

FINANCE AND ADMINISTRATION CABINET
Department of Revenue
(Amendment)

103 KAR 30:120. Machinery for new and expanded industry.

RELATES TO: KRS 139.010, 139.480, 241.010, 243.030, 243.040

STATUTORY AUTHORITY: KRS 131.130(1)

NECESSITY, FUNCTION, AND CONFORMITY: KRS 131.130(1) authorizes the Department of Revenue to promulgate administrative regulations for the administration and enforcement of Kentucky tax laws. This administrative regulation interprets ~~[To interpret]~~ the sales and use tax law as it applies to exemption qualification for "machinery for new and expanded industry."

Section 1. Definitions. (1) "Directly used in the manufacturing or industrial processing process" is defined by KRS 139.010(12).

(2) "Industrial processing" is defined by KRS 139.010(17).

(3) "License" is defined by KRS 241.010(34).

(4) "Machinery" means machines, in general, or collectively; also, the working parts of a machine, engine, or instrument; as, the machinery of a watch. (Webster's New International Dictionary). This definition does not specify that machinery must have working parts and be able to perform a function in and of itself, as a "machine" would. The machinery of a manufacturing operation is composed of all the components making up the process, including the fixed and nonmoving parts as well as the moving parts. This is illustrated in the example of the machinery of a watch.

(5) "Machinery for new and expanded industry" is defined by KRS 139.010(19).

(6) "Manufacturing" is defined by KRS 139.010(20).

(7) "Plant facility" is defined by KRS 139.010(28).

(8) "Premises" is defined by KRS 241.010(44).

(9) "Recycled materials" is defined by KRS 139.010(31).

Section 2. Requirements for Exemption. The machinery and the appurtenant equipment necessary to the completed installation of such machinery, together with the materials directly used in the installation of such machinery and appurtenant equipment, which are incorporated for the first time into new or existing plant facilities or licensed premises as provided in KRS 139.010(19), or which are installed in the place of existing ~~[plant]~~ machinery having a lesser productive capacity, and which are directly used in a manufacturing or industrial processing ~~[processing production]~~ operation shall be exempt from the sales and use tax. ~~[The term "processing production" shall include: the processing and packaging of raw materials, in-process materials, and finished products; the processing and packaging of farm and dairy products for sale; and the extraction of minerals, ores, coal, clay, stone and natural gas.]~~ In summary, the following four (4) specific requirements must be met before machinery qualifies for exemption:

(1) It must be machinery.

(2) It must be used directly in the manufacturing or industrial processing process.

(3) It must be incorporated for the first time into:

(a) ~~Plant [plant]~~ facilities established in this state; or

(b) The premises of alcohol beverage producers in this state that include a retail establishment licensed under KRS 243.030 or KRS 243.040.

(4) It must not replace other machinery.

Section 3.~~[2.]~~ Analysis of Requirements. (1) It must be machinery. [~~The term "machinery" shall mean: machines, in general, or collectively; also, the working parts of a machine, engine, or instrument; as, the machinery of a watch. (Webster's New International Dictionary). This definition does not specify that machinery must have working parts and be able to perform a function in and of itself, as a "machine" would. The machinery of a manufacturing operation is composed of all the components making up the process, including the fixed and nonmoving parts as well as the moving parts. This is illustrated in the example of the machinery of a watch.]~~

(2) It must be used directly in the manufacturing or industrial processing process. Machinery must be intimately involved in production in order to be considered used "directly" in the manufacturing or industrial processing process. The fact that machinery is necessary for a manufacturing or industrial processing process ~~shall~~ ~~[does]~~ not automatically qualify it for exemption. A single manufacturer may, within its ~~[his]~~ primary manufacturing process, have more than one (1) production activity.

(a) Primary manufacturing process.

1. The primary manufacturing process is the production operation resulting in a finished product which will be transferred from the producing plant for distribution to customers or for further processing at another plant site. Production begins at a point where the raw material enters a process and is acted upon to change its size, shape, or composition or is transformed in some manner. Production ends when the finished goods are packaged or ready for sale. Packaging is considered complete when the product is in the container in which it is normally received by the purchaser.

2. All activities preceding the point of introduction of the raw material into the manufacturing process and following the point at which the finished product is packaged or ready for sale are not production activities and the machinery used therein shall be ~~[is]~~ subject to tax.

3. Storage facilities, including those provided for the storage of in-process materials which have been removed from the production line to await further processing, are not used directly in the manufacturing process and shall be ~~[are]~~ subject to tax. Proximity of storage facilities to the production line is immaterial.

(b) Contributory or secondary manufacturing process. This activity generally falls into one (1) of four (4) categories:

1. The manufacture of industrial tools to be used in the manufacturing process. Examples include the manufacture of dies, patterns, rolls, molds, cutters and cutter blades, and like property. The exemption for machinery used shall be ~~[herein is]~~ determined by the same criteria used for determining the exemption provided in the primary manufacturing process.

2. The processing of materials which do not become an ingredient of the finished product but are consumed as industrial supplies directly in the primary manufacturing process. Examples include water cooling systems, bottle washing preparatory to filling, and chemical processes whereby the chemical is used as a catalyst directly on the product being manufactured. This machinery exemption begins at the point where the material is acted upon to condition it for use in the manufacturing process or at the point where it performs a function itself, if it is not acted upon prior to that point. The exemption ends when the material leaves the process.

3. Electrical machinery and similar equipment used directly in the operation of other machinery which is used directly in the manufacturing process.

4. Machinery used exclusively for quality control of in-process material or the efficient operation of machinery. Examples are air cooling or air conditioning systems, control panels, exhaust systems, and similar activities.

(3) It must be incorporated for the first time into plant facilities or licensed premises estab-

lished in this state. To meet this requirement, the machinery must be installed in this state for the first time and it must be incorporated into plant facilities or licensed premises in this state. Machinery which has been once installed into manufacturing facilities or licensed premises in this state may be subject to tax ~~[as provided in 103 KAR 30:200]~~ when subsequently sold by that manufacturer. Machinery purchased and delivered in Kentucky shall be [is-]subject to tax when the machinery is not acquired for installation in Kentucky.

(4) It must not replace other machinery. New machinery purchased to replace other machinery in the plant or licensed premises shall be [is-]subject to tax unless the new machinery increases the consumption of recycled materials at the plant facility or licensed premises by not less than ten percent (10%), performs a different function, manufactures a different product, or has a greater productive capacity, measured by units of production, than the machinery replaced.

(a) Modification of existing machinery may qualify for exemption if the modification is to perform a different function or manufacture a different product [qualifies for exemption]. Modification of existing machinery is not replacement machinery but maintenance of existing machinery; therefore, modifications that merely provide a greater productive capacity as measured by units of production shall not qualify for exemption.

(b) Modification of existing machinery that results in automation of non-automated functions without performance of a different function or manufacture of a different product shall not qualify for exemption.

Section 4. Pursuant to KRS 139.470(22), charges for labor or services to apply, install, repair, or maintain tangible personal property directly used in manufacturing or industrial processing process shall not be subject to sales and use tax if the charges for labor or services are separately stated. Purchasers may issue a fully completed "Certificate of Exemption Labor or Services on Manufacturing Equipment," Form 51A360, or "Streamlined Sales and Use Tax Agreement—Certificate of Exemption," Revenue Form 51A206, to claim the applicable exemption for the labor or service charges on tangible personal property directly used in the manufacturing or industrial processing process.

Section ~~5~~[3]. In all cases where a question arises concerning the exemption of machinery for new and expanded industry, the burden of proof that each qualification has been met is upon the one seeking the exemption.

Section 6. Forms. The forms referenced herein may be inspected, copied, or obtained, subject to applicable copyright law, at:

(1) The Kentucky Department of Revenue, 501 High Street, Frankfort, Kentucky 40601;

(2) A Kentucky Taxpayer Service Center, Monday through Friday, 8:00 a.m. to 4:30 p.m.; or

(3) The Department or Revenue Web site at <http://revenue.ky.gov>.

THOMAS B. MILLER, Commissioner

APPROVED BY AGENCY: July 13, 2021

FILED WITH LRC: July 13, 2021 at 1:16 p.m.

