

REVENUE DEPARTMENT[701]

Adopted and Filed

Pursuant to the authority of Iowa Code sections 17A.3 and 423.42, the Department of Revenue hereby amends Chapter 15, “Determination of a Sale and Sale Price,” Chapter 18, “Taxable and Exempt Sales Determined by Method of Transaction or Usage,” and Chapter 230, “Exemptions Primarily Benefiting Manufacturers and Other Persons Engaged in Processing,” Iowa Administrative Code.

These amendments are necessary to reflect the enactment of 2016 Iowa Acts, House File 2433. House File 2433 modifies the exemptions contained in Iowa Code section 423.3(47) by exempting supplies and by defining replacement parts and supplies. The amendments incorporate these changes into new rules that implement Iowa Code section 423.3(47). The new rules are intended to modernize and simplify the administration of the exemptions under Iowa Code section 423.3(47). The amendments also update terminology and cross references used in existing rules.

Notice of Intended Action was published in IAB Vol. XXXIV, No. 2, p. 70, July 20, 2016, as **ARC 2636C**. The Department allowed public comments until September 22, 2016. The Department received three sets of comments from organizations representing businesses in Iowa. In response to the comments received, the Department has made the changes listed below:

- Paragraph 230.14(2)“c” has been revised to explain that tables on which property is assembled on an assembly line may be exempt equipment when the tables are used for an exempt purpose.
- Paragraph 230.14(2)“h” has been revised to include water used for cooling as a potentially exempt item when the cooling water is used for an exempt purpose.
- Subrule 230.14(4) has been revised to clarify a claimant’s responsibility to keep records in order to qualify for exemption under these rules.
- Paragraph 230.15(4)“b” has been revised to explain that self-produced patterns may be exempt supplies.
- Subrule 230.16(3) has been revised to clarify that a cooling or heating system may qualify as exempt machinery used to maintain the environmental conditions necessary for other machinery and equipment directly and primarily used in processing by a manufacturer.
- An additional example of exempt prototype materials directly and primarily used in research and development of new products has been added to rule 701—230.17(423).

In addition, Item 12 contains a nonsubstantive grammatical change.

These amendments are otherwise identical to those published under Notice.

After analysis and review of this rule making, the Department finds that the changes in the amendments are likely to have a positive impact on jobs by exempting supplies. The Department estimates that, between fiscal years 2017 and 2021, manufacturers will reduce their total state and local sales and use tax burden by \$29.2 million to \$34.8 million annually under the amendments. Reducing the tax burden on business inputs for manufacturers is likely to have a positive impact on jobs.

These amendments are intended to implement Iowa Code section 423.3(47) as amended by 2016 Iowa Acts, House File 2433, and section 423.3(48).

These amendments will become effective on November 16, 2016.

The following amendments are adopted.

ITEM 1. Amend paragraph **15.3(3)“a,”** definition of “Fuel consumed in processing,” as follows:

“*Fuel consumed in processing*” includes fuel used in grain drying; or providing heat or cooling for livestock buildings, fuel used for generating electric current, fuel consumed in implements of husbandry engaged in agricultural production, as well as fuel used in “processing” as defined in rules 701—18.29(422,423), ~~and 701—18.58(422,423), and 701—230.15(423)~~. See rule 701—17.2(422) for a detailed description of “fuel used in processing.” See rule 701—17.3(422,423) for extensive discussion regarding electricity and steam used in processing.

ITEM 2. Amend subrule 18.29(7) as follows:

18.29(7) Other department rules concerned with processing. Various sections of the Iowa Code set out activities ~~which that~~ are defined by statute to be “processing”. The rules interpreting these statutes for the purposes of sales and use tax law are the following:

a. ~~701—15.3(422,423) Certificates of resale, processing, and fuel used in processing~~ Exemption certificates, direct pay permits, fuel used in processing, and beer and wine wholesalers.

b. 701—17.2(422) Fuel used in processing—when exempt.

c. ~~701—17.3(422,423) Electricity, steam, or other taxable services to be used in the processing of tangible personal property intended to be sold ultimately at retail are exempt from sales tax~~ Processing exemptions.

d. 701—17.9(422,423) Sales of breeding livestock, fowl, and certain other property used in agricultural production. See 701—subrules 17.9(4), 17.9(5), 17.9(6), and 17.9(7) for processing exemptions.

e. 701—17.14(422,423) Chemicals, solvents, sorbents, or reagents used in processing.

f. 701—18.3(422,423) Chemical compounds used to treat water.

g. 701—18.45(422,423) Sale or rental of computers, industrial machinery and equipment; refund of and exemption from tax paid for periods prior to July 1, 1997.

h. 701—18.58(422,423) Sales or rentals of machinery, equipment, and computers and sales of fuel and electricity to manufacturers and sales or rentals of computers to commercial enterprises for periods on and after July 1, 1997, but before July 1, 2016.

i. 701—26.2(422) Enumerated services exempt. See 701—subrule 26.2(2) for the processing exemption.

j. 701—28.2(423) Processing of property defined.

k. 701—33.3(423) Fuel consumed in creating power, heat, or steam for processing or generating electric current.

l. 701—33.7(423) Property used to manufacture certain vehicles to be leased.

m. For property sold on or after July 1, 2016, computers, machinery, equipment, replacement parts, and supplies used for an exempt purpose under Iowa Code section 423.3(47). See rules 701—230.14(423) to 701—230.22(423).

