



**COLORADO**

**Department of Revenue**

Taxation Division

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GIL 17-016

August 21, 2017

XXXXXXXXXXXXXXXXXX  
XXXXXXXXXXXXXXXXXX  
XXXXXXXXXXXXXXXXXX

Re: Manufacturing Machinery

Dear XXXXXXXXXXXXXXX,

You submitted on behalf of your client (“Company”) a request for guidance regarding the applicability of the sales tax exemption for manufacturing machinery and machine tools used for contract manufacturing.

The Colorado Department of Revenue (“Department”) issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues, but is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department Rule 1 CCR 201-1, 24-35-103.5 at [www.colorado.gov/pacific/tax/letter-rulings](http://www.colorado.gov/pacific/tax/letter-rulings)

The Department treats this request as a general information letter. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not binding on the Department. If Company would like the Department to issue a private letter ruling on the issue raised here, Company can submit a request and pay the fee in compliance with Department Rule 1 CCR 201-1, 24-35-103.5.

**Issue**

Does the exemption for manufacturing machinery and machine tools set forth in §39-26-709(1)(a)(II), C.R.S. apply to the purchase and use of these items when the manufacturer is contracted by a third party for manufacturing services, known as contract manufacturing?

**Background**

Company owns manufacturing machinery and machine tools. It uses these machines and tools to perform manufacturing services on tangible personal property owned by a third party.

## Discussion

Colorado levies sales and use tax on the sale and use of tangible personal property. Manufacturing machinery and machine tools used in Colorado directly and predominantly in manufacturing tangible personal property for sale or profit is exempt from sales and use tax.<sup>1</sup>

Exemptions are sometimes enacted to avoid pyramiding of sales and use taxes.<sup>2</sup> For example, Colorado exempts the sale and purchase of ingredients used in processing or manufacturing of tangible personal property but only if the finished product is subject to sales or use tax.<sup>3</sup> In *Carpenter v. Carman Distributing Co.*, 144 P.2d 770 (Colo. 1944) the court concluded that the exemption for ingredients used in manufacturing applied only if the finished goods are sold subject to sales tax because the purpose of the exemption was to avoid pyramiding of sales taxes. Notably, the court reached this conclusion even though the statute did not expressly state that the sale of the finished product must be taxable. The question posed by this request for guidance is whether the exemption for manufacturing machinery also requires that the finished product must be subject to tax even though the statute does not expressly contain such a requirement.

The manufacturing machinery exemption is similar to the exemption for ingredients used in manufacturing in that both involve the manufacturing process where there is the potential for pyramiding taxes. Indeed, other states have enacted exemptions for manufacturing machinery but restrict the exemption to situations where the finished product is sold by the manufacturer, presumably in order to avoid pyramiding of taxes.<sup>4</sup> However, and unlike the exemption for manufacturing ingredients discussed in *Carpenter*, the exemption for manufacturing machinery expressly states that it applies to manufactured goods for sale or “profit.” Thus, this exemption applies even though the finished goods are not sold. For example, a company may use the machinery to produce finished goods that the manufacturer itself uses.<sup>5</sup> Some manufacturers provide manufacturing services to third parties who furnish the raw material that will be manufactured into a finished product. This is sometimes referred to as “contract

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<sup>1</sup> § 39-26-709(1)(a)(II) and (2), C.R.S. There are several qualifications to this exemption that are not relevant to the issue addressed in this letter and, therefore, are not discussed.

<sup>2</sup> There is no legal prohibition to pyramiding sales and use taxes, but the legislature may, for policy reasons, elect to exempt certain sales and uses to avoid such pyramiding. *Bedford v. Hartman Bros.*, 89 P.2d 584 (Colo. 1939); *Carpenter v. Carman Distributing Co.* 144 P.2d 770 (Colo. 1944).

<sup>3</sup> § 39-26-102(20), C.R.S.

<sup>4</sup> See, Department Private Letter Ruling (PLR) 14-003, citing, *inter alia*, *Armrel Byrnes Company v. Tax Commissioner of Ohio*, 2008-A-1261, Ohio Board of Tax Appeals (Ohio 2011) (manufacturer of asphalt did not sell the asphalt to a third party but, rather, consumed the asphalt as a contractor providing paving services).

<sup>5</sup> The department previously provided guidance that this exemption for manufacturing machinery and machine tools does not require that the finished goods be sold. See, Department Private Letter Ruling (PLR) 14-003 (machinery used to produce asphalt used by the manufacturer is exempt from tax even though the asphalt was not sold but, instead, was used by the manufacturer as a contractor providing paving services for a profit.)

manufacturing.” The contract manufacturer does not sell the finished product because it does not own the product - it simply is providing the service of manufacturing. The third party also may not sell the finished goods, but, instead, may use the finished goods.

The term “profit” suggests that the purpose of this exemption is not to avoid pyramiding of taxes but, rather, to encourage the purchase of manufacturing machinery and tools and, more generally, to encourage manufacturing enterprises. Given this apparent purpose, the rationale used in *Carpenter* to infer that the finished product must be subject to a taxable sale does not apply to this exemption.

For these reasons, the Department will likely allow the exemption set forth in §39-26-709(1)(a)(II), C.R.S. even if the finished product is not sold. However, the manufacturer must be engaged in a for-profit enterprise.

### **Miscellaneous**

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at [www.colorado.gov/tax](http://www.colorado.gov/tax) for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted letter.

Sincerely,

Office of Tax Policy  
Colorado Department of Revenue