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BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition For Correction)	<u>D E T E R M I N A T I O N</u>
of Assessment of)	
)	No. 03-0261
)	
...)	Registration No. . . .
)	Document No. . . .
)	Audit No. . . .
)	Docket No. . . .

RULE 13601 -- B&O TAX -- EXEMPTION -- M&E -- REPLACEMENT PARTS -- USEFUL LIFE OF LESS THAN ONE YEAR -- RE-TIPPING OF SAW BLADES. The replacement of diamond tips on saw blade cores, when those tips had a useful life of only 4-6 weeks, are not exempt M&E, even though the tips are expensive and necessary to Taxpayer's operation.

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.

Taxpayer objects to use tax assessment on the installation of diamond bits that were periodically installed on saw blades used in manufacturing rock products. We hold that Taxpayer was not entitled to the manufacturing and equipment (M&E) use tax exemption.¹

ISSUE:

Was Taxpayer entitled to an M&E use tax exemption for diamond bits that it periodically replaced on saw blades utilized in its rock-cutting facility?

FINDINGS OF FACT:

Bauer, A.L.J -- The Audit Division (Audit) of the Department of Revenue (Department) audited the business records of . . . (Taxpayer) from January 1, 1998 through December 31, 2001 ("audit period"). As a result, the above-referenced assessment was issued on June 10, 2002 in the total

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

amount of \$. . . , which amount included interest up to the date of the assessment. Taxpayer timely appealed the assessment on July 9, 2002. The amount at issue is \$

During the audit period Taxpayer manufactured and sold natural rock products. Taxpayer's products were sold to retailers, builders, and/or consumers for landscaping or other construction projects. Most of the rock from which Taxpayer manufactured its various products came from local suppliers in very large blocks; some granite was imported from

Taxpayer's lead machine in producing its cut rock products was an automated travelling bridge saw that could be programmed to run up to 21 hours per day.² This saw was designed to cut very large rock blocks -- predominantly sandstone, but some granite -- into prescribed smaller pieces or slabs. The saw used one 9-foot blade that was approximately 1-inch thick. Taxpayer depreciated the metal body of the blades themselves, which were called cores. Each core had approximately 140 teeth that had to be diamond tipped to enable the blade to cut through rock. The cores were useless once their diamond tips wore out because, absent the diamond tips, cores were softer than the rock they were to cut. At issue is the use tax assessed on Taxpayer's periodic replacement of the diamond tips. The diamond tips were expensed.

During the audit period, a core could be used in the bridge saw for only four to six weeks before its diamond tips wore out. Because the cores had to be periodically re-tipped, Taxpayer kept four interchangeable cores on hand. Taxpayer periodically had a third party fly in from out of state to re-tip the cores that had been used. It cost Taxpayer about \$. . . to \$. . . to re-tip each core. The cores were also balanced at the same time.

Because Taxpayer's cores during the audit period had to be re-tipped after every 4-6 weeks of use, Audit denied the M&E exemption on Taxpayer's costs of re-tipping.

ANALYSIS:

Taxpayer concedes that its cores were, on average, re-tipped after 4-6 weeks during the audit period. Taxpayer, however, contends that it could have slowed production in order to make each core last for more than a year. Taxpayer argues that the re-tipping of the cores is a very significant expense, and should not be considered in the same light as the relatively inexpensive saw blade tips that improve the performance of saws that cut materials such as wood. Without re-tipping the cores, they would not have a life in excess of one year and the saw would not be able to perform its intended function.

RCW 82.08.02565 provides a retail sales tax exemption for certain categories of machinery and equipment purchased by manufacturers.³ WAC 458-20-13601 (Rule 13601) is the administrative rule that implements this exemption. The Department has also recently issued a number of Excise Tax Advisories (ETAs) to address areas for which taxpayers had requested

² There was possibly only one other such saw in the State of Washington.

³ RCW 82.12.02565 provides a corresponding use tax exemption.

additional guidance.⁴ None of these ETAs addressed the issue to be here decided, and they will not be further mentioned.

RCW 82.08.02565 provides, in pertinent part:

(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. . .

(b) “Machinery and equipment” does not include: . . .

(ii) Property with a useful life of less than one year; . . .

(Emphasis added.) Rule 13601(2) allows the exemption for repair parts, as follows:

(a) In 1996, the exemption was extended to include charges for repairing, cleaning, altering, or improving the machinery and equipment. The same act also revised the definition of “machinery and equipment” to include tangible personal property that becomes an ingredient or component of the machinery and equipment, including repair and replacement parts.

[Emphasis added] But such repair parts must still meet the useful life requirements under subsection 7:

(All eligible machinery and equipment must satisfy the useful life criteria, including repair parts and replacement parts. For example, items such as blades and bits are generally not eligible for the exemption because, while they may become component parts of eligible machinery and equipment, they generally have a useful life of less than one year. Blades generally having a useful life of one year or more, such as certain sawmill blades, are eligible. See subsection (8) of this rule for thresholds to determine useful life.

[Emphasis added] The identification of the useful life of machinery is further explained in subsection 8:

⁴ ETA 2012.08.1601 provides a listing of these ETAs:

Document	Subject matter
ETA 2012-1S	Rental of tangible personal property and rental of equipment with an operator
ETA 2012-2S	Pollution control equipment
ETA 2012-3S	Electrical apparatus and utility systems
ETA 2012-4S	Devices
ETA 2012-5S	Design and Product Development
ETA 2012-6S	Manufacturing site
ETA 2012-7S	Buildings, fixtures, and support facilities
ETA 2012-8S	Computers
ETA 2012-9S	Prototypes

(8) **The “useful life” threshold.** RCW 82.08.02565 has a per se exception for “property with a useful life of less than one year.” Property that meets this description is not eligible for the M&E exemption. The useful life threshold identifies items that do not qualify for the exemption, such as supplies, consumables, and other classes of items that are not expected or intended to last a year or more. . . . If it is clear from taxpayer records or practice that an item is used for at least one year, the item is eligible, regardless of the answers to the four threshold questions. . . . In order to substantiate qualification under any step, a taxpayer must maintain adequate records or be able to establish by demonstrating through practice or routine that the threshold is overcome. . . . Assuming the machinery and equipment meets all of the other M&E requirements and does not have a single one-time use or is not discarded during the first year, useful life can be determined by answering the following questions for an individual piece of machinery and equipment:

(a) Is the machinery and equipment capitalized for either federal tax purposes or accounting purposes?

- If the answer is “yes,” it qualifies for the exemption.
- If the answer is “no,”

(b) Is the machinery and equipment warranted by the manufacturer to last at least one year?

- If the answer is “yes,” it qualifies for the exemption.
- If the answer is “no,”

(c) Is the machinery and equipment normally replaced at intervals of one year or more, as established by industry or business practice? (This is commonly based on the actual experience of the person claiming the exemption.)

- If the answer is “yes,” it qualifies for the exemption.
- If the answer is “no,”

(d) Is the machinery and equipment expected at the time of purchase to last at least one year, as established by industry or business practice? (This is commonly based on the actual experience of the person claiming the exemption.)

- If the answer is “yes,” it qualifies for the exemption.
- If the answer is “no,” it does not qualify for the exemption.

The repair parts at issue do not meet these useful life requirements. Taxpayer concedes that its own records establish that the diamond bits on each of its cores had only a 4-6 week useful life once a saw blade was placed into service. The continuous use of the saw -- which resulted in the diamond bits’ short life span -- was necessary if Taxpayer’s business was to be profitable. The bits, unlike the cores, were not capitalized; they were not warranted to last for at least one year; they were normally replaced at intervals of less than a year; they were not expected at the time of installation to last for at least one year. The fact that these replacement parts are expensive and necessary to Taxpayer’s operation is not a factor under Rule 13601. Accordingly, we sustain the assessment.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 31st day of July 2003.