



OFFICE OF  
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DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Deborah A. Butler  
Assistant Chief Counsel CC:DOM:FS

SUBJECT: Definition of Manufacturing Facility

This Field Service Advice responds to your memorandum dated August 31, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Corporation	=
City	=
Issuer	=
<u>c</u>	=
<u>d</u>	=
<u>e</u>	=
<u>f</u>	=
<u>g</u>	=
Date 1	=

ISSUE

Whether a facility used for the growing of plants is engaged in manufacturing within the meaning of I.R.C. § 144(a)(12)(C).

CONCLUSION

The operations of the facility, which appear to be agricultural in nature, do not meet the definition of manufacturing within the meaning of I.R.C. § 144(a)(12)(C).

## FACTS

Corporation is engaged in the business of growing garden plants for both the wholesale and retail market. Corporation holds a patent for a growing process that purportedly results in faster-growing and more durable plants than conventional growing methods.

Corporation's operations are conducted on a c acre facility ("the Facility") in City. The Facility produces approximately d plants annually. The patented growing process begins with the germination of plants in state-of-the-art greenhouses equipped with heated floors, robotic watering systems and retractable roofs. Seedlings are placed in bottomless pots which alters the growth process. After several weeks, the seedlings are transplanted to fields for approximately one year. At the correct time of the year, the plants are harvested. While some plants are sold after harvesting, many are transferred to cold storage facilities where they are kept in a dormant state until they are packaged and shipped to buyers. The dormant state permits nationwide delivery of plants regardless of the season.

On Date 1, Issuer issued e of revenue bonds (the "Bond"). The Bond proceeds were used to construct f acres of state-of-the-art greenhouses as described above and a g square foot cold storage building located at the Facility. The greenhouses and the cold storage facility are used in the growing process described above.

## LAW AND ANALYSIS

Section 103(a) of the Internal Revenue Code provides that gross income does not include interest on a State or local bond. Section 103(b)(1) provides that section 103(a) does not apply to any private activity bond, unless it is a qualified bond. Section 141(e)(1)(D) provides that a qualified small issue bond is a qualified bond.

Section 144(a)(1) provides that the term "qualified small issue bond" means any bond issued as part of an issue the aggregate authorized face amount of which is \$1,000,000 or less and 95 percent or more of the net proceeds of which are to be used for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or to redeem a prior issue that was used for those purposes. Under section 144(a)(4), the issuer may elect to increase the \$1,000,000 limitation to \$10,000,000 provided certain other requirements are also met. The proceeds, however, are still required to be used in the manner described in section 144(a)(1).

Section 144(a)(12) provides, in part, that section 144(a) does not apply to any bond issued after December 31, 1986, unless 95 percent or more of the net

bond proceeds are used to provide any manufacturing facility or any land or property in accordance with section 147(c)(2) relating to first-time farmers.

The exception for first-time farmers may apply if the land financed is to be used for farming purposes and is acquired by an individual who is a first-time farmer, who will be the principal user of such land, and who will materially and substantially participate on the farm of which such land is a part in the operation of such farm. I.R.C. § 147(c)(2)(B). For purposes of this section, "farm" has the meaning given such term by section 6420(c)(2). Section 6420(c)(2) defines farm to include "nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards."

By permitting either manufacturing facilities or specified farming activities, section 144(a)(12)(B) establishes a distinction between manufacturing and agriculture for purposes of the qualified small issue bond rules. In the instant case, it is apparently undisputed that the exception for first-time farmers does not apply. Rather, Issuer and Corporation contend that Corporation is engaged in a manufacturing activity within the meaning of section 144(a)(12)(C)

Section 144(a)(12)(C) states that the term "manufacturing facility" means any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). The term "manufacturing facility" includes facilities which are directly related and ancillary to a manufacturing facility (determined without regard to this sentence) if-(i) such facilities are located on the same site as the manufacturing facility, and (ii) not more than 25 percent of the net proceeds of the issue are used to provide such facilities.

While Corporation's growing process may require a high degree of technology and automation, they do not appear to be manufacturing facilities. The property financed with the Bond proceeds include greenhouses and other structures that are used primarily for the raising of garden plants, an agricultural commodity. While these facilities appear to meet the definition of farming under section 6420, the Issuer and Corporation apparently concede the exception for first-time farmers under sections 144(a)(12)(B)(ii) and 147(c)(2) does not apply. Thus, based on the information provided, it does not appear that the Bond proceeds were used for a qualified purpose under section 144(a).

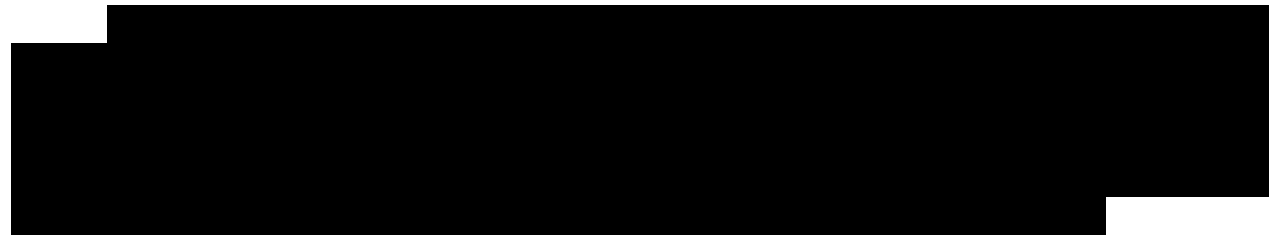
#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

While the facts presented support a determination that the activity in question is not manufacturing, as with any factual determination, there are some hazards to litigation. First, there is no published guidance or legal authority interpreting the phrase "used in the manufacturing or production of tangible personal property" as found in section 144(a)(12)(C). The only guidance in this

area comes from either private rulings or technical advice issued by the Service which, of course, provide no precedential authority. The risk, therefore, is that we are unable to determine how a court will interpret the terms “manufacturing” and “production.”

Further, the question of whether an activity constitutes manufacturing is highly fact sensitive. While it is normally difficult to predict how a court will interpret a given set of facts, such prediction becomes more problematic where dealing with a case of first impression, as we have here.

Despite these cautionary notes, the available facts provide strong evidence that the Facility is an agricultural facility. The Service has previously taken the position that agricultural facilities do not constitute manufacturing facilities for purposes of section 144(a)(12)(C). It is our opinion that this position is supported by the plain language of section 144(a)(12)(B) which distinguishes manufacturing facilities and certain farm property.



Please call if you have any further questions.

By: JOEL E. HELKE  
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cc: