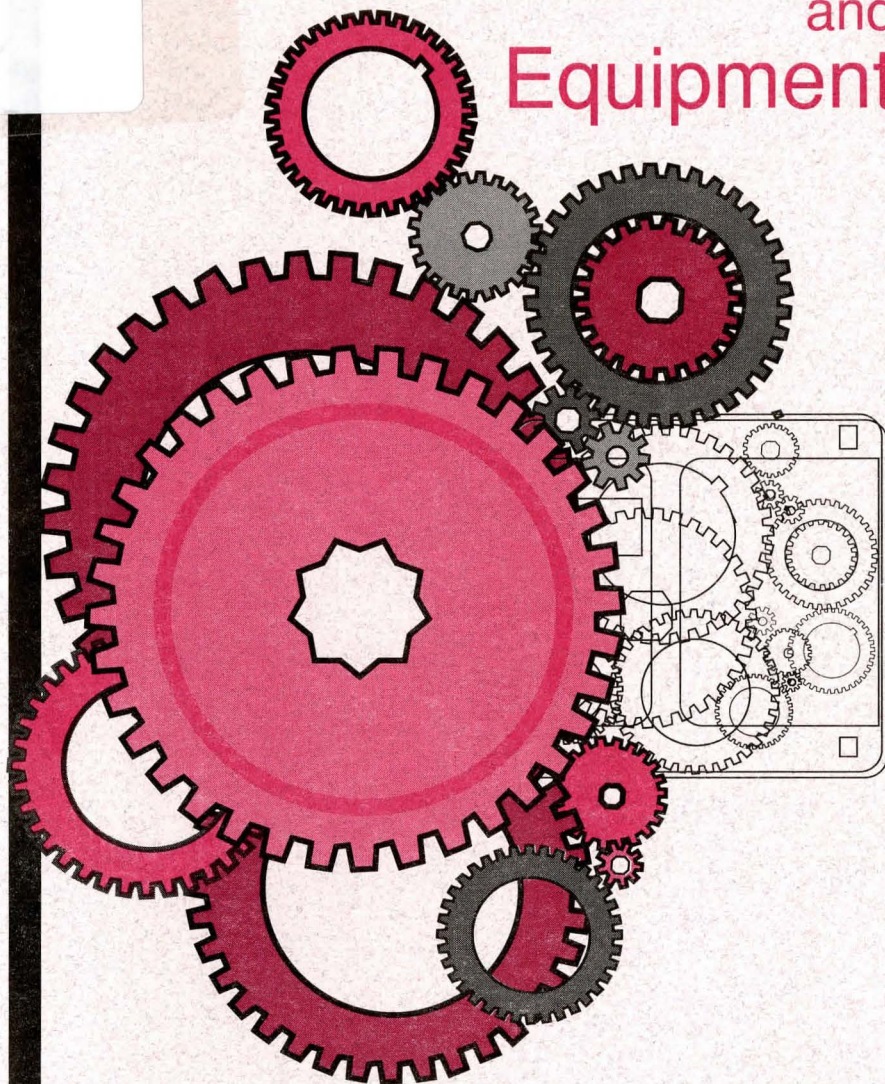


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Sales Tax on Computers and Industrial Machinery and Equipment



Iowa Department of
REVENUE and FINANCE

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COMPUTERS

The sale or rental of computers used in manufacturing, research and development or in processing or storage of data or information by an insurance company, financial institution or commercial enterprise is, under certain circumstances, exempt from tax.

The sale or rental of machinery, equipment, or computers *directly and primarily* used in the recycling or reprocessing of waste products is also exempt from tax.

The sale or rental of computers, including pollution control equipment, to public and private utilities is taxable.

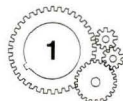
Hardware

“Computer” means stored program processing equipment and all devices fastened to it by means of signal cables or any communication medium that serves the function of a signal cable. Examples of devices fastened by a signal cable or other communication medium are terminals, printers, display units, card readers, tape readers, document sorters, optical readers, and card or tape punchers.

Also included within the meaning of the word “computer” is any software consisting of an operating or executive program upon which the basic operating procedures of a computer are recorded and which serves as an interface with an application program, and is purchased as a part of the sale of the computer for which it operates.

