of Revenue, 51 P3d 1053 (Colo. App. 2001).