Cite as Det. No. 99-339, 19 WTD 885 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 99-339
. . .	)	Registration No. . . .
	)	FY . . . / Audit No. . . .

[1] EMERGENCY RULE 13601; RCW 82.08.02565, 82.12.02565: MACHINERY AND EQUIPMENT (M & E) EXEMPTION – TANGIBLE PERSONAL PROPERTY. Machinery and equipment must be used to manufacture tangible personal property to qualify for the machinery and equipment exemption. If a taxpayer purchases machinery or equipment that is used to produce items that will be affixed to the real property where they are produced, then the taxpayer is not manufacturing tangible personal property. Therefore, the machinery and equipment exemption does not apply to that equipment.

[2] EMERGENCY RULE 13601; RCW 82.08.02565, 82.12.02565: MACHINERY AND EQUIPMENT (M & E) EXEMPTION – MANUFACTURING OPERATION. The exemption from the retail sales and use taxes applies to machinery and equipment used in a manufacturing operation. A manufacturing operation is a place or manufacturing plant and does not include delivery of manufactured products.

[3] EMERGENCY RULE 13601; RCW 82.08.02565, 82.12.02565: MACHINERY AND EQUIPMENT (M & E) EXEMPTION – DUAL USE. When a taxpayer purchases machinery or equipment that is used in both a qualifying and non-qualifying use, then the Department will use a majority use test to determine if the equipment qualifies for the machinery and equipment exemption from the retail sales or use tax.

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:

The taxpayer requests correction of a tax assessment of retail sales tax on its lease of concrete mixing trucks that it contends qualify as tax-exempt manufacturing machinery and equipment.[1]

BACKGROUND:

Coffman, A.L.J. -- The taxpayer is a corporation, which sells mixed cement. The taxpayer loads the mixer on the trucks with sand, cement, gravel, and water. The loading of the mixer occurs at the taxpayer's place of business and mixing begins there. The mixer rotates producing cement (commonly referred to as "mud"). The mixer continues to rotate while the trucks are driven to the customer's location, where the mud is poured into forms. When the mud dries concrete is formed.

The Department of Revenue's (Department) Audit Division reviewed the taxpayer's books and records for the period January 1, 1993 through December 31, 1996. The only adjustments made by the Audit Division related to the taxpayer's lease of cement mixer trucks. The taxpayer had not paid retail sales tax on its lease payments and the Audit Division found the retail sales tax was due.

The taxpayer bases its appeal on the manufacturing machinery and equipment (M&E) exemption from the retail sales tax found in RCW 82.08.02565. The taxpayer contends the tax assessment must be cancelled because the cement mixer trucks are machinery and equipment used in a manufacturing operation. The Audit Division denied the taxpayer's claim because the cement mixer trucks were not used at the taxpayer's manufacturing site, the cement mixer trucks are not manufacturing sites, and the trucks are used to deliver the product.

The taxpayer filed a timely appeal of tax assessment.

ISSUE:

Does a cement mixer truck used to both mix and deliver concrete to customers qualify as machinery and equipment used directly in a manufacturing operation as those terms are defined in RCW 82.08.02565?

DISCUSSION:

RCW 82.08.02565 provides an exemption from the retail sales tax for "machinery and equipment used directly in a manufacturing operation". RCW 82.12.02565 provides a parallel exemption from the use tax. There are several criteria that must be satisfied for the M&E exemption to apply. Among these are: (1) Use by a manufacturer; (2) directly used; and (3) in a manufacturing operation.

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

[1] A manufacturer is a person who manufactures items[2]. RCW 82.04.120 defines the term "to manufacture" as:

> …all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use, and shall include: (1) The production or fabrication of special made or custom made articles; (2) the production or fabrication of dental appliances, devices, restorations, substitutes, or other dental laboratory products by a dental laboratory or dental technician; (3) cutting, delimbing, and measuring of felled, cut, or taken trees; and (4) crushing and/or blending of rock, sand, stone, gravel, or ore.

(Emphasis added.)

Thus, if the item produced is not tangible personal property, then there is no manufacturing activity.[3] When the taxpayer produces concrete at the customer's site, it is not producing tangible personal property. Rather, it is producing items that will become affixed to or installed on the real estate.

In Morrison-Knudson v. State of Washington, 64 Wn.2d 90, 390 P.2d 712 (1964), the court was concerned about the construction of pontoons and anchor shells for the Hood Canal floating bridge. Morrison-Knudson built the pontoons and anchor shells in Seattle and transported them to Port Gamble where they were subjected to further modification and stored pending installation to create the bridge. The Department assessed manufacturing B&O tax on the activity of building the pontoons and anchor shells. The court said:

> [Morrison-Knudson] argue that these items were "constructed" rather than "manufactured," and that the term "to manufacture" implies the making of a product salable in ordinary commerce. The statutory definition does not so limit the term. We may concede that there are construction activities which are not "manufacturing." Road building, for example, is not "manufacturing" because it does not result in the production of an "article of tangible personal property," but rather the improvement of real property. But the constructing of new, different, or useful articles of tangible personal property is "manufacturing," as defined by the statute.

(Emphasis added.) Id., at 90-91.

The taxpayer's activity of producing concrete at the customer's site is indistinguishable from the road building activity referred to in Morrison-Knudson. Further, in United Builders of Washington, Inc. vs. Department of Rev., BTA Docket No. 193 (1968), the Board of Tax Appeals addressed a speculative builder's claim that the Department could not assess manufacturing B&O tax on activities away from the construction site, while not subjecting the

[2] While this is an over simplification of the RCW 82.04.110, it is sufficient for the purposes of this determination.