Excluded from the definition of computer is point-of-sale equipment, such as scanners and cash registers.

To be exempt, computers must be used in the processing or storage of data or information by a commercial enterprise or used in manufacturing.



Software

Prewritten “canned” software purchased separately from a computer is taxable. “Custom” software is exempt.

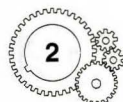
Processing/Storage Requirements

All computers store and process information. However, the “final output” for the user or consumer must be stored or processed data in order for the computer to be exempt.

Example

Property used in processing/storage of information or data.

A health insurance company has three computers. Computer A is used to monitor the temperature within the insurance company’s building. The computer transmits messages to the building’s heating and cooling system, telling it when to raise or lower the level of heating or air conditioning as needed. Computer B is used to store patient records and will recall those records on demand. Computer C is used to tabulate statistics regarding the amount of premiums paid in and the amount of benefit paid out for various classes of insured. The use of Computer B is for stored information. The final output of Computer C is processed information. The sale, lease, or use of Computers B and C is not taxable. Computer A is taxable.



Qualifying Businesses

Commercial Enterprises

“**Commercial enterprises**” includes for-profit businesses and manufacturers. It includes data processing services to insurance companies, financial institutions, businesses, and manufacturers.

Professions, occupations and nonprofit organizations are not commercial enterprises. A corporation which conducts any business which is a profession or occupation is not a commercial enterprise. A nonprofit hospital is not a commercial enterprise.

“**Profession**” means a vocation or employment requiring specialized knowledge and often long and intensive academic preparation. Lawyers and doctors are examples of professions.

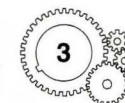
“**Occupation**” means the principal business *of an individual*. Farmers and plumbers are examples of occupations.

Being a commercial enterprise is one of the requirements necessary to purchase computers tax free. It is not, however, the only factor.

Financial Institutions

“**Financial institution**” is a bank incorporated under Iowa Code or Federal law; a savings and loan association incorporated under Iowa Code or Federal law; a credit union organized under Iowa Code or Federal law; or any corporation licensed as an industrial loan company under Iowa Code. Loan brokers governed by Iowa Code and production credit associations are not financial institutions.

Computers purchased by financial institutions to process or store data are exempt from tax. This includes automatic teller machines.



Insurance Companies

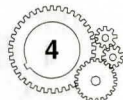
“Insurance company” means an insurer organized or operating under Iowa Code or authorized to do business in Iowa as an insurer or a licensed insurance agent under Iowa Code Chapter 522. Fraternal and beneficial societies governed by Iowa Code and health maintenance organizations governed by Iowa are not insurance companies.

Computers purchased by insurance companies to process or store data are exempt from tax.

Replacement Parts

To be exempt, replacement parts must be eligible for depreciation for State and Federal income tax purposes. They may also be deducted as a current expense. As long as the cost is depreciable, the sale or rental of the replacement part is exempt from tax. However, the person claiming the exemption must show that the replacement part which was deducted as an expense could have been depreciated under State and Federal income tax law.

Replacement parts must either materially add to the value of computers or appreciably prolong their lives. Replacement parts which only keep computers in their ordinarily efficient operating conditions are taxable.



Specified Property

“Specified property” means property that is a computer and depreciable replacement parts for that property.

The sale or rental of specified property is exempt if:

The property is real property; and

The property is directly and primarily used in one of the following:

In research and development of new products or processes of manufacturing, refining, purifying, combining of different materials or packing of meats to be used for the purposes of adding value to products; or

In processing or storage of data or information by an insurance company, financial institution, or commercial enterprise.

Research and development machinery and equipment that is not industrial real estate does not qualify for exemption.

The following specified property is taxable:

Property assessed by the Department of Revenue and Finance. For electric, gas, water, and other companies assessed under Iowa Code, only property owned by the company is assessed by the Department. For railroad, telephone, pipeline, and electric transmission lines companies, property leased to as well as owned by the company is assessed by the Department.

Point-of-sale equipment

The lease of the equipment is exempt if the tangible personal property is also exempt. Contact Taxpayer Services for more information.



Machine Repair of All Kinds

The repair of machines of all kinds is taxable. Qualifying replacement parts are exempt if separately billed. Labor charges are taxable. There is no exemption for labor used to repair machines.

“Machine” includes all devices having moving parts and operated by hand, powered by a motor, engine, or other form of energy. It is a mechanical device or combination of mechanical powers and devices used to perform some function and produce a certain effect or result.

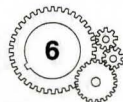
Warranties and Maintenance Contracts

“Mandatory warranty” is when the buyer, as a condition of the sale, is *required* to purchase the warranty or guarantee contract from the seller. The cost of the warranty is part of the cost of the item. Therefore, the sale of a mandatory warranty is taxable only if the item is taxable. Sales of replacement parts and materials to the seller furnishing them is a sale for resale and not taxable. Labor performed under a mandatory warranty is exempt, even if performed with a taxable service.

“Optional warranty” is when the buyer is *not required* to purchase the warranty or guarantee contract from the seller. The price of the optional warranty is taxable.

A **preventive maintenance contract** is a contract which requires only the visual inspection of equipment and no repair is or will be included. The gross receipts from the sale of a preventive maintenance contract are not subject to tax.

Additional charges for parts and labor furnished in addition to what is covered by a warranty or maintenance contract are taxable if the service is taxable. Only parts (not labor) are subject to tax when a nontaxable service is performed, but the labor charge must be separately stated.



INDUSTRIAL MACHINERY AND EQUIPMENT

The sale or rental of industrial machinery and equipment, replacement parts, and pollution control equipment used in manufacturing, research and development is, under certain circumstances, exempt from tax.

Note, however, that the sale or rental of industrial machinery, equipment, including pollution control equipment, to public and private utilities is taxable.

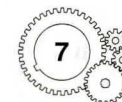
“Industrial machinery and equipment” means machinery and equipment used by a manufacturer in a manufacturing establishment.

“Machinery” is any mechanical, electrical, or electronic device designed and used to perform some function and to produce a certain effect or result. The word includes not only the basic unit of the machinery but also any adjunct or attachment necessary for the basic unit to accomplish its intended function. The word also includes all devices used or required to control, regulate, or operate a piece of machinery, provided such devices are *directly* connected with or are an *integral* part of the machinery and are used *primarily* for control, regulation or operation of machinery.

To be exempt, industrial machinery and equipment must be industrial real property used *directly and primarily* in the manufacturing process.

The following are examples of machinery which are not directly used in manufacturing; they are taxable:

- a. Machinery used exclusively for the efficient use of other machinery. Examples are air cooling, air conditioning, and exhaust systems. These are taxable.
- b. Machinery used in support operations, such as a machine shop, in which production machinery is assembled, maintained or repaired. These are taxable.



c. Machinery used by administrative, accounting, and personnel departments. These are taxable.

d. Machinery used by plant security, fire prevention, first aid, and hospital stations. These are taxable.

e. Machinery used in plant cleaning, disposal of scrap and waste, plant communications, lighting, safety, or heating. These are taxable.

Jigs, dies, tools, and other devices necessary to the operation of or used in conjunction with the operation of what is ordinarily thought of as machinery are also considered to be machinery.

Machinery does not include buildings designed specifically to house or support machinery.

“Equipment” is any tangible personal property used in an operation or activity. Examples of equipment are tables on which property is assembled on an assembly line and chairs used by assembly line workers.

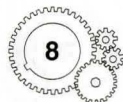
Machinery and equipment must be used by a manufacturer in a manufacturing environment.

Also see the definitions of “replacement parts” and “specified property” in this booklet.

Replacement Parts

To be exempt, replacement parts must be eligible for depreciation for State and Federal income tax purposes. They may also be deducted as a current expense. As long as the cost is depreciable, the sale or rental of the replacement part is exempt from tax. However, the person claiming the exemption must show that the replacement part which was deducted as an expense could have been depreciated under State and Federal income tax law.

Replacement parts must either materially add to the value of industrial machinery, equipment, or appreciably prolong their lives. Replacement parts which only keep machinery or equipment in their ordinarily efficient operating conditions are taxable.



Manufacturer

“Manufacturer” means any person, firm, or corporation who 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.

*Examples of businesses that **are** manufacturers:*

printing
newspaper publication
bookbinding
lumber milling
production of drugs or agricultural supplies

*Examples of businesses that **are not** manufacturers:*

construction contracting
quarrying
remanufacture or rebuilding of tangible personal property
(such as automobile engines)
providing health care
farming
transportation for hire
mining
the activities of restaurateurs, hospitals and medical doctors

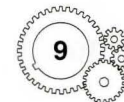
Qualifying as a manufacturer according to this definition is not the only criteria for being able to make tax-exempt purchases.

Example

Property not used in manufacturing

A plant located in Warren County manufactures widgets and fabricates its own patterns on a metal press machine in its machine shop located in Story County. The machine shop does not sell the patterns, and the metal press machine is used for no other purpose than to fabricate the patterns. The metal press machine is not directly used in manufacturing. The metal press machine is taxable.

“Processing” means an operation or series of operations whereby tangible personal property is subjected to some special treatment by



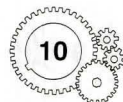
artificial or natural means which changes its form, context, or condition, and results in marketable tangible personal property.

This operation is commonly associated with labcreation, compounding, germination or manufacturing.

“Directly and primarily used” Property is directly used only if it is used to initiate, sustain, or terminate the transformation of any activity. Primarily means simply first importance. In determining whether any property is directly used, consideration should be given to the following factors:

1. The physical proximity of the property in question to the activity in which it is used;
2. The proximity of the time of use of the property in question to the time of use of other property used before and after it in the activity involved; and
3. The active causal relationship between the use of the property in question and the activity involved. The fact that a particular piece of property may be essential to the conduct of the activity because its use is required either by law or practical necessity does not, of itself, mean that the property is directly used.

Being directly and primarily used as defined above is only one criteria for machinery or equipment to qualify for exemption.



Specified Property

“Specified property” means property that is industrial machinery and equipment including pollution control equipment and depreciable replacement parts for that property.

The sale or rental of specified property is exempt if:

The property is real property; and

The property is directly and primarily used in one of the following:

By a manufacturer in processing tangible personal property; or

In research and development of new products or processes of manufacturing, refining, purifying, combining of different materials or packing of meats to be used for the purposes of adding value to products; or

In processing or storage of data or information by an insurance company, financial institution, or commercial enterprise.

Research and development machinery and equipment that is not industrial real estate does not qualify for refund or exemption.

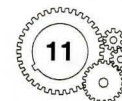
The following specified property is taxable:

Property assessed by the Department of Revenue and Finance. For electric, gas, water, and other companies assessed under Iowa Code, only property owned by the company is assessed by the Department. For railroad, telephone, pipeline, and electric transmission lines companies, property leased to as well as owned by the company is assessed by the Department.

Hand tools

Urban revitalization property and industrial machinery may also be exempt from sales tax. This property must meet other requirements in order to be exempt; contact the Department for more information.

The lease of the equipment is exempt if the tangible personal property is also exempt. Contact Taxpayer Services for more information.



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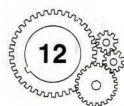
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“**Mandatory warranty**” is when the buyer, as a condition of the sale, is *required* to purchase the warranty or guarantee contract from the seller. The cost of the warranty is part of the cost of the item. Therefore, the sale of a mandatory warranty is taxable only if the item is taxable. Sales of replacement parts and materials to the seller furnishing them is a sale for resale and not taxable. Labor performed under a mandatory warranty is exempt, even if performed with a taxable service.

“**Optional warranty**” is when the buyer is *not required* to purchase the warranty or guarantee contract from the seller. The price of the optional warranty is taxable.

A **preventive maintenance contract** is a contract which requires only the visual inspection of equipment and no repair is or will be included. The gross receipts from the sale of a preventive maintenance contract are not subject to tax.

Additional charges for parts and labor furnished in addition to what is covered by a warranty or maintenance contract are taxable if the service is taxable. Only parts (not labor) are subject to tax when a nontaxable service is performed, but the labor charge must be separately stated.



DESIGN AND INSTALLATION

The services of design of new industrial machinery and equipment are exempt from sales tax. All installation charges are exempt from the sales tax if the following criteria are met:

- A. The industrial equipment and machinery are *new*, not used,
AND
- B. The industrial equipment and machinery qualify as *real property*, AND
- C. The industrial equipment and machinery are used in the *manufacturing* process.

New machinery and equipment designed or installed for rental as well as for sale are exempt. The gross receipts from design or installation must be separately identified, charged separately, and reasonable in amount for the exemption to apply.

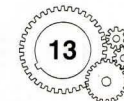
“New” means never having been used or consumed by anyone. Installation of reconstructed, rebuilt or repaired or previously owned machinery or equipment is taxable.

A computer is not considered to be machinery or equipment, and its installation or design is taxable.

The following are taxable unless they meet the criteria above: electrical, plumbing, welding, and pipe fitting. Call Taxpayer Services for additional taxable installation services.

Replacement Parts

To be exempt, replacement parts must be eligible for depreciation for State and Federal income tax purposes. They may also be deducted as a current expense. As long as the cost is depreciable, the sale or rental of the replacement part is exempt from tax. However, the person claiming the exemption must show that the replacement part which was deducted as an expense could have been depreciated under State and Federal income tax law.



Replacement parts must either materially add to the value of machinery or equipment or appreciably prolong their lives. Replacement parts which only keep machinery or equipment in their ordinarily efficient operating conditions are taxable.

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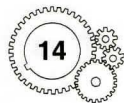
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Additional charges for parts and labor furnished in addition to what is covered by a warranty or maintenance contract are taxable if the service is taxable. Only parts (not labor) are subject to tax when a nontaxable service is performed, but the labor charge must be separately stated.



POLLUTION CONTROL EQUIPMENT

The sale or rental of air or water pollution control equipment is taxable unless the equipment is used *directly and primarily* by a manufacturer in processing. Noise pollution equipment is taxable

“**Pollution control equipment**” means any disposal system or apparatus used or placed in operation *primarily* for the purpose of reducing, controlling or eliminating air or water pollution. Liquid, solid and gaseous wastes are included within the meaning of the word “pollution.” The term does not include any apparatus used to eliminate “noise pollution.”

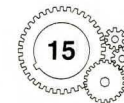
The equipment must be purchased and used by a commercial enterprise to be exempt from tax.

The sale or rental of industrial machinery, equipment, or computers, including pollution control equipment, to public and private utilities is taxable.

Replacement Parts

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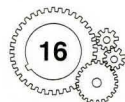
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RESEARCH AND DEVELOPMENT

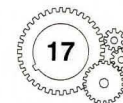
The sale or rental of machinery, equipment and computers used in research and development is exempt from tax.

“**Research and development**” means experimental or laboratory activity which has as its ultimate goal the development of new products, processes of manufacturing, refining, purifying, combining of different materials, or meat packing. The ultimate goal of research and development must be to add value to products. It does not include testing or inspection for quality control purposes, efficiency surveys, management studies, consumer surveys, advertising, promotions, or research in connection with literary, historical, or similar projects.

Machinery, equipment, and computers are used directly in research and development only if they are used in actual experimental or laboratory activity that qualifies as research and development. In this case, the purchase of machinery, equipment and computers is exempt.

Example

Frontier Hybrid, Inc., maintains a research and development laboratory to develop a corn plant. It purchases the following items: a computer which will process data relating to the genetic structure of the various corn plants which Frontier Hybrid is testing, an electron microscope for examining the structure of corn plant genes, a steam cleaner for cleaning rugs in the laboratory offices, and a typewriter for use by the laboratory director's secretary. The computer and the microscope are directly used in the research; the steam cleaner and the typewriter only indirectly used. Therefore, purchase of the computer and microscope is exempt from tax; purchase of the steam cleaner and typewriter is taxable.



Replacement Parts

To be exempt, replacement parts must be eligible for depreciation for State and Federal income tax purposes. They may also be deducted as a current expense. As long as the cost is depreciable, the sale or rental of the replacement part is exempt from tax. However, the person claiming the exemption must show that the replacement part which was deducted as an expense could have been depreciated under State and Federal income tax law.

