



HOUSE BILL 619: Alcohol Bev. Manufacture Sales Tax Exemption.

2021-2022 General Assembly

Committee:	House Rules, Calendar, and Operations of the House	Date:	June 30, 2021
Introduced by:	Reps. Moffitt, Richardson, Setzer, Winslow	Prepared by:	Trina Griffin
Analysis of:	Second Edition		Staff Attorney

OVERVIEW: House Bill 619 would exempt from sales and use tax sales of machinery, parts, accessories, supplies, and ingredients to certain ABC permittees for use in the manufacturing of beer, wine, and spiritous liquor for which the purchaser would otherwise be ineligible because the purchaser is primarily engaged in the restaurant business.

MANUFACTURING EQUIPMENT, PARTS, AND ACCESSORIES

CURRENT LAW: Sales of "mill machinery," including parts and accessories, to a "manufacturing industry or plant" are exempt from sales and use tax. A business that manufactures alcohol is considered a manufacturer and is eligible for the sales tax exemption on machinery, parts, and accessories that are used in the manufacturing process.

However, while there is no statutory definition for "manufacturing industry," the statute expressly excludes from the term "a retailer that is principally engaged in the retail sale of food prepared by it for consumption on or off its premises." The phrase "principally engaged" has been interpreted by the Department of Revenue to mean more than 50% of the business' total revenues. Therefore, a business cannot be considered a manufacturer if more than 50% of its revenue is derived from the retail sale of food that it prepares even though it may also manufacture alcohol.

BILL ANALYSIS: House Bill 619 would exempt from sales tax purchases of machinery, equipment, parts, and accessories used in the manufacture of beer, wine, and spiritous liquor by the holder of any of the following ABC permits who is primarily engaged in the restaurant business:

- Unfortified winery permit
- Fortified winery permit
- Brewer permit
- Distillery permit

While this new exemption would not be limited to distilleries or breweries that also operate restaurants, it would only change the law with respect to those that do since, as a practical matter, distilleries or breweries that only manufacture alcohol are already eligible for the exemption. It basically expands the application of the existing exemption as it relates to alcohol manufacturers by creating a stand-alone exemption with no "restaurant" limitation.

INGREDIENTS

CURRENT LAW: Sales to a manufacturer of items that become an ingredient or component part of the manufactured tangible personal property are exempt from sales tax. Additionally, items purchased for resale are exempt. Therefore, ingredients purchased by an alcohol manufacturer that become a component part of the manufactured product that is ultimately sold are already exempt. However, to the extent a

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business is not considered a "manufacturer" under current law because it is primarily engaged in the retail sale of food or if the product is not actually "sold," it would not be eligible for this exemption.

Along these lines, the Department has [opined](#) the following: *"A distillery is liable for the use tax at the applicable rate on the purchase price of ingredients used to manufacture the spirituous liquor given free of charge to customers, visitors, and employees on the distillery's licensed premises, provided the distillery is not engaged in the business of selling prepared food or drink for immediate or on-premises consumption."*

BILL ANALYSIS: House Bill 619 would have the effect of nullifying this Departmental interpretation because the bill exempts ingredients used in the manufacture of alcohol regardless of whether it is resold. As such, a distillery that is not engaged in the business of selling prepared food and drink would not be liable for use tax on ingredients used to produce spiritous liquor that is given free of charge to customers.

SUPPLIES

CURRENT LAW: Certain supplies purchased by a manufacturer that are worn by employees in production areas to protect the quality of and prevent contamination of the manufactured product are considered "mill machinery" accessories and are eligible for the sales tax exemption. When those same items are worn by employees in non-production areas or are primarily to protect the employees rather than the product, they are subject to sales tax.

BILL ANALYSIS: House Bill 619 would broaden the current exemption by exempting supplies purchased by an ABC permittee that are "used or consumed in the manufacture" of alcohol regardless of whether the supplies are for protection of the product.

BACKGROUND: The manufacturing exemption is one of the greatest sources of complexity in sales tax law and has generated innumerable court cases in virtually all states. The issues center around (1) what type of activity constitutes manufacturing; (2) when an entity qualifies as a manufacturer; and (3) what constitutes manufacturing equipment.

Since North Carolina has no statutory definitions for "mill machinery" or "manufacturing industry," the Department has had to develop guidance and criteria over the years to determine the application of the tax. It has done so through a combination of administrative rule and interpretation of case law. However, the criteria have not always been consistent or clear to taxpayers.

The Revenue Laws Study Committee last considered these issues in 2016, but ultimately did not make any recommendations.

EFFECTIVE DATE: This act would become effective July 1, 2021, and apply to sales made on or after that date.