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## Tax Information

**Guide 2009**

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# Provincial Tax Commission Fuel Tax Policy for Manufacturers

(This guide is provided to describe how fuel tax is applied to fuel consumed by a manufacturing operation.)

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# 1. Definitions

## *Revenue Act Regulations*

### Section 5

- (h) “custom sawing” means the service of sawing a customer’s logs;
- (o) “manufacture or production” means the transformation or conversion of raw or prepared material into a different state or form from that in which the raw or prepared material originally existed as raw or prepared material **but does not include production or processing**;
- (s) “motor vehicle” means every device in, upon or by which any person or property **is or may be transported or drawn upon a public highway**, excepting a motorized wheelchair and devices moved by human power or used exclusively upon stationary rails or tracks;
- (t) “non-renewable resource” means **any naturally occurring inorganic substance**, and includes coal, bituminous shales and other stratified deposits from which oil can be extracted by destructive distillation and includes petroleum;
- (v) “production or processing” means exploration for, extraction of, or transformation or conversion of **any non-renewable resource**.

# 2. Specific Application

## a. Raw Material

Generally speaking, fuel used during the receiving and storage of raw material is not within the “manufacture or production” exemption.

### Specific Taxable Areas

Specific examples of taxable activities in this area are:

- Unloading of transport vehicles.
- Transport to stockpile area.
- Inspecting, measuring, grading, sorting and unpacking the received goods prior to their removal from raw material storage.

Fuel used during any of the above-noted activities is taxable.

### Exceptions to the rule

#### Direct feed

If the storage facilities are integrated with the production line, the storage is exempt. This type of storage usually uses silos, tanks, or hoppers where flow to the line is automated. The level of integration and automated control are factors to help make this decision.

#### Unloading directly to production line

If the unloading process directly feeds the production line, therefore no raw material storage, the fuel consumed by the unloading equipment would be exempt.

### In storage processing

If the product is readied for production while in storage, then fuel consumed by equipment used in the process is exempt. An example would be to cool or dry a product to a temperature or moisture content necessary for production to continue. In this case, processing starts in the storage facility. Fuel used by equipment during unloading to storage prior to production and transport to storage would still be taxable.

## **b. Goods in Process**

### Intra/Inter process transportation

All fuel used by the material handling equipment used to move material through the process is exempt. This begins with the removal of the goods from raw material storage and ends after the goods have been placed in finished goods storage. This also includes on-site goods in process storage facilities.

This equipment is usually used in many areas and is subject to prorating. The fuel usage by this equipment will be prorated as follows:

- Fuel used in receiving and raw material storage - taxable
- Fuel used to transport direct to process - exempt
- Fuel used during and through the process - exempt
- Fuel used to transport direct to finished goods storage - exempt
- Fuel used in finished goods storage - taxable

### Remote Plants

Where a process involves more than one facility within the province, the product of one process is the prepared material for another. In this instance, the rules governing goods in process apply to the storage areas for finished goods of the first plant, and the raw or prepared material of the receiving plant. That is, these areas would be exempt. Fuel used by the transport equipment of the freight carrier (Highway, Rail, Air) used to transport the goods in process itself is taxable.

## **c. Repair and Maintenance**

The fuel used in equipment used in repair and maintenance activities on the production line is taxable, with a few exceptions noted below. The repair and maintenance process is separate from the production process and does not share the exemption.

### Taxable Activities

Taxable activities in this area include:

- Fuel used for general purpose repair and maintenance activities performed outside of the
  - production process.
  - Fuel used for material handling equipment used to install and dismantle equipment, and
  - to transport the equipment to and from the repair facility.
  - Fuel used for testing equipment used to identify necessary repairs, and for preventative maintenance.

## Exempt Activities

Maintenance activities required during production necessary to maintain the production process:

- An example is the emptying by a forklift of a container for defective product disposal attached to the production line.
- An example is the use of cleaning equipment where the cleaning is required for quality control.

## **d. Finished Goods**

### General rules

Once the product is in a form which is saleable to the plant's customers, including a sister plant, it is considered finished. The exemption ceases when the product is placed in finished good storage.

Fuel used in material handling equipment used to move goods from the end of the process to finished goods storage is exempt.

### For Example:

A sawmill produces a number of products other than lumber that are considered finished products for sale when production has ceased and the product is in storage. Finished products for sale would include hog fuel (bark and sawdust for use as boiler fuel), sawdust (for use in wood pellet production or as bedding material), wood chips (for use by pulp mills in pulp production or as bedding material), wood slabs in mills without a debarker (for use as firewood) and lumber ends from the trimmer (for use as firewood or re-manufactured products).

