

## ***PA Tax Tips***

### ***PA OFFERS MANY PRODUCTION-BASED EXEMPTIONS***

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Production-based tax exemptions have saved Pennsylvania businesses billions of dollars. These exemptions are known by various names, including "manufacturing," "processing," "printing," "mining," "R&D," "agriculture" and "industrial establishment." The taxes to which these exemptions apply are the Sales & Use Tax, the Capital Stock and Franchise Taxes, local Business Privilege Taxes and local Real Estate Taxes. The same term may have a different meaning for different taxes. The taxes have very different rules for exemption. To assist you in ascertaining whether your company is taking full advantage of these exemptions, this article will provide a broad overview of the available exemptions and future articles in this newsletter will discuss various aspects of the exemptions in more detail.

#### **Sales & Use Tax - A Plethora of Exemptions**

Pennsylvania's Sales and Use Tax offers a long list of exclusions and exemptions to companies engaged in production activities. Under the statutory category of "manufacture" the Legislature has excluded the direct and predominant use of various services and tangible personal property (including machinery, equipment and supplies) in:

- Manufacturing
- Fabricating
- Compounding
- Processing
- "Other operations" changing the form, composition or character of tangible personal property

"Manufacture" explicitly includes but is not limited to:

- Publishing Books, Newspapers, Magazines and other periodicals
- Printing
- Refining, Blasting, Exploring, Mining, or Quarrying or otherwise extracting natural resources, minerals and mineral aggregates
- Building, Rebuilding, Repairing, etc. of large vessels
- Conducting R&D
- Remanufacturing motor vehicle parts
- Remanufacturing aircraft, armored vehicles, etc.
- Remanufacturing locomotive parts

The following production activities also provide a basis for exclusion:

- Farming, Dairying or otherwise engaging in Agriculture, Horticulture or Floriculture
- Producing, delivering or rendering of a Public Utility Service
- Constructing, Reconstructing, Remodeling, Repairing or Maintaining Public Utility Facilities

In addition, the Legislature has established a sales and use tax exclusion category called "Processing," which includes a number of somewhat narrowly proscribed activities, many of which were added after tax auditors challenged their qualification under "manufacturing" or other more broadly-defined exclusions:

1. Filtering or heating Honey and packaging for wholesale distribution
2. Cooking, Baking or Freezing of Fruits, Vegetables, Mushrooms, Fish, Seafood, Meats, Poultry or Bakery Products and packaging for wholesale distribution
3. Cleaning, Cutting, Coring, Peeling or Chopping and treating, Fruits or Vegetables and sealing for wholesale distribution.
4. Scouring, Carbonizing, Cording, Combing, Throwing, Twisting or Winding Fibers
5. Spinning, Bleaching, Dyeing, Printing or Finishing of Yarns or Fabrics
6. Electroplating, Galvanizing, Enameling, Anodizing, Coloring, Finishing, Impregnating or Heat Treating of Metals or Plastics
7. Blanking, Shearing, Leveling, Slitting or Burning of Metals for sale to a manufacturer or processor
8. Rolling, Drawing or Extruding Ferrous and Non-ferrous Metals
9. Fabrication of Ornamental or Structural Metal (other than at construction site)
10. Preparation of Animal Feed or Poultry Feed for sale
11. Production, Processing and Bottling Non-alcoholic beverages for wholesale distribution
12. Operating a Saw Mill or Planing Mill
13. Milling Flour or Meal from Grains
14. Aging, Stripping, Conditioning, Crushing and Blending Tobacco
15. Slaughtering and Dressing of Animals for sale as meat
16. Preparing Meat Products for wholesale distribution
17. Processing of Use Lubricating Oils
18. Broadcasting of Radio and Television
19. Cooking or Baking of Bread, Pastries, Cakes, Cookies, Muffins or Donuts for sale (except at restaurant)
20. Cleaning and Roasting, and Blending, Grinding or packaging for sale of Coffee or the Production of Coffee Extract
21. Preparing Dry or Liquid Fertilizer for Sale
22. Producing, Processing and Packaging of Ice for wholesale distribution
23. Producing Mobile Telecommunication Services

#### **Franchise Tax - A Shorter List**

Although the Capital Stock Tax and the Franchise Tax are being phased-out, some companies still pay large amounts of tax. However, companies engaged in "manufacturing, processing, research or development" may lawfully avoid all or a significant proportion of the tax.

As under the Sales and Use Tax, the General Assembly also has statutorily established a "Processing" category including many activities. With some slight variations, these include the activities listed as numbers 1-17 and 20-22 under the above discussion of the Sales and Use Tax "processing" exclusion. In addition, for Capital Stock Tax and Franchise Tax purposes, "Processing" has been defined to include:

- Publishing of books, newspapers, magazines or other periodicals

- Blending, rectification, distillation or other production of alcohol or alcoholic liquors
- Salvaging, recycling or reclaiming of used materials to be recycled into a manufacturing process
- Development or substantial modification of computer software for sales to unrelated persons
- Refining, blasting, exploring, mining and quarrying or otherwise extracting limestone, sand, gravel or slag
- Cleaning, crushing, grinding, pulverizing, sizing or screening of limestone

#### **Local Business Privilege Taxes - Manufacturing, etc.**

The Local Tax Enabling Act provides broad taxing authority to municipalities and school districts outside of Philadelphia. However, the Act also provides fairly broad production-based exclusions limiting local business privilege and mercantile taxes levied on gross receipts.

Tax may not be collected on receipts from:

- Goods and articles manufactured in the political subdivision
- By-products of manufacture
- Minerals, timber and other natural resources produced in the political subdivision
- Farm products produced in the political subdivision
- Preparation or processing of minerals, timber, natural resources or farm products for use or market
- "Any privilege, act or transaction related to" the business of manufacturing, or to the production, preparation or processing of minerals, timber, natural resources or farm products

These exemptions may be claimed only by manufacturers, producers and farmers with respect to their own products.

The Act also exempts receipts from:

- Any privilege, act or transaction relating to the processing of manufacturing by-products
- Transportation, loading, unloading or dumping or storage of goods, articles, products or by-products listed above

#### **Real Property Tax - Industrial Establishments**

In Pennsylvania, *ad valorem* taxes are levied on real property by counties, school districts and municipalities. Exemptions, however, are governed by state law. These include:

- "Machinery, tools, appliances and other equipment" contained in any "mill, mine, manufactory or industrial establishment"
- Farm silos used for processing or storage of animal feed
- Farm grain bins or corn cribs used for processing or storage of animal feed
- Structures and containments used predominantly for processing and storage of animal waste
- Composting facilities incidental to farm operation
- Wind turbine generators and related appliances and equipment (including towers and foundations)

#### **Not on the Exemption List?**

If you did not see an exemption category that applies to your business, but you think your business is just as worthy of exemption as many of the enumerated categories, what do you do? First, you should make sure your business really doesn't qualify for an existing exemption. The exemption terminology is not always straightforward and the interpretation of it is not

always intuitive - we can assist you with these issues.

Second, if your company really does not qualify you may want to consider seeking a statutory amendment to exempt your type of activity. Again, we can advise you on the issues and hurdles one faces in seeking such exemptions. We have assisted a number of taxpayers in such efforts.

**Qualify But Haven't Been Claiming Exemption?**

If you think your business might qualify for exemption but hasn't been claiming exemption, a refund claim may be in order. We can assist you in verifying your entitlement to exemption and can help you to document and file your refund claim.

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