[3] Also, there would not be a manufacturing operation for the purposes of the M&E exemption because a "manufacturing operation" is defined as "manufacturing … tangible personal property". RCW 82.08.02565(2)(d).

same activities occurring at the construction site, to the manufacturing B&O tax. Specifically, United Builders constructed trusses, cabinets, and wall panels that were transported from its shop facilities in Yakima to the construction site. The Department assessed manufacturing B&O tax on these activities, but when the taxpayer built the trusses, cabinets, or wall panels at the construction site the Department did not assess B&O tax. The BTA explained:

> The roof trusses, wall panels, and cabinets are new, different, and useful articles of tangible personal property as they are transported from the Appellant's Yakima headquarters and must be considered to have been manufactured by the Appellant for its use in incorporating them into its speculatively built houses.

[2] Further, this distinction between manufacturing tangible personal property and improving real property is incorporated, in part, in the term "manufacturing operation" for the purposes of the M&E exemption. The M&E exemption only applies to "machinery and equipment used directly in a manufacturing operation or research and development 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". RCW 82.08.02565(1). The term manufacturing operation is defined in RCW 82.08.02565(2)(d) and states, in part: "The 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."

To the extent that the cement mixer trucks produces concrete at the customer's site, the trucks are not used at a manufacturing site. The product produced does not leave that site. It becomes attached to the real property. Therefore, this use of the cement mixer trucks is for improving real property and not in a manufacturing operation.

Likewise, the delivery function of the cement mixer trucks is not use in a manufacturing operation. House Bill 2337 (HB 2337) was approved by the legislature during the 1996 session. HB 2337, as passed by the legislature, included a change to the definition of "manufacturing operation" by adding the following:

> In the case of the manufacturing of building trusses in eligible areas, as defined in RCW 82.60.020(3)(e), the manufacturing operation ends at the point where the finished product[4] is delivered to the building site.

(Footnote added.) The Governor vetoed this portion of HB 2337. The Governor's partial veto is part of the legislative process and must be considered when determining legislative intent. Shelton Hotel Company, Inc. v. Jack E. Bates, 4 Wn.2d 498, 506, 104 P.2d 478 (1940); State v. Brasel, 28 Wn.App. 303, 309, 623 P.2d 696 (1981). The Governor explained his partial veto of HB 2337 by stating:

[4] Chapter 211, Laws of 1999 changed the term "finished product" to "processed material" retroactively.

> Section 6 of House Bill No. 2337 changes the definition of "manufacturing operation" so as to extend the manufacturer's sales and use tax exemption to purchases of vehicles used in timber impact areas to deliver trusses to a construction site. This legislation would establish a disturbing precedent. For purposes of a tax exemption, it would extend the concept of a manufacturing facility beyond the physical plant at which machinery and equipment are used to make a product to include the equipment used to deliver the product to the customer. This is contrary to the aim of the exemption enacted in the 1995 session.

(Emphasis added.) Governor's explanation of the partial veto of HB 2337 (Chapter 290, Laws of 1996), March 30, 1996. This veto message clarifies that machinery and equipment must be at manufacturing plant to qualify for the M&E exemption.

We find to meet "the used directly in the manufacturing operation" requirement, the machinery and equipment must be used at the physical plant, the manufacturing site as explained by the Governor, to qualify for the M&E exemption. We understand that the concrete mixing trucks are used to mix the raw ingredients of the mud (sand, gravel, cement, and water). Part of the mixing process occurs at the manufacturing site, the taxpayer's physical plant; and part of it occurs as the concrete mixing truck is driven to the customer's site and at the customer's site. The latter two uses occur after the trucks leave the manufacturing site. Once the trucks leave the taxpayer's physical plant, they are not on the manufacturing site and not part of a "manufacturing operation" as the term is defined in RCW 82.08.02565. Thus, the taxpayer uses the concrete mixing trucks in both qualifying (on-site) and non-qualifying (off-site) uses.

[3] In the case of a dual use, the Department uses a majority use test to determine if the property qualifies for the M&E exemption. While non-qualifying use does not disqualify the taxpayer's eligibility for the exemption, the taxpayer must demonstrate for each piece of equipment, most of its use was qualifying (on-site) use. Both the legislature and the executive branch have accepted this approach. The Governor said:

> I have assumed, as did the legislature (as indicated by our respective balance sheets), that there is no fiscal impact associated with sections 1 through 4 of the bill. That is based on the continuing application of the "majority use" standard for machinery and equipment that has both qualifying and nonqualifying uses. The majority use standard affords meaningful use of the exemption to taxpayers, is fair, and is a reasonable way to administer the exemption consistent with the law, legislative intent, and promotion of economic development in our state. I strongly support the Department of Revenue's continued use of this standard.

Governor's explanation of the partial veto of ESHB No. 1887, May 7, 1999.

Because the Audit Division did not consider the majority use test, we remand the file to the Audit Division to determine whether the taxpayer uses trucks more at the manufacturing site than off the manufacturing site.

DECISION AND DISPOSITION:

The taxpayer's petition is remanded to the Audit Division to determine if the taxpayer's use of the cement mixer trucks qualifies for the exemption from the retail sales tax found in RCW 82.08.02565 by applying the majority use test.

Dated this 29th day of December, 1999.