### Exceptions to the rule

An example would be to freeze or dry a product to a saleable state before it can be sold.

### Further Processing

Where further work is necessary to prepare a product ready for sale in a specific market, or to repair goods damaged in holding or transit, fuel consumed in equipment used in this activity would be exempt. This usually involves meeting varying quality levels or regulatory conditions. This would apply even if the work is performed by agents at sites remote from the plant if the work is necessary to make a product ready for sale.

### Quality Control

Quality control, which usually involves maintaining temperature or moisture, is taxable if it occurs outside the production process.

Quality control, which usually involves maintaining temperature or moisture, is exempt if it occurs within the production process.

For example, the fuel used in any equipment used to change or maintain temperature or moisture content such as the aging or curing of a product as part of a production process would be exempt.

### Packaging

The packaging of goods in the form usually sold to the plants customers is exempt. This usually takes place prior to finished goods storage.

Where goods are packaged for shipment subsequent to their placement in finished goods storage, (i.e. palletizers), the fuel used in the equipment used is not eligible for exemption.

### Backup Power Supplies

Stand-by generators and uninterruptible power supplies are exempt to the extent they support exempt equipment.

### Loading directly from production line

If the loading process directly feeds into transport equipment (freight carrier) from the production line, therefore no finished goods storage, the fuel consumed by the loading equipment would be exempt.

## **e. Prorating**

Many types of fuel powered equipment can be used for multiple tasks throughout the operations. The plant manager or production supervisor can usually provide data for determining percentages.

This would include items that are used part of the time in a taxable area and part of the time in an exempt area, such as material handling equipment.

### 3. The Production Exemption - General Rules

#### a. Supporting Legislation and Regulations

The production exemption is provided for the following sections of the *Revenue Act and Revenue Act Regulations*.

##### Revenue Act

s.12(2)(a) Regulation making authority for providing exemptions.

##### Revenue Act Regulations

Exemptions - (Marked Fuel) subject to Section 25 - See Below

s.22(2)(j)(iii) Exemption for fuel used to operate machinery and apparatus when used in the manufacture or production of goods for sale.

s.22(2)(j)(iv) Exemption for fuel used to operate machinery and apparatus used to develop electricity to power machinery and apparatus when used in the manufacture or production of goods for sale.

Refunds - subject to Section 25 - See Below

s.23(1)(j)(iii) Refund for fuel used to operate machinery and apparatus when used in the manufacture or production of goods for sale.

s.23(1)(j)(iv) Refund for fuel used to operate machinery and apparatus used to develop electricity to power machinery and apparatus when used in the manufacture or production of goods for sale.

##### Specific Exclusions From Manufacturing Exemption or Refund

- s.25
- (a) Removes the manufacture of asphalt or ready-mix concrete from the exemption and refund provisions.
  - (b) Removes repair and maintenance of any kind from the exemption and refund provisions.
  - (c) Removes salvaging of any goods or materials from the exemption and refund provisions.
  - (d) Removes oil exploration, production or processing from the exemption and refund provisions.
  - (f) Removes motor vehicles from the exemption and refund provisions.
  - (h) Limits on the scope of the exemption and refund provisions on the handling of raw materials prior to start of manufacture or production.
  - (i) Limits on the scope of the exemption and refund provisions on the handling of finished goods after manufacture or production.
  - (k) Removes custom sawing from the exemption and refund provisions.

By definition, the production or processing of non-renewable resources is excluded from the exemption and refund provisions available for manufacture or production.

## b. Fundamental Guidelines and Interpretations

From the legislation, regulations and court decisions, we can derive a set of basic rules for applying this exemption.

### Level of Integration

Equipment for normally taxable uses may be eligible for exemption if it is tightly integrated with the actual process. Examples of the level of integration are:

- Maintenance activity in a production area - A sawmill has a log deck on which logs are loaded for feeding into the production line. Bark and mud fall from the logs as they move across the log decks due to the actions of the feed chain and accumulates under the log deck until it affects the operation of the log deck. It is necessary to clean out under the deck on a regular basis to enable the feed chain on the log deck to continue to function. The fuel used in the equipment to carry the maintenance activity is exempt as it is necessary to maintain production.
- Raw material storage is a taxable area. One exception is tanks and silos that directly feed the line. Because these are attached to the process, and the continual flow or flow controlled by the process is required, the storage is exempt.

### Transform and Convert

The exemption applies to equipment used in processes where material is transformed into a different state or form. There must be some transformation for the exemption to apply. A stand-alone packaging and grading operation would not qualify.

