COLORADO
Department of Revenue
Taxation Division

Office of Tax Policy
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PLR-10-001

February 16, 2010

XXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXX
XXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXX

Re: private letter ruling re: CO_2, containers, and related fees

Dear XXXXXXXXXX,

Your firm submitted on behalf of XXXXXXXX ("Company") a request for a private letter ruling pursuant to Department Regulation 24-35-103.5 and relating to the application of sales and use tax to the sale of liquid and gas CO2 and nitrogen, the use and rental of containers for shipping and storage of these materials, and charges related to these transactions. This letter is the Department's private letter ruling.

Issues

1. Is the sale of liquid or gas CO_2, a mixture of CO2 and nitrogen, or pure nitrogen by the Company to retailers subject to sales tax?
2. Is the rental of Bulk Tanks and Cylinders by the Company to retailers subject to sales tax?
3. Is the total amount invoiced by the Company to retailers subject to sales tax if the invoice does not separately state the rental charge and the purchase price for CO2?
4. Does sales tax apply to fees, charges, and surcharges charged in connection with the rental of Bulk Tanks and Cylinders and the sale of liquid and gas CO2?

Conclusions

1. Sales of liquid and gas CO_2 to a retailer who uses the gas to carbonate beverages is exempt from tax. Sales of pure nitrogen or a mixture of CO_2 and nitrogen to retailers are not exempt.
2. Rental charges for Bulk Tanks and Cylinders by the Company to retailers are subject to sales tax.
3. The total amount invoiced by the Company to retailers is subject to sales tax if the

invoice does not separately state the rental charge and the purchase price for CO2.

4. Sales tax does not apply to optional and separately stated delivery fees and energy/fuel surcharges for Cylinders, but does apply to such fees and surcharges for liquid products. Tax applies to regulatory fees and charges for personal property tax.

Background

Company is a wholesaler of carbon dioxide (in liquid and gas form) and nitrogen for use in beverage carbonation systems, commonly known as soda fountains. Customers are retailers and include restaurants, convenience stores, movie theaters, theme parks, and sports venues.

Company delivers liquid CO2 into stainless steel cryogenic tanks (Bulk Tanks") owned by the Company[1] and installed at the retailer's premises. It delivers gas CO2using portable cast iron containers ("Cylinders") filled at the Company's facility and transported to, and unloaded at, the retailer's location. These tanks are connected to the retailer's beverage carbonation system (e.g., a soda fountain), which mixes the CO2 with syrup to create carbonated fountain drinks. In some cases, it sells a mixture of CO2 and nitrogen or pure nitrogen, which are used by retailers to carbonate and propel beer through a tap system. Retailers sell carbonated beverage to the ultimate consumer who pays sales tax on the beverage.

The Company states that it enters into two types transactions with retailers. The first transaction is the rental of Bulk Tanks or Cylinders to retailers and the second is the sale of liquid and gas CO2and/or nitrogen to retailers. The Company offers a variety of purchasing plans. The Budget Plan allows retailers to rent a Bulk Tank together with an annual allotment of liquid CO2 for a flat monthly rate. The invoice does not separately state a charge for renting the Bulk Tank and a charge for the sale of liquid CO2. The other purchasing plans separately state the charge for renting the Bulk Tank and the sale of liquid CO2.

In addition to charges for tank rental and CO2, Company charges retailers (1) delivery fees for delivering liquid CO2 or Cylinders containing CO2, (2) energy/fuel surcharge, (3) hazardous materials fees for handling hazardous materials and regulatory compliance, and (4) personal property tax charges, which are a combination of personal property tax and tax preparation service charges.

Discussion

1. *The sale of liquid and gas* CO2 *to a retailer who uses it to carbonate beverages is exempt from sales and use tax. The sale of pure nitrogen is taxable. The sale of a mixture of nitrogen and* CO2 *is not exempt unless the nitrogen is di minimis.*

Colorado exempts from sales and use tax the sale, use, storage, or consumption of tangible personal property that is either an ingredient of, and integral or constituent part of, a human food product, or acts directly on the food product or makes the food product more marketable. Specifically, §39-26-102(20), C.R.S., provides that:

[1] In some instances, not at issue here, the retailer owns the Bulk Tank.

(a) The sales to and purchases of tangible personal property by a person engaged in the business of manufacturing or compounding for sale, profit, or use any article, substance, or commodity, which tangible personal property enters into the processing of or becomes an ingredient or component part of the product or service which is manufactured, compounded, or furnished, and the container, label, or the furnished shipping case thereof, shall be deemed to be wholesale sales and shall be exempt from taxation under part 1 [sales tax].

(b) As used in subparagraph (a) of this subsection (20) with regard to food products, tangible personal property enters into the processing of such products and is therefore exempt from taxation when:

(I) It is intended that such property become an integral or constituent part of a food product that is intended to be sold ultimately at retail for human consumption; or

(II) Such property, whether or not it becomes an integral or constituent part of a food product, is a chemical, solvent, agent, mold, skin casing, or other material; is used for the purpose of producing or inducing a chemical or physical change in a food product or is used for the purpose of placing a food product in a more marketable condition; and is directly utilized and consumed, dissipated, or destroyed, to the extent it is rendered unfit for further use, in the processing of a food product that is intended to be sold ultimately at retail for human consumption.

See, also, §39-26-713(2)(e), C.R.S. (identical provision but applying to use tax). Similarly, §39-26-713(2)(b) exempts from use tax,

> [t]he storage, use, or consumption of any tangible personal property purchased for resale in this state, either in its original form or as an ingredient of a manufactured or compounded product, in the regular course of business.

Department regulation 39-26-713.2(b) states that the tangible personal property must become an essential[2] and constituent part of the food product, wholly or partially, either by chemical or mechanical means.

A retailer who combines beverage syrup and carbon dioxide is in the business of compounding and processing these items. Carbonated beverage for human consumption qualifies as food product.[3] The CO_2 is an ingredient and component of the carbonated beverage and is an integral part of the beverage. See, Department Regulation (39-)26-102.20 (sale by a supplier of carbon dioxide used by the retailer for the carbonation of soft drinks is not subject to sales tax); Colo. Code Regs. 26-106.2(b) ("Vendors dispensing liquor, wine or beer by the drink who purchase ingredients which they use in mixing the drinks are not required to pay sales tax on the purchase of such ingredients."). For these reasons, sales of liquid and gas CO_2 by the Company to retailers are exempt from tax pursuant to §39-26-713(2)(b).

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[2] Exempt tangible personal property must be "an essential component of the finished product." *C.F & I. Steel Corp. v. Charnes,* 637 P.2d 324, 328 (Colo. 1981).

[3] "Food" includes beverages. See, §39-26-102(4.5) and 7 U.S.C. 2012(g). We note that carbonated water marketed in containers is not a food product. See, §39-26-102(4.5), C.R.S. However, the sale of CO_2 to retailers for the purpose of carbonating water marketed in containers is, nevertheless, exempt under subsection 102(20)(a) because the CO_2 becomes ingredient or component parts of the carbonated water.

The Company also sells pure nitrogen and a mixture of CO_2 and nitrogen. Pure nitrogen is used by retailers to propel the beverage through the beverage dispensing machine. The Company does not allege that the pure nitrogen is compounded or processed into the beverage or that pure nitrogen is an integral or essential part of the beverage consumed by the customer. There is no representation that the gas chemically or physical changes the beverage or renders the food product more marketable. Therefore, the sale of pure nitrogen is not exempt from sales and use tax under subsections 102(20) or 713.[4] See, also, regulation (39-)26-102.20 (sale of CO2 to retailer who uses the gas to propel beverage through dispenser is taxable). Moreover, and notwithstanding the Company's general characterization of itself as wholesaler, the sale of the pure nitrogen is not an exempt wholesale sale because the retailer does not resell the gas to consumers, but, rather is, itself, the user and consumer of the pure nitrogen (to propel the beverage).

