

Cite as Det. No. 99-225R, 19 WTD 289 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition Refund of)	<u>F I N A L</u>
)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 99-225R
)	
...)	Registration No. . . .
)	FY. . . /Audit No. . . .
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[1] RULE 13601; RCW 82.08.02565; RCW 82.12.02565: MANUFACTURING EQUIPMENT AND MACHINERY EXEMPTION – PRINTING. Blank printing plates, purchased for use in an intermediate step in the printing process, are exempt from retail sales/use tax as machinery and equipment used directly in a manufacturing if they meet the one-year useful life requirement. Blank printing plates purchased for a one-time use are not exempt. Other supplies including film, tape, and developer, are not exempt from retail sales/use tax as machinery and equipment.

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:

An offset print shop protests retail sales tax assessed on purchases of film and blank print plates used in an intermediate step of its printing process.¹

FACTS:

S. Thomas, A.L.J. -- . . . ([T]axpayer) petitioned for reconsideration of our original decision, Det. No. 99-225. We will restate the relevant facts here for ease of reading only. The taxpayer did not assign any error to the facts as stated in our original decision.

The Department of Revenue (Department), Audit Division examined the taxpayer's books and records for the period January 1, 1993, through December 31, 1996, and issued tax assessment Document No. FY. . . . The tax at issue is the use tax (referred to as "*deferred sales tax*"), which

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

the Audit Division assessed on the purchase price of film, developer, and blank print plates on which the taxpayer did not pay Washington retail sales tax.

The taxpayer protested the use tax assessed on the purchases of film and blank print plates claiming these items are exempt from retail sales tax pursuant to RCW 82.08.02565. As the effective date of RCW 82.08.02565 is July 1, 1995, the taxpayer protests only the taxes assessed on certain supplies used in the printing process after that date.

We found in our original decision, Det. No. 99-225, the taxpayer owed the use tax because it purchased consumable items and put those items to intermediate use in producing a final product. We relied, in part, on the Department's Excise Tax Advisory 417.12.144 (ETA 417).

During the teleconference on reconsideration, the taxpayer explained the blank plates and film are machinery and equipment (M&E) used directly in a manufacturing process. The film is developed, then, the negatives are stored and reused as necessary on the taxpayer's premises. The completed plates are stored on the taxpayer's premises and reused as necessary. The taxpayer stores the customer's negatives and plates together in a large storage area near the printing presses. The taxpayer believes the other items (developer, masking tape, etc.) are consumed during the process.

The taxpayer asserts, based on these facts, the blank plates and film are exempt from retail sales tax pursuant to RCW 82.08.02565.

ISSUE:

Whether print plates and film used by the taxpayer during an intermediate step in the printing process are exempt from retail sales tax as M & E used directly in a manufacturing operation.

DISCUSSION:

The facts of this case are not in dispute. The items taxed as consumable supplies were used by the taxpayer in an intermediate step during the printing process. The intermediate step is the multi-step process of making the printing plate. The taxpayer photographs and develops camera-ready art and textual material (e.g. the customer's logo). The negative produced is then trimmed and physically positioned on a flat. Next, a "proof" is taken and presented to the customer for approval. Depending on the print job, the printer may need to make a "composite," from multiple exposures of the same film. The composite is used for shading or other element combinations in a complex print job. In the final process, the plate, which is a thin aluminum sheet that has a factory-applied light sensitive polymer coating, is imaged, or "burned". Imaging occurs when intense light is shined through the negatives and the light reacts with the coating on the plate causing a chemical change. The printing areas of the plate retain a coating; the non-printing areas do not and show the base metal of the plate. In summary, through a multi-step process, film, plates, developer, masking tape and other supplies are used by the taxpayer to produce a metal printing plate. The end product is the original blank printing plate with a raised surface created by the image burned on it from the negative.

When M&E is used directly in a manufacturing operation, the M&E is exempt from retail sales tax and use tax. RCW 82.08.02565; RCW 82.12.02565. A manufacturing operation means the manufacturing of articles for sale as tangible personal property. RCW 82.08.02565(2)(d). RCW 82.04.120 states:

“[t]o manufacture” 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, and shall include: (1) The production or fabrication of special made or custom made articles

WAC 458-20-136 (Rule 136), the Department’s rule implementing RCW 82.04.120 states:

The term 'to manufacture'. . . . 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.

(Emphasis added); See also, Excise Tax Advisory 398.04.136.²

RCW 82.08.02565 exempts from retail sales tax “sales to a manufacturer . . . of machinery and equipment used directly in a manufacturing operation” A manufacturing operation means the manufacturing of articles, substances, or commodities for sale as tangible personal property. The manufacturing operation begins at the point where the raw materials enter the manufacturing site and ends at the point where the finished product leaves the manufacturing site. WAC 458-20-13601(3)(e) (Emergency Rule 13601(3)(e)³). The letterhead and other printed products are new, different and useful products that are tangible personal property for sale by the taxpayer. The taxpayer meets the statutory definition of “manufacturing.”

Before July 1, 1995, the Department upheld retail sales tax assessed/paid on the purchase of materials for use in an intermediate step in the printing process. See Det. No. 92-352, 12 WTD 509 (1992). WAC 458-20-144 (Rule 144) states in part: “[s]ales to printers of equipment, supplies and materials which do not become a component part or ingredient of the finished printed matter sold or which are put to “intervening use” before being resold are subject to retail sales tax.” In the original determination, we relied on the “intervening use” status of the materials in question. See ETA 417. ETA 417 states the Department believes “printers are liable for sales or use tax as consumers of the materials” used to produce plates; the printer using these materials is a consumer of such items. However, the M&E exemption applies regardless of whether the taxpayer is viewed as the “consumer.” The M&E exemption examines the use and useful life of the tangible personal property for which the exemption is being claimed.

