



## North Carolina Department of Revenue

Roy Cooper  
Governor

Ronald G. Penny  
Acting Secretary

January 10, 2017

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

Re: Private Letter Ruling

Taxpayer: [REDACTED]

Taxpayer's FEIN: [REDACTED]

Dear Ms. [REDACTED]

The Department has completed its review of the Form NC-PLR, Request for Private Letter Ruling; letter and attachments thereto postmarked March 31, 2016 for [REDACTED] ("Taxpayer"); and the letter from your firm dated October 12, 2016.

This private letter ruling is a written determination issued under N.C. Gen. Stat. § 105-264.2 and applies the tax law to a specific set of existing facts furnished by Taxpayer's representative on behalf of Taxpayer. This written determination is applicable only to the taxpayer addressed herein and as such has no precedential value except to the taxpayer to whom the determination is issued on behalf of the Department. Pursuant to N.C. Gen. Stat. § 105-264, "[i]t is the duty of the Secretary to interpret all laws administered by the Secretary. . . . An interpretation by the Secretary is prima facie correct."

### **Overview and Relevant Facts**

You state that "[Taxpayer] and its affiliates, collectively, produce and export [REDACTED] biomass fuels to domestic and foreign industrial scale customers seeking to reduce their reliance on fossil fuels. [Taxpayer] is. . . [a] manufacturer of processed biomass fuels in the form of 100% [REDACTED] [REDACTED] with production facilities located in [REDACTED], [REDACTED], [REDACTED] and [REDACTED] which have an annual production capacity of approximately [REDACTED] metric tons of fuel [REDACTED]."

"[Taxpayer] is currently constructing a production facility in [REDACTED] County, North Carolina, ([REDACTED] facility)' which is expected to produce roughly [REDACTED] metric tons of [REDACTED] [REDACTED] per year. The [REDACTED] facility resembles a more traditional mill or manufacturing plant, starting with the handling and storage of raw materials (the biomass) on the plant site, the movement of those raw materials into actual production using cranes, conveyers, and material handling equipment, the continuation of the process through the various stages of production, including the stripping





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“Once the ██████ are reduced to the appropriate size, they are transferred from the dry ██████ by a conveyor to the dry storage silo. Once again the conveyor system is used in delivering the ██████ to the next stage in which it [sic] awaits further processing. . .”

“[T]he ██████ in the dry storage silo are conveyed to material ripening bins and then to the ██████ mill island which presses the ██████ through dies at high pressures and temperature.” Taxpayer states “[t]he ripening bin helps homogenize the ██████ prior to the ██████ process by mixing the ██████ that may be of different moisture levels. The mixing process ensures that wetter ██████ are mixed with dryer ██████ to ensure acceptable moisture levels are present in the lot as a whole. Upon being metered in the material ripening bin located above the ██████ mill, the materials are fed directly from the bin into a chute located at the top of the ██████ mill.

“The ██████ mill island is where the ██████ are formed. . . . The ██████ press uses high temperature and pressure to plasticize the chemical compound within the ██████ such that the extruded product will maintain a ██████ form. Once extruded, it is critical that the in-process products be cooled, in order to ensure that the plasticization process holds and to reduce breakage. The cooling process begins on the extrusion machinery but the ██████ are then transferred by gravity-fed hoppers and outbound conveyers to cooling chambers where the ██████ can continue to slowly cool in a moisture-controlled environment. Following the cooling process any non-████████ material is separated from the ██████ by vibrating screens.”

“Once screened, the ██████ are transferred via conveyors to storage silos. From there, the ██████ are loaded into bottom dump trailers or for delivery to the port. . .”

“The dry storage silo is classified as a building, using a straight line, 39 years under the Modified Accelerated Cost Recovery System for income tax reporting purposes.”

You further advise, “[t]he *cranes and front loading equipment* are exclusively used for both moving raw materials from the incoming delivery trucks into stockpiles, as well as moving the raw materials into the production process. The *cranes and front loading equipment* are used in the same proportion for both. Accordingly, [Taxpayer] proposes to prorate the tax for the *cranes and front loading equipment* by fifty percent, since half of their usage will not likely qualify for the mill machinery reduced rate.”

### Issue

Do Taxpayer’s purchases of machinery and equipment qualify as eligible purchases of machinery or equipment pursuant to N.C. Gen. Stat. § 105-187.51 on which a one percent (1.00%) privilege tax is imposed, with a maximum tax of eighty dollars (\$80.00) per article? You advise, “[Taxpayer] understand[s] machinery and equipment used to move raw materials within the stockpile or from delivery to the stockpiles generally do not qualify for the mill machinery exemption. Therefore, the only machinery and equipment included in the letter ruling request include equipment used in the production process at the ██████ facility, beginning with equipment used to move the raw materials from inventory into production and ending once the ██████ are conveyed to the finished silos.”

“To the extent that any items of equipment are dual use, i.e., used in activities qualifying for the mill machinery rate as well as activities that do not . . . we would appreciate advice on how specifically the mill machinery and retail sales and use taxes should be prorated.”

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### Applicable Statutes and References

Under Article 5F of the North Carolina Revenue Act (“Act”)<sup>1</sup>, N.C. Gen. Stat. § 105-187.50 *et. seq.*, a privilege tax is imposed on certain industries that purchase machinery or equipment that meet certain requirements. The privilege tax rate is one percent (1.00%) of the purchase price of the eligible machinery, equipment, or other personal property purchased, with a maximum of eighty dollars (\$80.00) per article. *Id.* Specifically, N.C. Gen. Stat. § 105-187.51(a)(1) provides a privilege tax is imposed on “[a] manufacturing industry or plant that purchases mill machinery or mill machinery parts or accessories for storage, use, or consumption in this State.”

The 1% privilege tax rate set forth in Article 5F is a lesser tax rate than the generally applicable rate of sales tax set forth in N.C. Gen. Stat. § 105-164.4. For this reason, Article 5F constitutes a partial exemption from taxation and must therefore be strictly construed against the claim of partial exemption and in favor of the imposition of the higher rate of tax. *Hatteras Yacht Co. v. High*, 265 N.C. 653, 144 S.E.2d 821 (1965). A taxpayer bears the burden of establishing it is eligible for the partial exemption and entitled to remit at the 1% privilege tax rate. *Piedmont Canteen Service, Inc. v. Johnson*, 256 N.C. 155, 123 S.E. 2d 582 (1962) (one who claims an exemption from tax has the burden of bringing itself within the exemption).

Published for the purpose of presenting the administrative interpretation and application of the Act, the Department’s administrative rules and Sales and Use Tax Technical Bulletins are considered “prima facie correct.” *Id.* The following administrative rule and Sales and Use Tax Bulletin are applicable to the classification of manufacturing activities for the application of the 1% privilege tax rate:

17 North Carolina Administrative Code (“NCAC”) 07D .0102

*(a) For the purposes of administering the privilege tax, the following classifications are based on the three principal activities of manufacturers and industrial processors and shall be followed by manufacturers purchasing tangible personal property which is used or consumed in different phases of the operation of an industrial plant:*

- (1) Production as a phase of industrial or manufacturing operations shall mean all steps performed in processing and refining rooms, and in other quarters and departments of a plant, where conditioning, treating or other operations are done on ingredient materials as an actual routine on a processing or assembly line turning out a finished product of manufacture. It shall also include the movement of raw materials or ingredients from an inventory or a stockpile located on the premises of the manufacturing facility to the assembly or processing line, the movement of goods in process along the processing line and the movement of manufactured products from the assembly or processing line into shipping or storage areas and yards located on the premises of the manufacturing facility. Purchases by a manufacturing industry or plant of machinery, and parts and accessories therefore for use in production, as defined above, are classified as mill machinery and mill machinery parts and accessories. The term production shall also mean the work of experimentation and research performed on the manufactured products. Purchases by a manufacturing industry or plant of research and development equipment and supplies for quality*

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<sup>1</sup> References to the Act and North Carolina General Statutes are based on the laws in effect as of the date of issuance of this private letter ruling.