ITEM 3. Amend rule 701—18.58(422,423), introductory paragraph, as follows:

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, but before July 1, 2016. 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, but before July 1, 2016. For sales that occur on or after July 1, 2016, see rules 701—230.14(423) to 701—230.22(423).

ITEM 4. Amend rule 701—230.5(423) as follows:

701—230.5(423) Exempt sales of gases used in the manufacturing process. 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 that~~ are similar to argon. An “inert gas” is any gas ~~which that~~ is normally chemically inactive. It will not support combustion and cannot be used as either a fuel or as an oxidizer. Argon, helium, neon, krypton, radon, and xenon are inert gases. Oxygen, hydrogen, and methane are nonexclusive examples of gases ~~which that~~ are not inert. These sales are exempt only if the gas is purchased by a “manufacturer,” for use in “processing,” as those terms are defined in ~~referenced~~ 701—subrule 18.58(1) subrules 230.15(3) and 230.15(4).

This rule is intended to implement Iowa Code section 423.3(51).

ITEM 5. Adopt the following new rule 701—230.14(423):

701—230.14(423) Exemption for the sale of computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies used for certain manufacturing purposes if the sale occurs on or after July 1, 2016. Rules 701—230.14(423) to 701—230.20(423) exempt the sales price of computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies when used in an exempt manufacturing purpose. Rule 701—230.21(423) exempts the purchase of fuel used in such computers, machinery, and equipment. Rule 701—230.22(423) exempts the service of designing or installing such machinery and equipment. Rules 701—230.14(423) to 701—230.22(423) apply to sales of such products occurring on or after July 1, 2016. For sales occurring prior to July 1, 2016, see rule 701—18.58(422,423).

230.14(1) Generally. The sales price of computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies is exempt from sales and use tax if the property is any of the following:

- a. Directly and primarily used in processing by a manufacturer (see rule 701—230.15(423)).
- b. Directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer, including test equipment used to control quality and specifications of the product (see rule 701—230.16(423)).
- c. Directly and primarily used in research and development of new products or processes of processing (see rule 701—230.17(423)).
- d. Computers used in processing or storage of data or information by an insurance company, financial institution, or commercial enterprise (see rule 701—230.18(423)).
- e. Directly and primarily used in recycling or reprocessing of waste products (see rule 701—230.19(423)).
- f. Pollution-control equipment used by a manufacturer, including but not limited to that required or certified by an agency of this state or of the United States government (see rule 701—230.20(423)).
- g. Fuel used in creating heat, power, steam, or for generating electrical current, or from the sale of electricity, consumed by computers, machinery, or equipment used in an exempt manner described in paragraph “a,” “b,” “c,” “e,” or “f” (see rule 701—230.21(423)).

230.14(2) Computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies.

a. **Computers.** “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 subparagraph 230.14(2) “g”(4). 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 procedure of a computer. An operating system or executive program is exempt from sales tax under rules 701—230.14(423) to 701—230.20(423) 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 701—18.34(422,423). Excluded from the meaning of the word “computer” is any software consisting of an application program. For purposes of this paragraph, “operating system or executive program” means a computer program that 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 that the computer is to perform and which calls upon the services of the operating system or executive program.

b. Machinery. “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. Machinery 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. 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.

c. Equipment. In general usage, “equipment” refers to devices or tools used to produce a final product or achieve a given result. Exempt “equipment” under these rules includes tables on which property is assembled on an assembly line, if those tables are directly and primarily used in processing by a manufacturer.

d. Replacement parts. “Replacement part” means tangible personal property other than computers, machinery, equipment, or supplies, regardless of the cost or useful life of the tangible personal property, that meets all of the following conditions:

- (1) The tangible personal property replaces a component of a computer, machinery, or equipment, which component is capable of being separated from the computer, machinery, or equipment;
- (2) The tangible personal property performs the same or similar function as the component it replaced; and
- (3) The tangible personal property restores the computer, machinery, or equipment to an operational condition, or upgrades or improves the efficiency of the computer, machinery, or equipment.

e. Supplies. “Supply” means tangible personal property, other than computers, machinery, equipment, or replacement parts, that meets one of the following conditions:

- (1) The tangible personal property is to be connected to a computer, machinery, or equipment and requires regular replacement because the item is consumed or deteriorates during use. Such supplies include, but are not limited to, saw blades, drill bits, filters, and other similar items with a short useful life.
- (2) The tangible personal property is used in conjunction with a computer, machinery, or equipment and is specially designed for use in manufacturing specific products and may be used interchangeably and intermittently on a particular computer, machine, or piece of equipment. Such supplies include, but are not limited to, jigs, dies, tools, and other similar items.
- (3) The tangible personal property comes into physical contact with other tangible personal property used in processing and is used to assist with or maintain conditions necessary for processing. Such supplies include, but are not limited to, cutting fluids, oils, coolants, lubricants, and other similar items with a short useful life.

(4) The tangible personal property is directly and primarily used in an activity described in rules 701—230.14(423) to 701—230.20(423). Such supplies include, but are not limited to, prototype materials and testing materials.

f. Materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies. “Materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies” means tangible personal property that is incorporated into a computer, machinery, equipment, replacement part, or supply when the computer, machinery, equipment, replacement part, or supply is constructed or assembled.

g. Exclusions. Sales of the following property, or materials used to construct or self-construct the following property, are not exempt under rules 701—230.14(423) to 701—230.20(423) regardless of how the property is used.

- (1) Land.
- (2) Intangible property.
- (3) Hand tools. “Hand tool” means a tool that can be held in the hand or hands and is powered by human effort.

(4) Point-of-sale equipment and computers. “Point-of-sale equipment and computers” means input, output, and processing equipment and computers used to consummate a sale and to record or process information pertaining to a sale transaction at the time the sale takes place and is located at the counter, desk, or other specific point where the transaction occurs. Point-of-sale equipment and computers do not include equipment and computers used primarily for depositing or withdrawing funds from financial institution accounts.

(5) Certain centrally assessed industrial machinery, equipment, and computers. Property that is centrally assessed by the department of revenue under Iowa Code sections 428.24 to 428.29 or chapters 433, 434, 437, 437A, 437B, and 438 does not qualify for exemption under rules 701—230.14(423) to 701—230.20(423). Property used but not owned by persons whose property is defined by such provisions of the Iowa Code, which would be assessed by the department of revenue if the persons owned the property, also does not qualify for exemption under rules 701—230.14(423) to 701—230.20(423).

(6) Vehicles subject to registration. The general sales and use tax does not apply to vehicles subject to registration under Iowa Code chapter 321. Instead, such vehicles are subject to the fee for new registration under Iowa Code section 321.105A. Vehicles subject to registration are not exempt from the fee for new registration under rules 701—230.14(423) to 701—230.20(423), unless the vehicle is directly and primarily used in recycling or reprocessing of waste products (see rule 701—230.19(423)).

h. Examples. When used for an exempt purpose under rules 701—230.14(423) to 701—230.20(423), the following items may be exempt computers, machinery, equipment, replacement parts, or supplies. This list is not all-inclusive.

- (1) Coolers, including coolers that do not change the nature of materials stored in them.
- (2) Equipment that eliminates bacteria.
- (3) Palletizers.
- (4) Storage bins.
- (5) Property used to transport raw, semifinished, or finished goods.
- (6) Vehicle-mounted cement mixers.
- (7) Self-constructed machinery and equipment.
- (8) Packaging and bagging equipment, including conveyer systems.
- (9) Equipment that maintains an environment necessary to preserve a product’s integrity.
- (10) Equipment that maintains a product’s integrity directly.
- (11) Quality control equipment.
- (12) Water used for cooling.

230.14(3) *Leased and rented property.* The exemptions under rules 701—230.14(423) to 701—230.22(423) apply to property regardless of how it is sold, including leased or rented property. The lease of computers, machinery, equipment, replacement parts, or supplies may be exempt from sales and use tax if the lessee uses the property in an exempt manner under rules 701—230.14(423) to 701—230.20(423). Additionally, a lessor’s purchase of computers, machinery, equipment, replacement parts, or supplies for lease or resale may be an exempt sale for resale under Iowa Code section 423.3(2).

230.14(4) *Record keeping.* Individuals claiming an exemption must always be able to prove they qualify for the exemption. To claim the exemptions described in this rule, purchasers must be able to prove that computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct the same are used for an exempt purpose under rules 701—230.14(423) to 701—230.20(423). When both exempt and nonexempt machinery and equipment are used in the same facility, replacement parts and supplies used in the machinery and equipment are exempt under these rules only to the extent the purchaser can prove which replacement parts and supplies were used in the exempt machinery and equipment. Detailed, contemporaneous records should be maintained to verify that qualifying property is used for an exempt purpose. The precise records required may vary from purchaser to purchaser. Computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct the same are not exempt under rules 701—230.14(423) to 701—230.20(423) if the property is not used for an exempt purpose.

This rule is intended to implement Iowa Code section 423.3(47) as amended by 2016 Iowa Acts, House File 2433.

ITEM 6. Adopt the following new rule 701—230.15(423):

701—230.15(423) Exemption for the sale of property directly and primarily used in processing by a manufacturer if the sale occurs on or after July 1, 2016. The sales price of computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies is exempt from sales and use tax when the property is directly and primarily used in processing by a manufacturer. For sales occurring prior to July 1, 2016, see rule 701—18.58(422,423).

