

701—18.29 (422,423) Processing, a definition of the word, its beginning and completion characterized with specific examples of processing.

18.29(1) Processing—a definition. For the purpose of these rules, “processing” means an operation or a series of operations whereby tangible personal property is subjected to some special treatment by artificial or natural means which changes its form, context, or condition, and results in marketable tangible personal property. These operations are commonly associated with fabricating, compounding, germinating, or manufacturing. *Linwood Stone Products Co. v. State Department of Revenue*, 175 N.W.2d 393 (Iowa 1970).

18.29(2) The beginning of processing. Processing begins when the “form, context, or condition” of tangible personal property is changed with the intent of eventually transforming the property into a saleable finished product. The severance of raw material from real estate is not processing, even if this severance results in a change in the form, context, or condition of the real estate. *Linwood Stone Products Co. v. State Department of Revenue*, 175 N. W.2d 393 (Iowa 1970). Furthermore, transportation of raw material after it is severed from real estate but prior to the time the initial change in the form, context, or condition of the raw material occurs is not processing. *Southern Sioux County Rural Water System, Inc. v. Iowa Department of Revenue*, 383 N.W.2d 585 (Iowa 1986).

18.29(3) The completion of processing. Processing ends when the property being processed is in the form in which it is ultimately intended to be sold at retail, *Hy-Vee Food Stores v. Iowa Department of Revenue*, 379 N.W.2d 37 (Iowa App. 1985). The storage or transport of property after that property is transformed into a finished product is not a part of processing.

18.29(4) Examples of when processing begins and ends. The following examples are intended to clarify but not to contradict the explanation of processing set out in subrules 18.29(2) and 18.29(3).

EXAMPLE A: A company blasts limestone from the ground, bulldozers pick the limestone up and put it in trucks; these trucks transport the limestone to a crusher some distance from the quarry site. The first change in the “form” or “condition” of the limestone, while it is tangible personal property, occurs when the stone is crushed in the crusher. The blasting of the stone from the ground and its transport to the crusher would be acts preparatory to and not a part of processing. Thus, fuel used in the bulldozers and transport trucks would not be fuel used in processing, *Linwood Stone Products*, supra.

EXAMPLE B: Pumps remove water from underground wells and pump that water through pipes to a water treatment plant. At the treatment plant, the water passes initially through an aeration system which adds oxygen to it. At other points in the plant, potassium and chlorine are added to the water and iron is removed. After these acts are performed, clean, drinkable water exists. The first change, however, in the condition of the water occurs when it passes through the aeration system and oxygen is added to it. The withdrawal of the water from the ground and its transport to the aeration system would not be a part of processing. Thus, electricity used by the pumps which pump the water to the aeration system would not be used in processing. However, by way of contrast, electricity used to transport the water between, for example, the aeration system and the point where potassium is added to the water would be used in processing. *Southern Sioux Rural Water System, Inc.*, supra.

EXAMPLE C: Water is processed in a treatment plant. The last act at the plant necessary to render the water drinkable or a “finished product” is the addition of chlorine. After the addition of chlorine, the water is pumped first into wells and later into water towers where it is held for distribution. The pumping of this drinkable water from the point where the chlorine is added to the wells and the tower is not a part of processing because processing of the water ended with the addition of the chlorine; thus, electricity used in these pumps is not electricity used in processing. *Southern Sioux County Rural Water System, Inc.*, supra.

18.29(5) Integral part of the production of the product test. Certain activities may be exempt as part of processing if those activities are very closely interconnected with, or an integral part of, the operation of the processing equipment while processing is occurring. *Southern Sioux Rural Water System, Inc.*, supra. Merely because an activity is vital or essential to a processing operation does not make that activity exempt as part of processing unless the activity itself is closely interconnected with, or an integral part of, the operation of the processing equipment while processing is occurring. *Mississippi Valley Milk*

Producers Ass'n v. Iowa Dept. of Revenue, 387 N.W.2d 611 (Iowa App. 1986). See the nonexclusive example below.

A manufactures nails. In A's factory is a machine which draws steel into long rods the width of whatever nail A may wish to manufacture. After this machine draws the steel into the desired-size rods, the rods are moved to a second machine by a conveyor belt. This second machine cuts the rods into the length of nail which A desires. A second conveyor belt then transports these cut rods to a third machine which sharpens one end of the rod to a point and puts a "nail head" on the other end of the rod. The activities of the three machines are clearly processing, in that they are activities which change the form, context or condition of raw material, and as a result of those activities, marketable tangible personal property or a finished product is created. The two conveyor belts move the partially finished nails from one piece of processing equipment to another while processing is occurring. Since the activities of the conveyors are very closely interconnected with and an integral part of the operation of the various pieces of processing equipment while processing is occurring, the conveyor belts are involved in processing as well.

18.29(6) *Other specific examples of processing.* The Iowa Supreme Court has also stated that the following activities are processing: manufacturing ice, refrigerating cheese to age it from "green" to edible, refrigerating eggs to change their flavor, pasteurizing and subsequent refrigeration of milk, "hard" freezing of meat and butter for aging, canning vegetables and cooking foodstuffs; *Fischer Artificial Ice & Cold Storage Co. v. Iowa State Tax Commission*, 248 Iowa 497, 81 N.W.2d 437 (1957); and, *Mississippi Valley Milk Producers v. Iowa Dept. of Revenue and Finance*, 387 N.W.2d 611 (Ia. App. 1986), also crushing of "flat rock" limestone and treating limestone in kilns. *Linwood Stone Products Co. v. State Dept. of Revenue*, 175 N.W.2d 393 (Iowa 1970). See 701—subrule 17.3(2) for an expanded definition of processing with regard to food manufacturing.

18.29(7) *Other department rules concerned with processing.* Various sections of the Iowa Code set out activities 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) 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) 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 as part of a contract entered into on or after July 1, 2016, computers, machinery, and equipment used for an exempt purpose under Iowa Code section 423.3(47). See rules 701—230.14(423) to 701—230.22(423).