

This letter discusses application of the manufacturing machinery and equipment explosives and related exemption to blasting equipment used for quarry blasting. See 86 Ill. Adm. Code 130.330. (This is a GIL.)

November 9, 2009

Dear Xxxxx:

This letter is in response to your letter dated September 11, 2009, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am writing to follow up on our July 8, 2009 meeting at your office and our telephone conversation this afternoon regarding the status of a sales and use tax exemption for explosives and related equipment use for quarry blasting.

During our meeting you indicated that agency auditing personnel had been advised that explosives and related equipment used for quarry blasting should not be charged sales or use tax pursuant to the manufacturing and assembly machinery and equipment exemption set forth in the Illinois Revenue Code. However, it is my understanding that your agency has not issued any guidance on this issue that may be relied upon by quarry operators and companies that sell explosives and related equipment used for quarry blasting. For that reason, I am providing the following narrative and legal analysis in support of a sales and use tax exemption for explosives and related equipment use for quarry blasting. It is my hope that you will respond to the following submittal with a letter that concurs with my thinking on this issue, thereby ensuring the uniform tax treatment of the aggregates industry.

The Use of Explosives in Quarries

Explosives are used in the mining process as a primary means of fragmenting the rock mass into a size that can be readily handled by equipment. This fragmentation is called

blasting. This first step in the manufacturing process facilitates additional processing of the rock mass into a manufactured product per specification from the final customer.

By weight, the largest component of the blasting process is a **Blasting Agent**. Blasting agents are loaded into the rock mass and can be in many different forms. Each type of blasting agent can be incorporated into the process by means of a bulk delivery system, loaded directly from a truck, or in a packaged configuration to meet the needs of the specific quarry.

Some explosive products are delivered to the quarry as an Oxidizer and are sensitized into a blasting agent at the time of loading the borehole. Blasting agents are **not** sensitive to detonation by means of a detonator or blasting cap. Due to the extreme stability of the Blasting Agent, High Explosives are used to initialize the detonation.

High Explosives are explosive products that are sensitive to detonation through the use of a detonator. High Explosives commonly used in the Blasting process are called Boosters. Boosters come in a variety of sizes and shapes based upon the configuration of the blast design. Other High Explosives are used as the main charge in a blast based upon the geologic conditions at the quarry.

Detonators come in a variety of signal delivery systems. These include: electric, shock tube, electronic, cap and fuse and detonating cord. As time progresses, other types of initiation systems may evolve. A detonator is designed to provide the detonation of the Booster at a predetermined time. The timing of individual charges in a blast is separated by milliseconds. Some blasting, specifically underground, utilizes Long Periods (LP's) which separate the individual charges by ½ second intervals.

The entire blast is connected to **Lead-In line** which sends a signal to the individual charges in the blast. This Lead-In line is connected to a **Blasting Machine** which programs the predetermined timing of the individual explosive charges.

Legal Analysis

Explosives and related equipment used for quarry blasting should be exempt from use and sales taxes under the manufacturing and assembly machinery and equipment exemptions set forth in the Illinois Revenue Code. See 35 ILCS 105/3-5(18); 35 ILCS 105/3-50; 35 ILCS 120/2-5(14); and 35 ILCS 120/2-45.

First, the blasting agent used for quarry blasting, ammonium nitrate and fuel oil (ANFO), is exempt as manufacturing equipment. As set forth in 35 ILCS 105/3-50(4) and 120/2-45(4):

Equipment includes chemicals or chemicals acting as catalysts but only if the chemicals or chemicals acting as catalysts effect a direct and immediate change upon a product being manufactured or assembled for wholesale or retail sale or lease.

As outlined in the narrative above, ANFO is a chemical that acts as a catalyst to make the first direct and immediate physical change to aggregates being manufactured. The manufacture of crushed stone cannot occur without the use of this chemical.

Second, the related equipment used to ignite the ANFO (high explosives, detonators, lead-in lines and blasting machines) would also be exempt as manufacturing equipment. 35 ILCS 105/3-50(4) and 120/2-45(4) further state, in relevant part:

'Equipment' includes an independent device or tool separate from machinery but essential to an integrated manufacturing or assembly process; including computers used primarily in a manufacturer's computer assisted design, computer assisted manufacturing (CAD/CAM) system; any subunit or assembly comprising a component of any machinery or auxiliary, adjunct, or attachment parts of machinery, such as tools, dies, jigs, fixtures, patterns, and molds; and any parts that require periodic replacement in the course of normal operation; but does not include hand tools. (Emphasis added)

As outlined in the narrative above, each piece of equipment used to ignite the ANFO is essential to quarry blasting, the initial stage of crushed stone production. ANFO will not ignite and fracture the bedded limestone without the use of the related equipment used for quarry blasting: high explosives, detonators, lead-in lines and blasting machines.