230.15(1) Required elements. To qualify for exemption under this rule, the purchaser must prove the property is:

a. Computers, machinery, equipment, replacement parts, supplies, or materials used to construct or self-construct computers, machinery, equipment, replacement parts, or supplies (see subrule 230.14(2));

b. Directly used (see subrule 230.15(2));

c. Primarily used (see subrule 230.15(2));

d. Used in processing (see subrule 230.15(3)); and

e. Used by a manufacturer (see subrule 230.15(4)).

230.15(2) Directly and primarily used.

a. Directly used.

(1) Generally. 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 to the exempt activity;

2. The temporal proximity of the use of the property to the use of other property that is directly used in the exempt activity; and

3. The active causal relationship between the use of the property and the exempt activity. 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.

(2) Examples. The following property typically is not directly used in an exempt manner:

1. Property used exclusively for the comfort of workers, such as air cooling, air conditioning, or ventilation systems.

2. Property used in support operations, such as a machine shop, where production machinery is assembled, maintained, or repaired.

3. Property used by administrative, accounting, or personnel departments.

4. Property used by security, fire prevention, first aid, or hospital stations.

5. Property used in communications or safety.

b. Primarily used. The primary use of property is the activity or activities for which the property is used more than half of the time.

230.15(3) Processing.

a. Generally. “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 processor. “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.

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

c. The completion of processing. Processing ends when the finished product is transferred from the processor or delivered for shipment by the processor. Therefore, a processor'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.

d. 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 that it uses as raw material. Company A's employees cut the trees, transport the logs to Company A's facility, store the logs in a warehouse to begin the curing process, and eventually take the logs to Company A's sawmill. The walnut trees are real property while they are growing. 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. Processing of the logs begins when they are placed on vehicles for transport to Company A's factory. However, if the transport vehicles are "vehicles subject to registration," the vehicles are not exempt from the fee for new registration under this rule (see subparagraph 230.14(2) "g"(6)).

EXAMPLE B: Company A from the previous example also buys mahogany logs from a supplier in Honduras. Company A uses its equipment to offload the logs from railroad cars at its facility. Company A then 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 it brews. Company C 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, including fermentation or aging (the transformation of the raw materials from one state to another) as well as the storage of hops in a bin and the storage of beer prior to bottling (the holding of materials in an existing state). Any movement of the product between containers is also a part of processing.

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

230.15(4) Manufacturer:

a. Generally. "Manufacturer" means a person that purchases, receives, or holds personal property of any description for the purpose of adding to its value by a process of manufacturing, refining, purifying, or combining of different materials, or by the packing of meats, with a view to selling the property for gain or profit, but also includes contract manufacturers. A "contract manufacturer" is a manufacturer that otherwise falls within the definition of manufacturer, except that a contract manufacturer does not sell the tangible personal property the contract manufacturer processes on behalf of other manufacturers. A business engaged in activities subsequent to the extractive process of quarrying or mining, such as crushing, washing, sizing, or blending of aggregate materials, is a manufacturer with respect to these activities. A person does not need to be primarily engaged in an activity listed in this subrule in order to qualify as a manufacturer for purposes of this rule.

b. Nonexclusive examples. 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; repairing 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 that ordinarily are not manufacturers.

EXAMPLE A: Company A owns and operates a gravel pit. Company A 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 and 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 that occur after it extracts the gravel from the ground.

EXAMPLE B: Company B owns a manufacturing plant. Company B also owns a machine shop where it uses a metal press machine to fabricate patterns. All of these patterns are used in Company B's manufacturing plant as part of processing, and the metal press machine is used solely to fabricate these patterns. The sales price of the metal press machine is not exempt from sales and use tax under this rule because Company B does not use the metal press machine to manufacture a product for sale at a gain or profit. Similarly, the sales price of replacement parts and supplies used in the metal press machine is not exempt from sales and use tax under this rule. However, the patterns themselves may be exempt supplies if they are directly and primarily used in processing, and the raw materials used to produce the patterns may be exempt under this rule. Additionally, the computers, machinery, equipment, replacement parts, and supplies used in Company B's manufacturing plant may be exempt if they are directly and primarily used in processing.

230.15(5) Replacement parts and supplies.

a. Replacement parts. To qualify for exemption under this rule, replacement parts must satisfy the definition contained in paragraph 230.14(2)“d.” In addition to the other requirements, an exempt replacement part must replace a component of a computer, machinery, or equipment that is directly and primarily used in processing by a manufacturer. Tangible personal property is not an exempt replacement part under this rule if the property exclusively replaces a component of a computer, machinery, or equipment that is not directly and primarily used in processing by a manufacturer.

b. Supplies. To qualify for exemption under this rule, supplies must satisfy the definition contained in paragraph 230.14(2)“e.” In addition to the other requirements, an exempt supply must be connected to, be used in conjunction with, or come into physical contact with a computer, machinery, or equipment that is directly and primarily used in processing by a manufacturer, or an exempt supply must itself be directly and primarily used in processing by a manufacturer. Tangible personal property is not an exempt supply under this rule if the property exclusively is connected to, is used in conjunction with, or comes into physical contact with a computer, machinery, or equipment that is not directly and primarily used in processing by a manufacturer.

