

A “drop shipment sale” occurs when the consumer places an order for the purchase of tangible personal property with the out-of-state retailer. The retailer does not own the property ordered at the same time the consumer’s order is placed. The retailer then purchases the property from the supplier. The supplier in turn ships the property directly to the consumer in Iowa. Under Iowa law the supplier in a drop shipment sale cannot be required to collect tax (either sales or use) from the consumer, even if the requisite “nexus” to require collection exists. See the next to last paragraph of this rule for a characterization of “nexus.” The supplier transfers possession of the goods to the consumer; however, transfer of possession alone has never been held to be a “sale” for the purposes of Iowa sales and use tax law. *Sturtz v. Iowa Department of Revenue*, 373 N.W.2d 131 (Iowa 1985) and *Cedar Valley Leasing v. Iowa Department of Revenue*, 274 N.W.2d 357 (Iowa 1979).

With reference to drop shipment sales: If delivery of the goods under the contract for sale has occurred outside of Iowa, sale of the goods has occurred outside of Iowa. If delivery of the goods under the contract for sale has occurred within Iowa, the sale has occurred here. See *Sturtz* above for more information regarding sales and delivery. If the sale has occurred in Iowa and the retailer possesses the requisite nexus to require it to collect Iowa tax, the retailer is obligated to collect Iowa sales tax upon the “gross receipts” from its sale of the goods to the consumer. If the sale has occurred outside this state, and the retailer possesses the nexus to require it to collect Iowa tax, the retailer is obligated to collect Iowa retailer’s use tax upon the purchase price of the goods. If the retailer does not have nexus sufficient to require it to collect either Iowa sales or Iowa use tax, or if the retailer fails to collect either tax, the consumer is obligated to pay a consumer use tax directly to the department upon the purchase price of the goods. These rules are illustrated in the following examples.

EXAMPLE A: A consumer in Des Moines, Iowa, purchases goods from a retailer in Minneapolis, Minnesota. The Minneapolis retailer contracts with a supplier in Iowa to manufacture and ship the goods to the consumer. The retailer has nexus with Iowa, and delivery under the contract for sale has occurred in this state. In this case, the consumer is obligated to pay and the retailer is obligated to collect Iowa sales tax. The supplier is not obligated to collect any Iowa tax.

EXAMPLE B: A consumer in Des Moines, Iowa, purchases goods from a retailer in Minneapolis, Minnesota. The Minnesota retailer contracts with a supplier in Iowa to manufacture and ship the goods to the consumer. The retailer has no nexus with Iowa. Delivery under the contract of sale is in Iowa. Under these circumstances, the consumer is obligated to pay consumer’s use tax directly to the department. Neither the retailer nor the supplier is obligated to collect any Iowa tax.

EXAMPLE C: A consumer in Des Moines, Iowa, purchases goods from a retailer in Minneapolis, Minnesota. The retailer contracts with a supplier in Minneapolis to manufacture and ship the goods to the consumer in Des Moines. The retailer has nexus with Iowa, and delivery under the contract for sale occurs in Iowa. Under these circumstances, the consumer is obligated to pay and the retailer is obligated to collect Iowa sales tax. The supplier is not obligated to collect any Iowa tax.

EXAMPLE D: A consumer in Des Moines, Iowa, purchases goods from a retailer in Minneapolis, Minnesota. The retailer contracts with a supplier in Minneapolis to manufacture and ship the goods to the consumer in Des Moines. The retailer has nexus with this state; delivery under the contract for sale is in Minnesota. Under the circumstances, the consumer is obligated to pay and the retailer is obligated to collect Iowa retailer’s use tax. The supplier is not obligated to collect or pay any Iowa tax.

EXAMPLE E: A consumer in Des Moines, Iowa, purchases goods from a retailer in Minneapolis, Minnesota. The retailer contracts with a supplier in Minneapolis to manufacture and ship the goods to the consumer in Des Moines. The retailer has no nexus with this state. Delivery can occur in either Minnesota or Iowa. In this example, the consumer is obligated to pay Iowa consumer’s use tax directly to the department. Neither the retailer nor the supplier is obligated to collect any Iowa tax.

EXAMPLE F: A consumer in Des Moines, Iowa, purchases goods from a retailer in Minneapolis, Minnesota. The retailer contracts with a supplier located in Madison, Wisconsin, to ship the goods to the consumer in Des Moines. The retailer has nexus with Iowa, and delivery under the contract for sale is in Iowa. Under these circumstances, the retailer is obligated to collect and the consumer obligated to pay Iowa sales tax. The supplier is not obligated to collect any Iowa tax.

EXAMPLE G: A consumer in Des Moines, Iowa, purchases goods from a retailer in Minneapolis, Minnesota. The retailer contracts with a supplier located in Madison, Wisconsin, to ship the goods to the consumer in Des Moines. The retailer has nexus with Iowa with delivery in Madison, Wisconsin. Under these circumstances, the retailer is obligated to collect and the consumer obligated to pay Iowa retailer's use tax. The supplier is not obligated to collect any Iowa tax.

EXAMPLE H: A consumer in Des Moines, Iowa, purchases goods from a retailer in Minneapolis, Minnesota. The retailer contracts with a supplier located in Madison, Wisconsin, to ship the goods to the consumer in Des Moines. The retailer has no nexus with Iowa. Delivery under the contract for sale may be in Iowa or Wisconsin. Under these circumstances, the consumer is obligated to pay Iowa consumer's use tax directly to the department. Neither the retailer nor the supplier is obligated to collect any Iowa tax.

