

## **When Do Electricity Generation Activities Qualify as “Manufacturing” for PA Sales and Use Tax Purposes?**

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The Pennsylvania Department of Revenue has issued a series of rulings that machinery and equipment used in the generation of electricity qualify for the Sales and Use Tax manufacturing exclusion. *See* Ruling No. SUT-10-001 (April 7, 2010) (machinery, equipment, parts and supplies for a solar energy facility, for which the electricity output will be transferred to a public utility through a high voltage transmission system, qualifies for the manufacturing exclusion); Ruling No. SUT-03-032 (July 1, 2003, reissued July 2, 2008) (machinery, equipment, parts and supplies used to generate electricity through “combined cycle technology,” using generators driven by both fuel-fired combustion and steam turbines, qualifies for the manufacturing exclusion); Ruling No. SUT-00-190 (December 12, 2000, reissued October 7, 2008) (production of electricity through the use of wind turbines qualifies as manufacturing). These rulings are based on the Department’s determination that the production of electricity constitutes the “manufacture of tangible personal property” because the sales tax statute defines “tangible personal property” to include “electricity for non-residential use.” *See* 72 P.S. § 7201(m).

The Department of Revenue recently issued Sales and Use Tax Bulletin 2010-01 (July 28, 2010), which is intended to further “clarify when a person’s activities rise to the level of being engaged in the business of manufacturing electricity,” in order to be eligible to claim the manufacturing exclusion on the purchase of equipment, machinery, parts and supplies used directly in the generation operations. The Bulletin states five requirements for being engaged in the “business” of manufacturing electricity, which are similar to the requirements for eligibility to claim the in-house printing exemption (e.g., conducting the activities in a distinct location, providing separate accounting or interdepartmental billing, and conducting electricity production activities that are “of sufficient size, scope and character that they could be conducted on a commercially viable basis separate and distinct from any other business activities”).

The Bulletin specifically states that (1) back-up or emergency generators and (2) residential electric systems such as solar panels/photovoltaic systems and windmills (regardless of whether some of the electricity is sold) do not qualify for the manufacturing exclusion.

The Bulletin also provides information on the manner in which an exemption certificate should be completed by a construction contractor when claiming exemption for property that will be transferred to an electricity producer for use directly in manufacturing electricity. Based on the content of this Bulletin, contractors have been put on notice that the manufacturing exclusion does not apply when they purchase property for installation as part of a residential electric generation system.

The sales tax statute explicitly requires that manufacturing activities be “engaged in as a business” in order to qualify for exclusion. *See* 72 P.S. § 7201(c). It is questionable, however, whether every requirement stated in Bulletin 2010-01 must be satisfied in order to meet the statutory prerequisite that electricity production activities be “engaged in as a business.” It is well established that the manufacturing exclusion applies to machinery and equipment used to manufacture tangible personal property for “use” by the manufacturer as well as to manufacture property for resale to others. If your company utilizes equipment to produce electricity for use in its other business operations, but does not satisfy all of the requirements set forth in the Bulletin, you may still have a viable claim to the manufacturing exclusion.

Although it has been the Department of Revenue's longstanding position that the production of electricity constitutes "manufacturing" for Sales and Use Tax purposes, no Pennsylvania court has yet addressed the issue. The tax statute limits the manufacturing exclusion to machinery and equipment used in the manufacture of "tangible personal property." See 72 P.S. § 7201(k)(8)(A). The production of electricity does not fall within the "traditional" concept of manufacturing tangible personal property (i.e., having tangible material as a starting point and a continuity of existence of the material into the final product), and the Commonwealth Court has refused to extend the exclusion to the production of certain other "services" included within the statutory definition of "tangible personal property." See *Bell Atlantic Mobile Systems, Inc. v. Commonwealth*, 799 A.2d 902 (Pa. Cmwlth. 2002), *aff'd per curiam*, 845 A.2d 762 (Pa. 2004) (holding that production of cellular telecommunications services does not qualify as "manufacturing" even though such services were then included within the statutory definition of "tangible personal property"). While the Department has consistently ruled that electricity production qualifies for the sales tax manufacturing exclusion, a letter ruling technically may be relied upon only by the particular taxpayer that obtained the ruling, based upon the facts supplied. See 61 Pa. Code § 3.3. Therefore, given the lack of direct guidance by statute or court decision, and the fact that the methods of producing electricity are continually evolving, we recommend that companies obtain a private letter ruling from the Department to confirm that their electricity production activities qualify for the manufacturing exclusion prior to constructing new facilities or expending significant sums on equipment for operating facilities.

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