PUBLIC HEARING AND PUBLIC COMMENT PERIOD: A public hearing on this administrative regulation shall be held on September 22, 2021, at 10:00 a.m. in Room 11A, State Office Building, 501 High Street, Frankfort, Kentucky 40601. The hearing may be conducted by video teleconference at the discretion of the agency. An individual interested in being heard at this hearing shall provide written notification to the agency of the intention to attend the hearing at least five (5) business days prior to the date scheduled for the hearing.. If no notification of in-

tent to attend the hearing is received by that date, the hearing will be cancelled. The hearing is open to the public. Any person who wishes to be heard will be given an opportunity to comment on the proposed administrative regulation. A transcript of the public hearing will not be made unless a written request for a transcript is made. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments shall be accepted through September 30, 2021. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

CONTACT PERSON: Gary Morris, Executive Director, Office of Tax Policy and Regulation, Department of Revenue, 501 High Street, Station 1, Frankfort, Kentucky 40601, phone (502) 564-0424, fax (502) 564-3875, email Gary.Morris@ky.gov.

REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Contact Person: Gary Morris

(1) Provide a brief summary of:

(a) What this administrative regulation does: This administrative regulation is an amendment that updates regulatory language to conform to recent statutory language revisions, clarifies previous guidance, and updates the regulation regarding the tax treatment for machinery eligible for the machinery for new and expanded industry exemption from sales and use tax.

(b) The necessity of this administrative regulation: The amendment is necessary to update outdated regulatory language; to clarify the guidance previously contained in the regulation; to specify treatment of certain labor charges; and to update the regulation regarding the tax treatment for machinery eligible for the machinery for new and expanded industry exemption from sales and use tax.

(c) How this administrative regulation conforms to the content of the authorizing statutes: The proposed amendment updates regulatory language to conform to KRS 131.130 and KRS 131.110.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: The proposed amendment updates regulatory language to address outdated information currently contained in the regulation.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: The amendment will change this existing administrative regulation to reflect recent legislative changes by updating the regulation regarding the tax treatment for machinery installed in the licensed premises of alcoholic beverage producers with retail establishments, the tax treatment of certain labor charges for repair and installation, and clarifies the previous guidance provided.

(b) The necessity of the amendment to this administrative regulation: See (1)(b).

(c) How the amendment conforms to the content of the authorizing statutes: See (1)(c).

(d) How the amendment will assist in the effective administration of the statutes: See (1)(d).

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: All individuals, businesses, and organizations involved in manufacturing and industrial processing that are eligible for the sales and use tax exemptions related to machinery for new and expanded industry.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have to

take to comply with this administrative regulation or amendment: The taxpayer will need to submit applicable exemption certificates to suppliers when claiming the machinery for new and expanded industry exemption, or an exemption for labor or service charges on the repair of such machinery.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3): There is no cost associated with executing the applicable exemption certificates. In fact, clear regulatory guidance should reduce any taxpayer compliance costs.

(c) As a result of compliance, what benefits will accrue to the entities identified in question (3): Taxpayers will benefit from the updated guidance to help them stay in good standing with the Department of Revenue.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially: There is no expected cost to implement the proposed amendment. Current staff and budgeted funding will absorb the implementation of this administrative regulation.

(b) On a continuing basis: There is no cost expected on a continual basis.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: Current departmental staff and funding will be used to implement and enforce this proposed amendment.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment: No additional funding or increase in fees is needed.

(8) State whether or not this administrative regulation established any fees or directly or indirectly increased any fees: No fees are directly or indirectly established or increased by the proposed amendment.

(9) TIERING: Is tiering applied? Tiering is not applicable as the proposed amended regulation will be applied equally to all entities impacted by it.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

1. What units, parts or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation? The Finance and Administration Cabinet, Department of Revenue is the only government entity impacted by this amendment.

2. Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. KRS 131.130 and KRS 131.131.

3. Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? None. The amended regulatory language addresses exemptions from sales and use tax. However, clear regulatory language helps ensure exemptions are properly handled so that the proper amount of tax is paid on transactions not eligible for the exemptions.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years? None. However, clear regulatory language helps ensure exemptions are properly handled so that the proper amount of tax is paid on transactions not eligible for the exemptions.

(c) How much will it cost to administer this program for the first year? No additional costs will

be incurred in the first year of this regulation being in effect. All costs will be absorbed by the current department budget.

(d) How much will it cost to administer this program for subsequent years? No additional costs will be incurred in subsequent years.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

Revenues (+/-): + See 3(a) for explanation.

Expenditures (+/-): None.

Other Explanation: