

Cite as Det. No. 18-0295, 40 WTD 028 (2021)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 18-0295
)	..
...)	Registration No. ...
)	

RCW 82.12.02565(1): RETAIL SALES/USE TAX – MACHINERY AND EQUIPMENT EXEMPTION – MAJORITY USE REQUIREMENT. A taxpayer must provide a comprehensive description, supported by adequate records, of all uses of the subject piece of machinery or equipment that shows it is used for a qualifying use greater than fifty percent of the time compared to overall use.

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.

Farquhar, T.R.O (successor to Simons, T.R.O.) – A logger protests the assessment of use tax on the purchase of a bulldozer used in its logging operations. The logger argues the bulldozer qualifies for the machinery and equipment (“M&E”) use tax exemption because it is “used directly” in a manufacturing operation by providing physical support for manufacturing equipment. However, the logger also uses the bulldozer for non-manufacturing purposes and we find that the logger failed to prove that the bulldozer meets the “majority use” requirement of the M&E exemption. Taxpayer’s petition is denied.¹

ISSUE

Whether a piece of equipment that is used for both manufacturing and non-manufacturing purposes qualifies for exemption from use tax as equipment “used directly” in a manufacturing operation under RCW 82.12.02565 and WAC 458-20-13601 (“Rule 13601”).

FINDINGS OF FACT

... (“Taxpayer”) is a Washington-based sole proprietorship engaged in the timber extraction industry. Taxpayer uses three pieces of heavy machinery that are relevant to the case at hand: a feller buncher, a yarder, and a bulldozer (“the Dozer”). The feller buncher is a large machine with a tree saw and grabbing arms that is used to cut standing trees and stack, or “bunch,” them together. The yarder is a system of cables and winches that drags logs from where they were cut down to a

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

collection area. The Dozer is an 850 John Deere Dozer. Taxpayer purchased the feller buncher in 2014 for \$. . . and later purchased the Dozer in 2016 for \$ Taxpayer did not pay retail sales tax on either purchase.

When logging on steep slopes, Taxpayer uses the Dozer to support other pieces of equipment. Taxpayer positions the Dozer at the top of the slope, then connects a cable from the Dozer to whichever piece of equipment Taxpayer is using. When Taxpayer is using the feller buncher, the cable support allows the feller buncher to move safely down the slope as it cuts and positions trees for further processing. Once the trees are on the ground, Taxpayer uses chainsaws to delimb the trees and cut them into shorter lengths. Taxpayer then uses the Dozer's cable to support the yarder while the yarder moves the logs to a loading area. The logs are then transported away from the logging site by truck. Taxpayer did not provide any information about what, if any, other tasks the Dozer is used for during the logging operation.

In 2017, the Department's Audit Division ("Audit") conducted an audit of Taxpayer's books for the period of January 1, 2013, through December 31, 2016. Audit found that Taxpayer had reported its income correctly, but that it had not properly reported use tax on the feller buncher and Dozer. Taxpayer told Audit that it used the Dozer fifty percent of the time to support the feller buncher and fifty percent of the time to support the yarder. Audit determined the feller buncher is used for extracting activities. Audit also determined that Taxpayer failed to show that it used the Dozer to support qualifying manufacturing equipment more than 50 percent of the time. As a result, Audit found that neither the feller buncher nor the Dozer qualified for the Machinery and Equipment use tax exemption ("M&E exemption") and assessed use tax on both purchases.

On May 9, 2017, Audit issued an assessment in the amount of \$ The assessment [comprises] \$. . . in use tax on the feller buncher, \$. . . in use tax on the Dozer, and \$. . . in interest.

On November 6, 2017, Taxpayer submitted a timely petition for review of the assessment of use tax on the Dozer only. Taxpayer asserts that its prior estimate that it used the Dozer 50 percent of the time to support the yarder and 50 percent of the time to support the feller buncher was inaccurate and, in fact, it used the Dozer to support the yarder 80 percent of the time and the feller buncher 20 percent of the time. Taxpayer conceded that supporting the feller buncher is a non-qualifying use for the purposes of the M&E exemption.

To support its argument, Taxpayer provided several invoices ("Invoices"). The Invoices appear to be from various timber sales and itemize the sale of certain wood products. Each line refers to "cutting and shovel" or "cutting and shoveling" of a type of wood product (e.g. sawlogs or pulp), followed by a quantity, unit price, and total price. The Invoices are undated and do not contain information about the location of the job or how long, if at all, Taxpayer used any specific piece of machinery. Taxpayer's explained the significance of the Invoices as follows:

[O]n jobs where the Dozer is used to support the yarding equipment, [Taxpayer] attributes 62% of the gross revenue to the yarding equipment as shown on [the Invoices]. [Taxpayer] charges \$. . . per 1000 board feet of timber for "cutting" and \$. . . per 1000 board feet of timber for "shoveling." The yarding phase of [Taxpayer's] operation is represented by the

shoveling portion of the operation and the Dozer is always used during the shoveling [portion].

Taxpayer's petition does not provide any additional details as to how Taxpayer calculated the 62% figure.