This rule is intended to implement Iowa Code section 423.3(47)“a”(1).

ITEM 7. Adopt the following **new** rule 701—230.16(423):

701—230.16(423) Exemption for the sale of property directly and primarily used by a manufacturer to maintain integrity or unique environmental conditions if the sale occurs on or after July 1, 2016. The sales price of computers, machinery, equipment, replacement parts, supplies and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies is exempt from sales and use tax when the property is directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer, including test equipment used to control quality and specifications of the product. For sales occurring prior to July 1, 2016, see rule 701—18.58(422,423).

230.16(1) Required elements. To qualify for exemption under this rule, the purchaser must prove the property is:

- a.* Computers, machinery, equipment, replacement parts, supplies, or materials used to construct or self-construct computers, machinery, equipment, replacement parts, or supplies (see subrule 230.14(2));
- b.* Directly used (see subrule 230.15(2));
- c.* Primarily used (see subrule 230.15(2));
- d.* Used by a manufacturer (see subrule 230.15(4)); and
- e.* Used to maintain:

- (1) A manufactured product's integrity;
- (2) Unique environmental conditions required for a manufactured product; or
- (3) Unique environmental conditions required for other computers, machinery, equipment, replacement parts, or supplies directly and primarily used in processing by a manufacturer.

230.16(2) Replacement parts and supplies.

a. Replacement parts. To qualify for exemption under this rule, replacement parts must satisfy the definition contained in paragraph 230.14(2)“d.” In addition to the other requirements, an exempt replacement part must replace a component of a computer, machinery, or equipment that is directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer. Tangible personal property is not an exempt replacement part under this rule if the property exclusively replaces a component of a computer, machinery, or equipment that is not directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer.

b. Supplies. To qualify for exemption under this rule, supplies must satisfy the definition contained in paragraph 230.14(2)“e.” In addition to the other requirements, an exempt supply must be connected to, be used in conjunction with, or come into physical contact with a computer, machinery, or equipment that is directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer, or an exempt supply must itself be directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer. Tangible personal property is not an exempt supply under this rule if the property exclusively is connected to, is used in conjunction with, or comes into physical contact with a computer, machinery, or equipment that is not directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer.

230.16(3) Example of property directly and primarily used to maintain integrity or unique environmental conditions. A manufacturer purchases a cooling system or heating system that qualifies as machinery. The manufacturer uses the system to directly and primarily maintain the proper temperature of other machinery and equipment. The manufacturer uses such machinery and equipment directly and primarily in processing. The system is not used for the comfort of the workers. Because the system directly and primarily maintains the environmental conditions necessary for machinery and equipment directly and primarily used in processing, the system is exempt from sales and use tax under this rule.

This rule is intended to implement Iowa Code section 423.3(47)“a”(2).

ITEM 8. Adopt the following **new** rule 701—230.17(423):

701—230.17(423) Exemption for the sale of property directly and primarily used in research and development of new products or processes of processing if the sale occurs on or after July 1, 2016. The sales price of computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies is exempt from sales and use tax when the property is directly and primarily used in research and development of new products or processes of processing. For sales occurring prior to July 1, 2016, see rule 701—18.58(422,423).

230.17(1) Required elements. To qualify for exemption under this rule, the purchaser must prove the property is:

- a.* Computers, machinery, equipment, replacement parts, supplies, or materials used to construct or self-construct computers, machinery, equipment, replacement parts, or supplies (see subrule 230.14(2));
- b.* Directly used (see subrules 230.15(2) and 230.17(3));
- c.* Primarily used (see subrule 230.15(2)); and

d. Used in research and development (see subrule 230.17(2)) of:

- (1) New products; or
- (2) Processes of processing.

230.17(2) “Research and development” means experimental or laboratory activity that has as its ultimate goal the development of new products or processes of processing.

230.17(3) Property is used “directly” in research and development only if it is used in actual experimental or laboratory activity that qualifies as research and development under this rule.

230.17(4) Replacement parts and supplies.

a. *Replacement parts.* To qualify for exemption under this rule, replacement parts must satisfy the definition contained in paragraph 230.14(2) “d.” In addition to the other requirements, an exempt replacement part must replace a component of a computer, machinery, or equipment that is directly and primarily used in research and development of new products or processes of processing. Tangible personal property is not an exempt replacement part under this rule if the property exclusively replaces a component of a computer, machinery, or equipment that is not directly and primarily used in research and development of new products or processes of processing.

b. *Supplies.* To qualify for exemption under this rule, supplies must satisfy the definition contained in paragraph 230.14(2) “e.” In addition to the other requirements, an exempt supply must be connected to, be used in conjunction with, or come into physical contact with a computer, machinery, or equipment that is directly and primarily used in research and development of new products or processes of processing, or an exempt supply must itself be directly and primarily used in research and development of new products or processes of processing. Tangible personal property is not an exempt supply under this rule if the property exclusively is connected to, is used in conjunction with, or comes into physical contact with a computer, machinery, or equipment that is not directly and primarily used in research and development of new products or processes of processing.