The Company's sale of a mixture of CO_2 and nitrogen for a single price is more problematic. As discussed above, the nitrogen in this mixture is used to propel the beverage from the dispenser and is not an integral or component part of the beverage. By selling the CO2 and nitrogen as a mixture, the Company bundles in one price the sale of both exempt and taxable goods. Generally speaking, a retailer has the burden of demonstrating that a transaction clearly falls within the exemption. *Security Life* & *Accident* Co. *v. Heckers,* 177 Colo. 455, 458 , 495 P.2d 225, 226 (1972); see, also, *General Motors Corporation v. City and County of Denver,* 990 P2d 59 (Colo. 1999). Colorado, as do most states, imposes tax on the entire price of a bundled transaction, unless the value of the taxable item is *de minimis.*[5] We cannot conclude here that the value of the nitrogen is *de minimis.* Therefore, the Company must collect sales tax on the entire purchase price. In the alternative, the Company can separately state the purchase price for the nitrogen and collect tax only on that price.

2. *Rental charges for Cylinders and Bulk Tanks used by the retailer for storage are not exempt.*

Rental charges for the Cylinders and tanks present novel issues. As discussed above, Colorado exempts the sale, use, storage, or consumption of "containers, labels, and shipping cases" of exempt ingredients. We begin our discussion by briefly reciting three specific and well established general rules of statutory construction and application. First, there is a strong presumption against exemptions from taxation. *Mesa Verde* Co. *v. Board of County Comm'rs,* 178 Colo. 49, 57 , 495 P.2d 229, 233-34 (1972) ; *Hagood v. Heckers,* 182 Colo. 337, 348 , 513 P.2d 208, 214 (1973). Second, as a consequence of the first rule, exemptions are narrowly construed. *Regional Transp. Dist. v. Charnes,* 660 P.2d 24, 25 (Colo. App. 1982). Third, the party asserting the exemption has the burden of establishing that it clearly is entitled to the exemption. *General Motors v. City and County of Denver,* 990 P.2d 59 (Colo. 1999).

With these principles in mind, and for the reasons discussed below, we conclude that the exemption for containers is limited to containers used for shipping the exempt product or the

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[4] The facts here are clearly distinguishable from *Coors Brewing Company v. Department of Revenue,* 949 P2d 110, (Colo. 1997) because, unlike in the present case, the beer adjunct was an essential and desirable component of the beer.

[5] See, e.g., GIL-09-004 (Sales tax on gift baskets containing taxable and non-taxable items whose prices are not separately stated is computed on the full purchase price unless the value of the taxable item is *de minimis.)*

finished product and does not extend to charges for use of containers as storage. We reach this conclusion because the references to "labels" and "shipping case" indicate that the exemption is limited to shipment. Moreover, the term "container" is most commonly used in the context of shipping. Thus, we have held that,

> Containers not used to deliver a product, or which are used for any purpose whatsoever prior to use in delivering a product to a customer, are subject to tax at the time of acquisition.

Colorado FYI Tax Publication No. Sales 13, 08/01/2002

"Container" is similarly limited to vessels used for delivery in the farm equipment exemption.

> Containers, crates, pallets, labels, and furnished shipping cases purchased by an agricultural producer are not subject to tax. "Containers" and "shipping cases" that are exempt when sold to agricultural producers include wire, twine, rope, tape, and similar binding materials, together with any other material or product used to wrap, bag, bundle, or similarly contain products.

Colo. Code Regs. 1 CCR 201-5 Sales and use tax-special regulations for agricultural producers. See also, Special Regulation re: optical sales and services ("Optical sales and services. Eyeglasses, lenses, frames, contact lenses, and similar articles, together with cases or similar containers used to transfer the property to the customer are exempt as prosthetlc devices" (emphasis added)). This is consistent with the department's determination that electrical transformers are not "containers" because they are more akin to capital equipment, [6] as are storage tanks. Other states also use the term "container" in connection with shipping. See, e.g., Fla. Admin. Code Ann. 12A-1.040 Containers and Other Packaging Materials; Mich. Admin. Code R205.68 Containers, cartons, and wrapping materials ("Sales of containers to a person, such as a manufacturer, wholesaler, jobber, or retailer who uses the container to ship or deliver goods, and who retains the ownership or legal right of possession of the containers, are taxable.")

The factual context in which this statutory exemption typically arises also indicates that the containers exempt from tax are those that are used for shipment. Suppliers of ingredients or components will typically ship their goods in containers or shipping cases. When the sale of the ingredients or components is exempt, the question arises whether the container by which ingredient is physically delivered is also exempt. Subsections 102(2) and 713 resolves this issue by making it clear that not only is the ingredient exempt, but also the shipping material used to deliver the ingredient.

However, it would be an unwarranted expansion of the exemption and contrary to the principles of strict statutory construction cited above to conclude that this container exemption also applies to storage vessels used by a compounder. Capital equipment used in compounding, such as storage bins or tanks, is generally not exempt from sales and use. The compounder is the end user and consumer of these capital assets and, as such, is liable for sales and use tax for such equipment, regardless of whether the compounder owns the asset or rents it from a third party.

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[6] Colorado Revenue Determination No. 38, 01/01/1993.

Thus, for example, it would be clearly unwarranted to apply the container exemption to storage tanks installed at a compounder's plant to receive ingredients, such as a compounder who installs a bulk storage tank to store chemicals later used in compounding.[7]

The Bulk Tanks at issue here are storage tanks. They are physically installed at a retailer's location. They are not used to ship the CO2. The principal purpose of these tanks Is to act as storage tanks. The rental fee is assessed for the use of these tanks as storage tanks. Therefore, we conclude that the rental fee for the Bulk Tanks is not exempt under the container exemption.

We reach a similar conclusion with respect to the rental fee for the Cylinders, although this requires further discussion because these Cylinders are used, in part, for shipping.[8] And in this discussion, we begin by noting that the Colorado supreme court addressed, in *Department of Revenue v. Coors,* 724 P.2d 1341 (Colo. 1984), an issue related to the issue presented here. In *Coors,* the beer manufacturer shipped beer in kegs to distributors and charged distributors a deposit fee for the kegs. Distributors and, in turn, retailers used the kegs to ship the beer and charged their respective customers a deposit. If the keg was returned to the respective seller (retailer, distributor, manufacturer), the deposit fee was refunded. The department argued that the statutory container exemption was a restatement of the wholesale sales exemption and, therefore, the exemption applied to the manufacturer's purchase and use of containers only if the manufacturer resold the container (to distributors, retailers, or consumers). Coors, the department argued, did not resell the kegs to distributors (the deposit was not a sale but merely a fee to ensure the return of the keg) and, therefore, Coors was the ultimate user and consumer of the kegs. The court rejected the department's position, holding that the statute did not limit the exemption only to containers that were resold; and, even if a resale was required by the container exemption, the deposit constituted a resale.

Coors is not dispositive of the issue before us. The issue in this ruling is not whether the Company's purchases of Cylinders are exempt from tax as containers. Moreover, we acknowledge that, had the Company resold the Cylinders to retailers or had the Company charged retailers a rental fee for the use of Cylinders to ship the CO_2, such sale or rental would be exempt from sales and use tax. However, the issue before us is whether tax applies to the rental charge for the use of the Cylinders as storage vessels at the retailer's place of business. We conclude that tax applies to the rental charge.