Replacement parts must either materially add to the value of machinery or equipment or appreciably prolong their lives.

Replacement parts which only keep machinery or equipment in their ordinarily efficient operating conditions are taxable.

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Additional charges for parts and labor furnished in addition to what is covered by a warranty or maintenance contract are taxable if the service is taxable. Only parts (not labor) are subject to tax when a nontaxable service is performed, but the labor charge must be separately stated.

RECYCLING WASTE PRODUCTS

The sale or rental of machinery, equipment, computers, and their replacement parts are exempt from tax if they are used *directly and primarily* in the recycling or reprocessing of waste products.

“**Recycling**” means any process by which waste – or materials which would otherwise become waste – are collected, separated or processed and revised or returned for use in the form of raw materials or products. The term includes, but is not limited to, the composting of yard waste which has been previously separated from other waste. Recycling does not include any form of energy recycling.

Machinery and Equipment

Machinery or equipment used in the recycling or reprocessing of waste products includes, but is not limited to, compactors, balers, crushers, grinders, cutters, or shears *directly and primarily* used for this purpose. The sale of an endloader, forklift, truck, or other moving device is exempt from tax if the device is *directly and primarily* used in the movement of property which is an integral part of recycling or reprocessing. The sale of a bin which is only for storage ordinarily is taxable.

Certain limits for exemption placed upon industrial machinery and equipment are not applicable to machinery and equipment used in recycling or reprocessing. For example, machinery, equipment, or a computer used in recycling or reprocessing does not need to meet the requirement of being real property for the exemption to apply.

Examples

1. Recycling or reprocessing begins when waste or material which will become waste is collected or separated. A vehicle used directly and primarily for collecting waste could be a vehicle used for an exempt purpose. Thus, the purchaser of a garbage truck could claim

this exemption if the truck were *directly and primarily* used in recycling and not, for instance, in hauling garbage to a landfill. Machinery or equipment used to segregate waste from material to be recycled or reprocessed or used to separate various forms of materials which will be reprocessed (glass and aluminum) can also be used at the beginning of recycling or reprocessing.

2. An operation or series of operations which do not actually recycle or reprocess waste may be exempt. For example, an endless belt which moves aluminum cans from a machine where they are shredded to a machine where the shredded aluminum is crushed into blocks is not taxable.

3. Any equipment used after the recycling or reprocessing ends is taxable. For instance, a corporation purchases a machine which grinds logs, stumps, pallets, crates and other waste wood into wood chips. After grinding, the wood chips are sold and transported to purchasers to various sites where the chips are dumped and spread out over the ground for use in erosion control. The machine which grinds the wood chips is a machine used in recycling. The truck which transports the wood chips from the machine to the sites is not used in reprocessing because, at the time the chips are placed in the truck, they are in the form in which they will be sold for use other than as a raw material in manufacturing, so recycling has ended.

Replacement Parts

To be exempt, replacement parts must be eligible for depreciation for State and Federal income tax purposes. They may also be deducted as a current expense. As long as the cost is depreciable, the sale or rental of the replacement part is exempt from tax. However, the person claiming the exemption must show that the replacement part which was deducted as an expense could have been depreciated under State and Federal income tax law.

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“Machine” includes all devices having moving parts and operated by hand, powered by a motor, engine, or other form of energy. It is a mechanical device or combination of mechanical powers and devices used to perform some function and produce a certain effect or result.

Warranties and Maintenance Contracts

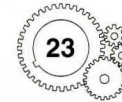
“**Mandatory warranty**” is when the buyer, as a condition of the sale, is *required* to purchase the warranty or guarantee contract from the seller. The cost of the warranty is part of the cost of the item. Therefore, the sale of a mandatory warranty is taxable only if the item is taxable. Sales of replacement parts and materials to the seller furnishing them is a sale for resale and not taxable. Labor performed under a mandatory warranty is exempt, even if performed with a taxable service.

“**Optional warranty**” is when the buyer is *not required* to purchase the warranty or guarantee contract from the seller. The price of the optional warranty is taxable.

