


ST 2105 - SALES TAX : COMPUTERS USED AS AIDS TO MANUFACTURE

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TAXATION RULING NO. ST 2105

SALES TAX : COMPUTERS USED AS AIDS TO MANUFACTURE

F.O.I. EMBARGO: May be released

REF H.O. REF: ST66/E88/1 DATE OF EFFECT: Immediate

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1122193	COMPUTERS AIDS TO MANUFACTURE	ITEMS 113A, B, C, FIRST SCHEDULE SALES TAX (EXEMPTIONS & CLASSIFICATIONS) ACT SALES TAX REGULATION 4

PREAMBLE

Many taxpayers have raised with this office the circumstances in which computers and peripheral equipment qualify for the exemption from sales tax provided for "aids to manufacture" as that expression is defined in the First Schedule to the Sales Tax (Exemptions and Classifications) Act (sub-clause 1(1)) and in the Sales Tax Regulations (sub-regulation 4(1)).

2. Because of the numerous requests for information in this area of the sales tax law and to indicate the extent to which this office considers that conditional exemption applies to computers and peripheral equipment as "aids to manufacture", the following general guidelines are provided. Computers and peripheral equipment, as a class of goods, are taxable at the general rate, currently 20%, unless conditional exemption applies.

RULING

3. The definitions of "aids to manufacture" cover a wide range of machinery, implements and apparatus for use by a manufacturer or a registered person exclusively, or primarily and principally, in the various stages of the manufacturing process. The definitions also extend in some instances beyond actual manufacturing processes to cover certain activities which are part and parcel of manufacturing operations e.g. cleansing or sterilizing machinery, etc. used in actual manufacturing processes, cleansing or sterilizing containers used in the storage of raw materials or partly processed goods and carrying out scientific research in relation to a manufacturer's manufacturing operations.

4. Certain classes of goods are specifically excluded from exemption as "aids to manufacture" by paragraphs (e) to (n) of the definitions. One such exclusion (paragraph (h)) is particularly relevant to the classification of computers. Paragraph (h) excludes -

"equipment or articles of a kind ordinarily used for office work, not being for use primarily and principally, and directly, in the manufacture of goods;"

5. Paragraph (h) was inserted in the definition of "aids

to manufacture" in the First Schedule by Act No. 142 of 1981 in substitution for excluding paragraph (g) which formerly read "office equipment which is not for use directly in the manufacture of goods". The purpose of the change was to clarify the position of computers. As explained in the explanatory memorandum which accompanied the amending Bill -

"Paragraph (h) replaces existing paragraph (g) which excludes office equipment which is not for use directly in the manufacture of goods. With technological developments, the term 'office equipment' does not adequately cover computers and other electrical devices that are ordinarily used for office work. Paragraph (h) has accordingly been expressed in wider terms so that if the equipment is ordinarily of a kind used for office work it will be excluded. Exemption is being preserved for office equipment which is primarily and principally for use directly in the manufacture of goods. Thus computers which operate manufacturing equipment can continue to qualify for exemption."

A similar amendment was made to the definition of "aids to manufacture" in the Sales Tax Regulations by Statutory Rules No. 284 of 1981.

6. The intention of the amendments was to ensure that computers and other electrical devices which are ordinarily used for office work are excluded from exemption as "aids to manufacture" by excluding paragraph (h) of the respective definitions.

7. Computers and peripheral equipment come within the ambit of the "aids to manufacture" definitions and qualify for exemption from sales tax where they are:-

- (a) for use exclusively, or primarily and principally, in any one or more of the operations or activities specified in sub-paragraphs (a)(i) to (a)(xi) of the definitions; and
- (b) for use directly in any one or more of the operations or activities specified in those sub-paragraphs.

8. To be used directly in operations or activities specified in sub-paragraphs (a)(i) to (a)(xi) of the definitions requires that a computer and peripheral equipment:-

- (a) directly activate, directly operate or otherwise directly control those operations or activities or the machinery, implements or apparatus employed in those operations or activities (e.g. by switching them on or off or otherwise conveying directions to them so as to regulate the operations or activities which they carry out) or;
- (b) is used directly by operatives engaged in the relevant operations or activities to feed information into the computer and to receive printed or visual instructions from the computer to enable the operatives to monitor, modify or

otherwise regulate those operations or activities (e.g. to ensure that pre-determined quantities of raw materials are added and that work-in-progress is being correctly processed or treated).

9. Even where a computer itself (i.e. central processing unit, registers and memory) is used primarily and principally and directly in operations or activities specified in sub-paragraphs (a)(i) to (a)(xi) of the "aids to manufacture" definitions, some components of the computer system, i.e. some items of peripheral equipment, may not be so used. For example, keyboards and visual display units (screens) may be connected to the computer but be located in office areas, reception areas, security areas, etc. and be used to facilitate functions in those areas. In these situations the keyboards and display units would not qualify as aids to manufacture.

10. It is necessary, therefore, when considering the application of the "aids to manufacture" definitions to establish the primary and principal, and direct use of each unit or component in a complete computer system and to determine separately whether or not that unit or component qualifies for exemption as an aid to manufacture.

11. The sales tax position of computer systems, and particular units or components of the systems, in relation to each of sub-paragraphs (a)(i) to (a)(xi) of the definitions of aids to manufacture is outlined as follows:

Sub-paragraphs (a)(i) and (a)(ii)

12. Computer systems will qualify for exemption as aids to manufacture under the sub-paragraphs where their primary and principal use is in a direct and immediate manner in processes or treatments which are specified in the sub-paragraphs e.g. computers which directly activate, directly operate or otherwise directly control the process or treatment or the machinery, implements or apparatus employed in the process or treatment. Computer systems will also qualify for exemption as aids to manufacture under the sub-paragraphs where they are used by operatives engaged in processes or treatments as specified in these paragraphs to feed information into the computer and to receive printed or visual instructions from the computer to monitor, modify or otherwise regulate those processes or treatments, for instance, to ensure that raw materials and work-in-progress are being correctly processed or treated.

Sub-paragraph (a)(iii)

13. Under this sub-paragraph computer systems may qualify for exemption where they are for use primarily and principally, and directly, in any process or treatment for the purpose of bringing goods manufactured by a manufacturer into, or maintaining those goods in, the form or condition in which those goods are to be marketed or used by him. Exemption will also apply to computers used by a registered person who carries out those same processes on behalf of a manufacturer.

14. By way of example finished articles manufactured by a manufacturer may be moved into a cool store to maintain them in the form or condition in which they are to be sold by the

manufacturer. A computer system may be used to control the operation of the cool store by monitoring the form or condition of the goods and adjusting the temperature of the cool store to ensure the form or condition of the goods is maintained. A computer system used primarily and principally in such circumstances would qualify for exemption as an aid to manufacture under sub-paragraph (a)(iii).

15. Computer systems for use for production planning, scheduling and control do not qualify for exemption as aids to manufacture. By monitoring such things as orders, inventories of materials, work-in-progress and finished goods, production, sales and other elements for various manufactured lines, a computer system that provides information needed for ordering stocks, scheduling production of various lines is not accepted as being within the scope of sub-paragraph (a)(iii) or any other of the sub-paragraphs. Production planning computers are discussed in paragraphs 31 and 32.

Sub-paragraph (a)(iv)

16. A distinction needs to be drawn between computer systems used to package, label, etc. goods in the course of manufacture and those used to package, label, etc. goods for purposes connected with the delivery of the goods. Computer systems used in a direct and immediate manner to dispense goods into packages, e.g. liquids into bottles, cans or other containers, and computer systems used to print or place descriptive labels on those goods during the manufacturing process will qualify for exemption as aids to manufacture if that is their primary and principal use. Computer systems used to print or attach delivery labels to containers of manufactured goods do not qualify as aids to manufacture under sub-paragraph (a)(iv) and are taxable.

Sub-paragraph (a)(v)

17. For computer systems to qualify for exemption as aids to manufacture under this sub-paragraph they must be used primarily and principally, and directly, in testing or checking the quality or specifications of goods processed or treated by a manufacturer or a registered person as specified in sub-paragraphs (a)(i) to (a)(iii).

18. A computer system which stores in its external storage units specifications of a manufacturer's products and is used primarily and principally in the course of manufacturing operations in analysing raw materials and partly processed goods and checking them against the specifications to ensure that standards of quality and desired physical and chemical characteristics are achieved and in indicating any necessary appropriate corrective adjustments to be made would come within the scope of this sub-paragraph.

Sub-paragraph (a)(vi)

19. For a computer system to qualify for exemption as an aid to manufacture under sub-paragraph (a)(vi) it must be used primarily and principally, and directly, in the disposal of waste substances resulting from any of the operations or activities specified in paragraph (a) of the definitions carried

out by a manufacturer or by a registered person on behalf of a manufacturer. Exemption, however, would not be available for a computer system used by a waste disposal contractor who ordinarily would be neither a manufacturer or a registered person.

Sub-paragraph (a)(vii)

20. Computer systems will qualify for exemption as aids to manufacture under the sub-paragraph where they are used primarily and principally in a direct and immediate manner either in the cleansing or sterilizing of bottles, etc. which the manufacturer uses in the storage of goods, e.g. raw materials and work-in-progress, which he processes or treats as specified in sub-paragraphs (a)(i) to (a)(iii) or in the cleansing or sterilizing of bottles, etc. which he uses in the marketing of such goods.

Sub-paragraph (a)(viii)

21. Provided that a computer system is for use primarily and principally, and directly, in the transportation of raw materials, partly processed goods or manufactured goods within relevant premises it will qualify for exemption as an aid to manufacture. An example would be a computer system which directly activates or controls the transportation of raw materials within the manufacturing premises.

Sub-paragraph (a)(ix)

22. Exemption will apply to a computer system for use by a manufacturer primarily and principally, and directly, in the storage of goods within relevant premises. It seems unlikely that a computer system would be used primarily and principally for such purposes. Most computer systems used in connection with the storage of goods are likely to come into the category of production planning types of computer systems which are for use principally as a management tool to advise management of the state of stocks of materials on hand, goods-in-progress, finished goods and other production reports. Computer systems for use in production planning are considered not to be for use directly in the manufacture of goods in operations or activities specified in paragraph (a) of the definitions and they do not qualify for exemption as aids to manufacture. Production planning computer systems are dealt with more fully in paragraphs 15, 31 and 32.

Sub-paragraph (a)(x)

23. Similar considerations apply in relation to the cleansing or sterilizing of manufacturing machinery, implements or apparatus as apply in relation to the disposal of waste substances under sub-paragraph (a)(vi) of the definitions. The observations made in paragraph 19 above in relation to sub-paragraph (a)(vi) apply in the case of sub-paragraph (a)(x) of the definitions.

24. Computer systems for use primarily and principally in operating or applying machinery, implements or apparatus used in any activity carried out by a manufacturer, or by a registered person, as specified in paragraph (a) of the definitions will

qualify for exemption as aids to manufacture under sub-paragraph (a)(x) provided that they are used in a direct and immediate manner in the operation or application. For example, a computer system directly connected to manufacturing plant and used principally to monitor the operating temperature of the plant and, where necessary, to modify the rate of its operation to keep its temperatures within acceptable pre-determined levels would be eligible under this sub-paragraph.

Sub-paragraph (a)(xi)

25. It is accepted that a computer system will qualify for exemption as an aid to manufacture under the sub-paragraph where it is for use by a manufacturer primarily and principally, and directly, in carrying out scientific research in relation to manufacturing operations conducted by the manufacturer.

26. Scientific research can cover a wide field of activities. Research can be conducted into possible future manufacturing operations, the improvement of existing manufacturing operations or certain specific aspects of manufacturing operations such as testing the suitability of raw materials for their possible use in manufacturing operations. Not all scientific research activities will necessarily relate to manufacturing operations conducted by the manufacturer or registered person. Some such activities may, as indicated, be concerned with future manufacturing operations that are merely contemplated in a completely different field to those which the manufacturer presently conducts.

27. "Scientific research in relation to manufacturing operations" within the meaning of sub-paragraph (a)(xi) of the "aids to manufacture" definitions would be involved where a manufacturer, for example, engages in systematic investigation and experimentation in the fields of natural or applied science for the extension of knowledge, into the manufacturer's existing materials or manufactured goods, existing physical processes of manufacture or into new alternative materials or alternative manufactured products or alternative physical processes of manufacture.

28. However, systematic and skilled utilization of a computer system to control and co-ordinate the use of raw materials, partly processed goods and manufacturing plant is not regarded as "scientific research in relation to manufacturing operations" for the purposes of sub-paragraph (a)(xi) of the "aids to manufacture" definitions. It is not accepted, for instance, that "scientific research in relation to manufacturing operations" is involved in the use of a computer system in projecting product demand, in scheduling the production resources of a manufacturer and in monitoring the performance of those resources.

29. Exemption under sub-paragraph (a)(xi) is limited to computer systems used primarily and principally, and directly, in the scientific researching of manufacturing operations currently being conducted by the manufacturer, i.e. computer systems used to research raw materials for goods currently being produced.

30. Production planning computer systems (refer also to

paragraphs 15, 31 and 32) do not qualify for exemption under this sub-paragraph. Production planning is not accepted as scientific research.

General Matters

31. Reference has been made earlier to computer systems used for production control, production planning and other business management decision-making. Where a computer system collects, processes or provides data for any of the following purposes, that use does not come within the scope of paragraph (a) of the "aids to manufacture" definitions:-

- (a) information in relation to customers' orders;
- (b) information in relation to raw material ordering, inventories or control purposes; or
- (c) checking raw materials received against raw material orders and customers' orders;
- (d) information for the preparation of reports for consideration and decision-making by management in relation to:-
 - (i) changes in the production process whether they be changes in the levels of production or changes to increase productivity or co-ordination;
 - (ii) predictions of production output or calculations of actual output;
 - (iii) raw materials, labour or machinery requirements;
 - (iv) production scheduling and sequencing; or
 - (v) long-term planning or policy.
- (e) accounting functions, word processing and mailing lists;
- (f) financial modelling and statistics; and
- (g) information storage and retrieval for management decision-making.

32. While the end result of the use of a computer in the circumstances outlined in the preceding paragraph might lead to increased overall efficiency of a manufacturer's operations and to increased ability to monitor, control, and marshal the manufacturer's resources to improve performance - obvious benefits to the management of a manufacturing concern - they fall short of use of the computer system in circumstances eligible for exemption as an "aid to manufacture".

33. The rulings on computer systems qualifying as aids to manufacture contained in CSTCM 3/1969 are withdrawn.