



COLORADO

Department of Revenue

Taxation Division

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GIL-2007-24

XXXXXXXXXXXXXX
Attn: XXXXXXXXXXXX
XXXXXXXXXXXXXX
XXXXXXXXXXXXXX

December 4, 2007

Re: Taxability of electricity, manufacturing

Dear XXXXXXXXXXXX,

This letter is in response to your letters to the Colorado Department of Revenue, dated May 21, 2007, re: taxability of electricity used in manufacturing. We apologize for the time it has taken to respond to your inquiry.

Issues

1. Is there an exemption to state sales tax or city fees available to manufacturers for the use of gas, electricity and water in the manufacturing process?
2. If yes, are research and development activities and packaging operations considered manufacturing?
3. What is your sales tax rate and statute of limitations?
4. Can local cities impose their own tax and are they subject to any exemptions?
5. If yes, are nursing homes and apartment buildings considered residential?
6. Are there any other circumstances where utilities could be considered exempt from tax?

Background

You are a professional engineering company that provides utility studies for clients.

Discussion

1. *Electricity and gas used in manufacturing is exempt from state and special district sales and use taxes and state-administered city and county sales taxes.*

Colorado exempts the sale and use of electricity, steam, wood, nuclear fuel, coal, gas, fuel oil, and coke when used for any of the following purposes: processing, manufacturing, mining (including oil and gas exploration and production), refining, irrigation, construction, telegraph, telephone and radio communication, street and railroad transportation services, and all industrial uses. §39-26-102(21) and 715(2)(b), C.R.S.

Gas” means natural or manufactured gas used in the production of energy or used in industry to heat greenhouses, used by industrial plants engaged in manufacturing or used for melting metal in foundries, for firing brick kilns, or for other industrial uses. Department regulation (39-)26-102.21.

“Manufacturing” means the operation of producing an item of tangible personal property different from and having a distinctive name, character, or use from raw materials. §39-26-709(1)(b)(III), C.R.S. Manufacturing begins at the point raw material stored at a location contiguous to the plant site is picked up to be moved

directly to the first machine, and ends at the point alteration of the product is complete. Packaging can be a completion step in the manufacturing process. Department publication FYI Sales 10.

“Industrial uses” means the use of electricity, coal, gas, fuel oil, coke, or nuclear fuel, in a continuing business activity of manufacturing or producing tangible personal property or services as set forth in C.R.S. 39-26-104(c), (d), (d.1) and (d.2). Department regulation (39-)26-102.21

When a manufacturing or industrial facility also uses energy for administrative offices or other non-exempt uses, the taxpayer must apportion the exempt and non-exempt uses. See, Department Regulation Sales 71 (Sales Tax Exemption on Industrial Usage). Nonexempt uses of utilities include: parking lot lighting; cooling and lighting in office portions of a building, lunch rooms, laboratories, maintenance rooms, computer rooms, lounges, waiting areas and any customer- used areas. Department publication FYI Sales 71. If exempt energy use is seventy-five percent or more, then the energy utility will bill the taxpayer without assessing sales or use tax and the taxpayer will file a tax return for the non-exempt use. If exempt usage is less than seventy-five percent, then the energy utility will bill the taxpayer sales and use tax and the taxpayer files a claim for refund from the department.

Special districts sales and use taxes and state-administered cities and counties sales taxes apply to energy sales on the same transactions to which state sales and use taxes apply. §29-2-105, C.R.S.; Department publication (DRP) 1002.

2. Research and development activities and packaging operations are not considered manufacturing.

The exemption for energy for manufacturing does not include research and development because manufacturing begins at the point the raw material is stored at a location contiguous to the manufacturing plant. §39-26-709(1)(b)(III), C.R.S.; FYI Sales 10. Research and development are activities that precede the actual manufacturing of the tangible personal property.

Similarly, packaging is not part of the process of manufacturing tangible personal property because it follows after the alteration of the tangible personal property is complete. §39-26-709(1)(b)(III), C.R.S.; FYI Sales 10.

There is, however, another exemption for research and development, but only if there is a surplus of state revenues for the year the tax is incurred. §39-26-602(2), C.R.S. The exemption applies only to tangible personal property used in research and development. Electricity is not tangible personal property and, therefore, it is not exempt under this statute. However, gas, coal, coke, wood and steam are tangible personal property and, therefore, these items are exempt. In order to qualify for the exemption, the property must be used in Colorado directly and predominantly for research and development or in a combined activity of research and development and manufacturing that is exempt pursuant to section §39-26-709 (1), discussed in paragraph 1, above.

The legislature suspended the operation of this exemption beginning July 1, 2005 until June 30, 2010. The exemption is available after that date, but, again, only if there is a revenue surplus of a certain amount. The exemption is not available at the time of the sale, use storage, or consumption, but, rather, is implemented as a refund of state taxes paid. The exemption does not include local sales and use taxes.

See, also FYI Sales 52 (Service Enterprises) for additional discussion of research and development contracts and custom manufactured products; and FYI Income 22 for tax credits for research and development activities within an enterprise zone.

3. State sales and use tax rate is 2.9% and there is a 3 year statute of limitation for refunds and assessments.

The sales tax rate for Colorado is currently 2.9%. §39-26-106(1)(a)(II), C.R.S. The statute of limitations for assessments is three years from the date the tax was payable (§39-26-125, C.R.S.), unless the taxpayer fails to file a return, files a false or fraudulent tax return, or otherwise attempts to evade tax (§39-26-125, C.R.S.). A refund claim must be filed within three years of the date the tax was paid. Department Regulation (39-)21-108(1)(b)(i), C.R.S.

4. *Cities, counties, and special districts impose sales and sales taxes and are subject to certain exemptions.*

The Department administers the sales tax for certain cities and counties, and the sales and use tax of special districts. These state-administered local jurisdictions are listed, together with their tax rates, in Department publication DRP 1002. They have the same exemptions that the state has, but cities and counties have the option to levy tax on certain transactions that are exempt from state sales and use tax (e.g., electricity and gas for residential use). §29-2-105, C.R.S. These options are also listed in DRP 1002.

In addition, Colorado has a number of home-rule cities and counties. The sales and use taxes levied by these jurisdictions are not administered by the department. Home rule jurisdictions are listed on DRP 1002.

5. *Residential use of electricity and gas is exempt from state tax, and exempt from state-administered city and county sales tax, unless the city or county elects to impose a tax.*

Gas and electricity are exempt from sales tax when to occupants of residences, whether owned, leased, or rented by said occupants, for the purpose of operating residential fixtures and appliances that provide light, heat, and power for such residences. "Gas" includes natural, manufactured, and liquefied petroleum gas, such as butane, propane, and fuel oils. §39-26-715(1)(a)(II), C.R.S.; Department Regulation 39-26-715(1)(a)(II). Water is not exempt from tax.

As noted above, electricity and gas are exempt if for residential use. "Residential use" means the use of gas or electricity by the individual customer exclusively for domestic purposes such as lighting, refrigeration, cooking, water heating, space heating and air conditioning, in a private home or individual living unit served through a single meter or a master metered multi-unit apartment, condominium, townhouse or mobile/trailer home used exclusively for domestic purposes. Department regulation (39-)26-715(1)(a)(II).

Users in a private home or individual living unit, such as apartments, condominiums, townhouses and mobile/trailer homes, who are served through a single meter and whose rate has been classified by the Colorado Public Utilities statute (title 40, articles 1 to 9, C.R.S. or the Colorado Public Utilities Commission's regulation as residential, are automatically exempt. Department regulation (39-)26-715(1)(a)(II).

Users in multi-unit apartments, mobile/trailer home parks or condominium and townhouse associations, who are billed through a master meter and are taking service under a commercial rate may, nevertheless, qualify for this exemption providing the gas or electricity is used for residential use as defined herein. Department regulation (39-)26-715(1)(a)(II).

Nursing homes will generally qualify for the residential exemption. They must have a preponderance of occupants who reside there for 30 consecutive days or longer. See, FYI Sales 66 (Sales Tax Exemption on Residential Energy Usage). Hospitals do not qualify as residences. Some portion of a nursing facility may not qualify if it is substantially the same as a hospital, or has other non-exempt facilities such as offices.

6. *Sales to exempt organizations and utilities used by restaurant to process food for immediate consumption are exempt or partially exempt.*

Certain entities can purchase tax free goods and services, including gas and electric services. These include charitable organizations (§39-26-713(2)(d), C.R.S.), the United States government, state of Colorado and its political subdivisions, and public and non-profit private schools. §39-26-704, C.R.S. There is also a partial exemption (up to 55%) for gas and electric service to restaurants, but only to the extent that the energy is used to process food for immediate consumption. See FYI Sales 30 (Gas and Electric Services).

Finally, the Department makes a good faith effort to provide accurate and complete answers to questions posed to it by taxpayers. However, the information and answers provided here are not binding on the Colorado Department of Revenue, nor do they replace, alter, or supersede Colorado law and regulations. The Executive Director, who by statute is the only person having authority to bind the Department, has not formally reviewed and/or approved this response.

Respectfully,

Office of Tax Policy
Colorado Department of Revenue