

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 2001-4

August 16, 2001

MANUFACTURERS' INVESTMENT CREDIT: READY-MIXED CONCRETE AND CEMENT TRUCKS

Syllabus:

Advice and guidance have been requested with respect to determining qualified property for purposes of the Manufacturers' Investment Credit (MIC). Specifically, this ruling is in response to questions presented regarding the manufacturing process for ready-mixed concrete and the characterization of cement trucks for purposes of the MIC.

ISSUES

1. For purposes of the MIC, what is the duration of the manufacturing process for ready-mixed concrete?
2. Are cement trucks that mix and transport ready-mixed concrete qualified property for purposes of the MIC?

BACKGROUND

The MIC is allowed under Revenue and Taxation Code sections 17053.49 (Personal Income Tax (PIT) Law) and 23649 (Bank and Corporation Tax (B&CT) Law). Regulations for the MIC can be found at California Code of Regulations, title 18, sections 17053.49-0 through 17053.49-11 (PIT) and 23649-0 through 23649-11 (B&CT). The MIC is allowable to qualified taxpayers who pay or incur qualified costs on or after January 1, 1994, for qualified property that is placed in service in California.

Generally, qualified property for the MIC is tangible personal property as defined in Internal Revenue Code section 1245(a)(3)(A) which is used in an establishment of the qualified taxpayer that is properly classified under Division D (Manufacturing) of the Standard Industrial Classification (SIC) Manual, 1987 edition, and is primarily used in a qualified activity. Qualified activities include manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating or recycling has altered tangible personal property to its completed form, including packaging (if required). (Rev. & Tax. Code, §§ 17053.49, subd. (d)(1)(A), & 23649, subd. (d)(1)(A).)

Ready-mixed concrete manufacturers are described in SIC Code 3273 as establishments "primarily engaged in manufacturing Portland cement concrete manufactured and delivered to a purchaser in a plastic and unhardened state." This is the only SIC code in Division D (Manufacturing) that refers to the physical state of the item manufactured in the definition of the product. The SIC Manual also provides:

Fabricating operations performed at the site of construction by contractors are not considered manufacturing, but the prefabrication of sheet metal, concrete and terrazzo products and similar construction materials is included in the Manufacturing Division.

(SIC Manual, p. 68.) Accordingly, job site mixed concrete activities are not considered manufacturing activities for purposes of the SIC Manual (instead they are generally classified under Division C (Construction), SIC Codes 1521 – 1799) and thus do not qualify for the MIC.

With respect to manufacturing activities, there are three types of ready-mixed concrete activities listed in SIC Code 3273: central-mixed concrete; shrink-mixed concrete; and truck-mixed concrete. Central-mixed concrete is completed in a stationary mixer located at an establishment with delivery to a job site in various forms of transportation alternatives. The other forms of concrete activities may involve mixing at a central establishment or mixing in a cement truck either at an establishment or while traveling to a job site or some combination of establishment/traveling mixing. Water or other additives may be added during transportation to the job site.

As discussed above, qualified property for the MIC is property that is primarily used for manufacturing, processing, refining, fabricating or recycling. (Rev. & Tax. Code, §§ 17053.49, subd. (d)(1), & 23649, subd. (d)(1).) For purposes of the MIC, "primarily" means that the property is used 50% or more of the time in any qualified activity. (Rev. & Tax. Code, §§ 17053.49, subd. (e)(5), & 23649, subd. (e)(5).)

FACTS

Assume the following facts:

X is a company located in California that manufactures and delivers ready-mixed concrete to customers located in proximity to its central manufacturing plant. X stores large amounts of raw ready-mixed material at its central plant. Following receipt of a job work order, X combines the raw materials and water together with other additives according to specifications for the order and delivers the orders to the customers' job sites.

For some of its jobs, X utilizes a large fixed central plant mixer into which raw materials are loaded and mixed with the mixture subsequently transported and delivered to the job site in company-owned cement trucks (wet mix process). For other jobs, X loads raw materials directly into its cement trucks, adds water, and mixes the load during the trip from the central plant to the job site (dry mix process).

Assume further that X's business activity is properly assigned to SIC Code 3273 under Division D (Manufacturing) and that X is a qualified taxpayer for purposes of the MIC. X is not doing business in an Enterprise Zone, Targeted Tax Area, Local Area Military Base Recovery Area, or Manufacturing Enhancement Area. Unless otherwise specified, assume all property discussed is qualified property for the MIC used primarily in X's manufacturing activity. Assume that no election is made to currently expense any portion of the costs paid or incurred with respect to any items of qualified property under Revenue and Taxation Code sections 17265 or 17266 (Internal Revenue Code section 179) or any other similar provision, such as the expensing provisions provided to taxpayers doing business in an economic incentive zone. California sales or use tax has been paid where required on all items of property and all amounts have been properly chargeable to X's capital account under X's method of tax accounting.

X pays the following amounts after January 1, 1994, for property used in its operations:

- (1) \$100,000 for a fixed central plant mixer.
- (2) \$8,000 for California sales tax on item (1) at the rate of 8%.
- (3) \$60,000 for a new cement mixer. Of this amount, \$24,000 is attributable to the concrete mixing drum and related truck-mounted mixing equipment and \$36,000 is attributable to the truck chassis.
- (4) \$4,800 for California sales tax on item (3) at the rate of 8%.

MANUFACTURING ANALYSIS

The MIC statutes provide that the manufacturing process is that period of time "beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer and ending at the point at which the manufacturing, processing, refining, fabricating or recycling activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, if required." (Rev. & Tax. Code, §§ 17053.49, subd. (e)(6), & 23649, subd. (e)(6), except that the phrase "qualified person" is substituted in the B&CT Law for the second reference to "qualified taxpayer" quoted above.) To resolve the issue of what constitutes the "completed form" of ready-mixed concrete requires a facts and circumstances analysis. Construing the manufacturing process narrowly, it could be asserted that manufacturing

of ready-mixed concrete is complete upon the expiration of the construction specification time-period for initial mixing. This mixing period would normally be a maximum of a 10-15 minute period. Under this narrow analysis of the manufacturing process, continued agitation of the mixture following this initial mixing period would not constitute "manufacturing activity," but instead would be considered stabilization or some other type of non-manufacturing activity that would not be a MIC qualified activity.

In its mixed state, ready-mixed concrete has no "shelf life" and is not a product capable of storage.¹ It must be utilized for its intended purpose while in a plastic and unhardened state prior to a specified expiration time and is not a useable product after that point. Once water is added to the dry mixture, ready-mixed concrete must remain in the same plastic and unhardened state at the completion of the initial mixing process until ultimate distribution at a particular job site. As a result, for purposes of the MIC the unique nature of ready-mixed concrete requires that the "completed form" of the manufacturing process for ready-mixed concrete be properly treated as occurring when the product is delivered to the job site in its plastic and unhardened state. (See Rev. & Tax. Code, §§ 17053.49, subd. (e)(6), & 23649, subd. (e)(6).) This is consistent with the manner in which the unique nature of ready-mixed concrete is acknowledged in the SIC Manual, as this is the only SIC code in Division D (Manufacturing) that includes the term "delivery" within its description and references the state of the product in the definition of the manufacturing activity. Therefore, all qualified property used during both the mixing process and the distribution process that otherwise meets the requirements of the statute is eligible for the MIC.

For ready-mixed concrete, the manufacturing process begins when water is added to the raw mixing materials and ends when the mix is distributed out of the mixer-truck at the job site. (See Cal. Code Regs., tit. 18, §§ 17053.49-2, sub.(l), & 23649-2, sub. (l).) Since the delivery process will generally include a point-to-point trip from an establishment to the job site, the time period for mixing, agitating, traveling to and distributing the load at the site, will generally be longer than the time spent on the trip back to the establishment following distribution of the load at the site. Utilizing the time period computation specified in the regulations to determine whether property is "primarily" used in a qualified activity, the property generally will be used 50% or more of the time in the manufacturing activity (subject to the discussion in the following portion of this ruling).

