

Cite as Det. No. 01-007, 20 WTD 214 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 01-007
)	
...)	Registration No. . . .
)	Docket No. . . .
)	FY. . . /Audit No. . . .

- [1] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION. RCW 82.08.02565, the manufacturing machinery and equipment (“M&E”) exemption, intends an exemption for specific classes of property and is to be . . . construed in favor of taxation. 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.

- [2] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- SUPPORT FACILITY. While the words “support” and “facility” each have a variety of meanings, in RCW 82.08.02565(2)(a) and WAC 458-20-13601(3)(m) they reference appurtenances to industrial fixtures or devices, specially designed or suited, and necessary, for holding the fixture or device in position.

- [3] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- SUPPORT FACILITY -- “CONTAIN” AN INDUSTRIAL FIXTURE OR DEVICE. Merely providing a room or other enclosure that houses machinery or equipment is not sufficient to qualify the enclosure or its components as “support facilities” for purposes of the M&E exemption.

- [4] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- INDUSTRIAL FIXTURE -- INTERIOR ENCLOSURES. Interior enclosures that . . . primarily perform wall/ceiling functions, generally are not “industrial fixtures” for purposes of the M&E exemption.

- [5] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- USED DIRECTLY -- INSULATED WALL PANELS. Insulated wall panels that make a building’s refrigeration system more efficient and help keep out airborne contaminants, but that are entirely passive structures, do not “control or regulate”

tangible personal property for purposes of the “used directly” requirement of the M&E exemption. Nor do they “act upon or interact” with an item of tangible personal property for purposes of the requirement.

- [6] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- USED DIRECTLY -- REFRIGERATION EQUIPMENT. Equipment that emits refrigerated air to maintain frozen food in a frozen state “acts upon or interacts with” the frozen food for purposes of the “used directly” requirement of the M&E exemption.

- [7] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- ELECTRICAL UTILITY SYSTEM. RCW 82.08.02565(2)(b)(iv)’s exclusion of electrical utility systems from the definition of “machinery and equipment” for purposes of the M&E exemption, excludes a manufacturing building’s electrical utility system, not some theoretical bare warehouse’s electrical system.

- [8] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- USED DIRECTLY -- ELECTRICAL SYSTEM. The provision in RCW 82.08.02565(3) stating that machinery and equipment is “used directly” in a manufacturing operation if it produces power for machinery and equipment does not encompass transformers and other electrical devices that regulate, switch, or transport the current.

- [9] RULE 13601; RCW 82.08.02565: SALES TAX -- M&E EXEMPTION -- USED DIRECTLY -- ELECTRICAL SYSTEM. Electrical substation equipment that controls the voltage of electricity flowing in the building’s electrical system, and therefore reaching machinery and equipment, does not thereby “control and regulate” the machinery and equipment for purposes of the “used directly” requirement of the M&E 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:

Manufacturer of frozen vegetables appeals disallowance of the manufacturing machinery and equipment (M&E) exemption from the retail sales tax, for portions of construction contracts and equipment installations relating to: special insulated panels used to form interior enclosed spaces; automatic overhead doors and other specialized doors; refrigeration system; electrical substations and transformers; boiler room and a sprinkler room; testing labs; and docks.¹

BACKGROUND:

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

Prusia, A.L.J. -- The taxpayer is a Washington corporation engaged in the business of freezing and packaging vegetables. It has plants at [Washington locations], as well as cold storage facilities in [Washington]. It also has out-of-state plants.

The Audit Division of the Department of Revenue (Department) examined the taxpayer's books and records for the period January 1, 1995 through December 31, 1998. The Audit Division found additional taxes owing, and on December 9, 1999, issued the above assessment in the amount of \$. . . tax plus statutory interest of \$. . . . The taxpayer paid the assessment, and at the same time requested partial refund of the payment, in the amount of \$. . . taxes plus related interest.

The taxpayer disputes portions of Schedules 14A, 15, 15A, and 16 of the assessment, which assessed use tax or deferred sales tax on portions of construction contracts and equipment purchases on which the taxpayer had not paid retail sales tax. In assessing the additional tax, the Audit Division disallowed the taxpayer's claim that those items were exempt from sales tax under RCW 82.08.02565. That statute, commonly referred to as the "M&E exemption," exempts certain sales, to manufacturers and processors, of machinery and equipment used directly in a manufacturing operation. The taxpayer argues all the disallowed portions of the construction contracts qualify for the M&E exemption. It further contends it is owed a refund of retail sales tax it paid on electrical portions of a construction contract during the audit period.

The disputed items are the following:

- 1) . . . insulated wall and ceiling panels at the [A] plant (\$. . . tax).
- 2) . . . insulated wall and ceiling panels at the [B] plant (\$. . . tax).
- 3) Automatic overhead doors, man doors, partition doors, and insulated truck doors at the [A] plant (\$. . . tax).
- 4) Portion of the refrigeration equipment installed for refrigerating the Cold Room at the [A] plant (\$. . . tax).
- 5) Portion of the electrical system installed at the [A] plant
- 6) Metal studs and other items related to construction of the boiler room and the sprinkler room in the [A] plant (\$. . . tax).
- 7) Insulated ceiling and walls, metal studs, stainless steel countertops, and shelves for books and lab equipment in the bulk laboratories installed in the [A] Plant and the [B] Plant, and equipping docks at the [A] Plant (\$. . . tax).

The disputed items are described in greater detail below, along with the Audit Division's reasons for denying the M&E exemption, and the taxpayer's arguments in support of the exemption.

ISSUE:

Are the insulated wall and ceiling panels, the doors, the refrigeration components that serve the [A] Cold Room, the electrical system components, the boiler room and sprinkler room metal studs, etc., and the laboratory and dock items, referenced above, machinery and equipment used directly in a manufacturing operation for purposes of the M&E exemption?

RELEVANT STATUTES AND RULES

All sales of tangible personal property to consumers in the state of Washington, including successive retail sales of the same property, are subject to retail sales tax, unless there is a specific exemption. RCW 82.08.020 and 82.04.050. In general, the use tax 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.

For excise tax purposes, the term "retail sale" includes the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the constructing, repairing, decorating, or improving of new or existing buildings or other structures on real property of or for consumers. RCW 82.04.050(2)(b). Thus, prime contractors are required to collect from consumers the retail sales tax measured by the full contract price. WAC 458-20-170 (Rule 170).

RCW 82.08.02565, effective July 1, 1995, 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.

The M&E exemption, like all tax exemptions in Washington, is strictly construed in favor of application of the tax and against the person claiming the exemption. The burden of proof is upon the one claiming the exemption. *Yakima Fruit Growers Ass'n v. Henneford*, 187 Wash. 252, 258, 60 P.2d 62 (1936); *All-State Construction Co. v. Gordon*, 70 Wn.2d 657, 425 P.2d 16 (1967); *Budget Rent-A-Car, Inc. v. Dept. of Revenue*, 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972). 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).

RCW 82.08.02565, as amended in 1999,² provides, in pertinent part:

² 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. . . . [Sections 2 and 3 of the] 1999 legislation [were] a clarification of the existing law, and [retroactive. Sections 5 and 6 of the 1999 legislation were prospective and extended the tax exemption

(1) The tax levied by RCW 82.08.020 shall not apply to sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation or research and development operation, [to sales to a person engaged in testing for a manufacturer or processor for hire of machinery and equipment used directly in a testing operation,] or to sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving the machinery and equipment . . .

(2) For purposes of this section and RCW 82.12.02565:

(a) "Machinery and equipment" means industrial fixtures, devices, and support facilities, and tangible personal property that becomes an ingredient or component thereof, including repair parts and replacement parts. "Machinery and equipment" includes pollution control equipment installed and used in a manufacturing operation[, testing operation,] or research and development operation to prevent air pollution, water pollution, or contamination that might otherwise result from the manufacturing operation[, testing operation,] or research and development operation.

(b) "Machinery and equipment" does not include:

- (i) Hand-powered tools;
- (ii) Property with a useful life of less than one year;
- (iii) Buildings, other than machinery and equipment that is permanently affixed to or becomes a physical part of a building; and
- (iv) Building fixtures that are not integral to the manufacturing operation[, testing operation,] or research and development operation that are permanently affixed to and become a physical part of a building, such as utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical.

(c) Machinery and equipment is "used directly" in a manufacturing operation[, testing operation,] or research and development operation if the machinery and equipment:

- (i) Acts upon or interacts with an item of tangible personal property;
- (ii) Conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site [or testing site];
- (iii) Controls, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site;
- (iv) Provides physical support for or access to tangible personal property;
- (v) Produces power for, or lubricates machinery and equipment;
- (vi) Produces another item of tangible personal property for use in the manufacturing operation[, testing operation,] or research and development operation;
- (vii) Places tangible personal property in the container, package, or wrapping in which the tangible personal property is normally sold or transported; or
- (viii) Is integral to research and development as defined in RCW 82.63.010.

(d) "Manufacturing operation" means the manufacturing of articles, substances, or commodities for sale as tangible personal property. A manufacturing operation begins at the point where the raw materials enter the manufacturing site and ends at the point where the processed material leaves the manufacturing site. The term also includes that portion of a cogeneration project

In May 1999, the Department adopted an emergency rule, WAC 458-20-13601 (Emergency Rule 13601) to explain the M&E exemption. It adopted a final Rule 13601 effective June 17, 2000. Portions of Rule 13601 that are relevant to this appeal are the following:

(3) **Definitions.** For purposes of the manufacturing machinery and equipment tax exemption the following definitions will apply:

. . .

(b) "Device" means an item that is not attached to the building or site. Examples of devices are: Forklifts, chainsaws, air compressors, clamps, free standing shelving, software, ladders, wheelbarrows, and pulleys.

(c) "Industrial fixture" means an item attached to the building or to land. Fixtures become part of the real estate to which they are attached and upon attachment are classified as real property, not personal property. Examples of "industrial fixtures" are fuel oil lines, boilers, craneways, and certain concrete slabs.

. . .

(g) "Manufacturing operation" means the manufacturing of articles, substances, or commodities for sale as tangible personal property. A manufacturing operation begins at the point where the raw materials enter the manufacturing site and ends at the point where the processed material leaves the manufacturing site. The operation includes storage of raw materials at the site, the storage of in-process materials at the site, and the storage of the processed material at the site. The manufacturing operation is defined in terms of a process occurring at a location. To be eligible as a qualifying use of M&E, the use must take place within the manufacturing operation, unless specifically excepted by law. Storage of raw material or other tangible personal property, packaging of tangible personal property, and other activities that potentially qualify under the "used directly" criteria, and that do not constitute manufacturing in and of themselves, are not within the scope of the exemption unless they take place at a manufacturing site. The statute specifically allows testing to occur away from the site.

. . .

(m) [k in the emergency rule] "Support facility" means a part of a building, or a structure or improvement, used to contain or steady an industrial fixture or device. A

support facility must be specially designed and necessary for the proper functioning of the industrial fixture or device and must perform a function beyond being a building or a structure or an improvement. It must have a function relative to an industrial fixture or a device. To determine if some portion of a building is a support facility, the parts of the building are examined. For example, a highly specialized structure, like a vibration reduction slab under a microchip clean room, is a support facility. Without the slab, the delicate instruments in the clean room would not function properly. The ceiling and walls of the clean room are not support facilities if they only serve to define the space and do not have a function relative to an industrial fixture or a device.

...

7) **What is not eligible for the exemption.** In addition to items that are not eligible because they do not meet the used directly test or fail to overcome the majority use threshold, there are four categories of items that are statutorily excluded from eligibility. The following property is not eligible for the M&E exemption:

(a) Hand-powered tools. Screw drivers, hammers, clamps, tape measures, and wrenches are examples of hand-powered tools. Electric powered, including cordless tools, are not hand-powered tools, nor are calipers, plugs used in measuring, or calculators.

(b) Property with a useful life of less than one year. All eligible machinery and equipment must satisfy the useful life criteria, including repair parts and replacement parts. . . .

(c) Buildings, other than machinery and equipment that is permanently affixed to or becomes a physical part of a building. Buildings provide work space for people or shelter machinery and equipment or tangible personal property. The building itself is not eligible, however some of its components might be eligible for the exemption. The industrial fixtures and support facilities that become affixed to or part of the building might be eligible. The subsequent real property status of industrial fixtures and support facilities does not affect eligibility for the exemption.

(d) Building fixtures that are not integral to the manufacturing operation, testing operation, or research and development operation that are permanently affixed to and become a physical part of a building, such as utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical. Examples of nonqualifying fixtures are: Fire sprinklers, building electrical systems, or washroom fixtures. Fixtures that are integral to the manufacturing operation might be eligible, depending on whether the item meets the other requirements for eligibility, such as the used directly test.

...

(9) **The "used directly" criteria.** Items that are not used directly in a qualifying operation are not eligible for the exemption. The statute provides eight descriptions of the phrase "used directly." The manner in which a person uses an item of machinery and equipment must match one of these descriptions. If M&E is not "used directly" it is not

eligible for the exemption. Examples of items that are not used directly in a qualifying operation are cafeteria furniture, safety equipment not part of qualifying M&E, packaging materials, shipping materials, or administrative equipment. Machinery and equipment is "used directly" in a manufacturing operation, testing operation, or research and development operation, if the machinery and equipment meets any one of the following criteria:

(a) Acts upon or interacts with an item of tangible personal property. Examples of this are drill presses, concrete mixers (agitators), ready-mix concrete trucks, hot steel rolling machines, rock crushers, and band saws. Also included is machinery and equipment used to repair, maintain, or install tangible personal property. Computers qualify under this criteria if:

(i) They direct or control machinery or equipment that acts upon or interacts with tangible personal property; or

(ii) If they act upon or interact with an item of tangible personal property.

(b) Conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site or the testing site. Examples of this are wheelbarrows, handcarts, storage racks, forklifts, tanks, vats, robotic arms, piping, and concrete storage pads. Floor space in buildings does not qualify under this criteria. Not eligible under this criteria are items that are used to ship the product or in which the product is packaged, as well as materials used to brace or support an item during transport.

