North Carolina Department of Revenue

Roy Cooper
Governor

Ronald G. Penny
Secretary

May 30, 2018

[redacted]

Re: Private Letter Ruling
Taxpayer: [redacted]
Taxpayer's Account: [redacted]

Dear [redacted]:

The Department has completed its review of the request for a written determination made on behalf of your client, [redacted] ("Taxpayer"). In making this written determination, the Department has considered the facts presented in the initial request as well as any supplemental information provided to the Department subsequent to the original request.

This private letter ruling is a written determination issued under N.C. Gen. Stat. § 105-264.2 and applies the tax law to a specific set of existing facts furnished by Taxpayer and Taxpayer's representative on behalf of Taxpayer. This written determination is applicable only to the taxpayer addressed herein and as such has no precedential value except to the taxpayer to whom the determination is issued on behalf of the Department.

Overview and Relevant Facts

You advise "[Taxpayer] operates [redacted] facilities in North Carolina. At these locations, [Taxpayer] designs landfills that are capable of producing methane gas that it subsequently sells."

"[redacted] ('Landfill') . . . is currently an active landfill that does have closed cells. This site is currently generating methane gas that is then collected and sold to its customer, [redacted] ('Customer')."

You advise that "[t]here are two primary activities occurring at Taxpayer's Landfill. First, to safely and efficiently dispose of waste that has been brought to the landfill by third parties who have collected it from the surrounding cities and counties and secondly, to generate and collect a renewable fuel (i. e., methane gas) for sale. The generation, collection and consumption of methane gas is an essential role in the Taxpayer's operations as today's businesses are continually being challenged to consider their impact on the environment. The value derived from the Taxpayer's methane gas collection operations is not limited to the monetary value of the royalties collected. The Taxpayer is also committed to pollution prevention and continuously improving its environmental performance by providing safe, environmentally responsible solutions. Exercising the utmost responsibility in operations, including landfill technology, engineering and day-to-day activities, the Taxpayer strives to operate in an environmentally friendly manner to minimize impacts to air, water and land. Such stewardship and intangible benefits to the company and its customers far outweigh the additional cost to integrate methane gas collection equipment into the landfill."

In your letter you state, "[t]he starting point to methane production begins with the collection of solid waste from commercial, industrial and residential sources. Hauling trucks regularly transport solid waste from numerous locations throughout the state to transfer stations. Transfer stations save time and energy as they allow waste collected from hauling trucks to be consolidated in central locations. Consolidated waste from transfer stations is then transported on larger long-distance vehicles to [Taxpayer's] landfills.

"Before any waste can be added to a landfill, [Taxpayer] must establish landfill cells upon which the solid waste can be placed. These cells consist of an impermeable barrier that is placed on an area of land that may encompass several acres. This barrier, consisting of clay and synthetic materials is established to ensure that liquids and leachate do not escape the landfill and contaminate groundwater. A high-density plastic liner is then placed over the barrier and a layer of drainage is installed over the liner in order to properly collect and reuse or dispose of the leachate."

Documents provided to the Department state that "[u]pon arrival at the landfill, bulldozers and other heavy equipment are used to transfer and spread the waste within the proper segment of the landfill. This waste is compacted and covered daily with layers of contaminated soil."[1] "The daily routine of spreading, compacting and covering the solid waste with soil accelerates the rate of decomposition, which in turn provides more space within the landfill cells and thus more methane gas to generate and collect."[2]

"Additionally, as the solid waste accumulates, [Taxpayer] lays pipelines at various levels in order to recover the methane that is produced from within the cells."[3] "Landfill cells and pipelines are installed as a requirement to operating a landfill, as regulated through the permit for the site with the North Carolina Department of [Environmental Quality] ('NCDEQ')."[4] "Throughout the life of the landfill, this process is continually repeated until the landfill has reached its target capacity. Once reached, methane gas, which is the product created in the landfill cells, is collected and transported to a facility that will convert the gas from methane to electricity. Methane is continually produced over the next several decades. The process and operation involved for the conversion of methane to electricity in North Carolina is currently outsourced to [Customer] who in turn pays a royalty of total methane produced to [Taxpayer]."[5]

The document entitled " Facility Plan Modification; ; Permit revised states ". . . a gas venting or collection system shall be installed below the low-permeability barrier to minimize pressures exerted on the barrier. . . . An active landfill gas extraction system has been installed at the facility. This system will remain in operation after closure to comply with [NCAC Rule .1624; Subparagraphs (b)(8), (b)(9) and (b)(15)]." In addition the Facility Plan Modification states, "[t]he landfill has a methane gas collection system to effectively manage the gas generated at the facility. The collection system is owned and operated by the facility and has the option to direct to a third party for the beneficial use of the gas."

"Permit to Construct and Operate" as recorded by the County Register of Deeds filed in Book page through "[t]he purpose of [the] recordation is to notify Buyers of said property that a sanitary landfill has operated on the property." Attached to the recordation is a copy of Permit No. that is applicable to the Landfill.

The "Amended and Restated Gas Sale and Purchase Agreement" (the "Agreement") dated between Taxpayer and Customer states:

> Priority of Landfill Operations. Notwithstanding anything herein to the contrary, [Customer] understands and agrees that [Taxpayer's] primary interest and obligation are the safe and efficient operation of the Landfill and the Collection System, in compliance with applicable laws and permit conditions, and that any interest of [Customer] in any Landfill Gas shall remain secondary to the operation of the Landfill and the Collection System, and any contractual obligations of [Taxpayer]

[1] Source: Attachment to Form NC-PLR, Request to Private Letter Ruling, March 17, 2017.
[2] Source: Response to the Department's request for additional information, August 31, 2017.
[3] Source: Attachment to Form NC-PLR, Request to Private Letter Ruling, March 17, 2017.
[4] Source: Response to the Department's request for additional information, August 31, 2017.
[5] Source: Attachment to Form NC-PLR, Request to Private Letter Ruling, March 17, 2017.

> to third parties that were in existence prior to the date of the 2000 Agreement. [Customer's] rights and interests hereunder shall not interfere with [Taxpayer's] compliance with any permits, authorizations, licenses, ordinances or regulations related to the Landfill or the Collection System, or with the lawful and safe operation of the Landfill and the Collection System, including, without limitation, the design, division, construction, operation, expansion (vertical or horizontal), maintenance, and monitoring of the Collection System or the Landfill, or the closure, and post-closure of the Landfill. [Customer] may operate its blowers and flares independent of [Taxpayer], if [Customer] deems it necessary. Subject to the foregoing, [Taxpayer] and [Customer] will work together in good faith to attempt to minimize adverse impacts to the Landfill Gas flow and [Taxpayer's] operations resulting from [Taxpayer's] primary interest and obligation; provided that nothing in this Agreement shall require [Customer] to incur out-of-pocket expenses in taking any actions that are not required to be taken by [Taxpayer] in this Agreement with respect to compliance with applicable laws and permits relating to the Landfill and [Taxpayer's] operations (without taking into account [Customer's] activities for purposes of making the foregoing determination).

In summary, Taxpayer is permitted to construct and operate Landfill. Taxpayer's primary activities at the Landfill include disposal of waste that has been brought to Landfill by third parties. A consequence of Taxpayer's landfill operation is the production of landfill gases ("methane gas"), resulting from biological decay of the waste brought to Landfill for disposal. The methane gas collection system is part of the requirement for the operation of Landfill as regulated through the permit for the site with the NCDEQ. Methane gas is extracted through Taxpayer's collection system in order to comply with the NCDEQ's solid waste management regulations. Taxpayer's transaction with Customer is secondary to the safe, efficient, and lawful operation of Landfill.

Issue

Do Taxpayer's methane-production activities qualify for an exemption from sales and use tax pursuant to N.C. Gen. Stat. § 105-164.13(5a)? More specifically, are purchases of product by Taxpayer for use in Taxpayer's methane-production activities subject to tax under Article 5F of Chapter 105 of the North Carolina General Statutes and exempt from sales and use tax?

Applicable Statutes and References

Under Chapter 105 of the North Carolina General Statutes, Article 5 ("Article") of the North Carolina Revenue Act ("Act")[6], N.C. Gen. Stat. § 105-164.1 *et. seq*.; Subchapter VIII, Local Government Sales and Use Tax, N.C. Gen. Stat. § 105-463 *et. seq*.; and Chapter 1096 of the 1967 Session Laws; State, local, and applicable transit sales and use taxes are imposed on a retailer engaged in business in the State on the retailer's net taxable sales or gross receipts of tangible personal property, certain digital property, and certain services at the applicable State, applicable local, and applicable transit rates of sales and use tax. N.C. Gen. Stat. §§ 105-164.3(1k), 105-164.3(9), 105-164.3(14), 105-164.3(24), 105-164.3(35), 105-164.3(46), 105-164.4, 105-164.8, 105-467, 105-468, 105-483, 105-498, 105-507.2, 105-509.1, and 105-537.

Imposed as an "excise tax," use tax is levied on the purchase price of certain services sourced to the State, tangible personal property, and certain digital property purchased, leased, or rented inside or outside the State for storage, use, or consumption in the State. N.C. Gen. Stat. §§ 105-164.3(14), 105-164.3(17), 105-164.3(32), 105-164.3(33), 105-164.3(44), 105-164.3(46), 105-164.3(49), 105-164.3(50), 105-164.6, 105-468, 105-483, 105-498,105-507.2, 105-509.1, and 105-517. The "person who purchases, leases or rents tangible personal property" is liable for payment of the use tax. "If the property purchased becomes a part of a building or other structure in the State and the purchaser is a contractor or subcontractor, the contractor, the subcontractor, and the owner of the building are jointly and severally liable for the tax. The

6 References to the Act and North Carolina General Statutes are based on the laws in effect as of the date of issuance of this private letter ruling except as otherwise noted herein.

liability of a contractor, a subcontractor, or an owner who did not purchase the property is satisfied by receipt of an affidavit from the purchaser certifying that the tax has been paid." Id.

The term "purchase price" is defined as having "the same meaning as the term 'sales price' when applied to an item subject to use tax." N.C. Gen. Stat. § 105-164.3(33). The term "sales price" is defined, in part, as "[t]he total amount or consideration for which tangible personal property, digital property, or services are sold, leased, or rented." N.C. Gen. Stat. § 105-164.3(37).

N.C. Gen. Stat. §105-164.13(5a) provides an exemption from the sales and use tax imposed by the Act for the sale at retail and the use, storage, or consumption in this State of "[p]roducts that are subject to tax under Article 5F" of the Act. The general rule is that a grant of exemption from taxation is never presumed. *Sale v. Johnson*. 258 N.C. 749,129 s.E.2d 465 (1963). Additionally, "[o]ne who claims exemption from tax coverage has the burden of brining himself with the exemption or exception." *Piedmont Canteen Serv., Inc. Johnson*. 256 N.C. 155,123 S.E.2d 582 (1962).

Under Article 5F of the Act, N.C. Gen. Stat. § 105-187.50 et. seq., a privilege tax is imposed on "[a] manufacturing industry or plant that purchases mill machinery or mill machinery parts or accessories for storage, use, or consumption in this State." The privilege tax rate "is one percent (1.00%) of the purchase price of the machinery, part, or accessory purchased. The maximum tax is of eighty dollars ($80.00) per article. As used in this section, the term 'accessories' does not include electricity." Id.

The 1.00% privilege tax rate set forth in Article 5F is a lesser tax rate than the generally applicable rate of sales tax set forth in N.C. Gen. Stat. § 105-164.4. For this reason, Article 5F constitutes a partial exemption from taxation and must therefore be strictly construed against the claim of partial exemption and in favor of the imposition of the higher rate of tax. *Hatteras Yacht Co. v. High*, 265 N.C. 653, 144 S.E.2d 821 (1965). A taxpayer bears the burden of establishing it is eligible for the partial exemption and entitled to remit at the 1.00% privilege tax rate. *Piedmont Canteen Service, Inc. v. Johnson*, 256 N.C. 155, 123 S.E. 2d 582 (1962) (one who claims an exemption from tax has the burden of bringing itself within the exemption). In *Henderson v. Gill*, 229 N.C. 313, 49 S.E. 2d 754 (1948) the Court relied on the case *Trustees of Rochester v. Pettinger*, 17 Wend. 265, 265 (N.Y. Sup. Ct. 1837). In that case:

> . . . a farmer was exempt from the law as to sale of his meats or other products of the farm. Though the defendant in that case owned and operated a farm, yet he also owned and operated as a regular business a butcher shop, and the holding was that the meat sold in the butcher shop was not within the exempt class though it came from the butcher's own farm. The court observes that his regular business was that of a butcher and that the farm an adjunct and largely a convenience to that business, and of consequence the defendant did not occupy the farm as a farmer within the meaning of the exemption provision, but as a butcher, saying: 'He would occupy it, not as a farmer, but as a butcher, with a view the better to promote his business in that line.'

