

Cite as Det. No. 99-183, 19 WTD 804 (2000)

BEFORE THE APPEALS 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>
a Departmental Ruling)	
)	No. 99-183
...)	Registration No. . . .
)	Appeal of L & P Letter Dated
)	September 23, 1997

- [1] RULE 135; RULE 136; RULE 13601: RCW 82.08.02565; RCW 82-12.02565; USE TAX DEFERRAL – QUALIFYING ACTIVITIES. Mining and transportation activities do not qualify as manufacturing activities. Rock crushing and smelting activities qualify as a manufacturing activity.

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:

Taxpayer appeals a letter ruling issued by the Department of Revenue (Department) finding that part of Taxpayer's proposed mining and smelting activity does not qualify for either the B&O tax credit for distressed areas allowed under 82.62 RCW or the use tax deferral for manufacturing under 82.60 RCW.¹

FACTS:

Lewis, A.L.J. – Taxpayer planned to develop a gold and silver mining and smelting operation in . . . , Washington. On July 25, 1997 Taxpayer filed a "Distressed Area Application for Sales and Use Tax Deferral & Exemption 82.60 RCW" and a "Distressed Area Application for B&O Tax Credit on New Employees."² Both the use tax exemption and the business and occupation (B&O) tax credit require that the operation qualify as a "manufacturer."

Based on the information contained in the applications The Department, concerned that Taxpayer's proposed operation would not qualify as a "Manufacturer," requested more information from the Taxpayer. In an August 18, 1997 letter to the Department Taxpayer explained:

Our manufacturing process includes taking the raw material, extracting ore, and sending it through a crushing circuit and milling process to reduce the material to microscopic

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

² Taxpayer estimated that the facility construction and machinery equipment purchases for the ore extraction (mine) and production of precious metal dore bar (gold smelting) would be \$. . . (Dore is a mixture of gold, silver and other metals.) Similarly, Taxpayer estimated that the ore extraction and smelting facility would create 128 new full time jobs.

particles. We then add reagents to the processed ore and through a chemical process separate the waste from the precious metals, which are at this time bonded to carbon. The final step in our manufacturing process is to melt the carbon through a smelting process to extract gold and silver, which are formed into dore bars. Although this is an oversimplified explanation of our process, we feel it clearly fits within the definition of manufacturing included in RCW section 82.04.120, which includes "...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 use..."

On September 23, 1997 the Department's Legislation & Policy Division (L&P) replied to Taxpayer's letter. The L & P Division stated:

Thank you for your letter of August 18, 1997 in which you explained the process by which [you] . . . mine ore. You mine ore in an aggregate form, wash, crush, and screen ore to produce a concentrate cake, and smelt the concentrate cake to produce dore bar.

You have applied for a B&O tax credit under chapter 82.62 RCW and for distressed area sales and use tax deferral under 82.60 RCW. Eligibility for both of these programs is conditioned on the applicant being engaged in manufacturing or research and development. From the tax standpoint, your manufacturing activities are separated from your extracting and transporting activities at the point at which raw materials are delivered to your smelter.

You are eligible for the B&O tax credit and the sales and use tax deferral for your manufacturing activities at the smelting facility. The smelting facility buildings and the smelting facility machinery and equipment that meet the definition of "qualified buildings" and "qualified machinery and equipment" are eligible for the deferral. The employment positions directly created for the eligible business project, the smelting facility, are eligible for the B&O tax credit.

The activities by which you produce raw materials for use in your manufacturing facility are not eligible for these two tax incentive programs. The buildings and machinery and equipment used by you for mining, preparing, and hauling the raw materials for use in your manufacturing facility are not covered by the deferral program. The employment positions created for the production of the raw materials to be used at the manufacturing facility are not eligible for the tax credit. The legislative intent in enacting the incentive program was to limit the tax exemptions to the manufacturing activity. The activities in which you are engaged prior to the smelting of the dore bar are not manufacturing and are therefore are not eligible for the tax credit or the tax deferral.

