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BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Interpretation of	)	D E T E R M I N A T I O N
	)	No. 00-148
. . .	)	Registration No. . . .
	)	Appeal of Letter Ruling

RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- CHAINSAWS -- TREE THINNING -- MANUFACTURING -- MANUFACTURING OPERATION. Sales of chainsaws to a taxpayer who performs only tree thinning and slashing in standing forests are not eligible for the manufacturing machinery and equipment exemption from retail sales tax. Where the use is not in cutting, delimbing, or measuring of felled, cut, or taken trees, and the taxpayer is not manufacturing articles for sale, the taxpayer is not a "manufacturer," nor is the use in a "manufacturing operation," for purposes of the exemption.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

A taxpayer engaged in the reforestation activities of tree thinning and slashing in standing forests protests a Department interpretation that purchases of chainsaws for those activities are not eligible for the manufacturing machinery and equipment (M&E) exemption from retail sales tax.[1]

FACTS:

Prusia, A.L.J. -- The taxpayer is a Washington corporation engaging in business as a reforestation contractor. The taxpayer performs tree thinning and slashing in standing forests. It purchases chainsaws and other equipment for performing those activities.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

On September 16, 1999, the taxpayer wrote the Department of Revenue ("Department") requesting information to help the taxpayer determine whether chainsaws it purchases and uses in its reforestation activities qualify as "manufacturing machinery and equipment" for purposes of the M&E exemption from sales tax provided in RCW 82.08.02565.

On October 25, 1999, the Department's Taxpayer Information and Education (TI&E) Section replied to the taxpayer's request as follows, in pertinent part:

> Your corporation is a reforestation contractor that performs tree thinning and slashing. You would like information to help you determine whether the chainsaws you purchase qualify as manufacturing equipment.
>
> Businesses engaged in manufacturing activities are not required to pay sales or use tax on machinery and equipment used directly by a manufacturer or processor for hire in a manufacturing operation. A processor for hire performs activities similar to a manufacturer but on materials owned by another. The 1999 Legislature passed a bill that amended the definition of "to manufacture" to include cutting, delimbing, and measuring of felled, cut, or taken trees.
>
> To be considered a manufacturer or a processor for hire, these services must be performed on trees <u>after</u> the trees have been felled. Tree thinning and slashing activities do not fall within the definition of "to manufacture." Therefore, the chainsaws you purchase do not qualify for the exemption.

The taxpayer appealed the instruction. In the appeal letter, the taxpayer stated its understanding that tree thinning is considered part of the manufacturing process. It stated it "knows of logging Companies who are receiving the sales tax exemption for chainsaws they are using to 'fell' trees." Finally, it stated that the Department told another company, which it names, that the other company is exempt from paying sales tax, and that company performs exactly the same function as the taxpayer. The taxpayer is concerned the Department is discriminating against it.

At hearing, we asked the taxpayer's representative whether the chainsaws are used for any purpose other than thinning and slashing for disposal, and whether any of the thinned trees are sold. The representative did not have the information. We gave the representative additional time to obtain and provide information in that regard, but received no additional information.

ISSUE:

Do sales of chainsaws that are used in tree thinning and slashing in a reforestation operation qualify for the M&E exemption?

DISCUSSION:

All sales of tangible personal property to consumers in the state of Washington are subject to retail sales tax, unless there is a specific exception or exemption. RCW 82.08.020 and 82.04.050.

RCW 82.08.02565, as amended in 1999,[2] provides a sales tax exemption for "sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation." RCW 82.12.02565 provides a similar exemption from the use tax.[3] This exemption, like all tax exemptions in Washington, is strictly construed in favor of application of the tax and against the person claiming the exemption. *Yakima Fruit Growers Ass'n v. Henneford*, 187 Wash. 252, 258, 60 P.2d 62 (1936); *All-State Constr. Co. v. Gordon*, 70 Wn.2d 657, 425 P.2d 16 (1967). However, the policy of strict construction of exemption provisions does not mean they will be read so narrowly that the legislative purpose and intent in enacting the provisions are undermined. *Cherry v. Metro Seattle*, 116 Wn.2d 794, 808 P.2d 746 (1991).

The Department rule explaining the M&E exemption is found at WAC 458-20-13601 (Rule 13601).

There are several required elements for the M&E exemption: (1) a sale; (2) to a manufacturer or processor for hire; (3) of machinery and equipment; (4) used directly; (5) in a manufacturing operation. RCW 82.08.02565 defines the terms "machinery and equipment," "used directly," and "manufacturing operation" for purposes of the exemption. The Department has interpreted the term "manufacturer" as used in the M&E exemption statute as having the same meaning as provided in chapter 82.04 RCW, and "manufacturing" as used in the M&E exemption statutes as having "the same meaning as 'to manufacture' in chapter 82.04 RCW." Rule 13601(3)(e) and (f).

There is no dispute that the first required element, a sale, is present in this case. We find that the third element, "machinery and equipment," also is met. RCW 82.08.02565 defines "machinery and equipment" as including "devices." Rule 13601 defines "device" as including chainsaws.

TI&E concluded that the taxpayer's purchases of chainsaws are not eligible because the taxpayer did not fit the definition of a "manufacturer" or "processor for hire."

