



**Associated
Industries
of Missouri**

The Voice of Missouri Business.

ISSUE REPORT

HOUSE BILL 131

ELIMINATING SALES TAX ON MANUFACTURING INPUTS

The Taxpayers Research Institute of Missouri, a division of Associated Industries of Missouri, supports HB 131 – a bill that would exempt from sales tax utilities, chemicals, raw materials, and machinery and equipment used in manufacturing and research and development from sales and use taxes.

This bill accomplishes what other states have accomplished: finally returning sales tax law to its originally intended purpose of taxing only final retail sales to customers by eliminating taxes on manufacturing and processing inputs such as utilities, chemicals, and materials.

The utility portion of this exemption will cost approximately \$8.5 million. The purchase of electricity is already exempted from sales tax for manufacturing operations whose electricity costs are more than 10% of total production costs and for manufacturers that use more than 25% recycled materials as raw materials. However, if gas, coal or another type of energy is used rather than electricity, no exemption is allowed. Gas was exempt if used in steelmaking from 1985 until that exemption was phased out in 2003. Missouri may be losing manufacturing jobs to other states, like Kansas, that allow manufacturers to purchase nearly all utilities exempt from sales tax. Total sales taxes from utility receipts total approximately \$55 million in Missouri. More than 85% of utility usage is already exempt or is not used in manufacturing or processing that would be exempted by this proposal. If it is assumed that the remaining 15% would be exempted by this proposal, this portion of the proposal would initially cost the state \$8.5 million. This is estimated to be the largest cost in the proposal.

Chemicals and other materials that are used in manufacturing or processing are exempt under current law if they are used in certain processes (like firebrick, gases and slagging materials used

in steelmaking) or if they become an ingredient or component of a finished product. Some processes require chemicals and other materials that are not present in the finished product. Such chemicals and materials are taxable in Missouri under current law. Missouri is one of only 15 states to tax chemicals that are consumed in the manufacturing process and NONE of our bordering states tax such chemicals, placing Missouri at an immediate competitive disadvantage.

Finally, the Missouri Supreme Court recently drew an imaginary line of distinction between research and development and manufacturing. Machinery and equipment that was used directly in the research and development phase of manufacturing was held to not be included in Missouri's sales tax exemption for manufacturing machinery and equipment. This bill would exempt such research and development machinery and equipment from sales and use taxes. The exemption will help make Missouri's manufacturing environment inviting to manufacturers and processors that are looking for the best place to produce their goods with the lowest possible overhead. Because this case was just decided in November 2006, fiscal impact of the exemption is negligible because manufacturers had not been paying the tax prior to the decision, and many may not be paying it now as they may not yet be aware of the decision.

The current sales tax law leaves much to the imagination of tax auditors and allows decisions such as these to be rendered by the courts. By passing a complete exemption for manufacturing inputs, you will be achieving an often mentioned goal of simplifying the tax code and eliminating guesswork on the part of the taxpayer and the tax collectors. You will also be returning Missouri's tax code to its originally intended purpose: to tax only final sales to consumers.

The dividends that will be paid in new, family supporting manufacturing jobs have the potential to greatly outweigh the small cost of this exemption in a short period of time as manufacturers seek out the best place to locate their next plant or processing line.

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