

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
February 16, 2000

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CASE MIS No.: TAM-116662-99/CC:DOM:FI&P:B5

District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Date of Conference: December 6, 1999

LEGEND:

City =

Bonds =

Facility =

Date 1 =

ISSUE:

Whether the Facility, used for the purpose of curing cheese, is a manufacturing facility under § 144(a)(12)(C) of the Internal Revenue Code.

CONCLUSION:

The Facility is a manufacturing facility under § 144(a)(12)(C).

FACTS:

City issued the Bonds on Date 1. The proceeds of the Bonds were used to purchase and equip the Facility. The Facility is used to cure cheese for various cheese producers. The Facility is a controlled atmosphere facility, with equipment and people that monitor and control temperature, air flow, and humidity. The Facility includes 4 large rooms with separate temperature and humidity controls. The rooms contain large

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racking structures to hold cheese during curing; these structures allow for proper air circulation.

Generally, the process of cheesemaking begins with the acidification of milk through the addition of bacteria. Then, enzymes are added to coagulate the milk into curds and whey. The set curd is cut, allowing the whey to escape. Salt is added to the curd, and the curd is molded and shaped. Then the curd is cured under controlled atmospheric conditions in a curing cooler. Temperature affects the rate of curing; air flow and humidity affect moisture content and the growth of mold and mildew on the cheese curd. Curing develops the texture and flavor of the curd into those characteristic of the type of cheese being made. Licensed cheese graders test the cheese during the curing process. The graders, based on the quality of the samples, predict how well the cheese will age and determine the recommended length of the curing. After curing is completed, the cheese may be blended with another type of cheese, and it is cut and packaged.

Federal Food and Drug Administration regulations govern the process of cheesemaking. See 21 C.F.R. § 133.3-.196 (1999). Among other requirements, these regulations set standards for each type of cheese as to the length of time and temperature for curing and the moisture content of that cheese. 21 C.F.R. § 133.102-.196 (1999).

Only the curing phase occurs at the Facility. The steps prior to and after curing the cheese occur elsewhere. The Facility receives molded and shaped cheese curd stacked on pallets from various cheese producers. Each pallet is tracked as to the temperature and amount of time cured. The conditions within the Facility are strictly monitored and controlled to fluctuate only within a narrow range, as deviations may adversely affect the development of the product. While the curd is being cured, the cheese producers send cheese graders to check the progress of, and make recommendations as to, the curing. The pallets may be moved by forklift from one room to another to change temperature or humidity conditions and, thereby, to accelerate or decelerate the curing process. No ingredients are added to the cheese while it is in the Facility. Once cured, the cheese is removed from the Facility and returned to the cheese producers for blending, cutting, and packaging.

LAW AND ANALYSIS:

Section 103(a) provides that gross income does not include interest on any State or local bond. Section 103(b)(1) provides that § 103(a) does not apply to any private activity bond which is not a qualified bond under § 141. 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

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\$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 § 144(a)(4), the issuer may elect to increase the \$1,000,000 to \$10,000,000 provided certain other requirements are met. Section 144(a)(12) provides, in part, that § 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) provides 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 such facilities are located on the same site as the manufacturing facility and not more than 25 percent of the net proceeds of the issue are used to provide such facilities.

The legislative history of the Technical and Miscellaneous Revenue Act of 1988 states: “All ancillary activities must occur at the same site as the manufacturing activity, and manufacturing must constitute substantially all of the on-site economic activity. All other activities must be subordinate to and integral to the manufacturing process.” H.R. Rep. 100-795, at 576 (1988). The legislative history contains examples of activities that are subordinate and integral to the manufacturing process. Short-term warehousing of raw materials incidental to production or the temporary warehousing of finished products, an on-site laboratory for product testing, loading docks for unloading raw materials and loading finished products, and forklifts and similar equipment may be subordinate and integral to manufacturing. *Id.*

Ancillary or subordinate and integral activities support and are related to core manufacturing, but are not part of core manufacturing. Core manufacturing consists of the key components of the manufacturing process. While ancillary or subordinate and integral activities must be located at the same site as core manufacturing, all of the key components of core manufacturing need not be located at the same site.

Making cheese is manufacturing or processing. The issue in this case, however, is whether curing cheese is part of the core manufacturing of cheese. If it is not, the Facility cannot qualify as a manufacturing facility because the Facility is located at a different site from where the rest of the cheesemaking process occurs.

We conclude that curing is a key component of manufacturing cheese. Curing is necessary to transform the inedible curd into edible cheese. The cheesemaking process is not complete until the curd is cured. Further, curing is required by Federal Food and Drug Administration regulations for the product to be sold as cheese. Thus,

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curing is part of the core manufacturing of cheese.

Accordingly, we conclude that the Facility is a manufacturing facility under § 144(a)(12)(C).

CAVEAT

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.