(Emphasis added; footnote deleted.)

On October 22, 1997 Taxpayer filed a petition appealing the Department's September 23, 1997 letter ruling that "the activities by which you produce raw materials for use in your manufacturing facility are not eligible for these two tax incentive programs." Taxpayer maintained that the letter

ruling was based on a misunderstanding that arose because of an oversimplification of the process by which dore bars are produced. Taxpayer included, as part of its appeal, a four and one-half page description of the activities it performs to produce a dore bar.

ISSUE:

Whether the activities by which Taxpayer produces raw materials for use in smelting facility qualify for the B&O tax credit under chapter 82.62 RCW and for the distressed area sales and use tax deferral under chapter 82.60 RCW.

DISCUSSION:

Eligibility for both the B&O tax credit under chapter 82.62 RCW and for a distressed area sales and use tax deferral under chapter 82.60 RCW is conditioned on the applicant being engaged in manufacturing or research and development. In May 1999, the 56th Legislature passed and the governor signed Engrossed Substitute House Bill 1887. The act revised the machinery and equipment tax exemption by more precisely describing terminology and eligibility; amending RCW 82.04.120, 82.08.02565, and 82.12.02565. On May 28, 1999 the Department filed three emergency rules to implement legislative changes to the manufacturing machinery and equipment exemption.³ All three rules assist in clarifying what activities qualify for the tax credits.⁴ Because the recent legislation and rules adopted pursuant to it are a clarification of the existing law, the rules and law can be applied retroactively to answer Taxpayer's 1997 appeal.

WAC 458-20-136 (Rule 136) 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 the production or fabrication of special made or custom made articles." (RCW 82.04.120.) It means the business of producing articles for sale or for commercial or industrial use from raw materials or prepared materials by giving these matters new forms, qualities, properties, or combinations. It includes such activities as making, fabricating, processing, refining, mixing, slaughtering, packing, curing, aging, canning, etc. The term "to manufacture" also includes:

...

(c) The crushing and/or blending of rock, sand, stone, gravel, or ore, effective July 1, 1995 (chapter 211, Laws of 1999, and chapter 3, Laws of 1995 1st sp.s.);

³ The rules became effective immediately on filing. The Department's L&P division has started the rulemaking process to allow for permanent adoption of all three rules.

⁴ The revised WAC 458-20-135; WAC 458-20-136; and, WAC 458-20-13601 are attached.

Thus, the definition of “manufacturing” includes the crushing of rock and ore and refining. However, noticeably absent from the definition are extraction or transportation activities.

WAC 458-20-135 (Rule 135) provides guidance for determining when an extracting activity ends and the manufacturing activity begins. This is particularly important in cases where the taxpayer that extracted the natural product also used the same extracted products in a manufacturing process. Rule 135(2) explains that:

RCW 82.04.100 defines the term “extractor” to mean every person who, from the person's own land or from the land of another under a right or license granted by lease or contract, either directly or by contracting with others for the necessary labor or mechanical services, for sale or for commercial or industrial use mines, quarries, takes or produces coal, oil, natural gas, ore, stone, sand, gravel, clay, mineral, or other natural resource product.

Rule 135(2)(b)(ii) gives an example of when an extracting process ends and a manufacturing process in a mining and quarrying operation begins:

Mining and quarrying operations are extracting activities, including the screening, sorting, piling, and washing of rock, sand, stone, or gravel if the extractor does not directly or by contracting with others crush or blend the materials at the site where the materials were taken or produced.

The crushing and/or blending of rock, sand, stone, or gravel are not extracting activities. These are manufacturing activities. (See WAC 458-20-136 on manufacturing.) Likewise, 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. If there is no separate first screen, only those activities subsequent to the materials being deposited into the screen are considered manufacturing activities.

