

MAINE STATE LEGISLATURE

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STATE OF MAINE

Inter-Departmental Memorandum Date March 22, 1966

To Ernest H. Johnson, State Tax Assessor Dept. Bureau of Taxation

From Jon R. Doyle, Asst. Attorney General Dept. " " "

Subject Taxability of Boiler Compounds

FACTS

Three tanneries which have recently been audited add certain boiler compounds (chemicals) to their boiler water to prevent scaling.

The boilers and the water in question are used primarily for heating the tanneries, including both manufacturing and non-manufacturing areas. The steam produced by the boilers is also used to a minor degree in processing.

QUESTION

Under these facts, can the chemicals in question be said to be consumed or destroyed in the process of manufacturing and thus excluded from taxation under the sales and use tax law?

LAW

" 'retail sale' and 'sale at retail' do not include the sale of tangible personal property which becomes an ingredient or component part of, or which is consumed or destroyed or loses its identity in the manufacture of, tangible personal property for later sale but shall include fuel and electricity. It shall be considered that tangible personal property is 'consumed or destroyed' or 'loses its identity' in such manufacture, if it has a normal physical life expectancy of less than one year as a usable item in the use to which it is applied" Title 36 M.R.S.A. § 1752, subsection 11.

Ernest H. Johnson, State Tax Assessor March 22, 1966

ANSWER

The boiler compounds that are present in steam used to heat the manufacturing area and in the steam used in processing are to be excluded. Those compounds present in steam used to heat nonmanufacturing areas are to be taxed.

REASONS

In order to be excluded from taxation under the above provisions tangible personal property must be:

1. Physically consumed or destroyed.
2. In the manufacture of,
3. Tangible personal property for sale.

In answering the question it is assumed that the chemicals in question are actually: "physically consumed or destroyed," and that the tanning of leather is a process of "manufacturing." (Cf. Oxford Paper Co. v. Ernest H. Johnson, State Tax Assessor, 155 Me. 380 (1959) and Bonnar-Vawter, Inc. v. Ernest H. Johnson, State Tax Assessor, 157 Me. 380 (1961).

The question really becomes whether the chemicals are "consumed or destroyed" "in the manufacture of" tangible personal property and more particularly whether it is required that they be "consumed or destroyed" directly in the manufacturing process in order to be excluded.

The Maine Supreme Court has had occasion to construe the pertinent exclusionary provision and it has indicated the legislative intent behind the enactment of the provision and its interpretation of the substance of the provision.

The Court said regarding legislative intent in the case of Bonnar-Vawter v. Johnson, supra, at page 391:

"A study of the pertinent provisions of our sales and use tax legislation leads us to the conclusion that the legislative intent in the use of the words "consumed and destroyed," (sic.) was to give relief from the payment of a use tax in those cases only where the personal property is physically consumed or destroyed in the

Ernest H. Johnson, State Tax Assessor March 22, 1966

manufacturing process to such an extent that it is rendered unfit for further practical use for its intended purpose."

The Supreme Court has also expressed its analysis of the substantive content of the provision in the case of Hudson Pulp & Paper Corp. v. Ernest H. Johnson, State Tax Assessor, 147 Md. 444.

In that case the State Tax Assessor sought to divide those things consumed or destroyed into two classes or categories, one taxable and the other nontaxable. In the language of the Court:

"Those things which were being acted upon in the process of manufacture, and by being acted upon were consumed or destroyed and thus lost their identity in the end product were treated as exempt from taxation. Those things which acted upon the material which was being processed, even if they were destroyed or consumed, would not be exempt from the tax." (Emphasis supplied by the Court). Hudson Pulp & Paper Co. v. Ernest H. Johnson, State Tax Assessor, supra, at page 447.

The Court rejected this view saying:

"The words 'consumed or destroyed' however, are each applicable not only to that which is being acted upon, the subject matter of manufacture, but also to those things which act upon the subject matter, viz. that which is being produced by manufacture. They are applicable to all of those expendibles by which the process of manufacture is carried on." (Emphasis supplied). Hudson Pulp & Paper Co. v. Ernest H. Johnson, State Tax Assessor, supra, at page 449.

The Court went on to conclude that oils and greases used to lubricate machinery and certain wires, wet felts and dry felts used on paper machines were excluded from taxation.

Under the facts of the problem here, the boiler chemicals act upon the subject matter either through their presence in the steam acting directly upon the subject matter or through their presence in the heat which heats the manufacturing area.