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[7] Tanks may qualify for the machinery and machine tool exemption if they are directly and predominantly used in manufacturing. §39-26-709, C.R.S. We do not address here whether beverage retailers are engaged in manufacturing, although it would appear at first blush that these retailers are in the business of compounding, not manufacturing, because manufacturing requires that they produce a new product. See, e.g., South Carolina case no. s-D-176, 08/22/1986 (distinguishing "processing" from Mmanufacturing," "[processing is an] operation by which a raw material is changed in form, context or condition so as to result in a finished product. [citations omitted]. However, manufacturing requires more [than creation of a new product. There must be the creation of a new and substantially different article having a distinctive name and substantially different character or use.").

[8] In GJL-07-022, we advised the Company that the rental of Cylinders was exempt. Having considered this issue in greater detail, and for the reasons set forth in this ruling, we find that that conclusion was in error.

The rental fee for the Cylinders in the present case is not exempt because the rental fee is charged, not for the exempt purpose of shipment but, rather, for the non-exempt use as storage vessels at the retailer's facilities. It is our understanding that these containers are placed in the retailers' facilities and remain there for some period of time until the gas is depleted. There would be no rental fee charged if the Cylinders were solely used to ship the CO2to the retailer.[9] The Company's rental fee is assessed for the retailer's use of the Cylinders as storage vessels at the retailer's location after the CO2 is delivered to the retailer. Given this factual predicate, we see no substantive distinction between the taxable rental of Bulk Tanks and the rental charge for these Cylinders; both charges are imposed for use of the vessels as bulk storage.[10]

Finally, we note that our conclusion is consistent with the tax treatment of these Cylinders had the Company sold them to retailers. The sale of Cylinders to retailers would be exempt under the container exemption, but the retailer's subsequent use of the Cylinders for purposes other than the exempt shipment (i.e., use as bulk storage vessels) subjects that use to tax. As a general proposition, a buyer's use of goods for non-exempt purposes will subject the buyer to use tax even though the buyer's original purchase may have been exempt. For example, in *International Business Machines v. Department of Revenue,* the company's exempt wholesale purchase of component goods later became subject to sales / use tax when the company pulled the goods from inventory and used them for its own purposes. Similarly, a manufacturer may purchase exempt from tax certain machine tools if they are used predominantly in manufacturing.[11] However, if the manufacturer later uses the tools predominantly for other purposes (e.g., repair and maintenance of its fleet of motor vehicles), the manufacturer becomes liable for sales *I* use tax on those tools. In this case, the retailer's subsequent use of, and the Company's rental charge for, Cylinders as storage vessels is not exempt.

3. *The total amount invoiced by the Company to retailers is subject to sales tax if the invoice does not separately state the rental charge and the purchase price for* CO_2.

Colorado follows the Separate Statement Rule,[12] which states that sales tax is calculated on the entire purchase price when the retailer does not separately state on the invoice the price for taxable and non-taxable items or services. If the Company does not separately state the price for the exempt CO2 from the taxable rental fee or from the taxable nitrogen, then sales tax is calculated on the entire price.

4. *Sales tax does not apply to fees, charges, and surcharges charged in connection with the rental of Bulk Tanks and Cylinders and the sale of liquid and gas* CO2.

Charges for separately stated non-taxable items are not included in the calculation of the sales and use tax unless the non-taxable item is inseparable from the sale of the taxable item. *A.O. Stores v. Department of Revenue,* 19 P.3d 680 (Colo. 2001). Transportation fees are generally separable from the sale of taxable goods and are not subject to sales and use tax if the

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[9] The cost of delivery of the Cylinders is, in fact, separately recovered by the Company's charge for delivery.
[10] Indeed, this obvious symmetry of purpose may well have led the Company to the conclusion that a rental charge should be imposed for Cylinders, as there is for Bulk Tanks.
[11] §39-26-709, C.R.S.
[12] See, Hellerstein, State Taxation (WG&L), ,I17.12 (The Separate Statement Rule).