As used in these examples, the requirement of "nexus" is discussed in *Good's Furniture House Inc. v. Iowa State Bd. of Tax Review*, 382 N.W.2d 145 (Iowa 1986); cert. den. 479 U.S. 817; *State Tax Commission v. General Trading Co.*, 10 N.W.2d 659, 233 Iowa 877 (1943) affd. 64 S.Ct. 1028, 322 U.S. 335, 88 L.Ed. 1309; and *Nelson v. Sears, Roebuck & Co.*, 292 N.W. 130, 228 Iowa 1273 (1940) reversed 61 S.Ct. 586, 312 U.S. 359, 85 L.Ed. 522, as well as other judicial decisions, and Iowa Code section 422.43(12).

This rule is intended to implement Iowa Code subsections 422.42(2) and 422.42(5).

701—18.56(422,423) Wind energy conversion property. On and after July 1, 1993, the gross receipts from the sale of property used to convert wind energy to electrical energy or the gross receipts from the sale of materials used to manufacture, install, or construct property used to convert wind energy to electrical energy shall be exempt from tax.

For the purposes of this rule, "property used to convert wind energy to electrical energy" means any device which converts wind energy to usable electrical energy including, but not limited to, wind chargers, windmills, wind turbines, pad mount transformers, substations, power lines, and tower equipment.

This rule is intended to implement Iowa Code section 422.45 as amended by 1993 Iowa Acts, chapter 161.

701—18.57(422,423) Exemptions applicable to the production of flowering, ornamental, and vegetable plants. On and after July 1, 1995, the production of flowering, ornamental, or vegetable plants by a grower in a commercial greenhouse or at another location is considered to be a part of agricultural production. The word "plants" does not include trees, shrubs, other woody perennials, or fungus. The exemption also applies to implements, machinery, equipment, and replacement parts directly and primarily used in the production of flowering, ornamental, or vegetable plants and fuel used for providing heating or cooling for greenhouses or buildings or parts of buildings dedicated to the production of flowering, ornamental, or vegetable plants intended for sale in the ordinary course of business. The following exemptions are applicable to the production of flowering, ornamental, or vegetable plants.

18.57(1) Sales of fertilizer, limestone, herbicides, pesticides, insecticides, plant food, and medication for use in disease, weed, insect control, or other health promotion of flowering, ornamental, or vegetable plants to a commercial greenhouse are exempt from tax. For the purposes of this subrule a virus, bacteria, fungus, or insect which is purchased for use in killing insects or other pests is an “insecticide” or “pesticide.” See rules 701—17.4(422,423) and 17.9(422,423) for more information regarding these exemptions.

18.57(2) Sales of fuel to provide heating or cooling for a greenhouse or building or a part of a building dedicated to the production of flowering, ornamental, or vegetable plants held for sale in the ordinary course of business are exempt from tax. Electricity is a “fuel” for the purposes of this subrule. Fuel used in a plant production building for purposes other than heating or cooling (e.g., lighting) or for purposes other than direct use in plant production (e.g., heating or cooling office space) is not eligible for this exemption. For example, assume that there is a separate meter for electricity used only for heating or cooling. If a greenhouse is used, partially for growing plants and partially for a nonexempt purpose, a proportional exemption from sales tax may be claimed based upon a percentage calculated from a fraction, the numerator of which is the number of square feet of the greenhouse heated or cooled and used for raising plants, and the denominator of which is the number of square feet heated or cooled in the entire greenhouse. It may be necessary to alter this formula (by the use of separate metering, for example) if a greenhouse has a walk-in cooler and the cooler is used directly in plant production. Plant production has ended when a plant has grown to the point that it is of the size or weight at which it will be prepared for shipment to the destination where it will be marketed. Examples of nonexempt purposes for which a portion of a greenhouse might be used include, but are not limited to, portions used for office space, loading docks, storage of property other than plants, housing of heating and cooling equipment and portions used for packaging plants for shipment. See rule 701—15.3(422,423) regarding fuel exemption certificates and subrule 18.48(8) regarding seller’s and purchaser’s liability for sales tax.

18.57(3) Sales of gas, electricity, steam or other tangible personal property for use as a fuel in implements of husbandry used in the production of plants in a commercial greenhouse or elsewhere are exempt from tax. See 701—subrule 17.9(6), paragraph “a,” for a definition of “implements of husbandry.”

18.57(4) Sales of self-propelled implements. Sales of self-propelled implements or implements customarily drawn by or attached to self-propelled implements and replacement parts for the same are exempt from tax if the implements are used directly and primarily in the production of plants in commercial greenhouses or elsewhere. See rule 701—18.44(422,423) for an extensive explanation of this exemption. Implements exempt under this subrule include, but are not limited to, forklifts used to transport pallets of plants; wagons containing sterilized soil and tractors used to pull the same.

18.57(5) Sale of water used in the production of plants is exempt from tax. If water is not separately metered, the grower of plants must determine by use of a percentage that portion which is used for a taxable purpose and that portion which is used for an exempt purpose.

Nonexclusive examples of taxable usage would be rest rooms, sanitation, lawns, and vehicle wash.

