

Chapter 14

Manufacturers, Processors, and Compounders

A. General Information

Manufacturers, processors, and compounders are eligible for numerous exclusions and exemptions from sales and use tax.¹ This chapter provides a more detailed discussion of the most common exemptions available to manufacturers, processors, and compounders, such as the sales tax exemption for machinery used in manufacturing, processing, compounding, mining, or quarrying tangible personal property for sale;² ingredient parts;³ electricity;⁴ fuel;⁵ packaging;⁶ and sales for resale.⁷

B. Machines, Parts, and Attachments

General Information. The “machine exemption”⁸ exempts from sales and use tax purchases of machines used in manufacturing, processing, agricultural packaging, compounding, mining, or quarrying tangible personal property for sale. The term “machines” includes the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of the machines and which are necessary to the operation of the machines and are customarily so used or are necessary to comply with the order of an agency of the United States or of South Carolina for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by a machine used in manufacturing, processing, recycling, compounding, mining, or quarrying tangible personal property for sale. This exemption does not include automobiles or trucks.

The applicability of this machine exemption depends on whether the machine is integral and necessary to the manufacturing process⁹ - i.e., is the machine an essential and indispensable component part of the manufacturing process and is it used on an ongoing and continuous basis during the manufacturing process. The court in *Hercules Contractors and Engineers, Inc. v. South Carolina Tax Commission*, 313 S.E. 2d 300 (1984) set forth a test for determining if a machine is integral and necessary to the manufacturing process; two South Carolina court decisions in 2003 have followed and clarified this theory. Each is briefly discussed below.

Hercules Contractors and Engineers, Inc. v. South Carolina Tax Commission, 313 S.E. 2d 300 (1984). *Hercules* involved whether a facility that treated waste on plant property that was produced in connection with the manufacture of textile products for sale was a machine. The

¹ South Carolina Code §§12-36-2120 and 12-36-120 and SC Regulation 117-302.

² South Carolina Code §12-36-2120(17).

³ South Carolina Code §12-36-120(2).

⁴ South Carolina Code §12-36-2120(19).

⁵ South Carolina Code §12-36-2120(9).

⁶ South Carolina Code §§12-36-2120(14) and 12-36-120(4).

⁷ South Carolina Code §12-36-120(1).

⁸ South Carolina Code §12-36-2120(17).

⁹ References to “manufacturing” include “processing,” “compounding,” “mining,” and “quarrying.”

Court held that the wastewater treatment facility was a machine and that its various parts and attachments (such as vats, basins, tanks, pumps, other mechanical devices, troughs, and pipes) are integral and necessary to the operation of the system as a whole.

The following test was used by the Court in determining what is an exempt “machine.” Are improvements, either fastened or loose,

1. Used directly in manufacturing the products that the establishment intended to produce;
2. Necessary and integral part of the manufacturing process;
3. Used for the purpose of manufacturing the product it was intended to produce; and
4. Not benefiting the land generally, and will not serve various users of the land.

The Court further defined the term “machine” to include “the concept of combination” (*i.e.*, combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result integral and necessary to the manufacturing process) and held that the statute “does not require a machine to have moving parts if it is an integral part of the manufacturing process” and that the statute makes no distinction “as to whether a machine is a fixture or personal property.”

Springs Industries, Inc., v. South Carolina Department of Revenue, South Carolina Court of Appeals, No. 2003-UP-029, (1/8/03) (unpublished), cert. denied, (10/8/03). *Springs* involved the applicability of the machine exemption to “machines used in manufacturing” at a textile plant, and to chemicals used at the plant’s wastewater treatment facilities to purify manufacturing waste. The court held that machinery is exempt if it is integral and necessary to the manufacturing process and used in an ongoing and continuous basis during the manufacturing process.

Anonymous Corporation v. South Carolina Department of Revenue (02-ALJ-17-0350-CC). This case involved whether buildings or parts of buildings could be exempt under the machine exemption. The Administrative Law Court held that building materials, such as paint and sealants, foundations, structural steel, steel decking and checkers plates for buildings, hangers and supports for process piping, and architectural roofing and siding, purchased to construct a manufacturing facility were not exempt as a machine.