230.17(5) Examples.

EXAMPLE A: Company A is a hybrid seed producer. Company A maintains a research and development laboratory for use in developing new varieties of corn seed. Company A purchases the following items for use in its research and development laboratory: a laboratory computer for processing data related to the genetic structure of various corn plants, an electron microscope for examining the structure of corn plant genes, a steam cleaner for cleaning rugs in the laboratory offices, and office furniture for use in the laboratory offices. The laboratory computer and the microscope are “directly” used in the research in which the laboratory is engaged; the steam cleaner and the office furniture are not directly used in research. Therefore, the sales prices of the laboratory computer and the microscope are exempt from sales and use tax. The sales prices of the steam cleaner and the office furniture are not exempt from tax under this rule.

EXAMPLE B: Company B is a manufacturer of agricultural equipment. Company B is researching and developing a new tractor. Company B purchases materials to produce a prototype of its new tractor. The prototype tractor will be tested in various settings, including a laboratory and actual agricultural production. The materials used to produce the prototype tractor are exempt supplies directly and primarily used in research and production of new products. The sales price for the materials is exempt regardless of whether Company B sells the prototype tractor after testing, or if it scraps the prototype tractor after testing.

This rule is intended to implement Iowa Code section 423.3(47) “a”(3).

ITEM 9. Adopt the following **new** rule 701—230.18(423):

701—230.18(423) Exemption for the sale of computers used in processing or storage of data or information by an insurance company, financial institution, or commercial enterprise if the sale occurs on or after July 1, 2016. The sales price of computers is exempt from sales and use tax when the computers are used in processing or storage of data or information by an insurance company, financial institution, or commercial enterprise. The sales price of machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment,

replacement parts, and supplies is not exempt under this rule. For sales occurring prior to July 1, 2016, see rule 701—18.58(422,423).

230.18(1) Required elements. To qualify for exemption under this rule, the purchaser must prove the property is:

- a. Computers (see paragraph 230.14(2) “a”);
- b. Used in processing or storage of data or information (see subrule 230.18(2)); and
- c. Used by:
 - (1) An insurance company (see subrule 230.18(3));
 - (2) A financial institution (see subrule 230.18(3)); or
 - (3) A commercial enterprise (see subrule 230.18(3)).

230.18(2) 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 from tax under this rule.

230.18(3) Insurance company, financial institution, or commercial enterprise.

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

b. *Financial institution.* A financial institution is any bank incorporated under the provisions of any state or federal law, any savings and loan association incorporated under the provisions of federal law, any credit union organized under the provisions of any state or federal law, any corporation licensed as an industrial loan company under Iowa Code chapter 536A, and any affiliate of a bank, savings and loan association, credit union, or industrial loan company.

c. *Commercial enterprise.* A commercial enterprise is a business or manufacturer conducted for profit, other than an insurance company or financial institution. “Commercial enterprise” includes centers for data processing services to insurance companies, financial institutions, businesses, and manufacturers, but excludes professions and occupations as well as nonprofit organizations. A hospital that is a not-for-profit organization is not a commercial enterprise. The term “profession” means a vocation or employment requiring specialized knowledge and often long and intensive academic preparation. The term “occupation” means the principal business of an individual, such as the business of farming. A professional entity that carries on any profession or occupation, such as an accounting firm, is not a commercial enterprise.

230.18(4) Exempt property. To qualify for exemption under this rule, tangible personal property must satisfy the definition of “computers” contained in paragraph 230.14(2) “a.” Other property, including machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies, is not exempt under this rule, even if the property is used in processing or storage of data or information by an insurance company, financial institution, or commercial enterprise.

230.18(5) Examples of computers used in processing or storage of data or information by an insurance company, financial institution, or commercial enterprise. A health insurance company has four computers. Computer A is used to monitor the temperature within the insurance company’s building. Computer A transmits messages to the building’s heating and cooling systems, which tell the systems when to raise or lower the level of heating or air conditioning. Computer B is used to store patient records and to 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 the employees can already do. Computer D uses various canned programs to accomplish this function. The final output of Computer A is neither stored nor processed information. Therefore, Computer A does not meet 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 sales prices of Computers B, C, and D are exempt from sales and use tax as computers used in processing or storage of data or information by an insurance company.

This rule is intended to implement Iowa Code section 423.3(47) “a”(4).

