

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:TEGE:EOEG:TEB-PLR-169099-01**

Date:

**May 7, 2002**

Legend

Facility =

Bonds =

Borrower =

Lessee =

City =

Issuer =

Dear

This is in response to your request for a ruling that the Facility you plan to finance by the proceeds of the Bonds would be a "manufacturing facility" under § 144(a)(12)(C) of the Internal Revenue Code (the "Code").

**FACTS AND REPRESENTATIONS**

You represent the following facts. The Borrower is a general partnership engaged in real estate development. The Borrower has entered into a lease agreement with Lessee to construct and lease to Lessee the Facility, which is located in the City. The Lessee intends to use the Facility in its publishing business.

The Borrower intends to obtain financing for the construction and equipping of the Facility by using Bond proceeds. The Bonds are planned to be issued by the City's industrial development authority as qualified small issue bonds under § 141(e)(1)(D). The Issuer will elect to increase the small issue exemption to \$10,000,000 under § 144(a)(4). The Borrower anticipates that the capital expenditure requirements under § 144 would be met. The improvements to the land on which the Facility will be located would be subject to an allowance for depreciation.

The Lessee is a publisher of business and other directories. Its primary customers are businesses that purchase advertising space and listings in the directories and subscribers to the directories. The process of publishing Lessee's directories can be divided into four phases. The first phase consists of the sale of advertising to a customer. The second phase consists of the process of creating the advertisement and designing the directory. The third phase is the "post-script" phase. The fourth and final phase is the printing and binding of the directories. The second and third phase occur at the Facility.

In the first phase, a Lessee sales representative meets with a potential customer to discuss the advertising. If the customer orders the advertising, the sales representative puts together a package and delivers it to the Facility. This package contains a sketch of the ad, also called the "copy sheet," representing the basic advertising idea, any customer instruction and other information to be used in the ad creation and design process, and the contract. This phase, including the creation of the "copy sheet," occurs away from the Facility.

The activities at the Facility begin with the second phase. In the second phase, the ad creation and directory design phase, a graphic artist creates the ad utilizing a desktop computer and graphic software. The graphic artist initially creates a proposed advertisement in accordance with the basic advertising idea in the "copy sheet." The proposed ad is then continually proofread and modified at the Facility and relayed to the customer until the customer gives the final approval for the ad. Once the ad is approved by the customer, the ad, together with surrounding listings, is placed and arranged on a particular page of the directory and the pages are numbered and proofread. Most of the Facility is used for this phase of the directory publishing process.

In the third phase, the compiled directory pages are put through the "post-script" process which entails formatting of the pages from computer language into a specialized machine language. The final proofs of each page are then created, proofread and approved. Upon final review and approval, the pages are downloaded onto a CD-ROM. A hard copy and the CD-ROM containing the final output copy of each page are then shipped to printing companies which are located in the geographic areas in which Lessee's directories are distributed. This concludes the activities at the Facility.

In the fourth and final phase, the final output copy is used by the printer to print and bind Lessee's directories. This phase occurs away from the Facility.

## LAW AND ANALYSIS

Section 103(a) of the Code 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 § 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 § 144(a)(1).

Section 144(a)(12)(A) 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) 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 § 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 and circumstances.

Section 144(a)(12)(C) distinguishes between core manufacturing and activities that are directly related and ancillary to core manufacturing. All ancillary activities must occur at the same site as the manufacturing activity, and the manufacturing activity must constitute substantially all of the on-site economic activity. H.R. Rep. No. 100-795, at 576 (1988). All other activity must be subordinated and integral to the manufacturing process. *Id.* The statute and legislative history indicate that core manufacturing should be narrowly defined. See *id.* The House Report gives examples of activities that may be ancillary, such as an on-site laboratory whose purpose is to test the manufactured product for quality or to experiment with different materials which might be used as raw materials for the product. *Id.* at 576-77. Also, forklifts or similar equipment are integral to a manufacturing operation, but trucks or vans to deliver the final product are not integral to the manufacturing process. *Id.* at 577. Similarly, the term "tangible personal property," as it is used in § 144(a)(12)(C), must be interpreted within the context of core manufacturing.

Substantially all of Lessee's activities at the Facility involve the processing and transformation of data and intellectual, literary, and artistic ideas. These activities are not core manufacturing. Therefore, manufacturing does not constitute substantially all of the activities at the Facility as required under § 144(a)(12)(C).

## CONCLUSION

Accordingly, the activities of the Lessee at the Facility planned to be financed by the Bond proceeds fail to qualify the Facility as a “manufacturing facility” under § 144(a)(12)(C).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,  
Assistant Chief Counsel  
(Exempt Organizations/Employment Tax/  
Government Entities)  
By: \_\_\_\_\_  
Timothy L. Jones  
Assistant Branch Chief  
Tax Exempt Bonds Branch