18.57(6) For sales occurring on or after July 1, 1996, the gross receipts for the sale of property which is a container, label, carton, pallet, packing case, wrapping, baling wire, twine, bag, bottle, shipping case, or other similar article or receptacle sold for use in agricultural, livestock, or dairy production are not subject to sales tax. This exemption also applies to producers of ornamental, flowering, or vegetable plants in commercial greenhouses or other places which sell such items in the ordinary course of business since that activity is considered to be agricultural. A noninclusive list of containers and packaging materials would include boxes, trays, labels, sleeves, tape, and staples.

18.57(7) Sales of machinery and equipment used in plant production which are not self-propelled or attached to self-propelled machinery and equipment are also exempt from tax. See rule 701—18.48(422,423) for a thorough explanation of this exemption. Listed below are a number of examples of machinery and equipment which are directly and primarily used in plant production. Sales of this machinery and equipment to commercial growers are usually exempt from tax.

Air-conditioning pads*

Airflow control tubes

Atmospheric CO₂ control and monitoring equipment

Backup generators

Bins holding sterilized soil

Control panels = heating and cooling

Coolers used to chill plants*

Cooling walls* or membranes

Equipment used to control water levels for subirrigation

Fans = cooling and ventilating*

Floor mesh for controlling weeds

Germination chambers

Greenhouse boilers*

Greenhouse netting or mesh = used for light and heat control

Greenhouse monorail systems*

Greenhouse thermometers

Handcarts used to move plants

Lighting which provides artificial sunlight

Overhead heating, lighting and watering systems

Overhead tracks for holding potted plants*

Plant tables*

Plant watering systems*

Portable buildings used to grow plants*

Seeding and transplanting machines

Soil pot and soil flat filling machines

Steam generators for soil sterilization*

Warning devices = excess heat or cold

Watering booms

*If not real property. See 18.48(1)“c”(1).

18.57(8) Miscellaneous exempt and taxable sales. Sales of pots, soil, seeds, bulbs, and “starter plants” for use in plant production are not the sale of machinery or equipment, but can be sales for resale and exempt from tax if the pots and soil are sold with the final product or become the finished product. Sales of portable buildings which will be used to display plants for retail sales are taxable. Finally, sales of whitewash which will be painted on greenhouses to control the amount of sunlight entering those houses are taxable sales of a “supply” rather than exempt sales of equipment. See 18.48(1) “c”(2) relating to “supplies.” See rule 701—18.7(422,423) relating to containers, including packaging cases, shipping cases, wrapping materials, and similar items sold to retailers, and see subrule 18.57(6).

This rule is intended to implement Iowa Code sections 422.42(1), 422.42(4), 422.42(11), 422.45(39) and 422.47(4) and Iowa Code section 422.45 as amended by 1996 Iowa Acts, chapter 1145.

701—18.58(422,423) Exempt sales or rentals of computers, industrial machinery and equipment, and exempt sales of fuel and electricity on and after July 1, 1997. The sale or rental of machinery, equipment, or computers used by a manufacturer in processing; the sale or rental of a computer used in the processing or storage of data or information by an insurance company, financial institution, or commercial enterprise; and the sale or rental of various other types of tangible personal property are, under certain circumstances, exempt from tax as of July 1, 1997.

18.58(1) Definitions. The following terms are defined for the purposes of this rule in the manner set out below.

“*Commercial enterprise*” includes businesses and manufacturers conducted for profit and includes centers for data processing services to insurance companies, financial institutions, businesses, and manufacturers, but excludes professions and occupations and nonprofit organizations. A hospital that is a not-for-profit organization would not be a “commercial enterprise.” The term “professions” means a vocation or employment requiring specialized knowledge and often long and intensive academic preparation. The term “occupations” means the principal business of an individual. Included within the meaning of “occupations” is the business of farming. A professional corporation which carries on any business which is a “profession” or “occupation” is not a commercial enterprise.

“*Computer*” means stored program processing equipment and all devices fastened to it by means of signal cables or any communication medium that serves the function of a signal cable. Nonexclusive examples of devices fastened by a signal cable or other communication medium are terminals, printers, display units, card readers, tape readers, document sorters, optical readers, and card or tape punchers. Excluded from the definition of “computer” is point-of-sale equipment. For a characterization of “point-of-sale equipment,” see 701—subrule 71.1(7). Also included within the meaning of the word “computer” is any software consisting of an operating system or executive program. Such software coordinates, supervises, or monitors the basic operating procedures of a computer. An operating system or executive program is exempt from sales tax only if purchased as part of the sale of the computer for which it operates. An operating system or executive program priced separately or sold at a later time is subject to the provisions of rule 18.34(422,423). Excluded from the meaning of the word “computer” is any software consisting of an application program. For purposes of this subrule, “operating system or executive program” means a computer program which is fundamental and necessary to the functioning of a computer. The operating system or executive program software controls the operation of a computer by managing the allocation of all system resources, including the central processing unit, main and secondary storage, input/output devices, and the processing of programs. This is in contrast to application software which is a collection of one or more programs used to develop and implement the specific applications which the computer is to perform, and which calls upon the services of the operating system or executive program.

“*Contract manufacturer*” is any manufacturer who falls within the definition of “manufacturer” set out subsequently in this subrule except that a contract manufacturer does not sell the tangible personal property which it processes on behalf of other manufacturers.

“Directly used.” Property is “directly used” only if it is used to initiate, sustain, or terminate an exempt activity. In determining whether any property is “directly used,” consideration should be given to the following factors:

1. The physical proximity of the property in question to the activity in which it is used;
2. The proximity of the time of use of the property in question to the time of use of other property used before and after it in the activity involved; and
3. The active causal relationship between the use of the property in question and the activity involved. The fact that a particular piece of property may be essential to the conduct of the activity because its use is required either by law or practical necessity does not, of itself, mean that the property is directly used.

“Financial institution” is a bank incorporated under any state or federal law; a savings and loan association incorporated under any state or federal law; a credit union organized under any state or federal law; or any corporation licensed as an industrial loan company under Iowa Code chapter 536A. Excluded from the meaning of the term are loan brokers governed by Iowa Code chapter 535C and production credit associations.

“Insurance company” means an insurer organized or operating under Iowa Code chapter 508, 514, 515, 518, 518A, 519, or 520 or authorized to do business in Iowa as an insurer or as a licensed insurance agent under Iowa Code chapter 522. Excluded from the definition of “insurance company” are fraternal and beneficial societies governed by Iowa Code chapter 512 and health maintenance organizations governed by Iowa Code chapter 514B. This list of exclusions is not intended to be exclusive.

“Machinery and equipment” means machinery and equipment used by a manufacturer. Machinery is any mechanical, electrical, or electronic device designed and used to perform some function and to produce a certain effect or result. The term includes not only the basic unit of the machinery, but also any adjunct or attachment necessary for the basic unit to accomplish its intended function. The term also includes all devices used or required to control, regulate, or operate a piece of machinery, provided such devices are directly connected with or are an integral part of the machinery and are used primarily for control, regulation, or operation of machinery. Jigs, dies, tools, and other devices necessary to the operation of or used in conjunction with the operation of what would be ordinarily thought of as machinery are also considered to be “machinery.” See *Deere Manufacturing Co. v. Zeiner*, 247 Iowa 1264, 78 N.W.2d 527 (1956). Also see the definition of “replacement parts” infra. Machinery does not include buildings designed specifically to house or support machinery. Equipment is any tangible personal property used in an operation or activity. Nonexclusive examples of equipment are tables on which property is assembled on an assembly line and chairs used by assembly line workers.

“Manufacturer” means any person, firm, or corporation that purchases, receives, or holds personal property for the purpose of adding to its value by any process of manufacturing, refining, purifying, combining of different materials, or by packing of meats with an intent to sell at a gain or profit. Those who are in the business of printing, newspaper publication, bookbinding, lumber milling, and production of drugs and agricultural supplies are illustrative, nonexclusive examples of manufacturers. Construction contracting; remanufacture or rebuilding of tangible personal property (such as automobile engines); provision of health care; farming; transportation for hire; and the activities of restaurateurs, hospitals, medical doctors, and those who merely process data are illustrative, nonexclusive examples of businesses which are not manufacturers. See *Associated General Contractors of Iowa v. State Tax Commission*, 255 Iowa 673, 123 N.W.2d 922 (1963) and *River Products Co. v. Board of Review of Washington County*, 332 N.W.2d 116 (Iowa Ct. App. 1982). The term “manufacturer” includes a contract manufacturer. Ordinarily, the word does not include those commercial enterprises engaged in quarrying or mining. However, effective July 1, 1998, a commercial enterprise, the principal business of which is quarrying or mining, is a manufacturer with respect to activities in which it engages subsequent to quarrying or mining. These subsequent activities include, by way of nonexclusive example, crushing, washing, sizing, and blending of aggregate materials.

EXAMPLE: Company A owns and operates a gravel pit. It sells the gravel extracted from the pit to others who use the gravel for surfacing roads and as an ingredient in concrete manufacture. Company A removes overlay and raw gravel from the pit. It then transports the gravel to a plant where washing and sizing of the gravel take place. Company A is a manufacturer, but only with respect to those activities which occur after it severs the gravel from the ground.

"Pollution control equipment" means any disposal system or apparatus used or placed in operation primarily for the purpose of reducing, controlling, or eliminating air or water pollution. The term does not include any apparatus used to eliminate "noise pollution." Liquid, solid, and gaseous wastes are included within the meaning of the word "pollution." "Pollution control equipment" specifically includes, but is not limited to, any equipment the use of which is required or certified by an agency of this state or the United States Government. Wastewater treatment facilities and scrubbers used in smokestacks are examples of pollution control equipment. However, pollution control equipment does not include any equipment used only for worker safety (e.g., a gas mask).

"Processing" means a series of operations in which materials are manufactured, refined, purified, created, combined, transformed, or stored by a manufacturer, ultimately into tangible personal property. Processing encompasses all activities commencing with the receipt or producing of raw materials by the manufacturer and ending at the point products are delivered for shipment or transferred from the manufacturer. Processing includes, but is not limited to, refinement or purification of materials; treatment of materials to change their form, context, or condition; maintenance of the quality or integrity of materials, components, or products; maintenance of environmental conditions necessary for materials, components or products; quality control activities; construction of packaging and shipping devices; placement into shipping containers or any type of shipping device or medium; and the movement of materials, components, or products until shipment from the manufacturer.

"Processing or storage of data or information." All computers store and process information. However, only if the "final output" for a user or consumer is stored or processed data will the computer be eligible for exemption of tax.

