

REQUEST LETTER

06-010

April 19, 2006

NAME
ADDRESS

COMPANY and subsidiaries (F.E.I.N. ##-#####) is investigating the Sales and use tax treatment of a purchase transaction involving tangible personal property that will have a taxable situs in your state.

We hereby request a ruling to clarify the application of your state and use tax law with respect to the transaction described below.

Transaction Background:

The equipment in questions, Ink-O-Dem (Inkjet Cartridge Refiller) will be purchased for placement in COMPANY and subsidiaries retail store locations.

Equipment, Features, and Use:

The Ink-O-Dem (the Unit) will be installed on site in our retail store locations. The Unit will be used by trained store personnel to refill customers Inkjet Cartridge's. The Unit performs the following functions during the refilling process:

- Pretests for electrical malfunctions**
- Evacuates old ink**
- Flushes/Cleans printhead**
- Replenishes ink supply**
- Performs print test**

COMPANY and subsidiaries primary business is the operation of retail drug stores, but we believe that a sales/use tax exemption may qualify based on the type and/or process use of the equipment under Manufacturing or Industrial Processing statues or other provisions existing in your laws.

We respectively request your review of the facts presented and situations described above. Also we would appreciate you furnishing is authority for your response (statute, regulation, rulings, opinions, etc.). We certainly appreciate your assistance in this matter. If you have any questions or need any additional information please call me at (###) ###-####. The response should be mailed to the undersigned at:

COMPANY
ADDRESS

Respectfully submitted,

NAME
ADDRESS

RESPONSE LETTER

October 10, 2007

NAME
ADDRESS

Re: Private Letter Ruling 06-010
Application of the manufacturing exemption to equipment used to refill printer ink cartridges.

Dear NAME,

This letter is in response to your request for tax guidance. This letter ruling is not intended as a statement of broad Tax Commission policy. It is an interpretation and application of Utah tax law as it relates to the facts presented in your request letter and the assumptions stated in the Analysis portion of this ruling letter. If the facts or assumptions are not correctly described in this letter ruling, please let me know so we can assure a more accurate response to your circumstances.

Facts

COMPANY has installed or plans to install equipment in its retail stores to test, refill, repair and sell printer ink cartridges. It identifies this equipment as an Ink-O-Dem unit. Trained store personnel will use this equipment to perform the following functions during the refilling process:

- Pretest for electrical malfunctions
- Evacuate old ink
- Flush/clean print head
- Replenish ink supply
- Perform print test

Normally, COMPANY personnel perform the above operations on a customer's ink cartridge. It is also possible that at some stage of the filling process, particularly in the testing phase, the COMPANY personnel might determine that the customer's ink cartridge is damaged or defective. When this happens, COMPANY offers an empty replacement cartridge to the customer. COMPANY then fills the replacement cartridge for the customer.

COMPANY asks for guidance on manufacturing or industrial processing statutes that might provide an exemption to sales and use tax for the purchase of equipment used to test and refill ink cartridges.

Relevant Utah Law

Utah Code Ann. § 59-12-104(14) provides for an exemption from sales tax for the purchase of certain manufacturing and industrial processing equipment. The statutory language describes both the types of equipment and purchasers qualifying for the exemption:

(a) except as provided in Subsection (14)(b), amounts paid or charged on or after July 1, 2006, for a purchase or lease by a manufacturing facility other than a cogeneration facility, for the following:

(i) machinery and equipment that:

(A) is used:

(I) for a manufacturing facility other than a manufacturing facility that is a scrap recycler described in Subsection 59-12-102(45)(b):

(Aa) in the manufacturing process; and

(Ab) to manufacture an item sold as tangible personal property; or

(II) for a manufacturing facility that is a scrap recycler described in Subsection 59-12-102(45)(b), to process an item sold as tangible personal property; and

(B) has an economic life of three or more years; and

(ii) normal operating repair or replacement parts that:

(A) have an economic life of three or more years; and

(B) are used:

(I) for a manufacturing facility in the state other than a manufacturing facility that is a scrap recycler described in Subsection 59-12-102(45)(b), in the manufacturing process; or

(II) for a manufacturing facility in the state that is a scrap recycler described in Subsection 59-12-102(45)(b), to process an item sold as tangible personal property;

(b) (i) amounts paid or charged on or after July 1, 2005, for a purchase or lease by a manufacturing facility that is a cogeneration facility placed in service on or after May 1, 2006, for the following:

(A) machinery and equipment that:

(I) is used:

(Aa) in the manufacturing process; and

(Ab) to manufacture an item sold as tangible personal property; and

(II) has an economic life of three or more years; and

(B) normal operating repair or replacement parts that:

(I) are used in the manufacturing process in a manufacturing facility in the state; and

(II) have an economic life of three or more years; and

(ii) for amounts paid or charged on or after July 1, 2005, but on or before June 30, 2006, for a purchase or lease described in Subsection (14)(b)(i), a cogeneration facility may claim the exemption allowed by Subsection (14)(b)(i) by filing for a refund:

(A) for sales and use taxes paid under this chapter on the purchase or lease payment; and

(B) in accordance with Section 59-12-110;

Although the exemption in Utah Code Ann. § 59-12-104(14) sets forth different requirements for different equipment, all exemptions under this statute share the requirement that the manufacturing equipment be purchased by a “manufacturing facility.” Utah Code defines a “manufacturing facility,” in relevant part, as “an establishment described in SIC Codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual of the federal Executive Office of the President, Office of Management and Budget.” Utah Code Ann. § 59-12-102(45).

An “establishment” is defined in Utah Administrative Code Rule R865-19S-85 (“Rule 85”), under subparagraph (1)(a), as “an economic unit of operations, that is generally at a single physical location in Utah, where qualifying manufacturing processes are performed.” Pursuant to the Standard Industrial Classification Manual (1987), activities may be treated as “separate establishments” if “(no one industry description in the classification includes such combined activities; (2) the employment in each such economic activity is significant; and (3) separate reports can be prepared on the number of employees, their wages and salaries, sales or receipts, and other types of establishment data.”

Rule 85(4) further states that:

Where manufacturing activities and nonmanufacturing activities are performed at a single physical location, machinery and equipment purchased for use in the manufacturing operation are eligible for the sales and use tax exemption if the manufacturing operation constitutes a separate and distinct manufacturing establishment.

(a) Each activity is treated as a separate and distinct establishment if:

(i) no single SIC code includes those activities combined; or

(ii) each activity comprises a separate legal entity.

(b) Machinery and equipment used in both manufacturing activities and nonmanufacturing activities qualify for the exemption only if the machinery and equipment are primarily used in manufacturing activities.

Analysis and Ruling

Applying Utah’s exemption for manufacturing equipment to the facts of COMPANY proposed equipment purchase, the Commission first considers whether a facility refilling ink cartridges can be considered a “manufacturing facility.” As you have explained the proposed ink cartridge operation, the cartridge refilling would take place within COMPANY retail stores. In order to qualify as a manufacturing facility, COMPANY would have to meet the requirements for an establishment identified under a SIC Code between 2000 and 3999. Clearly, COMPANY as a single establishment does not meet this criteria.

Nonetheless, we recognize that Utah Administrative Rule R865-19S-85(4) allows manufacturing operations and nonmanufacturing activities at the same location. However, the manufacturing activities have to constitute a “separate establishment” or be conducted by a “separate legal entity” to qualify for manufacturing exemptions. Consequently, before making a determination, as to whether the cartridge refilling qualifies as a manufacturing process or activity, we must determine whether those operations constitute a separate establishment. Based on the facts you have provided, we conclude that the cartridge refilling operations do not rise to the level of a separate economic unit. Rather, it appears that the operation is just one of many services provided by the retail stores. Nor are they conducted by a separate legal entity. Thus, they do not constitute a separate establishment within the meaning of the statute and the rule.

Because the facility does not constitute a manufacturing establishment, we need not address whether or not the cartridge refilling process is a manufacturing operation as defined under Utah law. We will, however offer our general view on the actual process in the hope that it may offer some clarification. To begin, we will describe what we believe to be a true manufacturing operation. That would be the production of the original cartridge. In that case we assume raw materials and parts are assembled to

“manufacture an item sold as tangible personal property,” i.e. the printer cartridge. To the extent that this process took place in a manufacturing facility, the equipment used to manufacture the cartridge, including any ink injection equipment, would qualify for the exemption. Your situation, in contrast, does not correspond to such a process. Rather it appears to be a situation where an already manufactured product, the cartridge, which no longer functions because of the lack of ink. As we stated in another letter to you, PLR 06-006, the process of replacing the ink appears to us to be more of a repair or renovation of a cartridge. Therefore it is unlikely that, even if the Ink-O-Dem were used in a manufacturing establishment, we would consider the process would qualify as a manufacturing process, unless it were incorporated into a larger printer cartridge production operation.

Conclusion

Equipment purchased to refill ink cartridges in COMPANY will not qualify for any applicable exemptions to Utah sales tax for manufacturing equipment. If you wish to address these or other Utah tax concerns further, please do not hesitate to contact us.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/CDJ
06-010