



OFFICE OF
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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Deborah A. Butler
Assistant Chief Counsel CC:DOM:FS

SUBJECT: I.R.C. § 144(a)(12)(C) Manufacturing Facility

This Field Service Advice responds to your memorandum dated August 31, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Corporation	=
Issuer	=
City	=
Year 1	=
Year 2	=
\$a	=

ISSUES

Whether certain operations of a vegetable processing facility, which include the cleaning, cooking, freezing, and packaging of freshly harvested vegetables, constitute manufacturing within the meaning of I.R.C. § 144(a)(12)(C).

CONCLUSIONS

Based on the information provided, the facility's operations of cleaning, cooking, freezing, and packaging vegetables appear to be a process that results in a change in the condition of tangible property that would meet the definition of manufacturing under I.R.C. § 144(a)(12)(C).

FACTS

Corporation is engaged in the processing and packaging of freshly harvested vegetables. In Year 1, Corporation opened its vegetable processing facility in City (the "Facility"). The Facility receives freshly harvested vegetables, such as snap peas, corn and lima beans. The vegetables are cleaned with an irrigation system, lightly cooked and frozen. The vegetables are then sorted by weight and packaged for shipment. The packaged vegetables are sold to private label companies for retail and institutional sale. Corporation operates three other similar facilities in different locations.

In Year 2, Issuer issued tax-exempt bonds in the amount of \$a. The proceeds of the bonds were used by Corporation for the acquisition of equipment and the construction of a building at Facility. The equipment and building are purportedly used in Corporation's vegetable processing operations at the Facility.

LAW AND ANALYSIS

Section 103(a) of the Internal Revenue Code¹ provides that gross income does not include interest on a State or local bond. Section 103(b)(1) provides that section 103(a) does not apply to any private activity bond, unless it is a "qualified bond." Section 141(e)(1)(D) provides that a "qualified small issue bond" is a "qualified bond."

Section 144(a)(1) provides that the term "qualified small issue bond" means any bond issued as part of an issue the aggregate authorized face amount of which is \$1,000,000 or less and 95 percent or more of the net proceeds of which are to be used for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or to redeem a prior issue that was used for those purposes. Under section 144(a)(4), the issuer may elect to increase the \$1,000,000 limitation to \$10,000,000 provided certain other requirements are also met. The proceeds, however, are still required to be used in the manner described in section 144(a)(1).

¹ References to the Internal Revenue Code are to the 1986 Code.

Section 144(a)(12) provides, in part, that section 144(a) does not apply to any bond issued after December 31, 1986, unless the bond proceeds are used to provide a manufacturing facility. Section 144(a)(12)(C) states that the term "manufacturing facility" means any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). The term "manufacturing facility" includes facilities which are directly related and ancillary to a manufacturing facility (determined without regard to this sentence) if-(i) such facilities are located on the same site as the manufacturing facility, and (ii) not more than 25 percent of the net proceeds of the issue are used to provide such facilities.

There is no authority interpreting the phrase "used in the manufacturing or production of tangible personal property" as found in section 144(a)(12)(C). Moreover, while the term manufacturing is used in various places in the Code, there is no uniform generalized meaning. Thus, we must look to the statutory language and legislative history to apply the provision to a given set of facts.

The statute and legislative history indicate that core manufacturing should be narrowly defined. Section 144(a)(12)(C) distinguishes between core manufacturing and activities that are directly related and ancillary to core manufacturing. For example, a loading dock to unload raw materials incidental to production may be integral to the functioning of the manufacturing plant, but is not part of the core manufacturing process. Similarly, a warehouse for the short-term storage of raw materials is not core manufacturing. H.R. Rep. No. 795, 100th Cong., 2d Sess. 576-577 (1988).

While legislative history provides useful insight into the definition of core manufacturing, the current question of whether the operations conducted at the Facility constitute manufacturing is best answered by simply analyzing the language of the statute. Under section 144(a)(12)(C), manufacturing includes "processing resulting in a change in the condition" of tangible property. In the instant case, the operations conducted at Corporation's Facility transform property, freshly harvested vegetables, into a product ready for commercial consumption and use. Accordingly, the process you describe (the cleaning, cooking, freezing and packaging of vegetables) appears to meet the definition of manufacturing for purposes of section 144(a)(12).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Although the processing operations appear to meet the definition of manufacturing, there are insufficient facts to determine whether the bond proceeds were spent on Corporation's core manufacturing activity. [REDACTED]

[REDACTED]

Based on the information provided, machinery or buildings used directly in the processing of the vegetables would be part of the core manufacturing process. Conversely, storage facilities or equipment used to move the product would not. [REDACTED]

[REDACTED]

Further, we suggest you consider the additional requirements imposed on qualified small issue bonds by section 144(a). Specifically, the \$10,000,000 limit of section 144(a)(4) is determined not only by taking into account the face amount of the issue and certain prior exempt small issues, but also the aggregate amount of capital expenditures with respect to certain facilities paid or incurred during the 6-year period beginning three years before the date of such issue and ending three years after such date (and financed otherwise than out of the proceeds of outstanding issues to which section 144(a)(1) [or the corresponding provision of prior law -section 103(b)(6)(A) of the 1954 Code] applies). [REDACTED]

[REDACTED]

[REDACTED]

Please call if you have any further questions.

By: _____
JOEL E. HELKE
Branch Chief
Financial Institutions & Products

cc: