BEFORE THE BOARD OF TAX APPEALS
STATE OF WASHINGTON

CUSTOM APPLE PACKERS QUINCY, INC.,	)	
Appellant,	)	Docket No. 39498
v.	)	Re: Excise Tax Appeal
STATE OF WASHINGTON DEPARTMENT OF REVENUE,	)	FINAL DECISION
Respondent.	)	

This matter came before the Board of Tax Appeals (Board) for an informal hearing on July 2, 1991. James A. Brown, Attorney, appeared for Appellant, Custom Apple Packers Quincy, Inc. (Custom Apple). Claire Hesselholt, Attorney, appeared for Respondent, Department of Revenue (Department).

This Board heard the testimony, reviewed the evidence, and considered the arguments made on behalf of both parties. This Board now makes its decision as follows:

STATUS IN CONTROVERSY

Custom Apple protests the Department's Determination No. 90-320 denying sales and use tax deferral for its newly constructed apple processing and packing plant located at Quincy, Washington.

PROCEDURAL FACTS

RCW 82.60 establishes a program in which sales and use taxes can be deferred for manufacturing projects built in certain economically distressed areas of the state. Custom Apple timely applied for the deferral under RCW 82.60 and WAC 458-20-24001 on March 21, 1990. Custom Apple sought deferral for a fruit processing, packaging, and storage plant it was building. The plant investment was approximately $6,000,000. By letter dated April 10, 1990, the Department denied the request for the deferral on the grounds that the fruit is still in its raw state when Custom Apple is finished with it, and not changed to sauce, juice, pie, or some other form. The Department concluded that fruit processing and packaging are not manufacturing activities. The Department found that Custom Apple's activities constituted fruit packing as

defined in WAC 458-20-214 and not manufacturing under RCW 82.60, WAC 458-20-24001, and WAC 458-20-136.

Custom Apple petitioned the Department for review of the decision. In Determination No. 90-320, the Department held that Custom Apple's activities were not manufacturing activities and that Custom Apple's plant did not qualify for the sales and use tax deferral for manufacturing plants. Custom Apple appealed the decision to the Director of the Department. By letter dated February 1, 1991, the Director upheld the decision. This appeal followed.

FACTS AND ISSUES

The question to be decided is whether Custom Apple's activities of controlled-atmosphere storage, washing, waxing, sorting, sizing, and packing apples are "manufacturing" as it is defined in RCW 82.60 so that Custom Apple's newly constructed plant can qualify for sales and use tax deferral in distressed areas.

The activities in which Custom Apple is engaged are described as follows:

Raw, orchard-run fruit is received in 800-pound wooden bins at the Custom Apple warehouse. At this point, the fruit is not as valuable as it is after Custom Apple performs its activities.

The fruit is unloaded from trucks and stored in state-of-the art, controlled-atmosphere storage facilities. These facilities combine atmospheric control, through the use of liquid nitrogen, with computerized refrigeration control to prolong the storage life of the fruit. The fresh fruit is cooled to 31 degrees and will decay if not chilled.

After the fruit is removed from storage, it is processed through complex packing machinery. This machinery is highly specialized. The fruit is pre-sorted, washed, dried, and waxed. Then, it is subjected to spectral analysis and computer-generated weight sizing to determine its grade. Each piece of fruit is individually analyzed by computer to determine where it belongs in the range of product sizes and grades that are processed. Over 25 different combinations of product are packed for shipment.

Hand labor is used throughout the process to place the product in containers. The packaged fruit is conveyed away to be labeled and palletized. The containers used for the

fruit are constructed in the plant from pre-formed fiberboard materials. The entire packing process contributes 40 to 50 percent of the wholesale value of the finished product.

DISCUSSION

RCW 82.60.040 provides that the Department will issue a sales and use tax deferral certificate for an eligible investment project in certain distressed areas of the state. This certificate allows the recipient to defer sales or use taxes associated with the project for two years, and then make partial payments for five years. Interest is waived on the deferred taxes. RCW 82.60.060. Eligible investment projects are essentially construction projects for manufacturing activities that create a specified number of jobs in the distressed area. RCW 82.60.020.

"Manufacturing" is defined at RCW 82.60.020(6):

> "Manufacturing" means all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different, or useful substance or article of tangible personal property is produced for sale or commercial or industrial use and shall include the production or fabrication of specially made or custom made articles. "Manufacturing" also includes computer programming, the production of computer software, and other computer-related services, and the activities performed by research and development laboratories and commercial testing laboratories.

WAC 458-20-24001 sets out the administrative rules to be used by the Department in administering RCW 82.60. Under WAC 458-20-24001(3)(j):

> "Manufacturing" has the meaning given in RCW 82.04.110 and WAC 458-20-136 now and as hereafter amended. Manufacturing, for purposes of this section, shall also include computer programming, the production of computer-related service, and the activities performed by research and development laboratories and commercial testing laboratories.

RCW 82.04.110 defines a "manufacturer", in part, as:

> every person who, either directly or by contracting with others for the necessary labor or mechanical services, manufactures for sale or for commercial or industrial use from his own materials or ingredients any articles, substances or commodities.

WAC 458-20-136(1) takes the definition provided in RCW 82.04.120 (the same definition used in RCW 82.60) and explains it as follows:

> ["To manufacture"] means the business of producing articles for sale, or for commercial or industrial use from raw materials or prepared materials by giving these matters new forms, qualities, properties, or combinations. It includes such activities as making, fabricating, processing, refining, mixing, slaughtering, packing, curing, aging, canning, etc. It includes also the preparing, packaging and freezing of fresh fruits, vegetables, fish, meats and other food products, the making of custom made suits, dresses, coats, awnings, blinds, boats, curtains, draperies, rugs, and tanks, and other articles constructed or made to order, and the curing of animal hides and food products.

WAC 458-20-136(4) is a paragraph that specifically excludes certain activities. It repeats the exclusion from the definition of manufacturing provided in RCW 82.04.120 for conditioning of seed, ice glazing of seafood, and mere cleaning and freezing of whole fish.

The Department further relies on the definition of "manufacturing" found in RCW 82.04.260(5) to include the processes of canning, preserving, freezing, or dehydrating fresh fruits and vegetables.

The issue raised by Custom Apple is that its activities of processing and packaging fruit, including a cooling process to 31 degrees, is analogous to the process of freezing since in both cases the fruit will decay if not chilled.

The Department believes that Custom Apple's activities are washing, sorting, and/or packing as defined under WAC 458-20-214 (the Department's rule dealing with tax treatment for those engaged in the business of washing, sorting, and/or preparing fresh perishable horticultural products).

WAC 458-20-214 has existed since 1939. Prior to 1947, it did not clearly explain the tax liability of one washing, sorting, and/or packing fresh perishable horticultural

products for other than the growers of the products. Since 1947, it has provided that receiving, washing, sorting, and packing fresh perishable horticultural products are not manufacturing activities and that charges for such activities are subject to tax under the "other business or service activities" classification of the business and occupation tax when performed for persons other than the growers. When performed for growers, such activities are not taxable. RCW 82.04.4287.

Manufacturing has been defined by Washington courts on many occasions. In J & J Dunbar & Co. v. State, 40 Wn.2d 763, 245 P.2d 1164 (1952), the court held that the activity of screening and filtering raw whiskey constitutes manufacturing. The following rationale was used:

> [I]n the process through which the whisky is put by Old Monastery Company labor and skill are applied by hand and machinery to the whisky and that as a result a different and useful substance of commerce is produced. A raw whisky, not suitable for consumption as a beverage, is converted into one that is capable of being used as such.

(Emphasis ours.) J & J Dunbar, supra at 766.

In Stokely-Van Camp, Inc. v. State, 50 Wn.2d 492, 312 P.2d 816 (1957), the process of preserving by freezing an already edible food was found to constitute manufacturing. Stokely-Van Camp was preparing fresh fruit and vegetables for packaging and freezing as well as performing the packaging and freezing activities. The preparation for the vegetables included sorting, cleaning, sizing, blanching, and sometimes cutting. The fruit was sorted, cleaned, and had sugar added to it. The blanching was described as a process to inactivate the enzymes, inhibit off-flavors, retain vitamins, and fix color. The court again compared the product before and after the process in question:

> It seems to us that frozen packed fruits and vegetables are new, different, and useful articles of trade or commerce compared with the articles brought to respondent's plants from the fields, because they are changed into a form in which they may be kept usable for months or years under proper refrigeration by the retailer and the ultimate consumer. The end result of respondent's activities more nearly resembles the objects attained

> by the food canning process than it does those connected with the pasteurization of milk.