"Receipt or producing of raw materials" means activities performed upon tangible personal property only. With respect to raw materials produced from or upon real estate, "production of raw materials" is deemed to occur immediately following the severance of the raw materials from the real estate.

"Recycling" means any process by which waste or materials which would otherwise become waste are collected, separated, or processed and revised or returned for use in the form of raw materials or products. The term includes, but is not limited to, the composting of yard waste which has been previously separated from other waste. "Recycling" does not include any form of energy recovery.

"Replacement parts." A "replacement part" is any machinery, equipment, or computer part which is substituted for another part that has broken, has become worn out or obsolete, or is otherwise unable to perform its intended function. "Replacement parts" are those parts which materially add to the value of industrial machinery, equipment, or computers or appreciably prolong their lives or keep them in their ordinarily efficient operating condition. Excluded from the meaning of the term "replacement parts" are supplies, the use of which is necessary if machinery is to accomplish its intended function. Drill bits, grinding wheels, punches, taps, reamers, saw blades, lubricants, coolants, sanding discs, sanding belts, and air filters are nonexclusive examples of supplies. Sales of supplies remain taxable.

Tangible personal property with an expected useful life of 12 months or more which is used in the operation of machinery, equipment, or computers is rebuttably presumed to be a "replacement part." Tangible personal property used in the same manner with an expected useful life of less than 12 months is rebuttably presumed to be a "supply."

"Research and development" means experimental or laboratory activity which has as its ultimate goal the development of new products or processes of processing. Machinery, equipment, and computers are used "directly" in research and development only if they are used in actual experimental or laboratory activity that qualifies as research and development under this subrule.

18.58(2) Exempt sales. On and after July 1, 1997, sales or rentals of the following machinery, equipment, or computers (including replacement parts) are exempt from tax:

a. Machinery, equipment, and computers directly and primarily used in processing by a manufacturer.

b. Machinery, equipment, and computers directly and primarily used to maintain a manufactured product's integrity or to maintain any unique environmental conditions required for the product.

c. Machinery, equipment and computers directly and primarily used to maintain unique environmental conditions required for other machinery, equipment, or computers used in processing by a manufacturer.

d. Test equipment directly and primarily used by a manufacturer in processing to control the quality and specifications of a product.

e. Machinery, equipment, or computers directly and primarily used in research and development of new products or processes of processing.

f. Computers used in processing or storage of data or information by an insurance company, financial institution, or commercial enterprise.

g. Machinery, equipment, and computers directly and primarily used in recycling or reprocessing of waste products.

h. Pollution control equipment used by a manufacturer. It is not necessary that the equipment be "directly and primarily" used in any kind of processing.

i. Materials used to construct or self-construct any machinery, equipment, or computer, the sale of which is exempted by paragraphs "a" through "h" above.

j. Exempt sales of fuel and electricity. Sales of fuel or electricity consumed by machinery, equipment, or computers used in any exempt manner described in paragraphs "a," "b," "c," "d," "e," "g," and "h" of this subrule are exempt from tax. Sales of electricity consumed by computers used in the manner described in paragraph "f" remain subject to tax.

18.58(3) Examples of exempt items. Sales of the following nonexclusive types of machinery and equipment, previously taxable, are exempt on and after July 1, 1997, if that machinery or equipment is sold for direct and primary use in processing by a manufacturer: coolers which do not change the nature of materials stored in them; equipment which eliminates bacteria; palletizers; storage bins; property used to transport raw, semifinished, or finished goods; vehicle-mounted cement mixers; self-constructed machinery and equipment; packaging and bagging equipment (including conveyer systems); equipment which maintains an environment necessary to preserve a product's integrity; equipment which maintains a product's integrity directly; quality control equipment and electricity or other fuel used to power the machinery and equipment mentioned above.

18.58(4) Processing—beginning to end.

a. The beginning of processing. Processing begins with a manufacturer's receipt or production of raw material. Thus, when a manufacturer produces its own raw material it is engaged in processing. Processing also begins when raw materials are transferred to a manufacturer's possession by a manufacturer's supplier.

b. The completion of processing. Processing ends when the finished product is transferred from the manufacturer or delivered for shipment by the manufacturer. Therefore, a manufacturer's packaging, storage, and transport of a finished product after the product is in the form in which it will be sold at retail are part of the processing of the product.

c. Examples of the beginning, intervening steps, and the ending of processing. Of the following, Examples A and B illustrate when processing begins under various circumstances; Example C demonstrates the middle stages of processing; and Example D demonstrates when the end of processing takes place.

EXAMPLE A. Company A manufactures fine furniture. Company A owns a grove of walnut trees which it uses as raw material. A's employees cut the trees, transport the logs to A's factory, offload them there, and store the logs in a warehouse (to begin the curing of their wood) before taking them to A's sawmill. The walnut trees are real property, *Kennedy v. Board of Assessment and Review*, 276 N.W. 205, 224 Iowa 405 (1937). Thus, no "production of raw materials" has occurred with regard to the trees until they have been severed from the soil and transformed into logs. In this example, "processing" of the logs begins when they are placed on vehicles for transport to A's factory. However, note that even though the transport vehicles are used in processing, if they are "vehicles subject to registration," their use is not exempt from tax. See 18.58(6) "d" infra.

EXAMPLE B. Company A from the previous example also buys mahogany logs from a supplier in Honduras. Company A uses its own equipment to offload the logs from railroad cars at its manufacturing facility and then transports, stores, and saws the logs as previously described in Example A. Processing begins when Company A offloads the logs from the railroad cars.