purchaser has the option to provide its own transportation services or those of a third party and the Company does not charge a hi her unit price for the goods if the customer use its own or third party transportation services.[1] We assume that customers have the option of using their own transportation services to pick up the Cylinders and that the Company does not charge customers a higher price for the gas if the customer provides its own transportation. In such cases, the transportation charge is not included in the sales tax calculation. We further assume that, due to the extreme low temperature requirements of liquid gases, customers must use the Company's transportation service. In this case, the transportation of liquid gases is substantially similar to the transportation of ready mix concrete, which requires special transportation equipment that customers must use.[14] In such cases, the transportation charge is inseparable from the sale of the ready mix concrete and sales tax is due on both the transportation charge and charge for ready mix concrete. Therefore, the transportation charge for liquid products is subject to tax. Energy/fuel surcharges are taxable or not to the extent that the transportation charge to which they are associated are taxable or not.

Property taxes are part of the retailer's cost of doing business and cannot be excluded from the calculation of sales tax even if they are separately stated.[15] Similarly, fees for licensing and other regulatory compliance requirements are part of the retailer's cost of goods sold and are included in the calculation of sales tax if the obligation for regulatory compliance is on the

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[13] See, Department Special Regulation 18 (Transportation Charges), which states,

> 1) The transportation of tangible personal property between a retailer and purchaser is a service presumed to be not subject to sales or use tax. Transportation charges are not taxable if they are both (1) separable from the sales transaction, and (2) stated separately on a written invoice or contract.
>
> *(a) "Transportation charges"* include carrying, handling, delivery, mileage, freight, postage, shipping, trip charges, stand-by, and other similar charges or fees.
>
> (b) *Separable charges.* Transportation charges are separable from the sales transaction if they are performed after the taxable property or service is offered for sale and the seller allows the purchaser the option either to use the seller's transportation services or use alternative transportation services (including but not limited to the purchaser picking up the property at the seller's location). The fact that transportation charges are stated separately does not, in and of itself, mean the charges are a separable charge.
>
> (c) *Stated Separately.* Transportation charges will be regarded as "separately stated" only if they are set forth separately in a written sales contract, retailer's invoice, or other written document issued in connection with the sale.
>
> (d) *Intermediate or "Freight in" charges.* Transportation charges incurred in connection with transporting tangible personal property from the place of production or the manufacturer to the seller or to the seller's agent or representative, or to anyone else acting in the seller's behalf, either directly or through a chain of wholesalers or jobbers or other middlemen, are deemed "freight-in" charges and are not a transportation charge exempt from tax.
>
> (e) *Overstated Transportation Charges.* The amount of transportation charges excluded from the calculation of tax shall be the amount of transportation charges separately stated in accordance with subparagraph (c), provided that such separate statement is not to avoid the tax upon the actual sales price of tangible personal property.

[14] See, Department Special Regulation 37 (Ready Mix Concrete), which states, "[r]eady-mix concrete is taxable on the delivered price, which includes minimum load and transportation charges. Standby charges charged after arrival at the destination are not taxable if segregated on the customer's invoice."

[15] See, Department Revenue Bulletin 99-19 (June 6, 1999) ("C.R.S. 39-26-114(1)(a)(XII) imposes a sales tax on "lease payments." It is the Department's position that anything paid by the lessee pursuant to the lease contract is a "lease payment." Therefore, if the lessee's reimbursement of the property taxes is made pursuant to the terms of the lease contract, it is a "lease payment" and is subject to tax.");

retailer, even if retailer ultimately passes the cost on to the purchaser as part of the purchase price or rental charge.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes.

This ruling is premised on the assumption that the Company has completely and accurately disclosed all material facts. This ruling is null and void if, and the to the extant that, any representation by the Company or assumption made by the Department in this ruling is not factually correct and such have a material bearing on the conclusions reached in this ruling. The department reserves the right, among others, to independently evaluate Company's representations. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5

Enclosed is a redacted version of this ruling which will be placed on the department's web site pursuant to department regulation. You previously stated that you have no objections to the redacted version.

Respectfully,

Office of Tax Policy
Colorado Department of Revenue