ITEM 10. Adopt the following new rule 701—230.19(423):

701—230.19(423) Exemption for the sale of property directly and primarily used in recycling or reprocessing of waste products if the sale occurs on or after July 1, 2016. The sales price of computers, machinery, equipment, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies is exempt from sales and use tax when the property is directly and primarily used in recycling or reprocessing of waste products. For sales occurring prior to July 1, 2016, see rule 701—18.58(422,423).

230.19(1) Required elements. To qualify for exemption under this rule, the purchaser must prove the property is:

a. Computers, machinery, equipment, replacement parts, supplies, or materials used to construct or self-construct computers, machinery, equipment, replacement parts, or supplies (see subrule 230.14(2));

b. Directly used (see subrule 230.15(2));

c. Primarily used (see subrule 230.15(2)); and

d. Used in:

(1) Recycling of waste products (see subrule 230.19(2)); or

(2) Reprocessing of waste products (see subrule 230.19(2)).

230.19(2) Recycling and reprocessing.

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

b. “Reprocessing” is not a subcategory of processing. Reprocessing of waste products is an activity separate and independent from the processing of tangible personal property.

c. Recycling or reprocessing generally begins when the waste products are collected or separated. Recycling or reprocessing generally ends when waste products are in the form of raw material or another non-waste product. Activities that occur between these two points and are an integral part of recycling or processing qualify as recycling or reprocessing.

230.19(3) Replacement parts and supplies.

a. *Replacement parts.* To qualify for exemption under this rule, replacement parts must satisfy the definition contained in paragraph 230.14(2) “d.” In addition to the other requirements, an exempt replacement part must replace a component of a computer, machinery, or equipment that is directly and primarily used in recycling or reprocessing of waste products. Tangible personal property is not an exempt replacement part under this rule if the property exclusively replaces a component of a computer, machinery, or equipment that is not directly and primarily used in recycling or reprocessing of waste products.

b. *Supplies.* To qualify for exemption under this rule, supplies must satisfy the definition contained in paragraph 230.14(2) “e.” In addition to the other requirements, an exempt supply must be connected to, be used in conjunction with, or come into physical contact with a computer, machinery, or equipment that is directly and primarily used in recycling or reprocessing of waste products, or an exempt supply must itself be directly and primarily used in recycling or reprocessing of waste products. Tangible personal property is not an exempt supply under this rule if the property exclusively is connected to, is used in conjunction with, or comes into physical contact with a computer, machinery, or equipment that is not directly and primarily used in recycling or reprocessing of waste products.

230.19(4) Examples.

a. Computers, machinery, and equipment that may be exempt from sales and use tax under this rule include, but are not limited to, compactors, balers, crushers, grinders, cutters, and shears if directly and primarily used in recycling or reprocessing.

b. End loaders, forklifts, trucks, conveyor systems, and other moving devices directly and primarily used in the movement of waste products during recycling or reprocessing may be exempt from sales and use tax under this rule.

c. A bin or other container used to store waste products before collection for recycling or reprocessing is not directly and primarily used in recycling or reprocessing, and its sales price is not exempt from sales and use tax under this rule.

d. A vehicle used directly and primarily for collecting waste products for recycling or reprocessing could be a vehicle used for an exempt purpose under this rule, and such a vehicle could be exempt from the fee for new registration. Thus, a garbage truck could qualify for this exemption if the truck is directly and primarily used in recycling; however, a garbage truck primarily used to haul garbage to a landfill does not qualify for exemption under this rule.

EXAMPLE A: Company A recycles household waste. Company A uses several machines in its facility to separate waste products into recyclable and nonrecyclable materials and to further separate the recyclable materials into paper, plastic, or glass. The sales prices of all separating machines are exempt from sales and use tax as machines directly and primarily used in recycling of waste products.

EXAMPLE B: Company B uses grinding machines to convert logs, stumps, pallets, crates, and other waste wood into wood chips. Company B then uses its trucks to deliver the wood chips to local purchasers. The sales prices of the grinding machines are exempt from sales and use tax as machines directly and primarily used in recycling or reprocessing of waste products. The trucks used to transport the wood chips are not used in recycling or reprocessing because the wood chips are in their final form when loaded onto the trucks.

This rule is intended to implement Iowa Code sections 321.105A(2) “c”(24) and 423.3(47) “a”(5).

ITEM 11. Adopt the following new rule 701—230.20(423):

701—230.20(423) Exemption for the sale of pollution-control equipment used by a manufacturer if the sale occurs on or after July 1, 2016. The sales price of pollution-control equipment, including but not limited to equipment required or certified by an agency of Iowa or of the United States government, is exempt from sales and use tax when the property is used by a manufacturer. Other equipment, and computers, machinery, replacement parts, supplies, and materials used to construct or self-construct computers, machinery, equipment, replacement parts, and supplies are not exempt from sales and use tax under this rule. For sales occurring prior to July 1, 2016, see rule 701—18.58(422,423).

230.20(1) Required elements. To qualify for exemption under this rule, the purchaser must prove the property is:

a. Pollution-control equipment (see subrule 230.20(2)); and

b. Used by a manufacturer (see subrule 230.15(4)).