The machine exemption does not apply to everything that can be useful to a manufacturer. The applicability of the machine exemption depends on whether the machine is integral and necessary to the manufacturing process.

C. Machine Exemption – General Rule

A machine qualifies for the machine exemption if the machine meets the following three requirements:¹⁰

1. The machine is used at a manufacturing facility whose purpose is manufacturing a product “for sale.” It does not apply to machines used at a facility whose purpose may be retailing, wholesaling, or distributing. For example, machines used by an industrial baker manufacturing breads for sale may be exempt; however, similar machines used by a local retail bakery are not exempt.
2. The machine is used in, and serves as an essential and indispensable component part of the manufacturing process, and is used on an ongoing and continuous basis during the manufacturing process. Note: A machine “integral and necessary” to the manufacturer, such as a machine used solely for warehouse, distribution, or administrative purposes, is not exempt under the machine exemption since it is not “integral and necessary” to the manufacturing process.
3. The machine must be substantially used (not necessarily exclusively used) in manufacturing tangible personal property for sale, *i.e.*, more than one-third of a machine’s use is for manufacturing.

A machine meeting the above requirements may be exempt even if it does not have moving parts or is a fixture upon the real estate where it stands. However, buildings and parts of buildings, as well as other improvements which benefit the land generally and may serve other users of the land, are not exempt.¹¹

D. Machines - Replacement Parts and Attachments

Parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of exempt machines are also exempt under the machine exemption if they are

- (1) used on or in the operation of exempt machines,
- (2) manufactured for use on or in the operation of exempt machines,
- (3) integral and necessary to the operation of exempt machines, and
- (4) customarily so used.

In order to be exempt, a part or attachment must be purchased in the form in which it will be used by the manufacturer without any fabrication or alteration by the manufacturer, except the usual and customary minor adjustment. It must be a standard part or attachment customarily used

¹⁰ SC Regulation 117-302.5.

¹¹ SC Regulation 117-302.5.

and, further, that the machine or machinery on which it is used would not do the work for which it was designed if it were not used. This exempts all parts and attachments without which the machine would do no work, and exempts parts and attachments designed to increase the efficiency of the machine.¹²

E. Examples of Exempt Machines or Machine Parts

Examples of exempt machines or parts of machines include the following:

- material handling or mechanical conveyor machines feeding the first processing machine; the machine that 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;
- chemicals, including greases, oils, lubricants, and coolants, used in an exempt manufacturing machine that are essential to the functioning of the exempt machine during the manufacturing process;
- tanks which are a part of the chain of processing operations (the exemption does not include storage tanks);
- transformers, capacitors, and voltage regulators used by manufacturers, processors, or compounders as a part of their manufacturing, processing, or compounding machinery;
- machines used to condition air (including humidification systems) for quality control during the manufacturing process of tangible personal property made from natural fibers and synthetic materials;
- recording instruments attached to manufacturing machines;
- belting purchased for use on a particular machine used in manufacturing tangible personal property for sale; and
- materials used by manufacturers or contractors in building machines that will manufacture tangible personal property for sale.

F. Examples of Non-Exempt Machines or Parts

Examples of taxable machines or parts include the following:

- material handling machinery and/or mechanical conveyors up to the point where the materials go into process;

¹² See SC Regulation 117-302.5 for guidance in determining what qualifies as a part or attachment to a machine.

- chemicals used to clean non-exempt machines, such as storage tanks, or the manufacturing facility;
- paint used on exempt manufacturing machines to prevent machine corrosion;
- greases, oils (*e.g.*, motor oils, gear oils, or chain oils), lubricants, and coolants used in an exempt manufacturing machine when such items are not integral and necessary to the manufacturing process, such as those that are not essential in ensuring the functioning of the machine during the manufacturing process;
- machines used for maintenance purposes (*i.e.*, machines used to maintain nonexempt machines that are not integral and necessary to the manufacturing process, or are not used on an ongoing, continuous basis to maintain exempt manufacturing machines that are integral and necessary to the manufacturing process), such as pressure washing machines and ultrasonic cleaning machines used to clean non-exempt machines or parts, such as storage tanks;
- storage racks used to store raw materials or finished goods, or storage tanks used to store raw materials, gasses, or water;
- warehouse machines used for warehouse purposes, such as loading and unloading, storing, or transporting raw materials or finished products;
- storage tanks and piping leading to and from storage tanks and piping bringing gas or water into the plant;
- power lines bringing electricity into the plant; and
- administrative machines, furniture, equipment and supplies such as office computers, paper, or items used for the personal comfort, convenience, or use of employees.

G. Machines – A Structure versus a Building

The machine exemption can apply to a machine that is a “structure.” However, a structure that is a building is not a “machine,” and the materials used to construct the building are not exempt from sales and use tax as a machine, part, or attachment used in manufacturing.¹³

The Department held that (1) a settling basin for a wastewater treatment facility was one part of a single entity and that the facility was a “machine”¹⁴ and (2) a gamma irradiator constitutes a machine.¹⁵

See Section S of this chapter for information on an exemption for the sale of construction material used in constructing a manufacturing facility meeting certain investment and job requirements.

¹³ See SC Regulation 117-302.5 and South Carolina Revenue Ruling #04-7 for more details.

¹⁴ South Carolina Revenue Ruling #89-7.

¹⁵ South Carolina Private Letter Ruling #90-3.

H. Pollution Abatement Machines¹⁶

Pollution control machines qualify for the machine exemption when installed and operated for compliance with an order of an agency of the United States or of this state to prevent or abate air, water, or noise pollution caused or threatened by the operation of other exempt machines used in the mining, quarrying, compounding, processing, and manufacturing of tangible personal property for sale.¹⁷

South Carolina Commission Decision #92-19 illustrates the application of the machine exemption to pollution abatement machines. In this decision, the Department held that stack liners and ash pond pipes and pumps located at a taxpayer's electrical generating facility were exempt from sales and use tax as pollution abatement machines on the grounds that these items were "operated exclusively in the abatement of pollution caused by the production of electricity."¹⁸

I. Machines Owned by Someone Other Than a Manufacturer

Ownership of the machine by the manufacturer is not required to qualify for the machine exemption. The use of a machine determines whether it is exempt from sales and use tax.¹⁹

This issue was considered in *Hercules*. The Court reviewed whether the machine exemption applied to materials purchased to build a waste treatment facility that was owned by a South Carolina town and used substantially by a manufacturer in the manufacture of tangible personal property for sale. The Court determined that the machine exemption applied to the materials used to construct that facility, without regard to the machine's ownership, since the facility satisfied a pollution control requirement and thereby allowed the manufacturer to remain in operation.²⁰

J. Machines Used Substantially in Manufacturing (Dual Usage Machines)

"Substantial" use, but not "exclusive" use, of a machine in the manufacture of tangible personal property for sale is required in order for the machine exemption to apply. Several examples illustrating this principle are provided below.

For example, the purchase of a forklift that is used substantially to move materials from one stage of the production process to another (an exempt purpose) and also used to load trucks (a non-exempt purpose) is allowed the machine exemption from sales and use tax. In addition, purchases of parts for the forklift are also exempt from tax.

Further, this principle was reviewed in *Hercules* where the Court determined that a municipally owned waste treatment facility was a machine used substantially in the manufacture of tangible personal property for sale. At this facility, approximately 35% of the waste treated was from a

¹⁶ South Carolina Code §12-36-2120(17) and SC Regulation 117-302.6

¹⁷ South Carolina Code §12-36-2120(17).

¹⁸ South Carolina Commission Decision #92-19.

¹⁹ South Carolina Code §12-36-2120(17).

²⁰ See also *Southeastern-Kusan v. South Carolina Tax Commission*, 280 S.E. 2d 57 (1981).

manufacturing plant and the rest was from ordinary municipal sources. The Court concluded that the machine exemption does not provide that the manufacturing use has to be exclusive nor does it require that the manufacturing use be the primary use to which the facility is devoted. In accordance with a regulation approved by the General Assembly, more than one-third of a machine's use in manufacturing is substantial.²¹

K. Tangible Personal Property that is an “Ingredient or Component Part” or “Used Directly” in the Process

South Carolina does not tax the sale of tangible personal property to a manufacturer or compounder that is an ingredient or component part of the tangible personal property or products manufactured or compounded for sale.²²

Further, South Carolina does not tax the sale of tangible personal property “used directly” in manufacturing, compounding, or processing tangible personal property for sale.²³ An item is “used directly” if the materials or products so used come in direct contact with and contribute to bring about some chemical or physical change in the ingredient or component properties during the period in which the fabricating, converting or processing takes place.²⁴

Examples of these exclusions from the tax are:²⁵

- (1) acetylene, oxygen, and other gases sold to manufacturers or compounders that enter into and become an ingredient or component part of the tangible personal property or products which he manufactures or compounds for sale, or which are used directly in fabricating, converting, or processing the materials or products being manufactured or compounded for sale, or
- (2) plates attached by the manufacturer to his product for identification purposes and which become a part of the product.

L. Electricity

The sale of electricity used by manufacturers, processors, miners, quarriers, or cotton gins to manufacture, mine, or quarry tangible personal property for sale is exempt from the tax.²⁶

This exemption applies to electricity that provides lighting necessary for the operation of machines used in manufacturing tangible personal property for sale and to electricity used to control plant atmosphere as to temperature and/or moisture content, in the quality control of tangible personal property being manufactured or processed for sale.²⁷

²¹ SC Regulation 117-302.5. See also *Anonymous Corporation v. South Carolina Department of Revenue* (06-CP-40-0103), Court of Common Pleas for the Fifth Judicial Circuit (2008).

²² South Carolina Code §12-36-120(2).

²³ South Carolina Code §12-36-120(3).

²⁴ SC Regulation 117-302.1.

²⁵ SC Regulation 117-302.1.

²⁶ South Carolina Code §12-36-2120(19).

²⁷ SC Regulation 117-302.4.

This exemption does not apply to sales of electricity used in administrative offices, supervisory offices, parking lots, storage warehouses, maintenance shops, safety control, comfort air conditioning, elevators used in carrying personnel, housekeeping equipment and machinery, machines used in manufacturing tangible personal property not for sale, cafeterias, canteens, first aid rooms, supply rooms, water coolers, drink boxes, unit heaters, and waste house lights.²⁸

M. Coal, Coke, and Other Fuel

The sale of coal, coke, or other fuel to manufacturers and electric power companies for the generation of heat or power used in manufacturing tangible personal property for sale or the generation of electric power or energy for use in manufacturing tangible personal property for sale is exempt from the tax.²⁹ For purposes of this exemption, mining and quarrying are considered to be manufacturing.

The sale of coal, coke or other fuel to manufacturers for the production of by-products or for the generation of electric power or energy for use in manufacturing tangible personal property for sale is also exempt.³⁰

This exemption applies to fuel used to control plant atmosphere as to temperature and/or moisture content in the quality control of tangible personal property being manufactured or processed for sale.

N. Fuel Used by Aircraft Manufacturer

Sales of fuel that will be used for test flights of aircraft by the manufacturer of the aircraft, or used in the transportation of an aircraft prior to its completion from one facility of the manufacturer to another facility of the manufacturer, are exempt from the tax if certain requirements are met.³¹ The exemption does not apply to fuel used for the transportation of major component parts for construction or assembly or fuel used for the transportation of personnel.

In order to qualify for this exemption, the taxpayer must notify the Department in writing before the first month it uses the exemption and must, over a seven year period, invest at least seven hundred fifty million dollars in real or personal property or both comprising or located at a single manufacturing facility and create at least three thousand eight hundred full-time new jobs at the single manufacturing facility.

This exemption became effective November 1, 2009 and required that a notice be filed with the Department prior to October 31, 2015 in order for the taxpayer to qualify for the exemption. This exemption continues to be available to eligible taxpayers who notified the Department prior to October 31, 2015.³²

²⁸ SC Regulation 117-302.4.

²⁹ South Carolina Code §12-36-2120(9).

³⁰ SC Regulation 117-302.3.

³¹ South Carolina Code §12-36-2120(9)(e) and (f).

³² Act No. 124 of 2009, Section 2B. See also SC Information Letter #15-18.

O. Packaging

The sale of materials, containers, cores, labels, sacks, or bags that are used incident to the sale and delivery of tangible personal property are not subject to the tax.³³ The terms “materials,” “containers,” and “cores” are defined as follows:³⁴

“Materials” include wrapping paper, twine, strapping, nails, staples, wire, lumber, cardboard, adhesives, tape, waxed paper, plastic materials, aluminum foils, and pallets used in packaging tangible personal property incident to its sales and delivery and used by manufacturers, processors, or compounders in shipping tangible personal property.

“Containers” include paper, plastic or cloth sacks, bags, boxes, bottles, cans, cartons, drums, barrels, kegs, carboys, cylinders, and crates.

“Cores” include spools, spindles, cylindrical tubes and the like on which tangible personal property is wound.

This sales and use tax exclusion applies to labels affixed to manufactured articles to identify such products only when such labels are passed on to the ultimate consumer of such products, and to excelsior, cellulose wadding, paper stuffing, sawdust and other packing materials used to protect products in transit. This exclusion does not apply to address stickers and shipping tags, and materials used to preserve property during shipment, such as dry ice and rust preventives.

P. Sales for Resale or Wholesale Sales

Sales by manufacturers and compounders of tangible personal property are not taxable if the property is sold for resale (*e.g.*, a wholesale sale).³⁵ Further, a manufacturer is considered to be making a wholesale sale and not liable for South Carolina sales and use tax when the manufacturer, at the request of a retailer, drop ships its product in South Carolina and bills the retailer for the product. See South Carolina Revenue Ruling #98-8 for further information on drop shipments.

A resale certificate, Form ST-8A, can be used by retailers to purchase tangible personal property for resale. It is not necessary that a resale certificate be obtained for each purchase; the seller must maintain only one resale certificate per customer. By accepting the resale certificate and having it on file, the seller is relieved of the tax liability. Sales to users or consumers are taxable. It is not required that Form ST-8A be used. A letter from the purchaser to the seller or a resale certificate from another state is acceptable provided it contains the same information requested on Form ST-8A. In addition, the “Uniform Sales and Use Tax Certificate” published by the Multistate Tax Commission (“MTC”) may be used by a purchaser for the purpose of purchasing tangible personal property that will be resold, leased, or rented in the normal course of the purchaser’s retail business.³⁶

³³ South Carolina Code §§12-36-120(4) and 12-36-2120(14).

³⁴ SC Regulation 117-302.2.

³⁵ South Carolina Code §12-36-120(1).

³⁶ See South Carolina Revenue Procedure #08-2 for further information on the acceptance of a resale certificate, Form ST-8A, and the liability for the tax.

Q. Material Handling Systems and Equipment³⁷

Sales of material handling systems and equipment for use in the operation of a manufacturing facility³⁸ are exempt from the tax if certain requirements are met. This exemption includes, but is not limited to, racks used in the operation of a manufacturing facility, whether or not used to support all or part of the facility structure.

The following are examples of material handling systems and material handling equipment that qualify for the exemption when used in the operation of a manufacturing facility or a distribution facility that meets the requirements of the exemption:

- Automated storage and retrieval systems
- Carts
- Conveyors
- Cranes
- Dollies/Forklifts (including battery chargers designed for the forklift)³⁹
- Hand Trucks
- Hoppers
- Piping
- Pumps
- Racks
- Shelving
- Stackers
- Tanks

The exemption does not apply to any material handling systems or material handling equipment that is not used in the operation of a manufacturing facility or a distribution facility (e.g., mail carts, shelving used in the office for books and records, office computers, copiers, and similar office equipment) and does not apply to any material handling systems or material handling equipment used in a manufacturing facility or distribution facility that does not meet all the requirements of the exemption.

In order to qualify for this exemption, the taxpayer must notify the Department in writing before the first month it uses the exemption and must, over a five-year period, invest at least thirty-five million dollars in real or personal property in South Carolina. In addition, the exemption is not applicable if the facility does not become operational as a manufacturing or distribution facility.

³⁷ See South Carolina Code § 12-36-2120(51) and SC Revenue Ruling #13-3 for a detailed analysis of what qualifies for the material handling exemption.