Stokely-Van Camp, supra at 498-99.

It is interesting to note the dissent by Justice Schwellenbach in which he states:

> I fail to see how the process of freezing fresh fruits and vegetables results in the produc-tion of "a new, different or useful article . . .". It was not so recognized by the tax commission until it revised its rule No. 136 on March 1, 1954. Although the obtaining of additional revenue is very laudable, I do not believe that the tax commission should be permitted to amend a statute enacted by the legislature by changing one of its rules.

Stokely-Van Camp, supra at 501. Justice Weaver concurred with the dissent.

The argument made by Stokely-Van Camp is the same argument used by the Department in this case. Stokely-Van Camp argued that the fruit and vegetables packaged and frozen by it were still the same fruit and vegetables they were when they arrived at its plant. In the instant case, the Department argues that the apples are the same fruit that arrived at the plant. The court found that the process of preparing and freezing fresh fruit and vegetables was essentially the same as canning them, which was classified as "manufacturing" by the Tax Commission in its Rule 136.

> The only difference between the two processes is that, as a result of canning, the articles are cooked and ready for human consumption, whereas in the freezing process they are only blanched and are not edible until the ultimate consumer cooks them. But the object of each process is the same, to wit, to preserve foods for an indefinite period for human consumption.

Stokely-Van Camp, supra at 497-98.

This articulation of what constitutes manufacturing was further refined in Bornstein Sea Foods, Inc. v. State, 60 Wn.2d 169, 373 P.2d 483 (1962), in which case the cutting of whole fish into fish fillets was held to be a manufacturing activity:

> We think the test that should be applied to determine whether a new, different, and useful article has been produced is whether a significant change has been accomplished when the end product is compared with the article before it was subjected to the process. By the end product we mean the product as it appears at the time it is sold or released by the one performing the process.

(Emphasis ours.) Bornstein, supra at 175. In Bornstein, the court found that the Tax Commission, by virtue of its Rule 136, had effectively utilized the statutory phrase, "so that as a result [of application of labor or skill] a new, different, or useful substance or article of tangible personal property is produced", to include "activities encompassing preparation and processing in the sense of treatment or handling as `curing, aging, canning, etc.' and `preparing, packaging and freezing.'" Bornstein, supra at 173. In the court's opinion, there was "clearly a significant difference between that portion of appellant's production which winds up frozen in package form and the whole fresh fish placed on the conveyor belt en route to the filleter." Bornstein, supra at 175. The court also noted that "the decision [in Stokely-Van Camp] was grounded upon the change in form from fresh to frozen and the fact that the end product was made more usable because of its frozen state." Bornstein, supra at 176. "The crucial point in each of these cases was the fact that the activities of the taxpayer changed a product to make it more usable. The process of filleting transforms near valueless whole bottom fish into useful and salable consumer items. This change is significant." Bornstein, supra at 177.

The Department's argument to the effect that "apples are apples" and therefore the processing should not be considered as manufacturing was argued and rejected in Bornstein. It is the total process accomplished in relation to the statutory definition and prior case law which must be considered, and the Bornstein court found that the measure was whether there is a significant difference between the product that is shipped and the product which comes into the plant.

The following year, 1963, the same court held that the operation of splitting peas was manufacturing. McDonnell & McDonnell v. State, 62 Wn.2d 553, 383 P.2d 905 (1963). The Department made no attempt to tax the operations relative to the processing of whole peas as a manufacturing activity. It did attempt to tax the operations relative to the split pea operation as a manufacturing activity.

The peas are removed from their pods prior to being acquired by the taxpayer. After the peas are received by the taxpayer, they are placed and kept in storage for three or four weeks. The peas are thereafter put through a machine called a clipper cleaner, whereby the undersized peas, parts of stalks, pods, vines, and any other less useful or foreign materials are removed. The next step in the preparation or processing is to put the peas through a gravity cleaner. This machine utilizes air pressure and a shaking motion to remove sub-standard and defective weevily peas. The weevily peas are infected with a small organism, actually a small beetle of the Rhyncophora group, which, during the three to four week period of storage referred to above, literally eats its way out of the peas. This results in the weevily peas being lighter, and this difference in specific gravity makes possible the separation by the gravity cleaner of the weevily peas from those uninfected. At the conclusion of these operations, approximately two thirds of the peas are bagged as whole peas and sold on the wholesale market. The tax commission has not attempted to tax these operations, relative to the processing of the whole peas, as a manufacturing activity.

We are concerned with the remaining third of the peas which are destined to become split peas. These are subjected to further processing through a screw type conveyor, a part of a machine or apparatus called the steam auger. As the peas are carried through a steam chamber, the steam treatment softens the hulls or shells to facilitate their removal and the subsequent splitting of the peas. Thereafter, the peas go through a splitter, which consists of a rotary drum with vertical plates. The peas are fed into the top of the splitter machine, where, by the exertion of centrifugal force, they are thrown against the side of the drum and split. . . . [A] witness for the taxpayer clearly indicate[s] that the peas usually must be processed through the splitter at least two or three times to accomplish splitting of all of the peas. The split peas next go through a machine similar to the clipper cleaner for the purpose of grading and further removal of undesirable portions. Then, after going through an apparatus or machine for polishing and improving the appearance of the peas, they are packed for shipment.

> During the process resulting in splitting of the peas, the hulls and hearts (the latter being a small stem in the pea) are removed. These scrap pieces, combined with the pea chips, constitute a by-product referred to as offal. Offal does not result from the processing of whole peas. The removal of the hull in the splitting process results in an end product, i.e., split peas, which differs in color from the original whole pea with the hull intact.

(Underlining added. Footnote omitted.) McDonnell, supra at 554-56.

In deciding the case, the court used the following rationale:

> The preparation or processing of the peas and the effect upon them closely approximates the situation with respect to the preparation and processing of bottom fish involved in the Bornstein case. We are convinced that the reasoning and the holding in Bornstein is applicable and controlling in the instant case.
> We realize that the criterion stressed in Bornstein--namely, whether there has been a significant change--is somewhat general in nature and may seem easier as a matter of articulation than as a matter of application. Nevertheless, as we stated in Bornstein, the end product--that is, the product or substance as it is released or sold by the one performing the process--must be compared with the substance initially received by that processor. In making this comparison, consideration should be given to the following factors: among others, changes in form, quality, properties (such changes may be chemical, physical, and/or functional in nature), enhancement in value, the extent and the kind of processing involved, differences in demand, et cetera, which may be indicative of the existence of a "new, different, or useful substance."

McDonnell, supra at 556-57. The court identified three significant factors of change in the McDonnell case: a change in value, difference in demand, and a change in form.

In a dissenting opinion, Justice Weaver argues:

> The nucleus of the comparison test is "signif-icant change," which, in the abstract, may mean many

> things to different men. Is the change from a whole pea to a split pea significant, meaningful, of consequence, or momentous? I do not think so. Implicit in "manufacturing" is the concept that something has been changed to make a new or different product.

McDonnell, supra at 559. Justice Weaver agreed with the trial court that there is no change in the pea substance either chemically, by change of color, change of taste, or otherwise. Justice Weaver argues that Bornstein fixes the outer boundary of the definition of "manufacturing" under the statute. It introduces a new element, the process of changing a product into a useful and salable consumer item. Justice Weaver concludes that there is no significant change in substance or usefulness in the pea-splitting process.

In 1963, the Washington Supreme Court adopted the collective rationale of these four cases to determine that the changing of green coffee beans, useful only to coffee processors, to a roasted and blended coffee, a usable item, was a manufacturing activity. Continental Coffee Co. of Washington v. State, 62 Wn.2d 829, 384 P.2d 862 (1963).

The Continental court found from a reading of RCW 82.04.120 that whether manufacturing has occurred depends on whether a "new, different, or useful" substance or article has been produced. The court states at 832:

> Applying this test [the Bornstein test], we find that the changing of green coffee beans, useful only to coffee processors, to a roasted and blended coffee, a usable consumer item, is a change of such significance as to render it manufacturing under the Bornstein decision
> In the Stokely-Van Camp case, we held that the processing and freezing of fresh fruits and vegetables constituted manufacturing, despite the taxpayer's contention that its activities did not create a degree of usefulness which had not previously existed, but merely preserved that same degree. The reasoning under the facts of the Stokely-Van Camp case is applicable to the instant case. Since, in the Stokely-Van Camp case, the process of preserving an already edible food constituted manufacturing, it follows that a process which takes an inedible product and, by blending and roasting, creates an edible product must also be manufacturing.

> . . . The activities in both the J & J Dunbar case and the instant case have achieved the same result--the conversion of a product not suitable for consumption to one that is. If the mere activity of screening and filtering of raw whiskey constitutes manufacturing, then the blending and roasting of green coffee must also constitute manufacturing.

Custom Apple argues that its activities are analogous to those found to be manufacturing in Continental and McDonnell. Custom Apple contends that orchard-run fruit is not usable or commercially viable, that the process of refrigeration prolongs the life of the fruit, and that the process of packing gives the fruit a new quality by washing, grading, and waxing. It is now in a new form in its container with uniform size and color as opposed to commercially unacceptable mixing in the orchard. The fruit is now part of a useful article for commercial sale when it is packaged. Its value is greatly enhanced. The functional properties of the fruit are now changed because the package has commercial utility compared to the unprocessed product in an orchard-run condition. All of these improvements are a result of extensive processing and fabrication of the package.

The Department argues that its interpretation that "manufacturing" does not include washing, sorting, or packing which is not associated with a change in form is entitled to weight. It is a common rule of statutory construction that "where the Legislature uses certain statutory language in one instance, and different language in another, there is a difference in legislative intent." United Parcel Service, Inc. v. Department of Revenue, 102 Wn.2d 355, 362, 687 P.2d 186 (1984). In this case, the same words are used in the statutes defining manufacturing (RCW 82.04.120 and RCW 82.60.020), creating a presumption that the same meaning is intended. Further, the Legislature has amended RCW 82.60.020 since the original adoption of the rule, and although the rule has been amended to conform with statutory changes, the sections regarding what constitutes manufacturing have not been altered. An agency's interpretation of a statute it is charged to administer is entitled to great weight, especially when the Legislature has acquiesced in this interpretation over a period of time. In re J.D., 112 Wn.2d 164, 769 P.2d 291 (1989).

We find the Department's interpretation reasonable.[1] Custom Apple's activities do not meet the test set out in McDonnell. Custom Apple does not change the form, qualities, or properties. What it begins with is a raw apple; what emerges is a raw apple, although in a more commercially appealing form, thereby creating more demand and value. The courts have so broadened the definition of manufacturing that the issue Custom Apple raises concerning its cooling process to prevent decay is more difficult to answer. However, the preparing, packing, and packaging activities of Custom Apple involve apples which are not frozen or canned or split (activities defined as manufacturing by the courts). We do not find that cooling changes the form. One could argue that Custom Apple meets the test of Continental and J & J Dunbar. The apple after Custom Apple's processing is different and more useful. But it is not a new product. Unlike the coffee beans and the whiskey, the apples are an already edible food before the activities of Custom Apple begin.

DECISION

The Determination of the Department is sustained.

DATED this _____ day of _____, 1991.

BOARD OF TAX APPEALS

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RICHARD A. VIRANT, Chair

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MATTHEW J. COYLE, Vice Chair

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[1] If any agency's interpretation is reasonable, defer-ence should be given to the agency's experience or expertise in a particular field. Martin v. Occupational Safety and Health Review Comm'n, 111 S. Ct. 1171 (1991).

LUCILLE CARLSON, Member

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Pursuant to WAC 456-10-755, you may file a petition for reconsideration of this Final Decision. You must file the petition for reconsideration with the Board of Tax Appeals within ten days of the date of mailing of the Final Decision. You must also serve a copy on all other parties. The filing of a petition for reconsideration suspends the Final Decision until action by the Board. The Board may deny the petition, modify its decision, or reopen the hearing.