Examples of transform and convert are:

- Recycling - a facility that produces a new product for sale in a distinctly new form from a process that uses a blend of scrap materials and other prepared materials as its raw materials is a production process that would qualify. The presence of non-renewable resources as raw materials results in a proration of the fuel consumption in equipment used in the production process between non-renewable vs all raw materials. The non-renewable portion will be taxable.
- Composting - a facility that produces compost for sale in a process that uses soil, sawdust, manure, and sand is a production process that would qualify. The presence of non-renewable resources as raw materials results in a proration of the fuel consumption in equipment used in the production process between non-renewable vs all raw materials. The non-renewable portion will be taxable.

### Goods for sale

The goods being manufactured must be for sale.



## Boundaries of the Exemption

The start and end of the manufacturing and production process mark the limit of the fuel tax exemption. Any fuel consumed in equipment used outside this area is not eligible for exemption. Any fuel consumed in equipment used between transportation in and transportation out that is reasonable necessary to the process is exempt.

- Transportation In

This is the point where the materials may reasonably be said to be at the start of the actual process of losing their characteristics as mere materials and acquiring the characteristics of the goods being made for sale. We have interpreted this to be the point at where goods leave raw materials storage. This should not be construed as the movement from a delivery vehicle to raw material storage.

- Transportation Out

Once the materials have been completely converted to goods for sale, the plant's finished product and are ready for transportation out, the exemption no longer applies. This refers to goods packaged for sale to the plant's customers. Finished goods cannot be allowed to pile up at the end of the line, so transport to finished goods storage is exempt. Once in finished goods storage, the exemption no longer applies.

- Reasonably Necessary

The test is: Can the goods in question be produced without this step in the process? If not, then the fuel used to power any equipment used to perform that step is exempt. The equipment being fueled must be part of the manufacturing process. Activities that support production, but are remote from and not integrated with the process, may not be eligible.

- Plant's finished product.

The exemption applies until the goods are in a form acceptable as a saleable product by the plant's customers. This would include extra work performed for special markets. It would also include repairs to goods damaged while in transit or in storage. This work would have to be performed by or for the manufacturer prior to sale.

## Retail Operations

- Scrap Dealers

Salvage and scrap activities are not considered manufacturing. The purpose of their operation is not to manufacture an identifiable product, but rather to cut, break or bundle materials in such a manner that would make them convenient for shipping.

- Packaging Without Processing

Equipment used in the packaging of a product where there has been no transformation or conversion (e.g. bagging apples), is not eligible for the exemption.

## Production & Processing

The definition of production and processing excludes the application of the manufacturing exemption in the non-renewable resource area. A manufacturing process that includes some raw materials that meet the definition of non-renewable resources would require a proration of the fuel consumption based on the percentage of non-renewable resources used (taxable) vs the remaining raw materials (exempt) that are reflected in the finished product.

Examples of the production and processing of non-renewable resources are:

(Note: Percentages and materials noted are for illustration purposes only.)

- Brick production

The finished product is composed of a combination of 35 % clay and 65 % shale. The production process involves mixing clay and shale in a mixer to create a mixture that is forced through a mold to create the brick shape. The brick shape coming from the mold is separated into individual bricks which are sent to a furnace for drying and hardening. The fuel used in equipment in the production process is taxable as the production uses raw materials that are 100% non-renewable.

- Cement block production

The finished product is composed of a combination of 10% cement, 39% sand, 13% stone, 36% granodiorite and 2% marble. The production process involves mixing the materials in a mixer to create a mixture that is poured into a mold to create the block shape. The block coming from the mold is sent to a furnace for drying and hardening. The fuel used in equipment in the production process is 90% taxable as the production process uses raw materials that are 90% non-renewable and 10% prepared materials (cement).

- Cement pipe production

The finished product is composed of a combination of 14% cement, 39% stone, 44% sand, 1% fly ash and 2% steel. The production process involves mixing the materials in a mixer to create a mixture that is poured into a mold containing a steel mesh for strength to create the pipe shape. The pipe coming from the mold is air dried to harden. The fuel used in equipment in the production process is 83% taxable as the production process uses raw materials that are 83% non-renewable and 17% prepared materials (cement, fly ash and steel).

- Fertilizer production

The finished product is composed of a combination of 40% nitrogen, 20% phosphate, 20% potash, 5% sand and 15% minerals (nutrients). The production process involves mixing the materials in a mixer to create a particular type of fertilizer that is then bagged for shipment out and placed in finished goods storage. The fuel used in equipment in the production process is 60% taxable as the production process uses raw materials that are 60% non-renewable and 40% renewable (nitrogen).