

DEPARTMENT OF TAXATION

2006 Fiscal Impact Statement

1. **Patron** Charles J. Colgan

3. **Committee** Senate Finance

4. **Title** Retail Sales and Use Tax: Exemption for the
Manufacture of Semiconductors

2. **Bill Number** SB 475

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would provide a retail sales and use tax exemption for semiconductor manufacturers that would include: semiconductor cleanrooms or equipment, fuel, power, energy, supplies, or other tangible personal property used primarily in the integrated process of designing, developing, manufacturing, or testing a semiconductor product, a semiconductor manufacturing process or subprocess, or semiconductor equipment without regard to whether the property is actually contained in or used in a cleanroom environment, touches the product, is used before or after production, or is affixed to or incorporated into real estate.

The effective date of this bill is not specified.

6. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Administrative Cost Impact

TAX has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, TAX considers implementation of this bill as "routine," and does not require additional funding.

TAX will provide specific administrative costs on any legislation that is not "routine." Additionally, TAX will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, TAX will identify the costs at that time.

Revenue Impact

If this bill is passed, the decrease in sales and use tax revenue is unknown. According to the 2002 Census of Manufacturing for Virginia, the semiconductor and related industries had a total cost of materials of \$273.8 million, some unknown portion of which is currently exempt under the existing manufacturing exemption.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Manufacturing Exemption

The industrial manufacturing and processing exemption is set forth in *Va. Code* § 58.1-609.3(2) and provides the exemption is applicable to industrial materials for future processing, manufacturing, refining or converting into an article for resale, and industrial materials that are coated upon or integrated into an article for resale. The exemption is also applicable to machinery, tools or repair parts that are **used directly** in the manufacturing process. The parameters of the industrial manufacturing exemption rely on the direct use concept as established by the Virginia courts. The term “used directly” is defined in the statute and the *Virginia Administrative Code* to include those activities that are an integral part of the production of a product, including all steps in an integrated manufacturing process, but does not include incidental activities such as general maintenance and administration. The integrated manufacturing process include the production line of a plant site, starting with the handling and storage of raw materials at the plant site and continues through the last step of production where the product is completed for sale and conveyed to a warehouse at the plant site. The process also includes production line testing and quality control. Tangible personal property used in both a taxable and exempt manner are taxed based on their preponderance of use.

Application of Manufacturing Exemption to Semiconductor Manufacturing

Semiconductor manufacturers currently enjoy the retail sales and use tax exemption afforded to all manufacturers for tangible personal property used directly in the manufacturing process. Due to the nature of the product being manufactured by a semiconductor manufacturer, a clean room environment is necessary to ensure the quality and integrity of the product. Clean rooms are basically a self-contained manufacturing environment within a manufacturing facility. TAX has allowed the current manufacturing exemption to apply to semiconductor manufacturers for most of the clean room operation. This includes walls, floors, ceilings, air systems, water systems, chemicals, raw materials, protective clothing and coverings, and other items used in the clean room in order to protect the integrity of the product being manufactured. Like all manufacturing operations, administrative items are generally taxable. Despite the broad application of the exemption to clean room activities, TAX has generally held administrative items used in a clean room taxable. These items include office furniture,

computers, computer stands, monitors, and other items used indirectly in the manufacture of semiconductors. Like all manufacturers, testing and quality control activities performed away from the production line are taxable. In addition, equipment supports, bases, foundations, and other equipment used to support or in conjunction with exempt manufacturing equipment are generally taxable.

Proposed Legislation

The exemption proposed in this bill goes beyond the current manufacturing exemption available to all manufacturers by creating an exemption for semiconductor manufacturers that is broader than the exemption for other manufacturers. This bill would exempt equipment, fuel, power, energy and supplies used primarily in the integrated process or sub-process of designing, developing, manufacturing or testing of semiconductors, without regard to whether the item is used in a clean room environment, touches the product, is used prior to or after production, or is affixed to real property.

For purposes of this new semiconductor manufacturing exemption;

- “Integrated process” as it applies to semiconductor manufacturers would mean a process that begins with the research and development of semiconductor products, equipment, or process, that would include the handling and storage of raw materials at a plant site, and continues to the point that the product is packaged for final sale and either shipped or conveyed to a warehouse. Semiconductor equipment, fuel, power, energy, supplies, or any other tangible personal property used before, during, or after actual production that contributes to high product quality, production yields, and process deficiencies.
- “Semiconductor clean rooms” would include, among other things, fixtures, piping, flooring, lighting, and all other property used to provide a controlled environment.
- “Semiconductor equipment” would include supports, bases, foundations, and other equipment, wafers, equipment used in quality control and testing, regardless of where or when the equipment is used or whether it comes in contact with the item being manufactured.

Items used in pre-production and in post-production testing and quality control, as well as, supports and foundations currently taxable to other manufacturers would be exempt to semiconductor manufacturers under this bill.

Similar Legislation

House Bill 530 is identical to this bill.

Senate Bill 601 would exempt from the retail sales and use tax semiconductor wafers for the use or consumption by a semiconductor manufacturer.

cc : Secretary of Finance

Date: 01/31/2006 WBS
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