I look forward to your response. Please contact me if you have any questions regarding this submittal.

DEPARTMENT'S RESPONSE:

The Retailers' Occupation Tax ("Act") does not apply to sales of machinery and equipment used primarily (over 50%) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease. See 86 Ill. Adm. Code 130.330. When determining whether a piece of equipment qualifies for the manufacturing machinery and equipment exemption, the requirements of 86 Ill. Adm. Code 130.330 must be met.

"Manufacturing", as defined in this regulation, is the production of articles of tangible personal property, whether such articles are finished products or articles for use in the process of manufacturing or assembling different articles of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining which changes some existing material or materials into a material with a different form, use or name. These changes must result from the process in question and be substantial and significant. See 86 Ill. Adm. Code 130.330(b)(2).

Manufacturing equipment, as noted in Section 2-45 of the Act and in Section 130.330 (c)(3), includes any independent device or tool separate from any machinery but essential to an integrated manufacturing or assembling process, including any subunit or assembly comprising a component of any machinery or auxiliary, adjunct, or attachment parts of machinery, such as tools, dies, jigs, fixtures, patterns, and molds, and any parts that require periodic replacement in the course of normal operation, but not including hand tools. As Section 2-45 of the Act notes, the exemption also includes chemicals or chemicals acting as catalysts but only if the chemicals or chemicals acting as catalysts effect a direct and immediate change upon a product being manufactured or assembled for sale or lease.

Your letter explains that the use of explosives in the quarrying process begins with blasting agents, which are available in a variety of forms. The blasting agent is loaded into the rock mass through any number of methods. Because blasting agents are not sensitive to detonation by means of a detonator or blasting cap, high explosives (also termed "boosters") are used to initialize their

detonation. The boosters are detonated at a predetermined time through the use of detonators, including electric, shock tube, electronic, cap and fuse and detonating cord delivery systems. The entire blast is connected to lead-in line which sends a signal to the individual charges in the blast, and is connected to a blasting machine which programs the predetermined timing of the individual explosive charges.

Generally, the types of equipment and material that you describe in your letter may qualify for the manufacturing machinery and equipment exemption. As Section 130.330 (b)(3) of the Department's regulations states, a manufacturing process occurs when an existing material is changed into a material with a different form, use or name by a process commonly regarded as manufacturing. The blasting process constitutes the first step in the manufacturing process, in which calculated blasting methods are used to change embedded quarry rock into smaller aggregate in order to meet specific customer requirements, either as a finished product or as a first step in further crushing or sizing to meet specific customer requirements. See also Nokomis Quarry v. Department of Revenue, 295 Ill.App.3d 264 (Fifth District, 1998)(explosives systematically placed holes and detonated to produce shot rock which could be immediately marketed was the first step in the manufacturing process).

The blasting agent, high explosives, detonators, lead-in line and blasting machine described in your letter are component parts of an integrated manufacturing process, the effect of which is to produce a direct and immediate change on the quarry rock. Although these items are separate from machinery, we consider them to be equipment that is essential to an integrated manufacturing process, and therefore, exempt. See Section 130.330 (c)(3).

It is important to note that the manufacturing machinery and equipment exemption is a use-based exemption. As a result, items do not qualify in and of themselves, but only if they are used primarily (over 50%) in a qualifying manner. In this case, the items described above will qualify only if used primarily to manufacture or assemble tangible personal property for wholesale or retail sale or lease. Since the aggregate produced by the manufacturing process could be used in a manner other than for wholesale or retail sale (for instance, the quarry itself could use the aggregate to fulfill construction contracts with customers), we cannot provide a determination that the exemption always applies to the items listed above. This can only be determined based on an analysis of the actual use of the equipment. However, given proper documentation regarding the equipment's use, the exemption could apply.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Jerilynn T. Gorden
Deputy General Counsel – Sales and Excise Taxes

JTG:msk