Thus, we find that the recently revised Rules 136 and 135 support the Department’s September 1997 ruling that:

The activities by which you produce raw materials for use in your manufacturing facility are not eligible for these two tax incentive programs. The buildings and machinery and equipment used by you for mining, preparing, and hauling the raw materials for use in your manufacturing facility are not covered by the deferral program. The employment positions created for the production of the raw materials to be used at the manufacturing facility are not eligible for the tax credit

Even if an activity qualifies as manufacturing, only machinery and equipment “used directly” qualify for the exemption. WAC 458-20-13601(9) (Rule 13601) explains the “used directly” criteria:

Items that are not used directly in a qualifying operation are not eligible for the exemption. The statute provides eight descriptions of the phrase "used directly." The manner in which a person uses an item of machinery and equipment must match one or more of these descriptions. If M&E is not "used directly" it is not eligible for the exemption. Examples of items that are not used directly in a qualifying operation are cafeteria furniture, safety equipment not a part or component of an eligible item of machinery and equipment, packaging materials, shipping materials, or administrative equipment. Machinery and equipment is "used directly" in a manufacturing operation, testing operation, or research and development operation, if the machinery and equipment meets any one of the following criteria:

(a) Acts upon or interacts with an item of tangible personal property. Examples of this are drill presses, cement mixers (agitators), ready-mix concrete trucks, hot steel rolling machines, rock crushers, and band saws. Also included is machinery and equipment used to repair, maintain, or install tangible personal property. Computers qualify under this criteria if: (i) they direct or control machinery or equipment that acts upon or interacts with tangible personal property or (ii) if they act upon or interact with an item of tangible personal property.

(b) Conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site or the testing site. Examples of this are wheelbarrows, handcarts, storage racks, forklifts, tanks, vats, robotic arms, piping, and concrete storage pads. Floor space in buildings does not qualify under these criteria. Not eligible under these criteria are items that are used to ship the product or in which the product is packaged, as well as materials used to brace or support an item during transport.

(c) Controls, guides, measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site. Examples of "away from the site" are road testing of trucks, air testing of planes, or water testing of boats, with the machinery and equipment used off site in the testing eligible under these criteria. Machinery and equipment used to take readings or measurements, such as devices that take readings or probe with sensors, is eligible under these criteria.

(d) Provides physical support for or access to tangible personal property. Examples of this are catwalks adjacent to production equipment, scaffolding around tanks, braces under vats, and ladders near controls. Machinery and equipment used for access to the building or to provide a work space for people or a space for tangible personal property or machinery and equipment, such as stairways, is not eligible under these criteria.

(e) Produces power for, or lubricates machinery and equipment. A generator providing power to a sander is an example of machinery and equipment that produces power for machinery and equipment. An electrical generating plant that provides power for a building is not eligible under these criteria. Lubricating devices such as hoses, oil guns, pumps, and meters, whether or not attached to machinery and equipment, are eligible under these criteria.

(f) Produces another item of tangible personal property for use in the manufacturing operation, testing operation, or research and development operation.

Machinery and equipment that makes dies, jigs, or molds, and printers that produce camera ready images are examples of this.

(g) Places tangible personal property in the container, package, or wrapping in which the tangible personal property is normally sold or transported; or

(h) Is integral to research and development as defined in RCW 82.63.010. There is no requirement that the research and development operation produce tangible personal property for sale.

Based on the facts presented and in light of the recently enacted statute and administrative rules we find that Taxpayer's activities from rock crushing to the smelting activities that produce dore bars qualify as a manufacturing activity. Similarly, however, we uphold the September 1997 letter ruling by the L&P Division that found that the mining and transportation activities performed by Taxpayer did not qualify as a manufacturing activity. In addition, Taxpayer need pay special attention to the provisions of Rule 13601 that clarify what types of machinery and equipment qualify for the exemption in the qualifying portion of the operation.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 16th day of June 1999.