Cite as Det. No. 99-288, 19 WTD 582 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 99-288
	)	
. . .	)	Registration No. . . .
	)	Petition for Refund
	)	

[1] RULE 135; RULE 13601; RCW 82.08.02565: RETAIL SALES TAX -- MANUFACTURING EQUIPMENT AND MACHINERY (M&E) EXEMPTION -- EXTRACTING -- MANUFACTURING OPERATION -- WHERE MANUFACTURING OPERATION BEGINS. The use of a loader at a manufacturing site by a producer and seller of ready-mix concrete and sand and gravel products, limited to moving previously quarried but unprocessed materials from stockpiles to the sorting and washing area, is not use in a manufacturing operation. Only those activities that take place after the first screen are considered part of the manufacturing operation.

[2] RULE 13601; RCW 82.08.02565: RETAIL SALES TAX -- MANUFACTURING EQUIPMENT AND MACHINERY (M&E) EXEMPTION -- MAJORITY USE REQUIREMENT. The Department considers machinery and equipment to 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 measure, is in a manufacturing 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.

NATURE OF ACTION:

The taxpayer appealed for refund of retail sales tax it paid on a wheel loader it principally uses to excavate and load raw materials onto trucks for hauling to its manufacturing plant. The taxpayer contends the loader is exempt from sales tax under the exemption for sales of manufacturing machinery and equipment, RCW 82.08.02565.[1]

FACTS:

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

Prusia, A.L.J. [successor to Breen, A.L.J.] -- The taxpayer produces and sells ready-mix concrete, and also sells sand and gravel. In September 1996, the taxpayer purchased a wheel loader from an auctioneer. The taxpayer paid retail sales tax on the purchase.

In March 1997, the taxpayer requested a refund of the sales tax paid on the loader under the statute exempting sales of manufacturing machinery and equipment, RCW 82.08.02565 ("M&E exemption").

The Taxpayer Account Administration (TAA) of the Department of Revenue responded to the request, advising the taxpayer that TAA could not process a refund directly to the taxpayer, and suggesting the taxpayer contact the retailer for a refund of the retail sales tax. The taxpayer treated the response as a denial of its refund request, and appealed. In the appeal, the taxpayer states it would not be possible to collect the tax from the auctioneer.

The taxpayer explains it principally uses the loader to dig gravel out of a pit and load it into dump trucks to be hauled to the taxpayer's concrete plant. The taxpayer owns the pit, which is located a short distance from the concrete plant. At the concrete plant, the gravel is sized, using screens, and washed. The taxpayer uses most of the gravel and sand in making concrete, and sells the rest as a byproduct. Sometimes the gravel is stockpiled at the plant instead of being used immediately, and the loader is taken to the plant site and used to load the stockpiled gravel into the sorting and washing area.

ISSUE:

Is purchase of the loader exempt from retail sales tax under RCW 82.08.02565?

DISCUSSION:

Before addressing the issue presented, we will note that generally a customer who believes it has paid sales tax on a transaction that was not taxable should request a refund directly from its seller, but under certain circumstances the Department may make refunds directly to the consumer. WAC 458-20-229 (Rule 229) describes the appropriate procedures and proof required when a consumer requests a refund directly from the Department.[2]

[2] The rule provides, in pertinent part:

> Taxpayer request. When a taxpayer discovers that it has overpaid taxes, penalties, or interest, it may file an amended return or a petition for refund or credit with the department. The petition or amended tax return must be submitted within the statute of limitations. Refund or credit requests should generally be made to the division of the department to which payment of the tax, penalty, or interest was originally made. The amended tax returns or petitions are subject to future verification or examination of the taxpayer's records. If it is later determined that the refund or credit exceeded the amount properly due the taxpayer, an assessment may be issued to recover the excess amount, provided the assessment is made within four years of the close of the tax year in which the taxes were due or prior to the expiration of a statute of limitations waiver. The following are examples of refund or credit requests:

We now address the underlying issue. RCW 82.08.02565 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 82.08.02565 provides, in pertinent part:

> (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, 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, but only when the purchaser provides the seller with an exemption certificate in a form and manner prescribed by the department by rule. The seller shall retain a copy of the certificate for the seller's files.
>
> (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 . . . .
>
> . . .
>
> (c) Machinery and equipment is "used directly" in a manufacturing operation or research and development operation if the machinery and equipment:
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> (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;

. . .

(ii) A customer of a seller pays retail sales tax on a transaction which the customer later believes was not taxable. The customer should request a refund or credit directly from the seller from whom the purchase was made. If the seller determines the tax was not due and issues a refund or credit to the customer, the seller may request a refund or credit from the department. It is generally to the advantage of a consumer to seek a refund directly from the seller for retail sales tax believed to have been paid in error. This is because the seller has the source records to know if retail sales tax was collected on the original sale, knows the customer, knows the circumstances surrounding the original sale, is aware of any disputes between itself and the customer concerning the product, may already be aware of the circumstances as to why a refund of sales tax is appropriate such as the return of the merchandise. When in doubt as to whether sales tax should be refunded, a seller may contact the department and request advice. However, in certain situations, upon presentation of acceptable proof of payment of retail sales tax, the department will consider making refunds of retail sales tax directly to consumers. These situations are as follows:

(A) The seller is no longer engaged in business.

