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SC PRIVATE LETTER RULING #93-7

TO: ZIP Company

TAX MANAGER: John P. McCormack

SUBJECT: Machines and Equipment Stored and Repaired in South Carolina  
(Sales and Use Tax)

DATE: November 3, 1993

REFERENCES: S.C. Code Ann. Section 12-36-2120(17) (Supp. 1992)  
S.C. Code Ann. Section 12-36-120 (Supp. 1992)  
S.C. Code Ann. Section 12-36-1310 (Supp. 1992)  
S.C. Code Ann. Section 12-36-1370(B) (Supp. 1992)  
S.C. Code Ann. Section 12-36-140 (Supp. 1992)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1992)

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies to the specific facts and circumstances related in the request.

Private Letter Rulings have no precedential value and are not intended for general distribution.

Question:

Is ZIP Company liable for sales and use taxes with respect to the purchase or transfer of machines, equipment or repair parts for repair, reconditioning and testing in South Carolina, as described in the facts, prior to subsequent shipment of these items to a new manufacturing facility in Mexico?

Facts:

ZIP Company ("ZIP"), with headquarters in ZIP, USA, is a manufacturer of automotive ride products for the commercial market. The primary products manufactured are shocks and struts for original equipment and aftermarket sales. In the United States, ZIP has manufacturing plants in South Carolina, Arkansas, Georgia, and Nebraska. They also have an assembly facility in Delaware. Outside of the United States, ZIP has manufacturing plants in Canada, Belgium, Australia, the United Kingdom, and Brazil.

ZIP will begin manufacturing operations in Mexico in October of 1994. the machines and equipment to operate this facility will be assembled from transfers of available machines from current manufacturing plants in the United States and from foreign countries and from the purchase of new machines and equipment from various suppliers.

The machines and equipment will be temporarily stored in Anderson, South Carolina, either in ZIP's facility or a rented warehouse for the purpose of:

1. Utilizing engineering and technical services of ZIP and its U.S. suppliers to repair, recondition, and prepare the necessary machines, equipment, and tooling to initiate manufacturing operations in Mexico.
2. Testing the machines and equipment to insure operational standards.
3. Coordinate the bulk transfer of the machines and equipment to Mexico.

The machines and equipment will be stored in Anderson, South Carolina for the above purposes for six to nine months.

#### Discussion:

The issue is whether the machines and equipment, as described in the facts, will be subject to sales or use taxes in South Carolina.

Code Section 12-36-910(A) imposes the South Carolina sales tax and reads, in part:

A sales tax, equal to five percent of the gross proceeds of sales is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail.

Code Section 12-36-1310(A) imposes the South Carolina use tax and reads in part:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State.

Therefore, for the 5% sales or use taxes to apply, there must be a retail sale or purchase of tangible personal property.

The statute provides several exemptions and exclusions that may be applicable and are described below.

#### **MACHINES USED IN MANUFACTURING**

Code Section 12-36-2120(17) exempts from sales and use tax the gross proceeds of sales, or sales price of:

Machines used in manufacturing, processing, compounding, mining, or quarrying tangible personal property for sale. "Machines" include the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of machines and which are necessary to the operation of the machines and are customarily so used.

In order to determine whether machines and attachments are used in manufacturing automotive ride products for sale, it is essential to ascertain at which point the manufacturing will begin and end at the manufacturing site in Mexico. American Law Reports Annotated 2d suggests the following in making this determination and reads:

While the determination of whether the use is a taxable one or not appears to depend largely upon the peculiarities of the taxpayer's operations, so as to be essentially a question of fact in each case, it seems that tax will be imposed where the transportation or storage is clearly of raw materials prior to the start of manufacturing or processing, or of the completed product after such operations have clearly terminated, but that handling and storage intermediate to the various manufacturing or processing operations may be regarded as a part of those operations, and so free from the tax. Annot., 30 A.L.R. 2d 1449 (1955).

Furthermore, in Bird & Son, Inc. v. Limbach, 45 Ohio St. 3d 76, 543 N.E. 2d 1161(1989), the Ohio Supreme Court concluded that "tangible personal property which is employed in operations preliminary or preparatory to the production of the marketable product, ..., or employed subsequent to the completion of the manufacturing process, ... , is not exempt" (Emphasis added).