CEMENT TRUCK ANALYSIS

Due to the nature of ready-mixed concrete, cement trucks are generally necessary for

¹ Frozen manufactured products (such as ice cream) require packaging and refrigeration in order to have a shelf life. In contrast to cement trucks, however, refrigeration trucks are not used in the manufacturing process but exclusively for transportation. Ice cream is packaged (and thus manufacturing has been completed) before it is placed in the refrigeration truck, while cement in its mixed state is never packaged.

delivery of the product to a job site. However, cement trucks are actually dual-purpose assets containing both a manufacturing element and a transportation element.² The mixing drum is used to either mix the load or to agitate a pre-mixed load to maintain the mixture in a plastic and unhardened state for distribution at the job site. The truck chassis, however, is utilized almost exclusively for transportation, with any other use, such as to provide power to the mixer, being de minimis. Finally, transportation activities are not considered qualified activities for purposes of the MIC. (Rev. & Tax. Code, §§ 17053.49, subd. (d), & 23649, subd. (d); Cal. Code Regs., tit. 18, §§ 17053.49-2, sub. (n), & 23649-2, sub. (n).)

Based upon the foregoing analysis, it is the department's position that for purposes of calculating qualified costs for the MIC, the cost of the cement truck must be bifurcated between the chassis and the mixing drum, with the former amount to be properly treated as a non-qualified cost for MIC purposes to reflect its primary use as a transportation item of property. Conversely, only qualified property placed or mounted on the truck chassis that is primarily used for the actual manufacturing activity, as defined in the MIC statute, will be eligible for the MIC. Examples of qualified property under this analysis would include the mixing drum mounted to the chassis and any related equipment designed primarily for use in connection with the mixing drum. Costs associated with the mixing drum and related equipment may qualify for the MIC if all of the other requirements of the statute are met.³

HOLDINGS

1. Due to the unique characteristics of ready-mixed concrete, the manufacturing process will not be treated as completed until the ready-mixed concrete is delivered to the job-site in a plastic and unhardened condition. All qualified costs for the manufacturing activity that otherwise meet the requirements of the MIC statute during this time are eligible for the MIC. It makes no difference whether a wet mix (mixed at a central plant) or a dry mix (mixed entirely in a cement mixer) method of manufacturing is utilized; for purposes of the MIC, the manufacturing process does not end until the mixture is delivered to the job site.

² For federal tax purposes, cement trucks have historically been recognized as having a dual-purpose function: manufacturing and transportation. (See former Int. Rev. Code § 4063(a)(5), repealed by Pub.L. No. 98-369, § 735(a) (July 18, 1984) 98 Stat. 980, 1984 U.S. Code Cong. & Admin. News, No.1), exempting the manufacturing component of a cement truck (mixing drum and related equipment) from the transportation excise tax levied on the truck chassis (transportation component); see also Priv. Ltr. Rul. 9509004 (Nov. 7, 1994); A.O.D., In re: *Rex Chainbelt, Inc. v. United States* (Feb. 15, 1972), and T.D. 7090, 1971-1 C.B. 370, for discussions of separating the dual-purpose functions.)

³ It should be noted that, for MIC purposes, this analysis pertains only to dual-purpose assets with a transportation element. For example, this analysis should not be applied to other modes of transportation not approved for highway use. Cement trucks are approved for highway transportation and thus contain both a transportation and a manufacturing element. Other modes of non-highway use transportation, such as small forklifts, do not require a dual-purpose analysis for purposes of the MIC.

2. Cement trucks used to transport ready-mixed concrete to the job site will be treated, for MIC purposes, as dual-purpose assets. While the cost of the concrete mixing drum and related truck-mounted equipment may be eligible for the MIC, the cost of the truck or trailer chassis does not qualify for the MIC since the chassis components are used primarily for transportation, which is specifically not a qualified activity for purposes of the MIC.

Under the facts of this ruling, X may include the following amounts as qualified costs for the MIC:

- (1) \$100,000 for the central plant mixer upon which sales tax was paid.
- (2) \$24,000 for the cost of the mixing drum and related truck-mounted equipment attached to the cement truck chassis upon which sales tax was paid.

Therefore the total qualified costs X may include for the MIC equal \$124,000. X's MIC would equal \$7,440 ($\$124,000 \times 6\%$).

DRAFTING INFORMATION

The principal author of this notice is Geoffrey Way of the Franchise Tax Board, Legal Branch. For further information regarding this notice, contact Mr. Way at the Franchise Tax Board, Legal Branch, P. O. Box 1720, Rancho Cordova, CA 95741-1720, (916) 845-6351.