ANALYSIS

In Washington, all sales of tangible personal property to consumers are subject to retail sales tax unless the sales are otherwise exempt from taxation. RCW 82.08.020; RCW 82.04.050. Use tax complements retail sales tax by imposing a tax of like amount upon the privilege of using within this state as a consumer any article of tangible personal property acquired without payment of retail sales tax. *See* RCW 82.12.020(1), (2).

Here, Taxpayer acquired the Dozer without paying retail sales tax, Audit determined that Taxpayer had used the Dozer in Washington, and assessed use tax upon the purchase price of the Dozer. Taxpayer asserts that the Dozer is exempt from use tax under RCW 82.12.02565.

Sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation are exempt from use tax under RCW 82.12.02565. This exemption is commonly known as the "M&E exemption." The M&E exemption has four elements:

1. The purchaser/user must be a "manufacturer" or "processor for hire;"
2. The purchased/used item must be "machinery and equipment;"
3. The purchased/used item must be "used directly;"
4. In a "manufacturing operation."

See Det. No. 03-0325, 24 WTD 351 (2005). The M&E exemption does not apply if any of the four elements are not met.

The first and second elements of the M&E exemption are not at issue here. As discussed below, certain elements of Taxpayer's logging operations are considered manufacturing activities, thus Taxpayer is considered a "manufacturer" for the purposes of the M&E exemption. Furthermore, Audit does not dispute that the Dozer qualifies as the type of machinery that may be eligible for the exemption. Therefore, our task is to determine whether the Dozer is "used directly" in a "manufacturing operation" and whether it satisfies the majority use requirement. For clarity, we will address the "manufacturing operation" element first.

RCW 82.08.02565 defines a "manufacturing operation" generally as "the manufacturing of articles, substances, or commodities for sale as tangible personal property." RCW 82.08.02565(2)(f). 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" *Id.* Rule 13601 further explains that a "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 exempted by law." Rule 13601(2)(i). In logging, the Department considers the entire area that is being actively logged (known as a "cutting

unit” or “harvest unit”) to be a single, contiguous manufacturing site. The logs “enter” the manufacturing site when they are extracted (i.e. cut down). The logs are then “manufactured” at the site via cutting to length, delimiting, and measuring. The logs then leave the site when they are transported away from the harvest unit.

RCW 82.04.120 and WAC 458-20-13501 (“Rule 13501”) limit the types of logging activities that constitute “manufacturing.” RCW 82.04.120 states that the “[c]utting, delimiting, and measuring of felled, cut, or taken trees” qualifies as “manufacturing.” RCW 82.04.120(1)(c). Rule 13501 states that “cutting into length (bucking), delimiting, and measuring (for bucking) of felled, cut (severed), or taken trees is a manufacturing activity as defined in RCW 82.04.120.” -Rule 13501(2)(c).

Manufacturing activities are distinguished from extracting activities, which also occur during logging. Rule 13501(2)(b) states that the “felling, cutting (severing from the land), or taking of trees is an extracting activity.” The manufacturing activities cannot begin until the trees have been extracted from the land. *See* Det. No. 15-0156, 34 WTD 586 (2015) ([stating that] “[t]he manufacturing operation does not begin until after the standing trees are cut and bunched”).

Here, Taxpayer testified that its logging operations involve both extracting and manufacturing activities. Taxpayer first extracts logs from the harvest unit using the feller buncher.² After the logs are on the ground, Taxpayer then delimits and cuts them to length before moving them with the yarder. The cutting to length and delimiting activities constitute “manufacturing” under RCW 82.04.120(1)(c) and Rule 13501. The Department considers the entire logging area to be a manufacturing site. Therefore, because Taxpayer delimits, cuts to length, and/or measures felled trees within a defined manufacturing site, we find that those activities constitute a “manufacturing operation.”

The next step is to determine whether the Dozer is “used directly” in the manufacturing operation. RCW 82.08.02565 states that machinery is “used directly” in a manufacturing operation if it:

- (ii) Conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site or testing site;
- ...
- (iv) Provides physical support for or access to tangible personal property;

RCW 82.08.02565(2)(c).

Here, Taxpayer argues that the Dozer is “used directly” in the manufacturing operation because it is part of a system of machinery that performs manufacturing activities. We agree. To show how the Dozer relates to manufacturing, we must look at the entire system, beginning with the yarder.

² Although Taxpayer appears to concede that the feller buncher is not eligible for the M&E exemption, it is important to note that we have consistently ruled that a feller buncher does not perform any manufacturing activities. *See* Det. No. 15-0156, 34 WTD 586 (2015) ([stating that] “[t]he manufacturing operation does not begin until after the standing trees are cut and bunched”); Det. No. 00-138, 20 WTD 167 (2001) (holding cutting trees is an extracting activity and not a manufacturing activity); Det. No. 11-0097, 31 WTD 31 (2012) (holding the feller buncher was performing extraction activities and therefore not used in a manufacturing operation).

Unlike the Dozer, the yarder acts directly on the manufacturing materials by moving the logs from where they were cut down to a collection point. Because the entire logging area is considered to be a single manufacturing site, such movement is considered conveying or transporting “at the manufacturing site.” In this case, the yarder is analogous to a conveyor belt or forklift operating inside a factory. We have previously found yarding equipment to be part of a manufacturing operation. *See* Det. No. 00-138, 20 WTD 167 (2001) (“It appears that log yarders and log loaders are used after the extraction activity has ended. Therefore, if the taxpayer’s customers purchased these items for use as a [system of power-operated winches and a tower used to haul logs from a stump to a landing], it appears they would meet the Washington definition of “manufacturer” with regard to the log yarders and loaders.”) (Emphasis removed and footnote omitted). Therefore, we find that the yarder is part of the manufacturing operation pursuant to RCW 82.08.02565(2)(c).

We must then consider whether providing support to the yarder makes the Dozer part of the manufacturing operation as well. Rule 13601(8)(d) states that qualifying machinery may provide “physical support for or access to tangible personal property.” Therefore, because the Dozer is used to support the yarder, which, in turn, is used to move manufactured logs within the manufacturing site, we find that the Dozer is “used directly” in a “manufacturing operation.”

However, our analysis does not end there. Rule 13601 states that machinery and equipment that is used directly for both qualifying and non-qualifying purposes is eligible for the M&E exemption “only if the qualifying use satisfies the majority use requirement.” Rule 13601(9)(a). To satisfy the majority use requirement, the machinery or equipment must be used for a “qualifying use . . . greater than fifty percent [of the time] compared to overall use.” *Id.* A taxpayer claiming the M&E exemption “must retain records documenting the measurement used to substantiate a claim for exemption or, if time, value, or volume is not the basis for measurement, be able to establish by demonstrating through practice or routine that the requirement is satisfied.” *Id.* The taxpayer may use any of the following measures to establish majority use:

(i) **Time.** Time is measured using hours, days, or other unit of time, with qualifying use of the M&E the numerator, and total time used the denominator. Suitable records for time measurement include employee time sheets or equipment time use logs.

(ii) **Value.** Value means the value to the person, measured by revenue if both the qualifying and nonqualifying uses produce revenue. Value is measured using gross revenue, with revenue from qualifying use of the M&E the numerator, and total revenue from use of the M&E the denominator. If there is no revenue associated with the use of the M&E, such as in-house accounting use of a computer system, the value basis may not be used. Suitable records for value measurement include taxpayer sales journals, ledgers, account books, invoices, and other summary records.³

Rule 13601(9)(a).

³ Rule 13601(9)(a)(iii) and (iv) also provide for measurements based on product volume and “other comparable measurement for comparison,” which requires Department approval. Taxpayer did not assert arguments for either of those measurement, so we will not address them here.

Taxpayer admits that the Dozer is also used to support the feller buncher, which is not a qualifying use. Because the Dozer is used for both qualifying and non-qualifying uses, Taxpayer must satisfy the majority use requirement by proving that the Dozer is used for a qualifying purpose “greater than fifty percent [of the time] compared to overall use.” Rule 13601(9)(a). Taxpayer argues that the Invoices support the notion that the Dozer is used to support the yarder – a qualifying use – 80 percent of the time. However, we find that the Invoices are inadequate proof because they do not contain enough information to provide a measure of qualifying use based on time or value as required by Rule 13601(9)(a).

Taxpayer first argues a time measurement by saying it “uses the Dozer to support the yarding equipment approximately 80% of the time.” However, the Invoices do not contain any information regarding how much each piece of machinery is used. Instead, the Invoices list the total value of the various forestry products produced by Taxpayer. Even if the Invoices did contain a breakdown based on time, Taxpayer would need to show that the Invoices represent an accurate sample of Taxpayer’s overall operations. It is not enough to show that the Dozer meets the majority use requirement on some projects; Rule 13601(9)(a) requires that Taxpayer meet the requirement based on its “overall use.” This is of particular concern with a piece of machinery like the Dozer. Bulldozers are versatile pieces of equipment that can be used for a range of purposes. For example, bulldozers are often used for building logging roads, which is considered an extracting activity. *See* Rule 13501(12).

Taxpayer then argues a value measurement by attributing 62% of its gross revenue to the yarding equipment “on jobs where the Dozer is used to support the yarding equipment.” *See* Taxpayer’s petition, page 4. Taxpayer stated that it calculated the percentage by applying the different hourly rates for cutting and shoveling/yarding to the total amount of each invoice. However, as noted above, cutting and shoveling are grouped together in every line item. It is unclear how Taxpayer knew what percentage of each line item to attribute to cutting versus shoveling/yarding. Furthermore, even if the 62% figure is true for “jobs where the Dozer is used to support the yarding equipment,” we would need more information on the jobs in which the Dozer is *not* used to support the yarding equipment. This goes to our primary concern regarding the majority use issue: without a comprehensive description, supported by adequate records as required by Rule 13601(9)(a), of how Taxpayer uses the Dozer across *all* of its operations, we cannot say that Taxpayer meets the majority use requirement.

Therefore, because Taxpayer has failed to satisfy the majority use requirement, the Dozer does not qualify for the M&E exemption. Taxpayer’s petition is denied.

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 6th day of November 2018.