(c) Controls, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site. Examples of "away from the site" are road testing of trucks, air testing of planes, or water testing of boats, with the machinery and equipment used off site in the testing eligible under this criteria. Machinery and equipment used to take readings or measurements is eligible under this criteria.

(d) Provides physical support for or access to tangible personal property. Examples of this are catwalks adjacent to production equipment, scaffolding around tanks, braces under vats, and ladders near controls. Machinery and equipment used for access to the building or to provide a work space for people or a space for tangible personal property or machinery and equipment, such as stairways or doors, is not eligible under this criteria.

(e) Produces power for or lubricates machinery and equipment. A generator providing power to a sander is an example of machinery and equipment that produces power for machinery and equipment. An electrical generating plant that provides power for a building is not eligible under this criteria. Lubricating devices, such as hoses, oil guns, pumps, and meters, whether or not attached to machinery and equipment, are eligible under this criteria.

(f) Produces another item of tangible personal property for use in the manufacturing operation, testing operation, or research and development operation. Machinery and equipment that makes dies, jigs, or molds, and printers that produce camera-ready images are examples of this.

(g) Places tangible personal property in the container, package, or wrapping in which the tangible personal property is normally sold or transported.

(h) Is integral to research and development as defined in RCW 82.63.010.

Rule 13601(10) sets out a threshold majority use requirement for machinery and equipment that is both used directly in a qualifying operation and used in a nonqualifying manner. Generally, machinery and equipment may qualify for the M&E exemption only if the majority of the use, as measured by percentage of time, percentage of revenue, volume of products derived, or other reasonable comparison measure, is in a “manufacturing operation.”

DESCRIPTION OF DISPUTED ITEMS;
AUDIT DIVISION’S RATIONALE; TAXPAYER’S ARGUMENTS:

The disputed portions of the construction contracts, the Audit Division’s rationale in disallowing the M&E exemption, and the taxpayer’s arguments, are as follows.

1) . . . insulated wall and ceiling panels at the [A] plant.

Facts: In 1996-97, the taxpayer rebuilt its [A] plant The new plant is a large building within which are a number of separate, specialized rooms or enclosures for processing, handling, storing, and packing peas and other vegetables.

Several of the rooms were constructed as enclosed “boxes within a box.” They have walls separate from the outer building walls and separate ceilings. The walls and ceilings are composed of . . . insulated panels. The taxpayer constructed the enclosures inside its building for two reasons. First, enclosing the initial processing area, where the vegetables are blanched (scalded) and then fed into tunnels to be flash frozen, helps to minimize the serious danger of contamination with the pathogen *Listeria Monocytogenes*.³ Using . . . panels also furthers this purpose because they have a surface that is easy to keep clean.

Second, it is necessary that the air be kept refrigerated and dry in the processing area and in all rooms where the vegetables are handled or stored after flash freezing. The initial processing area is kept at 45° because that aids in flash freezing, which is the second step in processing. After flash freezing, the vegetables must be stored in rooms that are dry and maintained at 15° or below, and handled in rooms that are dry and kept at 45° or below, to prevent deterioration of the

³ The first step in processing is blanching -- scalding the vegetables briefly before flash freezing them. Blanching is done in the [A] plant’s processing area, which is one of the . . . panel enclosures. Blanching is necessary to kill pathogenic bacteria, particularly *Listeria Monocytogenes*, which poses a major food safety problem in the food processing industry. The *Listeria* bacterium comes from the soil and can be carried by dust in the air. After blanching, there is a risk the vegetables can become re-contaminated with *Listeria* from dust in the air. To minimize or eliminate the risk of re-contamination, it is necessary that the processing area be enclosed. The taxpayer provided a considerable body of material that establishes *Listeria monocytogenes* has become a serious problem in food processing plants, and poses substantial health risks. The pathogen kills approximately 20 percent of the people it infects, with pregnant women, newborns, and the elderly at highest risk. The materials include an article on President Clinton’s *Listeria* initiative, in the May 2000’s *Food Safety Issues*, U.S. Food and Drug Administration regulations, and information published by the Washington Department of Agriculture.

product. Once frozen, the vegetables must be kept frozen. Enclosing the areas enables the Taxpayer to maintain the required temperatures.

The enclosed, insulated areas at the [A] plant are the initial processing room (where the vegetables are blanched and taken to the freezing tunnels), the bulk packaging room (where the product leaving the tunnels is lab-tested and put in totes for transportation to cold storage), cold storage rooms, and a repacking room (where vegetables that have been in totes in cold storage are bagged, before being returned to cold storage to await shipment).

The Audit Division allowed the M&E exemption for insulated panels the taxpayer used to insulate the frozen storage section of the plant. It disallowed the exemption for insulated panels used for enclosures around the processing and packaging lines.⁴

Audit Division's Rationale for Disallowing Exemption for Panels. In disallowing the M&E exemption for insulated wall and ceiling panels at the [A] plant (other than those used for the cold storage room), the Audit Division concluded the panels do not qualify as "support facilities" under the statute and rule. The Auditor's Detail of Differences and Instructions (audit report) accompanying the assessment explained the disallowance as follows:

We do not believe these items qualify as support facilities. While they are a part of the building, they do not appear to have been specially designed and necessary for the proper functioning of an industrial fixture or device. Nor do they appear to contain or steady an industrial fixture in any way other than that of a normal building. . . . Plastic FRP wall insulation panels help keep packaging and processing rooms at or near certain temperatures. It is also much easier to keep clean and sterile than concrete. It does not, however, appear to have any special function relative to a piece of manufacturing equipment or fixture.

Taxpayer's Arguments With Respect to Panels. The taxpayer contends the insulated panels are industrial fixtures integral to the manufacturing process, meet Rule 13601's definition of "support facility," and meet the rule's "directly used" criteria (9)(a),(c), and (e).

The taxpayer argues it is obvious the panels are not used as part of the building itself. They were not installed to provide workspace for people, or shelter for machinery and equipment. Instead, they create a "box inside the box," where temperature-sensitive manufacturing operations can be performed. Maintaining refrigerated temperatures is essential to prevent the product from deteriorating. It argues the panels fit subsection 3(m)'s definition of "support facility," in that the enclosed rooms are used to contain equipment and fixtures integral to manufacturing, and the panels are necessary for the proper functioning of the equipment and fixtures, which require a controlled atmosphere.

⁴ See footnote 6.

Regarding the three “used directly” criteria, the taxpayer argues the panels meet “used directly” criterion (9)(c), in that they are equipment used to “control” and “regulate” tangible personal property at the manufacturing site. They control and regulate the temperature of the product. Another way they “control” and “regulate” is that they keep the products free of contaminants such as *Listeria*. This is a critical part of the taxpayer’s manufacturing process. The . . . panels not only provide a physical barrier to the flow of outside air, they are specifically designed to be easy to clean.

The taxpayer argues the panels meet “used directly” criterion (9)(a), in that they “act upon or interact with” the frozen foods, to keep them frozen.

It argues the panels appear to meet “used directly” criterion (9)(e), in that they are very similar to an air compressor or generator providing power to machinery and equipment, which are exempt under subsection (9)(e).

2) . . . panels at the [B] plant.

Facts. During the audit period, the taxpayer rebuilt its bulk packaging room at [B]. To increase the size of the bulk packaging room, it was necessary to extend the room into the existing cold storage room. The taxpayer used . . . panels to insulate common walls between the two rooms in order to control the separate room temperatures. Both the bulk packaging room and the cold storage room temporarily store the frozen product, and both rooms required controlled atmospheric conditions, with temperatures appropriate to each room’s particular function.

Audit Division’s Rationale for Disallowing Exemption for [B] Panels. The Audit Division disallowed the M&E exemption for insulated wall and ceiling panels at the [B] plant for the same reason it disallowed the exemption for panels at the [A] plant – the panels do not qualify as “support facilities” under the statute and rule.

Taxpayer’s Arguments. The taxpayer argues the panels fit subsection 3(m)’s definition of “support facility,” in that both rooms are used to contain equipment and fixtures integral to manufacturing, and the panels are necessary for the proper functioning of the equipment and fixtures, which require a controlled atmosphere.

It argues the panels meet “used directly” criterion (9)(b), in that the two rooms at the [B] plant qualify as “temporarily storing” the frozen product.

It argues the (9)(a) “used directly” criterion also is met, in that both rooms act upon or interact with an item of tangible personal property, and the insulation between the rooms is necessary to control the atmospheric difference.

3) Doors at the [A] plant.

Facts. In rebuilding the [A] plant, the taxpayer installed overhead doors on its processing, handling, and storage enclosures. The doors rise and close automatically for forklifts. Having the doors open and close automatically aids in maintaining control of the temperature, humidity, and sanitation in the processing rooms. The automatic doors between the freezer unit and the loading dock are particularly critical to maintaining the necessary temperature. If the doors remained open, the handling area would quickly become too warm, and the frozen foods would thaw while they were being loaded. The taxpayer also installed doors in interior partitions, man doors, and insulated truck doors in the loading area.

Audit Division's Rationale for Disallowing Exemption for Doors. The Audit Division disallowed the M&E exemption for doors for the same reason it disallowed the exemption for the insulated wall and ceiling panels used in the [A] construction -- they do not qualify as industrial "support facilities" under the statute and rule. The audit report explained the disallowance as follows:

While [the doors] are a part of the building, they do not appear to have been specially designed and necessary for the proper functioning of an industrial fixture or device. Nor do they appear to contain or steady an industrial fixture or device in any way other than that of a normal building [O]verhead doors that rise automatically for forklifts may be convenient but, they are not specially designed for that forklift. Overhead doors are found on many buildings that are of a non-manufacturing nature. Your man doors help provide a positive pressure seal which helps decrease bacteria. This does not, however, appear to be necessary for any given fixture or device.

Taxpayer's Arguments With Respect to Doors. The taxpayer argues: "These doors are clearly "building fixtures or support facilities that are integral to manufacturing" as discussed previously under insulated wall and ceiling panels." It argues they are essential to maintaining the controlled manufacturing environment. The taxpayer references Rule 13601's subsection (3)(m) (the "support facility" definition), and subsection (7)(c) (which clarifies that buildings are not eligible, but machinery and equipment permanently affixed to or part of the building might be eligible).

The taxpayer argues the automatic, insulated doors meet "used directly" criterion (9)(c), in that they "control" and "regulate" the temperature of the rooms and the frozen foods that pass through them.

4) Portion of the refrigeration equipment installed for refrigerating the Cold Room at the [A] plant.

Facts. In rebuilding the [A] plant, the taxpayer installed refrigeration equipment for refrigerating the air in all areas of the plant where refrigerated air is required. On its books, it allocated portions of the system to the particular rooms those portions serve. It placed the portion used for the Cold Room on its books as "Heating and Ventilation of the Cold Room." The equipment is used to maintain a constant temperature of 45 degrees in the cold room.

Audit Division's Rationale for Disallowing Exemption for Refrigeration Equipment. The audit report did not state the basis for disallowing the M&E exemption for this portion of the refrigeration equipment.

Taxpayer's Arguments. The taxpayer states it erroneously placed this item on its books as Heating and Ventilation. It concedes heating and ventilation equipment would not qualify for the exemption. It contends the items should have been classified as Cold Room Refrigeration Equipment, and as such qualify.

The taxpayer argues the refrigeration equipment meets "used directly" criterion (9)(b), in that it temporarily stores an item of tangible personal property at the manufacturing site. It argues the Cold Room refrigeration equipment meets this criterion in that the Cold Room equipment, fixtures, and environment are built to provide the steady, quick movement of frozen product from the bulk state to the packaged goods state, so the temperature does not go above 15 degrees before the product is returned to cold storage.

The taxpayer argues the refrigeration equipment meets "used directly" criterion (9)(a), in that the controlled room atmosphere "acts upon or interacts with an item of tangible personal property," in this case frozen vegetables.

The taxpayer argues that subsection (3)(g) of Rule 13601 [numbered (3)(e) in the emergency rule] provides a definition of "manufacturing operation" that suggests the storage of in-process materials at the site falls within the definition. It argues: "the equipment that creates the controlled atmosphere in this room is of the same type, which is qualified as exempt equipment controlling the air and interacting with the product in the main storage room."

5) Portion of the electrical system installed at the [A] plant.

Facts. In rebuilding the [A] plant, the taxpayer installed two electrical substations with separate transformers and various control panels. The taxpayer paid retail sales tax on the portion of the system it considered to be a basic electrical system of the building. It calculated the basic building requirements called for a 500 KVA transformer. Because of the equipment operation demands of its manufacturing operation, the taxpayer had to install two separate sub-stations with two separate sets of switch gear, including two 2500 KVA transformers and two 3700 KVA transformers with additional switch gear. The panels run about ten times as much power as would be required if the building were used only as a warehouse. The total electrical system cost was in excess of \$. . . , and the taxpayer paid retail sales tax on approximately \$. . . of the contracts.

The taxpayer submitted a statement by the project manager on the electrical construction, which states the basic electrical work required for a basic . . . square foot warehouse building would cost \$. . . , broken down as follows: main distribution switchboard and sub panels, \$. . . ; transformers, \$. . . ; lighting, \$. . . ; branch circuit wiring, \$. . . , light fixture installation, \$. . . ,

main service to building, \$. . .; direct supervision, \$. . ., and overhead and profit, \$. . . . On appeal, the taxpayer seeks the M&E exemption for all electrical costs in excess of \$. . . . It requests a refund of \$. . . sales tax paid on the electrical system.

The Audit Division allowed the M&E exemption for the motor control center portion of the electrical system, but otherwise disallowed the claimed exemption.

Audit Division's Rationale for Disallowing Exemption for Electrical System. The Audit Division disallowed the M&E exemption for building electrical systems, other than the motor control center and its wiring, for the following reason, as stated in the audit report:

[Rule 13601]⁵ indicates that electrical systems do not qualify for the M&E exemption. It is the Department of Revenue's position that your electrical system up through your switchgear (breakers) is taxable.

Taxpayer's Arguments With Respect to Electrical. The taxpayer contends the Audit Division interpreted paragraph (9)(e) of the rule too narrowly in stating that electrical systems do not qualify for the M&E exemption. It argues that Rule 13601 specifically recognizes that special purpose electrical equipment qualifies for the M&E exemption if it is integral to the manufacturing operation and meets each of the regular requirements for eligibility, such as the "used directly" test and the majority use threshold. It contends its equipment meets each of the requirements necessary to qualify for the M&E exemption. Specifically, the taxpayer argues:

- RCW 82.08.02565 makes a clear distinction between electrical equipment that is simply a part of an ordinary building's electrical utility system, and other electrical equipment that produces power for manufacturing machinery and equipment. Subsection (2)(a) states qualifying "machinery and equipment" includes industrial fixtures. See also Rule 13601's definition of "industrial fixture." Both the statute and rule recognize that machinery and equipment permanently attached to the building may qualify for the M&E exemption. Indeed, the statute presumes industrial fixtures will qualify unless they fall within one of the narrow exclusions in subsection (2)(b) of the statute.
- The Audit Division misunderstood the exclusions in subsection (2)(b) of the statute. Under (2)(b)(iii), buildings are excluded from the M&E exemption. But the statute is careful to distinguish between the actual building, i.e., the structural members, and "machinery and equipment that is permanently affixed to or becomes a physical part of the building." Obviously, that phrase refers to industrial fixtures. Thus, subsection (2)(b)(iii) says that industrial fixtures that are permanently affixed to or become a physical part of a building can still qualify for the exemption.

⁵ The audit report referenced the emergency rule. We note the permanent rule has the same provision ((9)(e)).

The statute's subsection (2)(b)(iv) states that "building fixtures that are not integral to the manufacturing operation" do not qualify for the M&E exemption, and explains that certain "utility systems for . . . electrical" that are "a physical part of the building" are part of this exclusion. The Audit Division apparently based its decision on the reference to utility systems. But the Audit Division overlooked the subsection's caveat that it is only "building fixtures that are not integral to the manufacturing operation" that are excluded. Through the careful use of the word "not," subsection (2)(b)(iv) stands for the proposition that building fixtures that are integral to the manufacturing operation do qualify for the M&E exemption.

- Distinguishing between "building fixtures that are integral to the manufacturing operation" (which qualify for the M&E exemption) and "building utility systems," including "building electrical systems" (which do not qualify), is easy when one understands the history of the M&E exemption statute.

Prior to the M&E exemption, the state already had an incentive program for economically distressed counties, found in Chapter 82.60 RCW. That program allowed a business that made a significant new investment to defer the payment of sales and use taxes on the entire investment in buildings, machinery, and equipment. In 1995, Chapter 82.60 was amended to turn the deferrals into a permanent exemption for the entire investment project. At the same time, the M&E exemption was enacted. It was intended to grant a lesser incentive in other areas of the state, covering only "industrial fixtures, devices and support facilities" that are "integral to the manufacturing operation."

In discussions with industry representative after enactment of the M&E exemption, and during the Rule 13601 rulemaking process, Department representatives consistently took the position that only the normal, 110 volt electrical systems built into every building do not qualify for the M&E exemption, and high voltage or high ampere electrical systems specifically designed to produce power for industrial machinery and equipment would qualify as "industrial fixtures" and be eligible for the M&E exemption.⁶

- Paragraph (7) of the rule, which distinguishes between what is eligible and what is not, also clearly recognizes that electrical equipment can qualify if it meets each of the statute's normal exemption requirements.

⁶ Specifically, the taxpayer alleges that immediately after enactment of the M&E exemption, a Department representative explained, in a meeting of members of the tax bar, that the distinction between the distressed area exemption and the M&E exemption was that a typical building and the normal utility systems contained in a typical building, including the typical 110 volt electrical system, were only tax exempt in distressed counties. The representative said that high voltage or high ampere electrical systems specifically designed to produce power for industrial machinery and equipment would qualify as "industrial fixtures" and be eligible for the M&E exemption.

The taxpayer's representative participated on a task force that worked with the Department in developing Rule 13601. The representative recalls that in task force discussions, Department representatives agreed with the aforementioned assessment: atypical, high-voltage or high-amperage electrical systems designed specifically to produce power for the manufacturing equipment within a building would qualify for the M&E exemption. The representative's understanding is that it has always been the Department's position that only the normal, 110 volt electrical systems built into every building do not qualify for the M&E exemption because they are properly considered to be a normal part of a building and are not integral to a particular manufacturing operation.

Specifically, paragraph (7)(c) recognizes that, although buildings are not eligible for the exemption, industrial fixtures that become affixed to or a part of the building can still qualify. Similarly, paragraph (7)(d) recognizes the distinction between normal building utility systems that do not qualify and “building fixtures that are integral to the manufacturing operation” and do qualify. Paragraph (7)(d) emphasizes that building fixtures that are integral to the manufacturing operation will be eligible if they meet each of the regular requirements for eligibility. It is especially important to note that paragraph (7)(d) refers to “building electrical systems” as being non-qualifying fixtures, thereby emphasizing that electrical systems that are not a part of the regular building are not excluded.

To be excluded, paragraph (7)(d) says a building fixture must (1) not be integral to the manufacturing operation and (2) be a physical part of the building. Because the conjunctive term “and” is used, both requirements must be met before an item is excluded.

- The taxpayer’s electrical system meets each of the requirements necessary to qualify for the M&E exemption. Specifically, the equipment qualifies as “industrial fixtures” because it is attached to the building. Rule 13601(3)(c) & (7)(c). It was purchased by a manufacturer (13601(3)(e)), is used in a “manufacturing operation” (13601(3)(g)), and is used in a “manufacturing site” (13601(3)(l)). The equipment is not hand-powered (13601(7)(a)). Each item has a useful life of a year or more (13601(7)(b)), and is capitalized on the taxpayer’s books for federal income tax purposes and accounting purposes (13601(8)).
- The electrical equipment is “used directly,” in that it “produces power for” machinery and equipment. RCW 82.08.02565(2)(c); Rule 13601(9)(c). An ordinary dictionary meaning of “produce” is “to extend in length.” Webster’s Ninth New Collegiate Dictionary, p. 938 (1984). The taxpayer’s electrical system “produces” power by extending the length of that power, from its point of origin to its connection with the other manufacturing equipment and machinery that is powered by this electricity.

The electrical equipment also meets “used directly” criterion (9)(a), in that it acts upon or interacts with other items of tangible personal property (i.e., the machinery it produces power for). It also meets “used directly” criterion (9)(c), in that it “controls” and “regulates” other items of tangible personal property – it controls the amount of electrical energy supplied to the machinery, and thereby controls and regulates the machinery’s normal operation.

- The electrical equipment meets the “majority use threshold” set out in Rule 13601(10). As demonstrated by the contractor’s written statement, 90% of the volume of electricity controlled by this equipment is used to operate the taxpayer’s manufacturing equipment.

6) Metal studs, etc., for the boiler room and sprinkler room in the [A] plant. The taxpayer’s petition disputed the disallowance of the M&E exemption for “metal studs etc.” for boiler

room/sprinkler room. The taxpayer has not elaborated on what items it disputes. Audit Schedule 15-A disallowed sprinkler valve room and boiler room items that it labels as follows: Man Doors; Metal Stud/GWB/Finish.”

The petition states the following basis for the appeal: “Same explanation as above for doors.” It did not present any additional argument during the appeal.

7) Insulated ceiling and walls, gaskets, metal studs, stainless steel countertops, and shelving for books and lab equipment in the bulk labs; Dock equipment.

Facts. In rebuilding the [A] plant, and in rebuilding the bulk packaging room at the [B] plant, the taxpayer built bulk labs inside its bulk packaging rooms, to test the product after it comes out of flash freezing. The Audit Division disallowed the M&E exemption for construction related to the labs, including walls, ceilings, metal studs, doors, gaskets, and custom lab counters. Audit Schedule 14-A highlights non-construction related lab safety equipment that also is disputed.

The petition does not state what dock equipment is the subject of the appeal. Disallowed dock equipment referenced in Schedule 15A is: “Dock Pit Assy w/Cone; Man Doors; Metal Stair; and Overhead Doors.”

Audit Division’s Rationale for Disallowing Exemption. The audit report stated the following reason for disallowing the M&E exemption for laboratory countertops and equipment:

Basically, they consist of safety equipment, lab counters and cabinets and, storage shelves for books and tools. WAC 458-20-13601, attached, specifically lists most safety equipment as non-qualifying. We feel that the lab counters are simply building fixtures that are not integral to the manufacturing process. Nor are they support facilities. They are not specifically designed and necessary for the proper functioning of an industrial fixture or device. The same reasoning applies to the tool shelving and bookshelves.

Taxpayer’s Arguments. The taxpayer argues that the whole purpose of the labs is to test product, the government requires testing, and therefore the labs and their equipment and interior fixtures are “used directly” in the manufacturing process.

The taxpayer did not specifically address dock equipment.

DISCUSSION

Several of the items for which the taxpayer claims the M&E exemption require that we determine where the line is between buildings and “building fixtures that are not integral to the manufacturing operation,” on the one hand, and industrial fixtures, devices, and support facilities that are eligible for the M&E exemption, on the other. They also require that we determine whether the M&E statute is a general exemption for manufacturing plant and equipment, with a

few narrow exceptions, or an exemption for specific classes of property that is to be narrowly construed.

We address the second question first. We must be mindful of several long-accepted general rules of statutory construction. Taxation is the rule; exemption is the exception. *Spokane County v. City of Spokane*, 169 Wash. 355, 13 P.2d 1084 (1932). Exemptions from a taxing statute are to be narrowly construed. *Budget Rent-A-Car, Inc. v. Dept. of Revenue*, 81 Wn.2d 171, 500 P.2d 764 (1972), *Dept. of Revenue*, 89 Wn.2d 660, 574 P.2d 735 (1978). Exemptions are not to be extended by judicial construction. *Pacific Northwest Conference of the Free Methodist Church v. Barlow*, 77 Wn.2d 487, 463 P.2d 626 (1969). Courts and administrative bodies will not read into an act provisions they conceive the legislative body has unintentionally omitted. *Dept. of Labor & Industries v. Cook*, 44 Wn.2d 671, 269 P.2d 962 (1954).

[1] We must assume the Legislature was aware of these general principles when it drafted the M&E statute. The statute does not state broadly that manufacturing plant and equipment is exempt from sales and use tax, with a few exceptions. If that [were] the intent, the Legislature certainly could have phrased the statute that way. Instead, the M&E statute limits the exemption to “machinery and equipment” that is “used directly” in a “manufacturing operation.” It defines those terms, and does so in considerable detail. Applying general rules of statutory construction, we read the statute as intending an exemption for specific classes of property that is to be narrowly construed in favor of taxation.

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. The first, second, and fifth elements are not in dispute with respect to any of the items for which the taxpayer seeks the exemption. At issue are whether the items are “machinery and equipment,” and whether the items are “used directly” in the manufacturing operation.

Insulated wall and ceiling panels used for interior enclosures

The statute and rule restrict M&E eligibility to items that fit one of three categories of “machinery and equipment.” The items must be “industrial fixtures, devices, [or] support facilities.” The statute expressly excludes from the definition of “machinery and equipment” buildings, “other than machinery and equipment that is permanently affixed to or becomes a physical part of a building.” Do the taxpayer’s panels fit any of the three categories of “machinery and equipment, and are they “building” that is excluded from the definition?

Clearly the panels are not “devices.” A “device” is “an item that is not attached to the building or site.” Rule 13601(3)(b). The taxpayer’s panels form enclosures that are attached to the building’s floor and/or exterior walls. Whether the panels are eligible “industrial fixtures” or “support facilities” is a more difficult question.

[2], [3] Rule 13601 defines a “support facility” as a part of a building, or a structure or improvement (on the land), “used to contain or steady an industrial fixture or device.” The

taxpayer argues the panels in question are “support facilities,” because the panels form an enclosure that, in the language of the rule, is “used to contain . . . an industrial fixture or device.” In its broadest sense, “contain” can mean “having within.” *See*, Webster’s Third New International Dictionary, page 491 (1993). However, in this instance the word “contain” is used to reference a category of “support facility.” While the words “support” and “facility” each have a variety of meanings, in the context of the rule we believe they reference appurtenances to industrial fixtures or devices, specially designed or suited, and necessary, for holding the fixture or device in position. The panels do not have such a relationship to any industrial fixture or device in the plant. To call a room that houses machinery a “support facility” would require an extremely broad interpretation, which we do not believe is warranted by the language of the statute or the rule.

Rule 13601(3)(c) defines “industrial fixture” as “an item attached to the building or the land,” and then restates the common law definition of “fixture.”⁷ The taxpayer’s interior enclosures, for which it seeks to exempt the construction components, are attached to the floor and/or outer walls of the building. They are items “attached to” parts of the building. Are they therefore “industrial fixtures”? We do not believe attachment alone is determinative. The statutory exclusion of “buildings” requires that we determine whether these “items attached” are fixtures attached to the building, or simply parts of the building attached to other parts.⁸

Buildings, after all, are constructed of various items attached to one another. Building materials are attached together to form floors, walls, roofs, ceilings, and other structural parts. The floor, walls, and roof are attached to one another. Buildings commonly have interior walls and partitions. They often have suspended or false ceilings. Where is the line between a “building,” which is excluded from the definition of “machinery and equipment,” and an “item attached to the building” that is included?

Neither the statute nor the rule directly addresses this question. In answering it, we believe it is appropriate to consider whether the taxpayer’s enclosures primarily perform wall/ceiling functions, and whether the taxpayer’s enclosures can be distinguished from alternative construction that clearly would not qualify.

[4] The taxpayer has established that it did not build the enclosures to define working areas or provide shelter. It has established that it must minimize outside contamination, and that, in its buildings, the panels are necessary to achieve that purpose. It has established that it must maintain certain temperatures in certain processing and storage areas, and that, in its buildings, the panels are necessary to achieve that purpose. However, we believe those are functions

⁷ *Black’s Law Dictionary* 574 (5th Ed. 1979) defines a fixture as: “An article in the nature of personal property which has been so annexed to the realty that it is regarded as a part of the land.” It gives as examples: “a furnace affixed to a house or other building; counters permanently affixed to the floor of a store; a sprinkler system installed in a building.”

⁸ We note that at common law, a building erected on land, unless it is a “trade fixture” brought upon the land by a tenant, is itself considered a fixture. *See* Am. Jur. 2d “Fixtures” §§ 78, 3 and 89. RCW 82.08.02565, however, expressly excludes the “building” to which qualifying machinery and equipment is affixed.

ordinarily performed by walls and ceilings. Maintaining a controlled environment is a common requirement in manufacturing plants, and walls, ceilings, insulation, and/or special coverings are common methods of controlling the interior environment. Moreover, we find it impossible to meaningfully distinguish the taxpayer's structures from construction that clearly would not be considered "industrial fixtures."

Suppose the taxpayer had built its building with extra thick or heavily insulated exterior walls and with controlled entrance areas. It could have achieved its purposes, but the walls and insulation would not be considered "industrial fixtures." They would be considered building materials. What if the taxpayer had achieved its controlled atmosphere requirements by constructing a number of adjoining buildings, in each of which a separate function was performed, and each of which had exterior walls with a thickness, insulation, and coverings, appropriate to the activity to which the building was dedicated? The walls, insulation, and wall coverings of the various buildings would not be "industrial fixtures." . . . Even if the panels were, by some stretch of the imagination, found to be "industrial fixtures" or "support facilities," they nonetheless would not qualify for the M&E exemption, because they fit none of the "used directly" requirements of the statute. We will address the specific descriptions the taxpayer claims the panels meet.

[5] The taxpayer argues the panels meet "used directly" criterion (9)(c), that they "control and regulate" the product by maintaining it at a certain temperature, and "control and regulate" the product by helping keep it free of contaminants. This argument would require an extremely broad interpretation of the statute and rule. The panels are passive structures. They are not like refrigeration equipment and air filtration equipment that actively regulate the air. They are not parts of such equipment. We conclude that the taxpayer's reading of criterion (9)(c) is broader than the statute or rule allows, and the panels do not meet the criterion.

The taxpayer argues the panels meet "directly used" criterion (9)(a), that they "act upon or interact with" the frozen foods, to keep them frozen. This argument also requires an extremely broad interpretation not warranted by the language of the statute and rule. The panels are passive structures. They do not act upon or interact with anything. The panels are not anything like the examples in the rule -- drill presses, concrete mixers, rock crushers, etc. Those are items that directly act upon or interact with the product.

Finally, the taxpayer argues that the panels appear to meet "used directly" criterion (9)(e), in that they are very similar to an air compressor or generator providing power to machinery and equipment, which are exempt under that criterion per the rule. We believe the panels clearly do not meet the criterion. They neither produce power nor lubricate.

The taxpayer does not argue the panels meet any other "used directly" criterion, nor does it appear to us that they meet any. Because the panels are not "used directly" in a manufacturing

operation, they do not qualify for the M&E exemption. The petition must be denied with respect to the wall and ceiling panels used in constructing interior enclosed areas in the two plants.⁹

Automatic doors and insulated doors

Doors are generally considered part of the building. RCW 82.08.02565(2)(b)(iii) states: “‘Machinery and equipment’ does not include . . . [b]uildings, other than machinery and equipment that is permanently affixed to or becomes a physical part of a building.” Thus, the question before us is whether the particular doors for which the taxpayer requests the M&E exemption are “buildings” or “machinery and equipment,” as defined by the statute and rule. To be “machinery and equipment,” they must be “industrial fixtures, devices, [or] support facilities.”

The taxpayer argues the doors are “support facilities,” for the same reason the insulated panels are “support facilities.” For the same reasons that we concluded the panels are not “support facilities,” we conclude the doors are not “support facilities.”

The taxpayer argues the doors are potentially qualifying “industrial fixtures,” because they are essential to maintaining the controlled manufacturing environment. As with the insulated panels, we do not disagree that the doors are essential to maintaining the necessary controlled environment, but find they are building components rather than machinery and equipment affixed to the buildings. Doors are commonly installed in manufacturing buildings to keep out cold, heat, rain, dust, etc. We do not believe that a manufacturer’s need for doors that close faster, or seal tighter, than run-of-the-mill doors, transforms the doors into fixtures.

Moreover, as with the panels, we find the doors do not meet the statute’s “used directly” requirement. They do not fall within any of the eight descriptions of “used directly.” The taxpayer argues the doors meet “used directly” criterion (9)(c), advancing the same argument it made with respect to the panels -- they “control” and “regulate” the temperature of the rooms, and thereby the temperature of the product that passes through the rooms, and help keep out bacteria. For the same reasons we concluded the panels do not meet criterion (9)(c), we conclude the doors do not. The doors are passive structures.

Portion of the refrigeration equipment at the [A] plant

The Audit Division has not contradicted the taxpayer’s statement that the disallowed equipment for the Cold Room was incorrectly labeled HVAC equipment on its books, and actually is refrigeration equipment. The taxpayer manufactures food products by freezing them. Its refrigeration equipment is integral to the manufacturing operation, and not merely a utility

⁹ The audit report does not explain why the Audit Division allowed the exemption for insulated wall panels used in frozen storage areas. We question whether those panels would meet any “used directly” test. However, that issue is not before us, and we do not decide it. In the future, the taxpayer should request a ruling from the Department with respect to the potential eligibility of any insulated wall panels.

system. It is not expressly excluded from the definition of “machinery and equipment” by RCW 82.08.02565(2)(b)(iv) and Rule 13601(7)(d).

Is the refrigeration equipment “machinery and equipment,” as defined by the statute or rule? To be such, it must be “industrial fixtures, devices, [or] support facilities.” We find it meets the definition of “industrial fixture.” It is an item attached to the building. It is not a utility air conditioning system.

Does the refrigeration equipment meet a “used directly” criterion? The taxpayer argues it meets criterion (9)(b) -- that it temporarily stores an item of tangible personal property at the site. We disagree. The argument seems to be that the frozen food is stored in the room, and proper storage requires that the air be refrigerated, and the equipment refrigerates the air, therefore the equipment “stores” the food. We believe the “temporarily stores” provision intends a more direct relationship, and intends physical storage, like the examples specifically listed in the rule – vats, tanks, piping, etc.

The taxpayer argues that the rule’s subsection (3)(g) provides a definition of “manufacturing operation” that suggests the storage of in-process materials at the site is within the “manufacturing machinery and equipment” definition. We do not disagree with that interpretation of the subsection. However, we have found that the refrigeration equipment does not “store” the in-process materials. Subsection (3)(g) does not help the taxpayer’s argument.

The taxpayer argues the refrigeration equipment meets “used directly” criterion (9)(a), that the controlled atmosphere the equipment creates, “acts upon or interacts with” an item of tangible personal property. We agree that the refrigeration equipment falls within criterion (9)(a), but our analysis differs from the taxpayer’s.

[6] We find the refrigeration equipment directly acts upon the product, using the medium of air. Sending out refrigerated air, specific gases, or liquids to contact items of tangible personal property is how refrigeration equipment works. In the taxpayer’s case, air is the medium the equipment uses to act upon the product. It “acts upon” the product in the same sense that equipment that uses a Bernoulli wand to move items acts upon tangible personal property,¹⁰ or machinery that superheats specific gases to chemically react with a product “acts upon” the product.

Accordingly, the taxpayer’s petition is granted with respect to the [A] Plant’s Cold Room refrigeration equipment.