(B) The seller has moved and the consumer can not locate the seller.

(C) The seller is insolvent and is financially unable to make the refund.

(D) The consumer has attempted to obtain a refund from the seller and can document that the seller refuses to refund the retail sales tax. However, the department will not consider making refunds directly to consumers when the law leaves it at the discretion of the seller to collect the tax. See, for example, RCW 82.08.0273.

WAC 458-20-229(3)(b).

> (iii) Controls, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site;
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> (iv) Provides physical support for or access to tangible personal property;
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> (v) Produces power for, or lubricates machinery and equipment;
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> (vi) Produces another item of tangible personal property for use in the manufacturing operation or research and development operation;
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> (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.
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> (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 . . . .

Thus, the allowance of the exemption requires that five elements be met: (1) a sale; (2) to a manufacturer or processor for hire; (3) of machinery and equipment; (4) used directly; (5) in a manufacturing operation.

Is the Taxpayer a manufacturer or processor for hire? The term "to manufacture" is defined in RCW 82.04.120. The statute provides that the term:

> . . . embraces 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, . . .

Clearly, the making of concrete is "manufacturing." See, Lone Star Industries, Inc. v. Dept. of Rev., 97 Wn.2d 630, 647 P.2d 1013 (1982); Det. No. 92-161, 13 WTD 75 (1993). In 1999 the Legislature clarified that "to manufacture" includes "crushing and/or blending of rock, sand, stone, gravel or ore."[3]

The crushing and blending that constitutes "manufacturing" is to be distinguished from changes that occur in the process of extracting rock, sand, stone, gravel, or ore. WAC 458-20-135 (Rule 135) provides guidance for determining where an extracting process ends and a manufacturing process begins in a quarrying activity. It provides that mining and quarrying activities are extracting activities, and that "any screening, sorting, piling, or washing of the material, when the activity takes place in conjunction with crushing or blending, is considered a part of the manufacturing activity if it takes place after the first screen."

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[3] In May 1999, the 56th Legislature passed and the governor signed Engrossed Substitute House Bill 1887. The act's stated intent was to clarify the Legislature's intent as to the application of the M&E exemption. The legislation had a retroactive effective date of July 1, 1995. On May 28, 1999, the Department filed three emergency rules to implement the legislative changes to the M&E exemption. Because the rules also clarify the law, they are retroactive to July 1, 1995.

Based upon the statutory definition of "to manufacture" and Rule 135, we find that the taxpayer is a "manufacturer" of concrete. It is not a "manufacturer" of gravel and sand, because its production of those commodities does not involve blending or crushing.

[1] Does the taxpayer use the loader in "a manufacturing operation"? RCW 82.12.02565(2)(d) provides that the manufacturing operation begins "at the point where the raw materials enter the manufacturing site." Rule 135(2)(b)(ii) clarifies that the manufacturing process in the case of extracted materials does not begin until after the first screen. The taxpayer uses the loader at the pit, and occasionally at the plant before the raw materials are screened. Thus, its use of the loader is entirely before the manufacturing process begins. We find that the loader is not used in a manufacturing operation.

[2] Even if the occasional use of the loader at the plant, to load stockpiled gravel into the sorting and washing facilities, were viewed as use in the manufacturing operation, the loader would not be eligible for the exemption. The Department considers machinery and equipment to qualify for the exemption only if the majority of the use, as measured by percentage of time, percentage of revenue, volume of products derived, or other reasonable measure, is in a manufacturing operation.[4] The taxpayer mostly uses the loader at the pit, for digging and loading.

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[4] In its 1999 revision of RCW 82.08.02565, the Legislature, as well as the Governor, considered whether a "majority use" test must be met for machinery and equipment to qualify for the exemption. After the legislation was introduced as House Bill 1887, the Department advised the House Finance Committee it applied a majority use test to determine whether dual use machinery and equipment qualified for the exemption.[4] See Audit Practice Document submitted as part of Director Fred Kiga's testimony before the House Finance Committee on March 4, 1999. Aware the Department applied a majority use test, under the existing language in RCW 82.08.02565, the House did not alter the relevant language.

Following passage by the House of Representatives, the sponsors in the Senate discussed the majority use test. See Floor Colloquy between Senators Loveland and Snyder, ESHB 1887, read at 3:01 PM April 16, 1999. One Senator inquired regarding the absence in the bill of the dual use standard regarding qualifying and nonqualifying use. Another Senator explained:

> It is not necessary. The current administrative practice of DOR is "majority use," which means over 50 percent based on time, value, volume, or other measurement for comparison, is reasonable. It is within the administrative authority of the department to use this standard, both for the past and in the future. It is therefore appropriate for the department to put this standard in rule.

Again, the bill passed without changes to the applicable language. Finally, the Governor expressed his understanding in his veto message:

> ESHB 1887 clarifies the scope of a tax exemption and is very important. Taxpayers who are eligible for the exemption, as well as our state and local governments, need the certainty that this bill will provide. 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

Based upon the facts presented, and in light of the recently enacted statute and administrative rules, we conclude that the taxpayer's purchase of the loader is not eligible for the M&E exemption. Accordingly, we must deny the petition for refund.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

Dated this 29th day of October, 1999.

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.