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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

District Director:

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's EIN:

Tax Years Involved:

Legend:

City =

State =

Company =

Bonds =

Date 1 =

a =

b =

c =

d =

ISSUE:

Whether the proceeds of the Bonds were used to provide a "manufacturing facility" within the meaning of § 144(a)(12)(C) of the Internal Revenue Code.

CONCLUSION:

The proceeds of the Bonds were not used to provide a manufacturing facility. Thus, the Bonds are not qualified small issue bonds.

FACTS:

The City is a political subdivision of the State and is authorized to issue revenue bonds to finance the acquisition, expansion, improvement, or repair of facilities for agricultural, commercial, industrial, natural resources, recreational, and manufacturing purposes. On Date 1, the City issued the Bonds to finance the acquisition of certain equipment (the "Equipment"). The Equipment was leased by the City to the Company.

The Company engages in various businesses, however, the Equipment is used solely at the site where the Company mines and crushes limestone. The Company uses the following process to mine and crush limestone. First, the site is prepared, which includes removal of the top soil. Second, the overburden of material and soft rock is removed to expose the limestone. The removed overburden is generally deposited in a previously mined area as part of that site's reclamation process. Third, explosives are used to reduce the limestone into pieces that can be loaded into a rock crusher. Fourth, the limestone is crushed into a particular size or grade to meet customer specifications. Fifth, the limestone is stockpiled until it is loaded and hauled away. Finally, the area in which the limestone was mined is reclaimed.

The Equipment consists of one loader, two bulldozers and one rock crusher. The bulldozers are used for site preparation (including removal of the overburden) prior to extraction of the limestone and for reclamation of the mined area after extraction is completed. The loader is used to load rock into the rock crusher and the trucks, and to stockpile the crushed rock. The rock crusher is used to crush the limestone. The rock crusher is on wheels and can be moved from one work area to another.

The amount of Bond proceeds spent on the Equipment is as follows: $a for the loader, $b for the bulldozers, and $c for the crusher, for a total of $d. The amount of the proceeds spent on the bulldozers ($b) exceeds 25% of the net proceeds of the Bonds.

ANALYSIS:

Section 103(a) provides that gross income does not include interest on a State or local bond. Section 103(b)(1) provides that § 103(a) does not apply to any private activity bond, unless it is 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 $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 also met, however the proceeds are still required to be used in the manner described in § 144(a)(1).

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) 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.

In this case, over 25 percent of the net proceeds of the Bonds are allocated to the bulldozers that are used to prepare a site for extraction of the limestone and to reclaim the site once extraction is completed. Thus, the bulldozers must be part of a core manufacturing facility for the Bonds to be qualified small issue bonds; if they are merely directly related and ancillary to a core manufacturing facility, the 25 percent test of § 144(a)(12)(C) will cause the Bonds to fail to be qualified small issue bonds.

City argues that the mining and crushing process, including the removal of the overburden and the reclamation, is a single core manufacturing facility. In the alternative, City argues that mining is a manufacturing facility and that removing the overburden and reclamation of the area are parts of that core manufacturing facility. Thus, the City concludes that the bulldozers are part of a core manufacturing facility.

We disagree. The statute and legislative history indicate that core manufacturing should be narrowly defined. First, in the statute, Congress differentiated between core manufacturing and activities that are directly related and ancillary to that manufacturing. For example, a warehouse for short-term storage of raw materials is not part of the core manufacturing process. Likewise, forklifts or similar equipment used in the manufacturing or production process are not part of the core

manufacturing process. See H.R. Rep. No. 795, 100th Cong. 2d Sess. 576-77 (1988). By making this distinction, Congress suggested a narrow definition should be used for core manufacturing.

Second, the legislative history to the 1988 Act provides that if a distinct and separate economic activity is performed at a single physical location where manufacturing takes place, that activity is not part of the manufacturing facility when the employment in such activity is significant even if that activity is integral and subordinate to the manufacturing facility. For example, a showroom staffed with full-time sales personnel is not part of a manufacturing facility. H.R. Rep. No. 795 at 576-77. By excluding from core manufacturing certain activities that are subordinate and integral to core manufacturing, the legislative history supports a narrow interpretation of core manufacturing facilities.

Accordingly, we conclude that the Company's mining and rock crushing process is not a single core manufacturing facility. We further conclude that even if mining or rock crushing were a core manufacturing process, the bulldozers would not be part of either core manufacturing process. Thus, the Bonds are not qualified small issue bonds.

The conclusions reached in this technical advice memorandum apply to the issuer and any holder of the obligation, unless the holder initiates a request for technical advice on the same issue addressed in this memorandum and the national office issues a technical advice memorandum involving that issue and that holder. Section 16.02 of Revenue Procedure 98-2, 1998-1 I.R.B. 74, 94.

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