RCW 82.04.110 defines the term "manufacturer" 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

[2] The original M&E exemption statute was effective July 1, 1995. In May 1999, the 56th Legislature passed and the governor signed Engrossed Substitute House Bill 1887, which amended RCW 82.04.120, RCW 82.08.02565, and RCW 82.12.02565. The act revised the M&E exemption by more precisely describing terminology and eligibility. The 1999 legislation was a clarification of the existing law, and is retroactive to the date of the original 1995 M&E exemption.

[3] The use tax, which is not at issue in this appeal, applies upon the use within Washington of any tangible personal property the sale or acquisition of which has not been subjected to the Washington retail sales tax. It complements the retail sales tax by imposing a tax of like amount. WAC 458-20-178 (Rule 178); RCW 82.12.020; RCW 82.12.0252.

> his or her own materials or ingredients any articles, substances or commodities. (Emphasis added.)

The term "processor for hire" means a person who performs labor and mechanical services upon property belonging to others, who would be a "manufacturer" if they performed the labor and services upon their own materials. WAC 458-20-136(3) (Rule 136(3)).

RCW 82.04.120 provides that the term "to manufacture":

> embraces 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**: . . . (3) **cutting, delimbing, and measuring of felled, cut, or taken trees**; . . . (Emphasis added.)[4]

Based upon the information the taxpayer provided, TI&E was correct in concluding that the taxpayer's activity does not fall within the definition of "to manufacture" because the chainsaws the taxpayer purchases are not used to perform services on trees after the trees are felled.
The taxpayer's use of the chainsaws it purchases also does not fit the definition of "to manufacture" because the taxpayer is not producing an article "for sale or commercial or industrial use." Based upon the information the taxpayer has provided, we find the taxpayer is not producing anything for sale or for any further use.[5] It is merely performing the service of thinning and slashing in a standing forest. Thus, the taxpayer is not engaged in "manufacturing" for purposes of the M&E exemption, and the purchases are not eligible for the M&E exemption.

RCW 82.08.02565's definition of "manufacturing operation" also contains a manufacturing-for-sale requirement. Subsection (2)(d) states as follows, in pertinent part: "'Manufacturing operation' means the manufacturing of articles, substances, or commodities **for sale as tangible personal property**." We find that the taxpayer is not using the chain saws it purchases in a "manufacturing operation," and on that basis also conclude the purchases are not eligible for the M&E exemption.

In sum, the taxpayer's purchases of chainsaws are not eligible for the M&E exemption because the taxpayer's use of the chainsaws is not shown to be subsequent to the falling, cutting, or taking of trees in a manufacturing operation.

Regarding the taxpayer's statement that it knows of logging companies that are receiving the sales tax exemption for chainsaws they are using to "fell" trees, we note that it is possible some

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[4] WAC 458-20-136 (Rule 136) further explains the application of the B&O tax, sales tax, and use tax to manufacturers and processors for hire.

[5] The term "commercial or industrial use" is defined in WAC 458-20-134 (Rule 134). It means the use, by the extractor or manufacturer of a product, as a consumer or in manufacturing articles, substances, or commodities. An example would be the use of lumber by a manufacturer to build a shed for its own use.

logging companies' saw purchases do qualify for the exemption. In a logging operation, chainsaws may be used both in falling trees and in the cutting, delimbing, and measuring of felled, cut, or taken trees. The Department has long held that machinery and equipment may qualify for the M&E exemption if the majority of the use, as measured by percentage of time, percentage of revenue, volume of products derived, or other reasonable measure, is in a "manufacturing operation." The Legislature has acquiesced in this interpretation and practice.[6] The majority use requirement is set out in Rule 13601(10).

Regarding the taxpayer's contention that the Department has given different advice to another taxpayer whose situation the taxpayer believes is exactly the same as the taxpayer's, we note we may not discuss another taxpayer's return or information with the taxpayer. We also note that the advice the Department gives a particular taxpayer depends upon the particular facts and circumstances presented to the Department, as well as the statutes, rules, and interpretations current at the time the advice is given.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of interpretation is denied.

Dated this 31st day of July, 2000.

[6] In the 1999 revision of RCW 82.08.02565, the Legislature, as well as the Governor, considered whether a "majority use" test must be met for machinery and equipment to qualify for the exemption. After the legislation was introduced as House Bill 1887, the Department advised the House Finance Committee it applied a majority use test to determine whether dual use machinery and equipment qualified for the exemption. *See* Audit Practice Document submitted as part of Director Fred Kiga's testimony before the House Finance Committee on March 4, 1999. Aware the Department applied a majority use test, under the existing language in RCW 82.08.02565, the House did not alter the relevant language. Following passage by the House of Representatives, the sponsors in the Senate discussed the majority use test. *See* Floor Colloquy between Senators Loveland and Snyder, ESHB 1887, read at 3:01 PM April 16, 1999. One Senator inquired regarding the absence in the bill of the dual use standard regarding qualifying and nonqualifying use. Another Senator explained:

> It is not necessary. The current administrative practice of DOR is "majority use," which means over 50 percent based on time, value, volume, or other measurement for comparison, is reasonable. It is within the administrative authority of the department to use this standard, both for the past and in the future. It is therefore appropriate for the department to put this standard in rule.

Again, the bill passed without changes to the applicable language. *See also* Governor Locke's partial veto message.