



8200 Woolery Way
Fallon , NV 89406

April 12, 2002

Mr. Guy Hobbs, Chairman
Governor's Task Force on Tax Policy in Nevada
C/o Legislative Counsel Bureau
401 South Carson Street
Carson City, NV 89701-4747

RE: Sales and Use Tax
Nevada Administrative Code 372.370 'Property used in manufacturing'

Dear Mr. Hobbs:

The purpose of this letter is to ask your task force to consider amending NAC 372.370 to expand the definition of tax-exempt raw materials incorporated in articles manufactured for sale.

SMI Joist, based in Arkansas, is a division of Commercial Metals Corporation, a publicly traded company headquartered in Texas. SMI Joist manufactures steel roof joists primarily for commercial buildings, shopping centers, and government installations. In addition to the plant in Fallon SMI Joist has production facilities in Arkansas, Iowa, South Carolina, and Florida.

The production of steel roof joists is a labor-intensive process that involves cutting and welding structural steel. Next to steel the most costly raw material used in this process is 'welding gas'. In practically all industrial states and most of the states in which SMI Joist has production facilities welding gas is considered a raw material used in the production process and is thus tax-exempt.

NAC 372.370 (1) states that: *'The tax applies to ... a chemical used as a catalyst or otherwise to produce a chemical or physical reaction such as the production of heat or the removal of impurities.'* Therefore, Nevada sales tax applies to welding gas based on the wording of this section of the Code.

In order to comply with your request for brevity the following page summarizes the reasons we feel as though your task force should consider this issue. In addition, I have referenced sections of Arkansas and Iowa codes as examples of two states that exempt welding gas. I will be glad to provide additional testimony to your task force or technical working group.

Please feel free to contact me if you or your task force have any questions or wish to discuss in more detail.

Sincerely,

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CC: Brent Holcolm, Controller SMI Joist Nevada

Reasons to consider amending NAC 372.370:

1. **Technical:** Most sales and use tax manufacturing exemptions on the books today were written many decades ago when the manufacturing process in general was not as technically diverse as it is today. Years ago manufacturing was thought of in terms of simply bolting or nailing together materials to produce a product for sale. Today, however manufacturing involves many diverse and unique processes – processes that often obscure the lines between what is and what is not a raw material.

Consider welding gas an example. Welding gas, as used in this context, is carbon dioxide, argon, or combination of the two – not acetylene. These gases are used as ‘flux’ to prevent oxidation of metals during the welding process. As such, it has a physical effect on the finished product not unlike paint applied to raw metal to prevent rust. Paint used in the production process has universally been considered a raw material thus exempt from tax.

Prior to the use of these gases the electric welding process used steel welding rods with a ‘flux’ material applied to the rod itself. Since it was not practical to segregate the cost of the steel portion of the rod that became part of the manufactured item from the flux material on the rod the entire cost of the rod in all taxing jurisdictions was exempt from sales tax.

At this point it is important to note that acetylene gas is used in welding but is used to produce heat and would not under any interpretation be considered a raw material. However, it is also important to note that the manufacturing process incorporating welding gas is only one of many manufacturing processes that were not in use when many of the existing manufacturing exemptions were originally drafted. For this reason, I have provided examples of statutes in other states that take these processes and related materials into consideration.

2. **Benefits to the State:** Practically all states that have significant levels of manufacturing as well as states that wish to attract manufacturing industry have broadened the manufacturing exemptions to reflect modern processes as outlined herein. The reason for this is that these states realize manufacturing is labor-intensive. Labor used in this context is predominantly ‘blue collar’ but typically wages in manufacturing exceed wages in service industries and agriculture for comparable skill levels. Therefore, manufacturing is usually considered to be attractive from the standpoint of providing a higher level of income and standard of living than alternative industries. The higher income results in higher state income and sales tax.

Many states that do not have a substantial manufacturing segment have incorporated changes such as the ones suggested herein in order to attract industry that will diversify the economic base within the state. This is one reason I believe your task force should consider these issues. SMI Joist has, within the 5 years since opening the plant in Fallon, become one of the leading civilian employers not only in Fallon but in all of Churchill County by introducing an industry previously not found in the Fallon area.

Modifications to the manufacturing exemption alone is not enough to attract manufacturing to a state, but this along with other incentives, can provide an attractive package to firms wishing to move into a given state.

3. **Benefits to SMI Joist:** Needless to say amending NRC 372.370 would have a positive impact upon the SMI Joist plant in Fallon. It would be too simplistic, however, to assume the positive impact would simply be a reduction in sales tax expense along with a corresponding improvement in corporate profitability.

The steel fabricating industry is very competitive and characterized by thin profit margins. Profits to a great extent are a function of cost control with labor, raw materials, and transportation being the three primary direct costs of doing business. Assuming labor costs remain constant for a given level of production, a reduction in raw materials cost (sales tax reduction) means the company can expand its potential market by assuming a greater amount of transportation cost. Put simply, if raw materials cost go down the company can afford to ship materials to a greater distance yet keep prices the same to a potential customer.

Over 80% of the steel joists produced at the plant in Fallon are shipped to customers out of state. Needless to say the cost to ship steel is substantial. Therefore, there is a geographical limit to the distance SMI Joist can solicit customers at competitive prices. Raw materials cost reduction make it possible to extent the geographical customer base. More customers mean increased production that helps SMI Joist preserve its most valuable asset – the base of employees in Fallon.

Examples of state rules and regulation reflecting broader definitions of materials used in the production process:

1. The SMI Joist division headquarters and largest production plant are located in Arkansas. Welding gas is tax-exempt under the following regulation within the state: Arkansas Gross Receipts Regulation GR-55.1©1:

The gross receipts or gross proceeds from the sale of catalysts, chemicals, reagents and solutions which are consumed or used directly in manufacturing or processing articles of commerce at manufacturing or processing plants or facilities in the State of Arkansas are exempt from gross receipts tax.

Welding gas is specifically addressed in Arkansas Revenue Legal Counsel Opinion No. 20000326 dated June 12, 2000 which reads in part:

Gross Receipts Regulation 55.1 is the regulation governing the exemption of chemicals used in manufacturing from Arkansas sales and use tax. In order to be exempt, substances (which includes chemicals, catalysts, reagents or solutions defined in Gross Receipts Regulation 55.1) must be used by a manufacturer during a manufacturing process. ... A substance is consumed or used if it is used to produce a chemical or physical effect during the manufacturing process and the chemical or physical effect is a direct and necessary step in the production of the articles of commerce.

Since welding produces a physical effect, welding gases used or consumed during the manufacturing process are exempt provided that this physical effect is a direct and necessary step in the production of the article of commerce.

2. The newest plant in the SMI Joist division opened in Iowa within the past two years. Welding gas is exempt in Iowa under the following regulation: Iowa Department of Revenue and Finance Rule 701-17.14

Chemicals, solvents, sorbents, and reagents directly used and consumed, dissipated, or depleted in processing tangible personal property intended to be sold ultimately at retail shall be exempt from sales and use tax.

Rule 701-14(1)(d) states: *The chemical, solvent, sorbent, or reagent need not become an integral or component part of the processed tangible personal property.*