Cite as Det. No. 04-0143, 23 WTD 364 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Letter Ruling of	)	D E T E R M I N A T I O N
	)	No. 04-0143
. . .	)	Registration No. . . .
	)	Appeal of Taxpayer Information & Education Letter Dated September 15, 2003
	)	Docket No. . . .

[1] RULE 13601; RCW 82.08.02565; ETA 2012-6S: RETAIL SALES TAX – MANUFACTURING MACHINERY AND EQUIPMENT EXEMPTION; TESTING EQUIPMENT. Testing equipment was not used directly within a manufacturing operation where the testing occurred after the goods were manufactured and related only to the shipment and sale of the goods after manufacture.

[2] RULE 13601; RCW 82.08.02565; ETA 2012-6S: RETAIL SALES TAX – MANUFACTURING MACHINERY AND EQUIPMENT EXEMPTION; TESTING OPERATION. A "testing operation" is defined as the testing of tangible personal property for a manufacturer or processor for hire. A manufacturer's offsite testing facility was not a "testing operation" because it did not perform third party testing for manufacturers.

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:

Chartoff, A.L.J. – Taxpayer, a manufacturer of . . . agricultural products, protests a Taxpayer Information and Education (TI&E) letter ruling that held only testing equipment at Taxpayer's ship-loading and testing facility in . . . , Washington, qualifies for the machinery and equipment exemption to the retail sales tax (exemption). While the appeal was pending, TI&E changed its position and argued that none of the facility qualifies for the exemption because the taxpayer did not use the equipment within the scope of a manufacturing operation. The taxpayer contends that qualifying testing equipment need not be located at the manufacturing site. We conclude

that while testing equipment may be located off-site, it nevertheless must be used within a manufacturing operation to qualify for the exemption. Accordingly, the taxpayer's purchase of the Washington facility does not qualify for the exemption and the taxpayer's petition is denied.[1]

ISSUES:

1. Is the taxpayer's ship loading and testing facility used directly in a "manufacturing operation"?

2. Is the taxpayer's ship loading and testing facility a "testing site" for purposes of RCW 82.08.02565(c)(ii)?

FINDINGS OF FACT:

. . . (taxpayer) is a . . . processor [of agricultural products] with manufacturing plants in . . . mid-western states. The taxpayer manufactures [agricultural products] for sale. In order to facilitate sales to Asia, the taxpayer constructed a direct rail-to-ship loading and testing facility . . . in . . . Washington.

The taxpayer describes the facility as follows. Manufactured products, . . . , arrive by rail car.[2] The product is dumped from the rail car directly onto a conveying system. The conveyers transport the product into the scale tower, where it is introduced into the testing equipment. The product is tested for weight, water content, and quality, following which it is conveyed directly to the . . . Terminal . . . and on board the ship. The facility provides for a continuous loading and testing operation from rail car to on board the vessel.

In the taxpayer's petition to the Appeals Division (Appeals) of the Department of Revenue (Department), the taxpayer described its testing activities as follows:

> The testing performed at the . . . facility is to determine the properties, qualities, and any limitations of the [agricultural products]. The [agricultural product] is tested for protein, fiber and fat content, moisture levels, foreign materials and particle sizing. Based upon this testing, adjustments can be made at our processing plants to increase or decrease desired levels of product properties.

In a supplemental letter to Appeals, dated April 5, 2004, the taxpayer provided the following additional information regarding the testing:

> The testing occurs after the completion of the processing operation in the Midwest because [Washington location] is the point of origin for export in accordance with USDA

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] The manufactured product is either manufactured by the taxpayer at facilities outside the state, or purchased from third parties.

> Standards . . . . The testing is required to determine the properties . . . agricultural products that are exported.
>
> …
>
> Processed agricultural products differ from most other manufactured products in that their characteristics can change in relatively short periods of time. Specifically, changes in moisture content and contamination can take place during shipment by railcars.
> The testing at [Washington location] is not only to assure quality standards for our customers but also results in adjustments to pricing of the product sold based upon the characteristics of the product.
>
> …
>
> The fact is [taxpayer] does test the [agricultural products] at its processing plants in the Midwest. However, the [agricultural products] transloaded at the [Washington location] facility normally comes from various processing plants and contains various levels of protein, moisture, and fiber. Therefore, sample testing is used in order to get average levels of those characteristics for each shipload.

The taxpayer constructed the facility from November 2002 through November 2003. In July 2003, the taxpayer wrote to TI&E for a letter ruling that the facility qualified for the manufacturing and equipment exemption from retail sales tax. On September 15, 2003, TI&E ruled that only the testing equipment qualified for the M&E exemption because the ship loading and testing facility was outside the manufacturing operation. The taxpayer filed this appeal contending the entire facility should qualify for the exemption because the testing function is an integral part of the facility. While under appeal, TI&E determined that it erred when it ruled that the testing equipment qualifies for the exemption, and argued that no part of the facility qualifies. TI&E argued that in order to qualify for the exemption, the testing must take place while the goods are still being manufactured. The taxpayer disagrees.

ANALYSIS:

RCW 82.08.02565 provides an exemption from the retail sales tax for sales to manufacturers or processors for hire of machinery and equipment used directly in a manufacturing operation.

A manufacturing operation is defined in RCW 82.08.02565(d), which provides, in part:

> "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.

WAC 458-20-13601(3)(g) (Rule 13601) further defines "manufacturing operation" and provides, in part:

> 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.

Excise Tax Advisory 2012-6S.08.12.13601 (ETA 2012-6S) defines "site" as "one or more immediately adjacent parcels of real property." In other words, the manufacturing site is the physical location where the manufacturing operation takes place.

In the present case, the taxpayer manufactures [agricultural products] in manufacturing plants located outside Washington. The manufacturing operation begins at the point where the [agricultural products] enter the manufacturing site and ends at the point the [agricultural products] leaves the manufacturing site. The taxpayer therefore engages in manufacturing operations at these out of state plants.

The taxpayer does not argue that any manufacturing takes place at the Washington facility. Instead, the taxpayer argues that the statute specifically allows testing activities to occur away from the manufacturing site. Under the statute, machinery and equipment must be "used directly" in a manufacturing operation in order to be eligible for the exemption. There are eight "used directly" tests. The third "used directly" test provides that equipment is "used directly" in a manufacturing operation if it: "Controls, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site." RCW 82.08.02565(2)(c)(iii) (Emphasis ours). The taxpayer contends that the testing equipment may therefore qualify for the exemption even though it is located away from the manufacturing site.

We agree that testing equipment need not be located at the manufacturing site to qualify for the exemption. However, the testing activity, wherever located, must be performed within the scope of the manufacturing operation in order to qualify. ETA 2012-6S explains:

> If an activity comes under the "used directly" test of "[c]ontrols, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site" then no part of the activity need take place at the site. The activity described above, meaning the controlling or guiding, and so forth of tangible personal property, must be performed within the scope of the "manufacturing operation." The "manufacturing operation" begins with raw materials and ends with processed material. Therefore, an activity outside of this operation, such as design, does not qualify. See ETA 2012-5S for a discussion of design.

(Emphasis ours). In the present case, the taxpayer's testing activity is not performed within the scope of a manufacturing operation. Instead, the testing takes place long after the manufacturing is complete. The taxpayer concedes that it initially tests the product at the manufacturing site. The finished product is then loaded onto train cars and shipped to the taxpayer's Washington facility. The Washington facility tests the finished product for changes in the product during shipping, including changes in water content and contamination. The testing is also used to determine the average quality of the product, which comes from several sources, and to set a sales price. We conclude that this testing relates to shipment and sale of the goods after manufacture, and therefore, does not take place within a manufacturing operation. Accordingly, the testing equipment does not qualify for the exemption.

The taxpayer further argues that the conveying equipment and tower at the Washington facility qualify under the second "used directly" test. The second "used directly" test states that equipment is "used directly" in a manufacturing operation if it: "Conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site or testing site." RCW 82.08.02565(2)(c)(ii) (Emphasis ours). The taxpayer contends that its Washington facility is a "testing site" because the testing operation is integral to the ship loading operation.

A testing site is the physical location in which a testing operation takes place. A "testing operation" is defined in RCW 82.08.02565(2)(h), which provides, in part:

> "Testing operation" means the testing of tangible personal property for a manufacturer or processor for hire. A testing operation begins at the point where the tangible personal property enters the testing site and ends at the point where the tangible personal property leaves the testing site.

We do not agree that the taxpayer's offsite facility is a "testing site" under the statute. Rule 13601(3)(p) explains that a "testing operation" applies only to testing by third party testers. In the present case, the taxpayer does not have a testing operation because it does not perform third party testing for manufacturers. Therefore, the taxpayer's Washington facility is not a "testing site," as defined by statute. The taxpayer cannot satisfy the second "used directly" test because the equipment is not located at a manufacturing site or testing site.

DECISION AND DISPOSITION:

Taxpayer's petition for correction of TI&E's letter ruling is denied. The taxpayer's purchase of equipment at the Washington facility does not qualify for the machinery and equipment exemption from the retail sales tax.

Dated this 21st day of June 2004.