³⁸ This exemption also applies to distribution facilities complying with the notice requirements and meeting the investment requirements of the exemption. A port facility as defined in Code Section 12-6-3375 is considered a distribution facility for purposes of South Carolina sales and use tax exemptions. See Code Section 12-36-2140. The Navy Base Intermodal Facility is considered to be a distribution facility for the purpose of sales and use tax exemptions associated with the purchase of equipment and construction materials for State Fiscal Year 2022 – 2023. See Temporary Proviso and 50.20 (Act No. 239 of 2022, Part IB), respectively.

³⁹ The battery charger qualifies for the exemption since the forklift, and the battery charger designed for it, are two parts of a material handling system. See South Carolina Revenue Ruling #13-3.

R. Computer Equipment

Sales of computer equipment that will be used in connection with a manufacturing facility are exempt from the tax if certain requirements are met.⁴⁰

In order to qualify for this exemption, the taxpayer must notify the Department in writing before the first month it uses the exemption and must, over a seven year period, invest at least seven hundred fifty million dollars in real or personal property or both comprising or located at a single manufacturing facility and create at least three thousand eight hundred full-time new jobs at the single manufacturing facility.

“Computer equipment” means original or replacement servers, routers, switches, power units, network devices, hard drives, processors, memory modules, motherboards, racks, other computer hardware and components, cabling, cooling apparatus, and related or ancillary equipment, machinery, and components, the primary purpose of which is to store, retrieve, aggregate, search, organize, process, analyze, or transfer data or any combination of these, or to support related computer engineering or computer science research.⁴¹

This exemption became effective November 1, 2009 and required that a notice be filed with the Department prior to October 31, 2015 in order for the taxpayer to qualify for the exemption. This exemption continues to be available to eligible taxpayers who notified the Department prior to October 31, 2015.⁴²

S. Construction Material

Sales of construction materials used in the construction of a new or expanded single manufacturing facility are exempt from the tax if certain requirements are met.⁴³

The taxpayer must meet one of two sets of investment and job requirements:

- (1) The taxpayer must make a capital investment of at least one hundred million dollars in real and personal property at a single site in the State over an eighteen month period.⁴⁴

⁴⁰ South Carolina Code §12-36-2120(65)(b). An exemption for computer equipment also applies to technology intensive facilities, as defined in South Carolina Code §12-6-3360(M)(14)(b), complying with the notice requirements and investment requirements set forth in South Carolina Code §12-36-2120(65)(a).

⁴¹ South Carolina Code §12-36-2120(65)(c).

⁴² Act No. 124 of 2009, Section 3B. See also SC Information Letter #15-18.

⁴³ South Carolina Code §12-36-2120(67).

⁴⁴ This exemption, requiring a capital investment of at least one hundred million dollars in real and personal property at a single site in the State over an eighteen month period, also applies to distribution facilities or combined manufacturing and distribution facilities. A port facility as defined in Code Section 12-6-3375 is considered a distribution facility for purposes of South Carolina sales and use tax exemptions. See Code Section 12-36-2140. The Navy Base Intermodal Facility is considered to be a distribution facility for the purpose of sales and use tax exemptions associated with the purchase of equipment and construction materials for State Fiscal Year 2022 – 2023. See Temporary Proviso 50.20 (Act No. 239 of 2022, Part IB), respectively.

- (2) The taxpayer must make a capital investment of at least seven hundred fifty million dollars in real or personal property or both comprising or located at the facility over a seven year period and must create at least three thousand eight hundred full-time new jobs at the facility during that seven year period. **This exemption became effective November 1, 2009 and required that a notice be filed with the Department prior to October 31, 2015 in order for the taxpayer to qualify for the exemption. This exemption continues to be available to eligible taxpayers who notified the Department prior to October 31, 2015.**⁴⁵

In order to qualify for this exemption, the taxpayer must notify the Department in writing before the first month it uses the exemption. In addition, the exemption is not applicable if the facility does not become operational as a manufacturing or distribution facility.

⁴⁵ Act No. 124 of 2009, Section 4B. See also SC Information Letter #15-18.