The Department also finds compelling logic in the case of *Chicago, M. St. P & P. R. Co. v. Custer County*, 96 Montana 566,32 P2d 8 (1934) that states:

> . . . All persons who can be said to have "manufactured" an article are not to be classed as "manufacturers," regardless of circumstances, but rather only those who manufacture articles of trade as the principal part of their business. (*In re Kenyon*, 1 Utah, 47.) "A manufacturer * * * makes to sell, and depending for his profit on the labor which he bestows on the raw material." (*State v. American Sugar-Ref. Co.*, 51 La. Ann. 562, 25 So. 447, 453. See, also, *Nixa Canning Co. v. Lehmann-Higginson Co.*, 70 Kan. 664, 79 P. 141, 70 L.R.A. 653; In re Church Con. Co., (D.C.) 157 Fed. 298; *Walker Roofing Heating Co. v. Merchant Evans Co.*, 173 Fed. 771, 97 C.C.A. 495, and lengthy note in 64 L.R.A. 33.) *Where a person, engaged in a business other than manufacturing, incidentally manufactures something used in his regular business or as a by-product thereof, his business is not thereby transformed into a manufacturing business. (Commonwealth v. Keystone Laundry Co.*, 203 Pa. 289, 52 A. 326; *State ex rel. Ernst v. State Board of Assessors*, 36 La. Ann. 347; 38 C.J. 968; 1 Fletcher's Cyc. of Corp. 129.) [Emphasis added]

The term "manufacturing facility" is not defined by statute. It is therefore presumed to be used in its ordinary meaning. *Parkdale America, LLC v. Hinton.* _ N.C. App. _, 684 S.E.2d 458, 461 (2009) (where words of a statute are not defined, it is presumed that the "legislature intended to give them their ordinary meaning determined according to the context in which those words are ordinarily used"). Although it appears North Carolina courts have not directly determined the ordinary meaning of the term "manufacturing facility," it has been addressed in other states. For example, in reviewing a particular sales and use tax exemption statute, the Connecticut Supreme Court determined that the "ordinary meaning of the term 'manufacturing facility,' connotes a place where manufacturing is carried on either primarily or exclusively." *Stop 'N Save, Inc. v. Department of Revenue Services,* 212 Conn. 454, 460, 562 A.2d 512, 515 (1989).

The word "**landfill**" is defined, in part, in the Merriam-Webster Dictionary as "a system of trash and garbage disposal in which the waste is buried between layers of earth to build up low-lying land."

Ruling

Consistent with the holding in *Stop 'N Save, Inc. v. Department of Revenue Services* a "manufacturing facility connotes a place where manufacturing is carried on either primarily or exclusively." Taxpayer's primary interest and obligation, as documented by the Agreement, is safe and efficient operation of Landfill, which includes the methane gas collection system. NCDEQ issued a permit to Taxpayer for the construction and operation of Landfill. The methane gas collection system was installed as a requirement of operating a landfill, as regulated through the permit for Landfill. Analogous to the facts in *Trustees of Rochester v. Pettinger*, Taxpayer occupied the property not as a methane producer, but rather primarily as a landfill operator.

Purchases made by Taxpayer of products for the Collection System are made in the capacity of a landfill operator and are subject to the general State, applicable local, and applicable transit rates of sales and use tax. Purchases of such products by Taxpayer do not qualify for the exemption from sales and use tax pursuant to N.C. Gen. Stat. § 105-164.13(5a) and do not qualify for the 1% privilege rate of tax imposed under Article 5F of the Act.

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. If the facts and circumstances given are not accurate, or if they change, then the taxpayer requesting this ruling may not rely on it. If a taxpayer relies on this letter ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this letter ruling, the letter ruling will not afford the taxpayer any protection. It should be noted that this letter ruling is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Issued on behalf of the Secretary of Revenue
By the Sales and Use Tax Division