¹⁰ A Bernoulli wand sends currents of air or specific gases around an object, and the air or gas wand carries the object, without anything other than the air currents touching the object. See, e.g., http://nucleus.stanford.edu/~djconnel/research/Ge_graded_epi/equipment/

Portion of the electrical system at the [A] plant

The M&E statute expressly excludes from the definition of “machinery and equipment” building fixtures “that are not integral to the manufacturing operation . . . such as utility systems for . . . electrical.” Rule 13601(7)(d), after repeating the statutory language, states: “Examples of nonqualifying fixtures are . . . building electrical systems.”

Both the statute and the rule leave room for interpretation. Does the statute intend to exclude only portions of the electrical system that are not “integral” to the manufacturing? That interpretation would expand the exemption to most of the utility system, other than parts that serve only offices, rest rooms, etc. Even a manufacturing building’s basic wiring would be “integral” to the manufacturing operation, under that interpretation.¹¹ Or, does the exclusion intend that we entirely exclude utility systems from the exemption? The use of the words “such as” suggests the latter interpretation is the more likely intent.

[7] We must keep in mind that the statute and the rule reference utility systems in the context of manufacturing. Most buildings used for manufacturing will have utility systems that are more complex than those found in a basic warehouse. It would seem to follow that the statutory direction to exclude from the exemption electrical utility systems would require us to exclude the manufacturing building’s electrical system, not some theoretical bare warehouse’s electrical system. To be consistent with general rules of statutory construction, we believe the better reading of the statute is that the electrical system of a manufacturing building is not eligible for the M&E exemption, unless it falls within a specific provision.

We do not read Rule 13601 as providing otherwise. The taxpayer’s recollection of statements and conversations made by Department personnel prior to, or during, rulemaking may or may not be accurate. Alternative interpretations commonly are put forward during rulemaking, for discussion purposes. In the end, the adopted rule governs.

[8] Subsection (2)(c)(v) of the M&E statute (and subsection (9)(e) of the rule) is a specific provision making certain electrical equipment eligible for the M&E exemption. That subsection provides that machinery and equipment is “used directly” in a manufacturing operation if it “produces power for” machinery and equipment. Rule 13601(9)(e) clarifies that “[a] generator providing power to a sander is an example of machinery and equipment that produces power for machinery and equipment,” but “[a]n electrical generating plant that provides power for a building is not eligible under this criteria.” Those provisions relate only to machinery and equipment that produces power. Thus, they would not encompass transformers and other electrical devices that only regulate, transport, or switch the current. None of the electrical machinery and equipment for which the taxpayer seeks the M&E exemption is power-generating machinery or equipment. We conclude, therefore, that none of it falls within RCW 82.08.02565(2)(c)(v).

¹¹ The term “integral” is not defined. Its most common meanings are “essential to completeness” and “organically joined or linked.” See, Webster’s Third New International Dictionary, page 1173 (1993).

We also note that Rule 13601(9)(e) distinguishes between generators that provide power only to specific manufacturing machinery and equipment, and electrical machinery and equipment that provides power for the building. Thus, the provision would not cover power-generating equipment that is necessary because of the high power needs of an operation, but contributes to the overall need rather than providing power only to specific manufacturing machinery and equipment.

[9] The other “used directly” criteria the taxpayer cites are (9)(a) (“acts upon”) and (9)(c) (“controls” or “regulates”). We cannot see how substation transformers and switches, or building wiring, that simply regulate, route, or carry the electric current through the building, could qualify under either criterion. They act upon or interact with the electric current, not with any item of tangible personal property.¹² As for controlling or regulating, the wiring is passive, and the substation transformers and switches do not direct or control specific machinery or equipment.¹³ We disagree with the taxpayer’s interpretation that any device that controls the voltage of electricity flowing in the building’s electrical system, and therefore reaching machinery and equipment, “controls and regulates” the machinery and equipment. The relationship is too indirect. The taxpayer’s expansive reading would make the statute’s exclusion of building utility systems virtually meaningless.

In sum, we conclude that the Audit Division correctly denied the M&E exemption for the [A] electrical equipment that is the subject of this appeal. We also conclude the portions of the construction contract that are the subject of the request for refund are not eligible.

Metal studs, etc. for boiler room and sprinkler valve room at [A]

The taxpayer did not describe items in this appeal category, or state a basis for allowing the M&E exemption for them, other than reference to its argument with respect to doors. We note it argued the doors were not part of the building per se, and therefore could be considered “support facilities,” and the doors helped “control” and “regulate” the product.

We have no factual basis for determining whether any items the taxpayer had in mind under this heading are eligible for the M&E exemption, and therefore deny this portion of the petition.

Labs/metal studs/dock equipment, at [A] and [B]

The taxpayer’s argument with respect to the lab wall and ceiling panels, studs, counters, and shelves refers us to its argument with respect to the insulated doors, and adds that the whole purpose of a lab is to test product. We note it argued the doors were not part of the building per

¹² For excise tax purposes, electricity is not tangible personal property in Washington. See Department of Revenue’s report to the Legislature, “Study of Electricity Taxation,” December 1, 1999, Chapter 2.

¹³ Controls that control or regulate specific machinery or equipment, such as controls that govern its speed, or direct its movement, are properly viewed as part of the specific machinery or equipment and not part of the building’s electrical system.

se, and therefore could be considered “support facilities,” and the doors helped “control” and “regulate” the product.

The labs are insulated boxes inside refrigerated boxes. The taxpayer has provided no facts that would indicate the walls, ceilings, and studs have any purpose other than a building function -- to separate the lab work area from the rest of the space, and allow the lab personnel to work in a warmer area. We do not find they meet the definition of “industrial fixture.” They do not fit the definition of “support facility,” in that they are not used to contain or steady an industrial fixture of device. Based upon the limited facts presented, we conclude the lab structures do not fall within the definition of “machinery and equipment.”

We agree with the Audit Division that countertops and shelves for books and lab tools are not “support facilities.” They are not specially designed and necessary for the proper functioning of an industrial fixture, device, or equipment.

The countertops do fit the definition of “industrial fixture.” However, they do not meet any “used directly” criterion. While they provide temporary physical support for products during testing, their purpose is not support but rather to provide a working surface for lab personnel. They do not test the product, but rather are where the product is tested.

Safety equipment that is not part of otherwise qualifying machinery and equipment is not considered “used directly” in a qualifying operation, and therefore is not eligible for the exemption. Rule 13601(9). The taxpayer has not provided facts or argument supporting its exemption claim for lab safety equipment.

In sum, the taxpayer has not shown any of the disallowed lab components and items meet the requirements for the M&E exemption. Accordingly, the appeal is denied with respect to lab portions of construction contracts and lab equipment.

We have no factual basis for determining whether any disallowed dock items are eligible for the M&E exemption. The taxpayer did not describe the dock items or identify how its arguments relate to them. Therefore, we deny the petition with respect to dock items.

DECISION AND DISPOSITION:

The taxpayer’s petition is granted with respect to the [A] Cold Room refrigeration equipment, but otherwise denied. The file is remanded to the Audit Division for refund consistent with this Determination.

Dated this 30th day of January, 2001.