SC Regulation 117-174-134, entitled "Conveyors", reads in part:

The general rule with reference to material handling machinery and/or mechanical conveyors is that such machinery is subject to the tax up to the point where the materials go into the process. The machine feeding the first processing machine(s) is exempt. The last machine to come within the exemption is that machine which discharges the finished product from the last machine used in the process. Material handling machinery used for transporting (in process) material from one process stage to another comes within the exemption. Warehouse machinery used only for warehouse purposes, loading and unloading, storing, transporting raw materials and finished products, etc., is held to be subject to the tax.

If material handling machinery is customarily used for a dual purpose, that is partly for an exempt purpose and partly for a taxable purpose, the machinery may be purchased free of the tax under the machine exemption ...

The South Carolina Supreme Court held in Hercules Contractors and Engineers, Inc. v. South Carolina Tax Commission, 280 SC 426, 313 S.E. 2d 300 (1984) that machinery used for both taxable and exempt purposes must be used substantially for an exempt purpose in order to come within the provisions of the machine exemption under Code Section 12-36-2120(17).

Based on the above, machines that will be used in manufacturing (as described above) ZIP's automotive ride products for sale may be stored in South Carolina free of the sales and use tax before they are transported to ZIP's new facility in Mexico. "Machines' include the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of machines and which are necessary to the operation of the machines and are customarily so used."

### **EQUIPMENT "USED DIRECTLY" IN MANUFACTURING**

Code Section 12-36-120 defines the terms "wholesale sale" and "sale at wholesale". This section provides several exclusions from the tax, including one in which tangible personal property may be purchased free of the tax if it is "used directly" in manufacturing tangible personal property for sale. Under SC Regulation 117-174.30, tangible personal property is "used directly" if it comes in direct contact with the product being manufactured for sale and it contributes to bring about a chemical or physical change to the product.

Based on the above, equipment and other items that will be used directly in manufacturing (as described above) ZIP's automotive ride products for sale may be stored in South Carolina free of the sales and use tax before they are transported to ZIP's new facility in Mexico.

### **TANGIBLE PERSONAL PROPERTY SUBSTANTIALLY USED OUTSIDE OF SOUTH CAROLINA**

Code Section 12-36-1310 imposes the use tax and reads, in part:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State.

Code Section 12-36-1370(B) states that "[i]t is presumed that tangible personal property received in [South Carolina] by its purchaser was purchased for storage, use or other consumption in [South Carolina]."

Therefore, in order for the use tax to apply, the property: (1) must be used, stored or consumed in South Carolina; (2) must have been purchased at retail; and (3) must have been purchased for use, storage or consumption in South Carolina. In addition, the statute specifically presumes that the property was purchased for use, storage or consumption in South Carolina.

SC Regulation 117-174.220 reads, in part:

Where property purchased in another state and used outside the State of South Carolina, is brought into [South Carolina] for use, storage or consumption in South Carolina, the use tax will apply unless the following conditions are conclusively established: (1) That the property when purchased was intended for a bona fide use outside the state of South Carolina; (2) That the first actual use of the property was outside the state of South Carolina; and (3) That the first actual use of the property was substantial and constituted the primary use for which the property was purchased.

The responsibility for proof rests upon the purchaser and until the above facts are established to the satisfaction of the [Department of Revenue], it will be presumed that the use of such property in South Carolina is subject to a use tax.

Based on the above, machines and equipment of ZIP that were purchased and used outside of South Carolina, and then brought into South Carolina for the purposes set forth in the facts, are not subject to the use tax if the facts required by SC Regulation 117-174.220 can be established.

### **TANGIBLE PERSONAL PROPERTY PURCHASED OUTSIDE SOUTH CAROLINA FOR TEMPORARY STORAGE IN SOUTH CAROLINA**

As stated above, the “use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, ...” (Emphasis added.)

Code Section 12-36-140 defines the term “storage” and reads in part:

(A) “Storage” includes any keeping or retaining in this State, for any purpose except sale in the regular course of business or subsequent use solely outside this State, of tangible personal property purchased at retail.

\* \* \* \*

(C) “Storage” and “use” do not include the keeping, retaining, or exercising of any right or power over tangible personal property:

- (1) for the exclusive purpose of subsequently transporting it outside the State for first use, or
- (2) for the purpose of first being manufactured, processed, or compounded into other tangible personal property to be transported and used solely outside the State.

Based on the above, machines and equipment of ZIP that were purchased at retail outside of South Carolina, and transported to South Carolina for the purposes set forth in the facts, are not subject to the use tax if any one of the exclusions provided for in subsections (A) or (C) of Code Section 12-36-140 is applicable.

### **REPAIR PARTS, SUPPLIES, AND LABOR**

SC Regulation 117-174.191 reads:

- (a) When repairs require only service or services with the use of an inconsequential amount of materials, the amount received is not subject to tax.
- (b) When material and service are used in making repairs to machines exempted under the machine exemption and when the materials used consist of standard replacement parts customarily used on such machines, neither service nor materials are subject to tax.

- (c) When material and service are used in repairing machines not exempted and when there is no separation in the billing, both materials and services are to be included in gross proceeds of sales.
- (d) When material and service are used in repairing taxable machines with service and materials shown separately, the material only is subject to tax.
- (e) Materials are taxable in any event when sold to repairmen for use in making repairs when such materials lose their identity as a result of such use. For instance, paint, solder, lumber, and sheet metal.

Conclusion:

### **MACHINES AND EQUIPMENT**

ZIP Company is liable for the sales and use tax with respect to the purchase or transfer of machines and equipment for repair, reconditioning and testing in South Carolina, as described in the facts, prior to subsequent shipment of these items to a new manufacturing facility in Mexico, unless any one of the following are applicable:

1. The property is a machine that will be used in manufacturing ZIP's automotive ride products for sale. See the discussion above for information concerning whether a machine is used in manufacturing products for sale.
2. The property is equipment or other items, other than a manufacturing machine, that will be "used directly" in manufacturing ZIP's automotive ride products for sale. See the discussion above for information concerning whether certain equipment is "used directly" in manufacturing products for sale.
3. The property was purchased at retail outside of South Carolina by ZIP and was intended for a bona fide use by ZIP in a plant outside of South Carolina; was first actually used at that plant outside of South Carolina; and, the first actual use at the plant outside of South Carolina was substantial and constituted the primary use for which the property was purchased.
4. The property was purchased at retail outside of South Carolina by ZIP, transported to South Carolina, and stored in South Carolina for subsequent use solely outside South Carolina or for the purpose of first being manufactured, processed, or compounded into other tangible personal property to be transported and used solely outside South Carolina.

Repair parts purchased to repair, in South Carolina, machines that will not be used in manufacturing tangible personal property for sale will be subject to the sales and use tax. These items are used, and not merely stored, in South Carolina and are not "manufactured, processed, or compounded into other tangible personal property".

## **REPAIR PARTS**

ZIP Company is liable for the sales and use tax with respect to the purchase or transfer of repair parts used to repair machines and equipment in South Carolina, as described in the facts, unless the property is a repair part for, or attachment to, a machine that will be used in manufacturing ZIP's automotive ride products for sale. See the discussion above for information concerning whether a machine is used in manufacturing products for sale.

## **SUPPLIES**

Supplies used in repairing ZIP's machines and equipment in South Carolina as described in the facts, and which lose their identity as a result of such use, are subject to the sales and use tax. For instance, paint and solder used in repairing or reconditioning a machine are taxable. Such supplies are subject to the sales and use tax whether or not the machine being repaired is an exempt machine.

## **LABOR**

The sales and use tax is applicable to the charges for labor performed with respect to ZIP's repair or reconditioning of machines and equipment in South Carolina, as described in the facts, as follows:

1. If repairs of ZIP's machines and equipment in South Carolina, as described in the facts, require only labor, the charge for the labor is not subject to the sales and use tax.
2. If ZIP has purchased the repair part from one person and later hires another person to install the part, the charge for labor is not subject to the sales and use tax. Only the purchase of the part is subject to the sale and use tax; however, the purchase of the part is not subject to the tax if it is installed in an exempt machine.
3. If a supplier of ZIP is making a sale and installation of the repair part, both the part and labor are included in gross proceeds of sales and subject to the sales and use tax if there is no separation of parts and labor on the billing to ZIP. If there is a separation of parts and labor on the billing to ZIP, only the parts are subject to tax.

However, as stated above, if the property is a repair part for, or attachment to, a machine that will be used in manufacturing ZIP's automotive ride products for sale, the sale and installation is not subject to the sales and use tax.