EXAMPLE C. Company C is a microbrewery. It uses a variety of kettles, vats, tanks, tubs, and other containers to mix, cook, ferment, settle, age, and store the beer which it brews. It also uses a variety of pipes and pumps to move the beer among the various containers involved in the activity of brewing. All stages of this brewing are part of processing whether those stages involve the transformation of the raw materials from one state to another, e.g., fermentation or aging, or simply involve holding the materials in an existing state, e.g., storage of hops in a bin or storage of the beer immediately prior to bottling. Also, any movement of the beer between containers is an activity which is a part of processing, whether this movement is an "integral part" of the production of the beer or not.

EXAMPLE D. After the brewing process is complete, Company C places its beer in various containers, stores it, and moves the beer to its customers by a common carrier that picks up the beer at C's brewery. C's activities of placing the beer into bottles, cans, and kegs, storing it after packaging, and moving the beer by use of a forklift to the common carrier's pickup site are activities which are part of processing.

18.58(5) *Various unrelated inclusions in and exclusions from this exemption.*

a. The following are nonexclusive examples of machinery which is not directly used in processing:

- (1) Machinery used exclusively for the comfort of workers. Examples are air cooling, air conditioning, and ventilation systems.
- (2) Machinery used in support operations, such as a machine shop, in which production machinery is assembled, maintained, or repaired.
- (3) Machinery used by administrative, accounting, and personnel departments.
- (4) Machinery used by plant security, fire prevention, first aid, and hospital stations.
- (5) Machinery used in plant communications and safety.

b. The following is an example of property directly used in research and development. Frontier Hybrid, Inc. maintains a research and development laboratory for use in developing a corn plant which is a perennial. It purchases the following items for use in its research and development laboratory: a computer which will process data relating to the genetic structure of the various corn plants which Frontier Hybrid is testing, an electron microscope for examining the structure of corn plant genes, a "steam cleaner" for cleaning rugs in the laboratory offices, and a typewriter for use by the laboratory director's secretary. The computer and the microscope are "directly" used in the research in which the laboratory is engaged; the steam cleaner and the typewriter only indirectly used. Therefore, purchase of the computer and microscope would be exempt from tax; purchase of the steam cleaner and typewriter would be subject to tax.

c. The following is an example of computers used and not used in processing or storage of information or data. A health insurance company has four computers. Computer A is used to monitor the temperature within the insurance company's building. The computer transmits messages to the building's heating and cooling systems telling them when to raise or lower the level of heating or air conditioning as needed. Computer B is used to store patient records and will recall those records on demand. Computer C is used to tabulate statistics regarding the amount of premiums paid in and the amount of benefits paid out for various classes of insured. Computer D is used to train the insurance company's employees to perform various additional tasks or to better perform work they can already do. Computer D uses various canned programs to accomplish this. The "final output" of Computer A is neither stored nor processed information. Therefore, Computer A does not fit the definition of an exempt computer. The final output of Computer B is stored information. The final output of Computer C is processed information. The final output of Computer D is processed information consisting of the training exercises appearing on the computer monitor. The sale, lease, or use of Computers B, C, and D would qualify for exemption.

d. The following is an example of property not used in processing. A manufacturing plant located in Warren County which manufactures widgets fabricates its own patterns used in manufacturing the widgets on a metal press machine in its machine shop located in Story County. The machine shop does not sell the patterns, and the metal press machine is used for no other purpose than to fabricate the patterns. The metal press machine is not used in processing because there is no intent to sell the patterns used by the machine shop at a gain or profit.

18.58(6) Exceptions. Sales of the following machinery, equipment, or computers are not exempt:

a. Machinery, equipment, or computers assessed by the department of revenue and finance pursuant to Iowa Code chapters 428, 433, 434, and 436 to 438, inclusive. For electric, gas, water, and other companies assessed under Iowa Code chapter 428, only property owned by the company is assessed by the department. For railroad, telephone, pipeline, and electric transmission lines companies, property leased to, as well as owned by, the company is assessed by the department. See 701—Chapters 71 and 77.

b. Hand tools. These are tools which can be held in the hand or hands and which are powered by human effort.

c. Point-of-sale equipment. See 701—subrule 71.1(7).

d. Vehicles subject to registration, except vehicles subject to registration which are directly and primarily used in recycling or reprocessing of waste products.

e. Machinery and equipment purchased by a person engaged in processing who is not a manufacturer. Restaurants, retail bakeries, food stores, and blacksmith shops are nonexclusive examples of businesses which process tangible personal property but are not manufacturers as that word is defined for the purposes of this rule.

f. The fact that the acquisition cost of rented or purchased machinery, equipment, or computers can be capitalized for the purposes of Iowa or federal income tax law is not an indication that their sale or rental would be exempt from tax under this rule.

18.58(7) Lessor purchases of machinery, equipment, or computers. The analysis regarding lessor purchases of farm machinery and equipment contained in subrule 18.44(3) explains that same problem regarding machinery, equipment, and computers.

18.58(8) *Designing or installing new industrial machinery or equipment.* The gross receipts from the services of designing or installing new industrial machinery or equipment are exempt from tax. The enumerated services of electrical or electronic installation are included in this exemption. To qualify for the exemption, the sale or rental of the machinery or equipment must be subject to exemption under this rule. In addition, the machinery or equipment must be “new.” For purposes of this subrule, “new” means never having been used or consumed by anyone. The exemption is not applicable to reconstructed, rebuilt, or repaired or previously owned machinery or equipment. The exemption is applicable to new machinery and equipment designed or installed for rental as well as for sale. The gross receipts from design or installation must be separately identified, charged separately, and reasonable in amount for the exemption to apply. A “computer” is not considered to be machinery or equipment, and its installation or design is not eligible for this exemption.

18.58(9) *Property used in recycling or reprocessing of waste products.* Gross receipts from the sale or rental of machinery (including vehicles subject to registration), equipment, or computers directly and primarily used in the recycling or reprocessing of waste products are exempt from tax. “Reprocessing” is not a subcategory of “processing.” Reprocessing of waste products is an activity separate and independent from the processing of tangible personal property. Machinery or equipment used in the recycling or reprocessing of waste products includes, but is not limited to, compactors, balers, crushers, grinders, cutters, or shears directly and primarily used for this purpose. The sale of an end loader, forklift, truck, or other moving device is exempt from tax if the device is directly and primarily used in the movement of property which is an integral part of recycling or reprocessing. The sale of a bin for storage ordinarily would not be exempt from tax; storage without more activity would not be a part of recycling or reprocessing. Certain limits for exemption placed upon industrial machinery and equipment are not applicable to machinery and equipment used in recycling or reprocessing. For example, the exemption will apply even if the machinery, equipment or computer is purchased by a person other than an insurance company, financial institution or commercial enterprise. A person engaged in a profession or occupation could purchase property for direct and primary use in recycling or reprocessing of waste products and the exemption would apply.

a. By way of nonexclusive examples, recycling or reprocessing can begin when waste or material which would otherwise become waste is collected or separated. A vehicle used directly and primarily for collecting waste which will be recycled or reprocessed could be a vehicle used for an exempt purpose under this rule. Thus, the purchaser of a garbage truck could claim this exemption if the truck were directly and primarily used in recycling and not, for instance, in hauling garbage to a landfill. Machinery or equipment used to segregate waste from material to be recycled or reprocessed or used to separate various forms of materials which will be reprocessed (e.g., glass and aluminum) can also be used at the beginning of recycling or reprocessing.

b. Machinery and equipment directly and primarily used in recycling or reprocessing. See subrule 18.58(1) for the definition of “directly used” which is applicable to this subrule. The examples of machinery not directly used in processing set out in 18.58(5)“*a*” should be studied for guidance in determining whether similar machinery is or is not used in recycling or reprocessing; e.g., machinery used in plant security (see 18.58(5)“*a*”(4)) is not machinery directly used in recycling or reprocessing.

c. Integral use in recycling or reprocessing. Ordinarily, any operation or series of operations which does not transform waste or material which would otherwise become waste into new raw materials or products would not be a part of recycling or reprocessing. However, activities which do not do this, but are an “integral part” of recycling or reprocessing, are themselves recycling or reprocessing. For example, an endless belt which moves aluminum cans from a machine where they are shredded to a machine where the shredded aluminum is crushed into blocks would be an endless belt used in recycling or reprocessing and the exemption applies. See subrule 18.29(5) for a discussion of when an activity is an integral part of “processing.” Some of that discussion is applicable to this subrule.

d. The end of recycling or reprocessing. Recycling or reprocessing ends when waste or a material which would otherwise become waste is in the form of raw material or in the form of a product. For instance, a corporation purchases a machine which grinds logs, stumps, pallets, crates, and other waste wood into wood chips. After grinding, the wood chips are sold and transported to various sites where the chips are dumped and spread out over the ground for use in erosion control. The machine which grinds the wood chips is a machine used in recycling. The truck which transports the wood chips from the machine to the sites is not used in recycling because at the time the chips are placed in the truck they are in the form in which they will be used in erosion control.

This rule is intended to implement Iowa Code Supplement section 422.45(27) as amended by 1998 Iowa Acts, Senate File 2288; Iowa Code section 422.45(29); and Iowa Code chapter 423.

701—18.59(422,423) Exempt sales to nonprofit hospitals. On and after July 1, 1998, the gross receipts from sales or rentals of tangible personal property to and from the rendering, furnishing, or performing of services for a nonprofit hospital licensed under Iowa Code chapter 135B are exempt from tax if the property or service purchased is used in the operation of the hospital. A hospital is not entitled to claim a refund for tax paid by a contractor on the sale or use of tangible personal property or the performance of services in the fulfillment of a written construction contract with the hospital. However, see the circumstances set out below in which sales of goods, wares or merchandise, or taxable services to a hospital for use in the fulfillment of a construction contract, are exempt from Iowa tax.