230.20(2) “Pollution-control equipment” is any disposal system or apparatus used or placed in operation primarily for the purpose of reducing, controlling, or eliminating air or water pollution. Other property, including replacement parts and supplies, is not exempt under this rule. Pollution-control equipment 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 of the United States government. Wastewater treatment equipment, dust mitigation systems, 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, such as a gas mask.

EXAMPLE: A manufacturer constructs a wastewater treatment facility to treat wastewater from its manufacturing facility. The wastewater treatment facility diverts wastewater from the local water treatment plant. The facility then converts wastewater into a biogas, which the manufacturer uses as an

energy source in its manufacturing facility. The sales price of the pollution-control equipment used in the wastewater treatment facility is exempt from sales and use tax.

This rule is intended to implement Iowa Code section 423.3(47) “a”(6).

ITEM 12. Adopt the following new rule 701—230.21(423):

701—230.21(423) Exemption for the sale of fuel or electricity used in exempt property if the sale occurs on or after July 1, 2016. The sales price of fuel or electricity consumed by computers, machinery, or equipment that is exempt from sales and use tax under rule 701—230.14(423), 701—230.15(423), 701—230.16(423), 701—230.17(423), 701—230.19(423), or 701—230.20(423) is also exempt from sales and use tax. The sales price of electricity or other fuel consumed by replacement parts, supplies, or computers used in processing or storage of data or information by an insurance company, financial institution, or commercial enterprise remains subject to tax even if such property is exempt under rules 701—230.14(423) to 701—230.20(423). For sales occurring prior to July 1, 2016, see rule 701—18.58(422,423).

EXAMPLE: A manufacturer operates a power plant. The manufacturer uses energy from the power plant to operate machinery and equipment used directly and primarily in processing at its manufacturing facility. The fuel consumed in the manufacturer’s power plant is exempt from sales and use tax.

This rule is intended to implement Iowa Code section 423.3(47) “b.”

ITEM 13. Adopt the following new rule 701—230.22(423):

701—230.22(423) Exemption for the sale of services for designing or installing new industrial machinery or equipment if the sale occurs on or after July 1, 2016. The sales price from the services of designing or installing new industrial machinery or equipment is exempt from sales and use tax. The enumerated services of electrical or electronic installation are included in this exemption.

230.22(1) Required elements. To qualify for the exemption, the purchaser must prove the service is:

- a. A design or installation service (see subrule 230.22(2));
- b. Of new (see subrule 230.22(3)); and
- c. Industrial machinery or equipment (see subrule 230.22(4)).

230.22(2) Design or installation services include electrical and electronic installation. “Design or installation” services do not include any repair service.

230.22(3) “New” means never having been used or consumed by anyone. The exemption does not apply to design or installation services on reconstructed, rebuilt, repaired, or previously owned machinery or equipment.

230.22(4) Industrial machinery or equipment.

a. *Generally.* “Industrial machinery or equipment” means machinery or equipment, as defined in subrule 230.14(2). The sale of industrial machinery or equipment must also qualify for exemption under any of the following:

(1) Property used directly and primarily in processing by a manufacturer (see rule 701—230.15(423)).

(2) Property used directly and primarily by a manufacturer to maintain the integrity of the manufacturer’s product or to maintain unique environmental conditions for computers, machinery, or equipment (see rule 701—230.16(423)).

(3) Property used directly and primarily in research and development of new products or processes of processing (see rule 701—230.17(423)).

(4) Property used directly and primarily in recycling or reprocessing of waste products (see rule 701—230.19(423)).

(5) Pollution-control equipment used by a manufacturer (see rule 701—230.20(423)).

b. *Exclusions.* The following property is not industrial machinery or equipment regardless of how the purchaser uses it:

- (1) Computers (see paragraph 230.14(2) “a”).
- (2) Replacement parts (see paragraph 230.14(2) “d”).

- (3) Supplies (see paragraph 230.14(2)“e”).
- (4) Materials used to construct or self-construct computers, machinery, equipment, replacement parts, or supplies (see paragraph 230.14(2)“f”).

230.22(5) Billing. The sales price for designing or installing new industrial machinery or equipment must be separately identified, charged separately, and reasonable in amount for the exemption to apply. The exemption applies to new industrial machinery or equipment regardless of how it is purchased, including leased or rented machinery or equipment.

EXAMPLE: Dealer sells and installs two new machines for Manufacturer. Manufacturer uses one machine on its production floor, where the machine is directly and primarily used in processing. Manufacturer uses the other machine in its machine shop, where the machine is not directly and primarily used in processing. Dealer gives an invoice to Manufacturer that separately itemizes the sales prices for each machine and each installation. The machine used on the production floor is new industrial machinery or equipment, and the sales prices of the machine and its installation are exempt from sales and use tax. The machine used in the machine shop is not new industrial machinery or equipment, and the sales prices of the machine and its installation are taxable.

This rule is intended to implement Iowa Code section 423.3(48).

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