A **preventive maintenance contract** is a contract which requires only the visual inspection of equipment and no repair is or will be included. The gross receipts from the sale of a preventive maintenance contract are not subject to tax.

Additional charges for parts and labor furnished in addition to what is covered by a warranty or maintenance contract are taxable if the service is taxable. Only parts (not labor) are subject to tax when a nontaxable service is performed, but the labor charge must be separately stated.

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FOR MORE INFORMATION...

Taxpayer Services
Iowa Department of Revenue and Finance
PO Box 10457
Des Moines, Iowa 50306-0457
515/281-3114 (out of state, Des Moines)

OR

1-800-367-3388 (Iowa, Omaha and Rock Island/Moline)

To receive forms and publications by mail:

515/281-7239 or
1-800-532-1531 (Iowa only)

To receive forms and publications by fax:

515/281-4139 or
1-800-572-3943 (Iowa only)

To access ERIN (computer bulletin board):

515/281-3248 or
1-800-972-2028 (Iowa only)

To access TDD for hearing impaired:

515/242-5942

To listen to pre-recorded tax messages:

515/281-4170 or
1-800-351-4658 (Iowa only)

To check on the status of your Iowa income tax refund:

515/281-4966 or
1-800-572-3944 (Iowa only)

To leave a comment at our e-mail address:

IADRF@IADRF.E-MAIL.COM



AVAILABLE PUBLICATIONS

The form number at the left is also the code for ordering via Tax Fax unless otherwise noted.

- 78-503 ___ Local Option Sales Tax brochure
- 78-506 ___ Charitable and Social Gambling brochure
- 78-507 ___ Farmers Guide to Iowa Taxes booklet
- 78-508 ___ Annual Report [no Tax Fax number]
- 78-510 ___ Farm Machinery and Equipment brochure
- 78-515 ___ Estimated Tax Payment Information for Individuals brochure
- 78-516 ___ Sales Tax on Food booklet
- 78-517 ___ Inheritance Tax booklet
- 78-522 ___ Hiring Ex-offenders brochure
- 78-523 ___ Auto Repair and Body Shops brochure
- 78-524 ___ Taxable Services brochure
- 78-526 ___ Tax Responsibilities of Cities and Counties
- 78-527 ___ Construction Contractors Tax Information booklet
- 78-529 ___ Questions About Iowa Taxes (Speaker Service) brochure
- 78-530 ___ Industrial Machinery, Equipment and Computers booklet
- 78-531 ___ Veterinarian's brochure
- 78-535 ___ Consumer's Use Tax brochure
- 78-539 ___ Sales and Use Tax Information booklet
- 78-543 ___ Solid Waste (Rules and Regs.) handout
- 78-544 ___ Environmental Protection Charge Information booklet
- 78-548 ___ Border States brochure (If you have customers in other states)
- 78-552 ___ Withholding Tax Information booklet
- 78-554 ___ Auctioneer Sales Tax Responsibilities handout
- 78-567 ___ Dentistry Sales and Use Tax brochure
- 78-571 ___ Automatic Data Processing (Rules and Regs.) handout
- 78-572 ___ Barber and Cosmetology Information booklet
- 78-574 ___ Bank and Financial Institution (Rules and Regs.) handout
- 78-578 ___ Hiring Persons With Disabilities brochure
- 78-579 ___ Small Business In Iowa brochure
- 78-583 ___ Tax Responsibilities of Military Personnel brochure
- 78-595 ___ Nonprofit Entities booklet
- 78-601 ___ Local Option Sales Tax Questions and Answers handout
- 78-619 ___ Iowa Taxpayer Rights brochure
- 78-626 ___ Penalty Waiver brochure
- 78-627 ___ Landscaping and Lawn care (Rules and Regs.) handout
- 78-628 ___ Discounts, Rebates and Coupons (Rules and Regs.) handout
- 78-630 ___ Tax-Fax (list of faxable forms) brochure
- 78-635 ___ ERIN (bulletin board) brochure
- 78-636 ___ Agribusiness handout
- 78-637 ___ Sales Tax Exemption Certificate brochure
- 79-102 ___ Iowa Tax and Your Winnings brochure
- 79-104 ___ Freedom of Information Guidelines brochure



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