For the purposes of this rule, the word “hospital” means a place which is devoted primarily to the maintenance and operation of facilities for diagnosis, treatment, or care, over a period exceeding 24 hours, of two or more nonrelated individuals suffering from illness, injury, or a medical condition (such as pregnancy). The word “hospital” includes general hospitals, specialized hospitals (e.g., pediatric, mental, and orthopedic hospitals, and cancer treatment centers), sanatoriums, and other hospitals licensed under Iowa Code chapter 135B. Also included are institutions, places, buildings, or agencies in which any accommodation is primarily maintained, furnished, or offered for the care, over a period exceeding 24 hours, of two or more nonrelated aged or infirm persons requiring or receiving chronic or convalescent care. Excluded from the meaning of the term “hospital” are institutions for well children; day nursery and child care centers; foster boarding homes and houses; homes for handicapped children; homes, houses, or institutions for aged persons which limit their function to providing food, lodging, and provide no medical or nursing care, and house no bedridden person; dispensaries or first-aid stations maintained for the care of employees, students, customers, members of any commercial or industrial plant, educational institution, or convent; freestanding hospice facilities which operate a hospice program in accordance with 42 CFR § 418 and freestanding clinics which do not provide diagnosis, treatment, or care for periods exceeding 24 hours. This list of inclusions and exclusions is not exclusive. For additional information see 481—Chapter 51.

Ordinarily, goods, wares, or merchandise (such as building materials, supplies, and equipment; see rule 701—19.3(422,423) for definitions) which is purchased by a hospital and used by a contractor in the fulfillment of a written contract with the hospital cannot be purchased exempt from Iowa tax. The goods, wares, and merchandise used in the fulfillment of these construction contracts are not used in the “operation” of a hospital but in activities at least one step removed from that operation. See *Polich v. Anderson-Robinson Coal Co.*, 227 Iowa 553, 288 N.W. 650 (1939).

However, for a limited period, the gross receipts from all sales of goods, wares, or merchandise or from services rendered, furnished, or performed are exempt from tax (or a claim for refund may be filed for tax paid) if the tangible personal property or the taxable service is used in the fulfillment of a written construction contract with a hospital and all of the following circumstances exist:

1. Deliveries under contracts of sale of the goods, wares, or merchandise occurred or the taxable services were rendered, furnished, or performed between July 1, 1998, and December 31, 2001, inclusive. A claim for refund may be filed for any tax paid for this period, so long as the claim is filed prior to April 1, 2002, and the requirements of "2" and "3" below are also met. Claims for refunds of tax, interest, or penalty paid for the period of July 1, 1998, to December 31, 2001, are limited to \$25,000 in the aggregate. If the amount of the claimed refunds for this period totals more than \$25,000, the department must prorate the \$25,000 among all claimants in relation to the amounts of the claimants' valid claims.

2. The written construction contract was entered into prior to December 31, 1999, or bonds to fund the construction were issued prior to December 31, 1999.

3. The property or services were purchased directly by the hospital or by a contractor as an agent of the hospital. For the purposes of this exemption, no hospital can retroactively designate a contractor to be its agent and by this means transform a contractor's purchases of goods, wares, merchandise, or services into its own. Upon the department's request, a hospital claiming that a contractor is or has been its purchasing agent must present suitable evidence of a principal-agent relationship between itself and the contractor during any period for which exempt sales or a refund is claimed. The best evidence of a principal and purchasing agent relationship is a written document setting out the terms of the relationship and the period for which the agency is in effect; however, other evidence, which is the equivalent of a written document in reliability, will be considered by the department when necessary.

This rule is intended to implement Iowa Code Supplement section 422.45 as amended by 2000 Iowa Acts, chapter 1207.

701—18.60 (422,423) Exempt sales of gases used in the manufacturing process. Effective May 24, 1999, but retroactive to January 1, 1991, sales of argon and other similar gases to be used in the manufacturing process are exempt from tax. For the purposes of this rule, only inert gases are gases which are similar to argon. An "inert gas" is any gas which is normally chemically inactive. It will not support combustion and cannot be used as either a fuel or as an oxidizer. Argon, nitrogen, carbon dioxide, helium, neon, krypton, and xenon are nonexclusive examples of inert gases. Oxygen, hydrogen, and methane are nonexclusive examples of gases which are not inert. These sales are exempt only if the gas is purchased by a "manufacturer," for used in "processing," as those terms are defined in subrule 18.45(1), for the period prior to July 1, 1997, and as those terms are defined in subrule 18.58(1) for the period beginning July 1, 1997.

This rule is intended to implement Iowa Code section 422.45 as amended by 1999 Iowa Acts, chapter 170.

701—18.61(422,423) Exclusion from tax for property delivered by certain media. For the period beginning March 15, 1995, and ending December 31, 2002, inclusive, a taxable “sale” of tangible personal property does not occur if the substance of the transaction is delivered to the purchaser digitally, electronically, or by utilizing cable, radio waves, microwaves, satellites, or fiber optics. This exclusion from tax is not applicable to any leasing of tangible personal property, a lease not being a “sale” of tangible personal property for the purposes of Iowa sales and use tax law, *Cedar Valley Leasing, Inc. v. Iowa Department of Revenue*, 274 N.W.2d 357 (Iowa 1979). The exclusion is also not applicable to property delivered by any medium other than those listed above. Sales of items such as artwork, drawings, photographs, music, electronic greeting cards, “canned” software (see subrule 18.34(1)), entertainment properties (e.g., films, concerts, books, and television and radio programs), and all other digitized products delivered as described above are not taxable, except the exclusion does not repeal by implication the tax on the service of providing pay television. See rule 701—26.56(422). If an order for a product is placed by way of any of the media described above but the product ordered is delivered by conventional, physical means, e.g., the U.S. Postal Service or common carrier, sale of the product is not excluded from tax under this rule.

This rule is intended to implement Iowa Code Supplement section 422.43 as amended by 2000 Iowa Acts, chapter 1195, section 2.

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