Ernest H. Johnson, State Tax Assessor March 22, 1966

The rule stated in the last sentence in the above quotation is broad and it could well be argued that this rule could be very liberally construed. However, I believe the rule should be construed in the light of the facts which gave rise to it. That is, its application should be limited to the expendibles which are found within the manufacturing area.

Our Court has never ruled whether these expendibles must be directly or indirectly consumed in the process of manufacture. Generally, the rule is that in order to be considered excluded the materials must be "consumed or destroyed" directly in the process of manufacture. This is so because many states, e.g., Ohio, Florida and Pennsylvania, indicate in their statutes that the use must be "directly" in the manufacturing process.

Michigan, although its law does not contain the word "directly" has elaborate administrative interpretation which leads to the same result. It is therefore seen, because of the language of our statute, that most decisions of other states will not be helpful.

However, the case of Commonwealth v. Yorktowne Paper Mills, Inc. 33 Pa. D & C. 2d 124, is interesting for its treatment of a somewhat similar factual situation under a law requiring a "direct" consumption or destruction.

In that case, the taxpayer, a paper manufacturer, purchased certain chemicals which it used continuously in its boilers to eliminate scale and corrosion. The steam produced by the boiler was used to dry paper, heat certain water in the manufacturing process and to run turbines operating machines.

The sales and use tax law in Pennsylvania provides that retail sale:

" . . . shall not include . . . consumption of tangible personal property . . . directly in any of the operations of . . . ' (i. the manufacture of tangible personal property)'" (Emphasis supplied).

(Commonwealth v. Yorktowne Paper Mills, Inc., supra)

The Commonwealth argued that the chemicals were not used directly in the manufacturing process. The Court said:

"It seems to us that (the chemicals) are essential to the conduct of this business, even though the product could conceivably be produced without them

Ernest H. Johnson, State Tax Assessor March 22, 1966

and that they are in close physical proximity and close time proximity to the production process and that there is an active causal connection between their use and the manufacturing process." Commonwealth v. Yorktowne Paper Mills, supra.

Therefore, it is seen that even if the statute requires a "direct" consumption or destruction the Court will exclude the chemicals which act in some way upon the subject matter, as in this case, through their presence in the steam produced by the boiler.

The decision of the Court in the case of Hercules v. Bowers, 168 N.E. 2d 404, 405 (Ohio) takes a similar broad view. In this case, a manufacturer of truck bodies, hoists, concrete mixers, grave vaults, etc. purchased gasoline cans to hold paint thinner in spray paint booths, detergent used to clean spray paint booths in which the manufactured products were spray painted; sweeping compound to put on oily floors to prevent workmen from slipping and optical wiping tissues which were used to clean safety glasses worn by the manufacturer's employees.

The Court held that the purchases of such items were properly exempted from the sales and use taxes on the ground that they were "used or consumed directly in the production of tangible personal property for sale." It does appear that the courts, including the courts of Maine, have given a rather liberal construction to this exclusion from taxation even considering the divergencies in the statutes.

The problem here is particularly complicated since the steam from the boiler performs three different functions, that is, heating of the manufacturing area, the heating of the nonmanufacturing area and use to a minor degree in processing.

It is clear, even under statutes which require a direct use, that the steam and the chemicals in it used in processing are consumed or destroyed in the process of manufacture and therefore are excluded from taxation.

It is also proper to conclude that steam (with the chemicals in it) used to heat the manufacturing area would be an "expendible by which the process of manufacture is being carried on" and thus excluded also.

Although the Maine court in the Hudson case did not specify whether the "expendibles by which the process of manufacture is carried on" were to be limited to a manufacturing area, I do not believe the court would broaden the exclusion to the extent of excluding from taxation steam and thus the chemicals, used in the nonmanufacturing

Ernest H. Johnson, State Tax Assessor March 22, 1966

areas. Other courts have indicated, for example, that transportation is not a part of the manufacturing process unless it occurs in the manufacturing area and I believe our court would view the heating of the nonmanufacturing area in the same light.

A practical problem may be created by the exclusion of a part of the chemicals and the taxation of another portion. Obviously, if a pro rata share cannot be computed the entire amount of the chemicals should be excluded.

We advise therefore that the chemicals used in the boiler so far as they are present in the steam used in the manufacturing area either by way of heat or acting directly upon the manufactured product, be excluded from taxation; those present in steam used to heat the nonmanufacturing area be taxed.

JHD:epd