



IOWA SUPREME COURT ISSUES

IMPORTANT SALES/USE TAX OPINION

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CHRISTOPHER E. JAMES

On Friday, October 8, 2010, the Iowa Supreme Court decided the state tax case, *The Sherwin-Williams Company v. Department of Revenue* - No. 071534. In *Sherwin-Williams*, the Iowa Supreme Court interpreted the term, “manufacturer” for purposes of a sales and use tax exemption, and held that the Taxpayer, *Sherwin-Williams*, was eligible for an exemption from sales and use tax. *Sherwin-Williams* argued for an exemption of its paint-mixing and color matching machines at their retail locations. The argument brought by *Sherwin-Williams* was essentially that the paint-mixing and color matching machines were used in the manufacture of, and were part of the process of producing, an end product of usable paint.

The claim of exemption was based upon Iowa Code § 423.3(47)(a)(1), which exempts the following receipts from sales/use tax:

[t]he gross receipts from the sale or rental of computers, machinery and equipment . . . if such items are any of the following:

(1) Directly and primarily used in processing *by a manufacturer*.

Iowa Code Chapter 423 does not specifically define the term, manufacturer, but rather, refers to the definition found in Iowa Code § 428.20, which is essentially the same as the definition in Iowa Admin. Code r. 701–18.58(1) which interprets Iowa Code § 428.20:

“*Manufacturer*” means any . . . corporation that purchases, receives, or holds personal property for the purpose of adding to its value by any process of manufacturing, refining, purifying, combining of different materials, or by packing of meats with an intent to sell at a gain or profit.

The Iowa Department of Revenue argued for a restrictive interpretation of the term, manufacturer. The core of the Department’s argument was that the exemption for manufacturing should be limited to those that are primarily manufacturers. The Department asserted that the manufacturing exemption was not meant for those whose primary business is retail sales. In support of this argument, the Department pointed to the fact that the property at which the equipment was located is not classified as industrial real estate but commercial real estate. The Department also argued that applying a broad

definition to the exemption would lead to absurd results and that companies such as fast-food restaurants could be considered manufacturers.

The Iowa Supreme Court rejected the Department's positions. The Court held that the term manufacturer was intentionally broadened by legislation in 1997. In the prior versions of the relevant code sections, the statutes required a primary use determination in order to claim the manufacturing exemption. After the amended legislation as set forth above, the Court held that the legislature intended a broader definition of manufacturing. Further, the Court held that it was not absurd for retailers to be granted the manufacturing exemption if they used equipment in the same way as would a traditional manufacturer. The Court also pointed to other states where they found in favor of the taxpayer in identical factual situations.

Factually, in determining that the machinery in question qualified for the exemption, the Iowa Supreme Court seemed to find that a key fact was that the paint base which is shipped to the retail locations is unusable until mixed with the chemical compounds of the color additives. For instance, the base paint is basic white in color; however, if a customer wishes to buy paint the same color as the base, colorant additives must still be mixed in to the paint in order to make the paint a usable end product.

This ruling is important for the ongoing definition and application of the manufacturing machinery and equipment exemption. While *Sherwin-Williams* is limited to the facts of the case, the Court's analysis could aid other taxpayers seeking to claim the exemption who may not fall into the traditional definition of a manufacturer.