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- control or the improvement of its manufactured products or for the development of products which it will manufacture are classified as mill machinery and mill machinery parts and accessories. Items which are not classified as mill machinery and mill machinery parts and accessories when purchased by manufacturing industries and plants for use in their research and development areas include such items as desks, calculators, personal computers and chairs and are subject to the applicable statutory state and local sales or use tax. Production does not include any activity connected with the movement of raw materials or ingredients into inventory nor does it include distribution as defined in Subparagraph (a)(2) of this Rule. Sales to manufacturing industries and plants of machinery, parts and accessories to such machinery, or other items of tangible personal property which are used in the movement of raw materials or ingredients into inventory or in distribution activities as defined or which are used for other similar purposes are subject to the applicable statutory state and local sales or use tax.*
- (2) *Distribution with reference to industrial and manufacturing plants shall mean any activity connected with the movement of manufactured products within storage warehouses, shipping rooms and other such finished products storage areas and the removal of such products there from for sale or shipment. Sales of distribution equipment to manufacturing industries and plants are subject to the applicable statutory state and local sales or use tax.*
- (3) *Administration with reference to industrial and manufacturing plants shall mean and include the administrative work of offices, promotion of sales and collection of accounts. Sales of administrative equipment, such as office equipment of all kinds, stationery and related articles such as pens, pencils, rubber stamps, paper cutters, printed forms, books of accounts and records, file cabinets, small tools*
- (b) . . . *Persons purchasing articles subject to the eighty dollars (\$80.00) maximum tax shall not treat as one article two or more articles which, when joined together, make a functional unit or several components of machinery or equipment purchased from the same or different vendors which may be assembled by the purchaser into a single article. . . .*

See also North Carolina Sales and Use Tax Technical Bulletins, Section 57-1 Classification of Activities of Manufacturing and Industrial Processing.

17 NCAC 07D .0104

*Purchases of tangible personal property by a manufacturer for use in its business are subject to either the sales or use tax or privilege tax.*

17 NCAC 07D .0202

*The following items are not considered mill machinery or mill machinery parts and accessories to manufacturing industries and plants and are therefore subject to the applicable statutory state and local sales or use tax:*

- (1) *tangible personal property attached to or in any way a part of any building or structure of any kind whatsoever; freight elevators; plumbing and sprinkler systems; electric wiring and electric fixtures; electric lamps and tubes; and fuses and fuse links. Electrical equipment, including control panels, or wiring and related conduit affixed to mill machinery to furnish power to mill machinery and equipment, is classified as an accessory to such machinery and is therefore subject to the one percent privilege tax with a maximum tax of eighty dollars (\$80.00) per article. However, electrical equipment or*

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*wiring and related conduit which is used for general distribution of power to or in a manufacturing industry or plant is subject to the applicable statutory state and local sales or use tax...*

See also North Carolina Sales and Use Tax Technical Bulletins, Section 58-1 D. Items Not Mill Machinery.

Under Article 5 (“Article”) of the North Carolina Revenue Act (“Act”), N.C. Gen. Stat. § 105-164.1 *et. seq.*, Subchapter VIII: Local Government Sales and Use Tax, and Chapter 1096 of the 1967 Session Laws, State, local, and applicable transit sales and use taxes are imposed on a retailer engaged in business in the State on the retailer’s net taxable sales or gross receipts of tangible personal property, certain digital property, and certain services at the percentage rates listed in subdivision N.C. Gen. Stat. § 105-164.4(a). N.C. Gen. Stat. §§ 105-164.3(24), 105-164.3(35), 105-164.3(46), 105-164.4, 105-164.8, 105-467, 105-468, 105-483, 105-498, 105-507.2, 105-509.1, and 105-537.

N.C. Gen. Stat. § 105-164.6(a) provides that an excise tax at the applicable rate set in N.C. Gen. Stat. § 105-164.4 is imposed on the purchase price of “tangible personal property or digital property purchased, leased, or rented inside or outside [the] State for storage, use, or consumption in [the] State.” N.C. Gen. Stat. §§ 105-164.3(14), 105-164.3(32), 105-164.3(33), 105-164.3(44), 105-164.3(49), and 105-164.6. “Purchase price” “has the same meaning as the term ‘sales price’ when applied to an item subject to use tax.” N.C. Gen. Stat. § 105-164.3(33). “Sales price” is defined, in part, as “[t]he total amount or consideration for which tangible personal property, digital property, or services are sold, leased or rented.” N.C. Gen. Stat. § 105-164.3(37). The “person who purchases, leases or rents tangible personal property” is liable for payment of the use tax. “If the property purchased becomes a part of a building or other structure in the State and the purchaser is a contractor or subcontractor, the contractor, the subcontractor, and the owner of the building are jointly and severally liable for the tax. The liability of a contractor, a subcontractor, or an owner who did not purchase the property is satisfied by receipt of an affidavit from the purchaser certifying that the tax has been paid.” *Id.*

N.C. Gen. Stat. §105-164.13(5a) provides an exemption from the sales and use tax imposed by Article 5 of the Act for the sale at retail and the use, storage, or consumption in this State of products that are subject to tax under Article 5F of the Act.

### **Ruling**

The Sales and Use tax statutes provide no definition for the term “manufacture,” therefore the Department is guided by North Carolina State court decisions. From *Duke Power Co. v. Clayton, Comr. Of Revenue*, 274 N.C. S.E.2d 289, 295, “[t]he word manufacture ‘is not susceptible of an accurate definition that is all-embracing or all-exclusive, but is susceptible of many applications and many meanings. \* \* \* In its generic sense, ‘manufacturing’ has been defined as the producing of a new article of use or ornament by the application of skill and labor to the raw materials of which it is composed.’ 55 C.J.S. Manufactures § 1 at pp. 667 and 670 (1948). Accord, *Bleacheries Co. v. Johnson, Comm’r of Revenue*, supra, 266 N.C. at 695-696, 147 S.E.2d at 179; *City of Louisville v. Ewing Vol-Allmen Dairy Co.*, 268 Ky. 652, 105 S.W.2d 801 (1937). ‘To make an article manufactured, the application of the labor must result in a new and different article with a distinctive name, character, or use. *Inhabitants of Leeds v. Maine Crushed Rock &*

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*Gravel Co.*, 127 Me. 51, 56, 141 A. 73, 75 (1928). Thus, the usual connotation of manufacturing is the making of a new product from raw or partly wrought materials."

*Master Hatcheries, Inc. v. Coble*, 286 N. C. S.E. 2d 150, (1975), states "[t]here are many holdings and statements to the effect that to constitute manufacturing, the operation, process, or activity in question must produce a new and different commodity or work a substantial change in the basic material." In *Master Hatcheries, Inc. v. Coble*, the use of complicated precision equipment is used along with the "application of skill and labor to the raw material (egg) to create a new and more valuable property (chicks)." In *Duke Power Co. v. Clayton* quoting from *Anheuser-Busch Brewing Association v. United States*, 207 U.S. 556, 28 S. Ct. 204, 52 L. Ed. 336 (1908), "[m]anufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labor, and manipulation. But something more is necessary \* \* \*. There must be transformation; a new and different article must emerge, `having a distinctive name, character, or use.' " *Id.* at 562, 28 S. Ct. at 206-207, 52 L. Ed. at 338.

Taxpayer pulverizes raw materials ([REDACTED] [REDACTED] [REDACTED] etc.) into particles and with the use of compression at high temperatures causes lignin molecules in the [REDACTED] particles to disassociate from the cellulose structure, plasticize and migrate to the surface of the [REDACTED] particles. When the [REDACTED] material cools, the lignin solidifies and transforms into a bonding agent. After solidification, a hydrophobic sheath forms that provides structural integrity to the [REDACTED]. The resulting product is a biologically-inert fuel [REDACTED] with significantly increased energy density and combustion characteristics. It is the Department's opinion that substantial changes have occurred from the processes performed by Taxpayer upon raw materials, making a new and different product, having new characteristics, for use by Taxpayer's customers. The biologically-inert fuel [REDACTED] is the "finished product of manufacture" that results from the production phase of Taxpayer's operations.

Purchases by Taxpayer of mill machinery, mill machinery parts and accessories for use in the production phase are classified as mill machinery and mill machinery parts and accessories. As such, purchases by Taxpayer of mill machinery, mill machinery parts and accessories primarily used in the production phase of industrial or manufacturing operations qualify for the 1.00% privilege tax rate with a maximum of eighty dollars (\$80.00) per article. Taxpayer is cautioned not treat as one article two or more articles which, when joined together, make a functional unit or several components of machinery or equipment purchased from the same or different vendors which may be assembled by the purchaser into a single article. Specifically, items such as conveyor sections are that may be connected are not a single article no matter that Taxpayer may identify a conveyor system as a single asset.

As discussed herein, the following items qualify as mill machinery and mill machinery parts and accessories:

- [REDACTED] drum
- [REDACTED]
- Knuckle boom hydraulic loader
- Conveyor belts from [REDACTED] [REDACTED] to secondary storage and dryer
- Furnace fuel bins
- [REDACTED] stoker grate system
- Furnace-induced draft fan
- Cyclone, baghouse, and wet electrostatic precipitators (pollution control)

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- Combustion fans
- Green [REDACTED] infeed conveyor
- Dry metering bin
- Dryer discharge
- Rotary dryer
- Dryer collection conveyor
- [REDACTED] [REDACTED] transfer conveyor (including moisture content meter)
- Dry [REDACTED] island
- Material ripening bins
- [REDACTED] [REDACTED] island (including [REDACTED] press, extrusion machinery, gravity fed hoppers, and outbound conveyors to cooling chambers)
- Cooling chambers
- Conveyor from [REDACTED] [REDACTED] island to finished good silos

Purchases by Taxpayer of machinery, parts and accessories to such machinery, or other items of tangible personal property which are not primarily used in the production phase and are used in the movement of raw materials or ingredients into inventory or in distribution activities or for other similar purposes are subject to the general 4.75% State, and the 2.25% [REDACTED] County rates of sales and use tax, currently in effect.

Purchases of the following items by Taxpayer do not qualify for the 1.00% privilege tax rate with a maximum of eighty dollars (\$80.00) per article but rather are subject to general 4.75% State and 2.25% [REDACTED] County local sales and use tax rates:

- *Dry storage silo.* – You advised, “[t]he dry storage silo is classified as a building, using a straight line, 39 years under the Modified Accelerated Cost Recovery System for income tax purposes.” Pursuant to NC AC 07D .0202 “*tangible personal property attached to or in any way a part of any building or structure of any kind whatsoever; freight elevators; plumbing and sprinkler systems; electric wiring and electric fixtures; electric lamps and tubes; and fuses and fuse links*” [emphasis added] are not considered mill machinery or mill machinery parts and accessories to manufacturing industries and plants.
- *Cranes and front loading mobile equipment* - You advised “[t]he cranes and front loading equipment are exclusively used for both moving raw materials from the incoming delivery trucks into stockpiles, as well as moving the raw materials into the production process. The cranes and front loading equipment are used in the same proportion for both.” In accordance with 17 NCAC 07D .0104 “[p]urchases of tangible personal property by a manufacturer for use in its business are subject to *either the sales or use tax or privilege tax.*” [Emphasis added.] Thus, tangible personal property purchased by a manufacturer for use regularly in production activities and non-production activities are subject to the general 4.75% State and applicable, and applicable transit rates of tax. Article 5F constitutes a partial exemption from taxation and must therefore be strictly construed against the claim of partial exemption and in favor of the imposition of the higher rate of tax. *Hatteras Yacht Co. v. High*, 265 N.C. 653, 144 S.E.2d 821 (1965). There is not a provision in the Act that affords allocation of the purchase price of a single piece of tangible personal property between two or more rates of tax. Therefore, purchases by the Taxpayer of cranes and front loading mobile equipment as

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discussed herein are subject to the general 4.75% State and 2.25% ██████████ County rates of sales and use tax in effect at this time.

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. If the facts and circumstances given are not accurate, or if they change, then the taxpayer requesting this ruling may not rely on it. If a taxpayer relies on this letter ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this letter ruling, the letter ruling will not afford the taxpayer any protection. It should be noted that this letter ruling is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Issued on behalf of the Secretary of Revenue  
By the Sales and Use Tax Division