² Effective July 1, 1998 ETAs replaced Excise Tax Bulletins (ETBs). ETAs are persuasive only.

³ WAC 458-20-13601 was adopted by the Department as an emergency rule on May 28, 1999. The purpose of the emergency rule is to explain the sales and use tax exemption provided by RCW 82.08.02565 and 82.12.02565.

Machinery and equipment exempt from retail sales tax, must be used directly in the manufacturing operation. RCW 82.04.02565(1); Emergency Rule 13601(9). During the intermediate step, the printer produces two items with lasting character: the printing plate, and the negative. The negative is used merely to convey an image onto the printing plate. The negative itself is not used directly in the manufacturing operation. Emergency Rule 13601(9). Therefore, the film is not M&E for the purposes of RCW 82.08.02565. Conversely, the printing plate applies the ink on to the paper as the paper is fed through the press. The plates are used directly in the manufacturing operation. Emergency Rule 13601(9). Therefore, the blank plates are M&E for the purposes of RCW 82.08.02565, and qualify for the exemption if they meet the other pertinent tests.

Property acquired for a one-time use, such as a mold or form that is discarded upon use, does not qualify for the M&E exemption. Emergency Rule 13601(8). For example, the developer is consumed during the process of making the printing plate. The same logic applies to the tape purchases; the taxpayer uses the tape to hold the negative in place. The tape is discarded after it is used. The taxpayer asserts the blank print plates are purchased with the expectation of reuse over a period of years. The taxpayer purchases several hundred of these blank plates each year at a relatively low cost. If the taxpayer had a reasonable expectation that each and every plate would be reused it seems probable that the number of plates purchased each year should be declining as the plates are reused. The taxpayer's plate purchases doubled in 1996 after a three year decline in plate purchases.⁴ Based on the number of plates purchased each year it is probable that some of the printing plates may be purchased for a one-time use. For example, if a customer orders flyers for a special promotion on a certain date, the print plates used to make the flyer would not be reused again. Blank print plates purchased for such a one-time use would not be M&E for the purpose of the retail sales tax exemption. However, other blank print plates, those purchased with a reasonable expectation of reuse (e.g. letterhead) would be qualifying M&E, if they meet the "useful life" test. Therefore, the only item purchased for use during the intermediate step, the step in which the printing plate is made, that may qualify as M&E for the purpose of the retail sales tax exemption, is the blank print plate when it is not purchased for a one-time use.

Property must have a "useful life" of at least one year. RCW 82.08.02565. Emergency Rule 13601(8) provides a series of four questions to determine whether the item meets the useful life threshold. If the answer to any of the four questions is yes, the property meets the "useful life" threshold. Question (a) asks "Is the machinery and equipment eligible to be and actually capitalized for either federal tax purposes or accounting purposes?" The taxpayer treats the plate purchases as included in the cost of production. The taxpayer was not able to provide federal tax forms showing the items purchased were capitalized. The answer to question (a) is no.

Question (b) asks whether the M&E is warranted by the manufacturer to last at least one year. The taxpayer said the plate manufacturer warrants the blank plates for two years. Additionally, the taxpayer offered to provide a written warranty on the completed plates, if the Department requested. However, the print shop does not routinely provide customers with such a warranty. The taxpayer

⁴ Schedule 7 reveals the taxpayer purchased: 893 plates in 1993, 682 plates in 1994, 502 plates in 1995, and, 1,122 plates in 1996.

believes customers expect print shops to reuse the completed printing plates for several years. The question here is whether the blank print plates are warranted, not whether the completed print plates are warranted. Therefore, even though the taxpayer has offered to produce a written warranty on the completed print plates, such warranty has no relevance to the issue at hand. What is important here is the print plate manufacturer warrants the blank plates for two years. The answer to question (b) is affirmative.

Question (c) asks “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.) The taxpayer asserts the plates are not replaced. Once the printing plate is made, the print shop will reuse the finished plate for an indefinite time period. The plates are replaced only upon customer request. According to the taxpayer, common industry practice is to reuse the completed printing plates with subsequent print jobs until the customer requests the printer do otherwise.

Question (d) asks whether the M&E is 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.) Question (d) in this case was answered by the taxpayer’s response to question (c). The taxpayer explained they do not replace the plates unless the customer so requests. The taxpayer explained the completed metal printing plates are expected to last virtually forever. In the industry, a customer is expected to take the completed plates with them should they conduct business with a different print shop. Therefore, the taxpayer’s response to questions (c) and (d) is affirmative.

The blank print plates that are not purchased for a one-time use, and that meet the one year useful life requirement, are therefore, eligible for the M&E retail sales tax exemption pursuant to RCW 82.08.02565. The taxpayer must provide an exemption certificate in accordance to RCW 82.08.02565 and Emergency Rule 13601.

DECISION AND DISPOSITION:

The taxpayer’s petition is affirmed in part and denied in part. Purchases of blank print plates after July 1, 1995 are exempt from retail sales tax if they are not purchased for a one-time use, and they meet the one year useful life test. This case is remanded to Audit to determine whether the blank print plates were purchased for a one-time use and to make adjustments consistent with this decision. All other purchases of supplies used during the intermediate step are subject to the retail sales tax assessed.

Dated this 29th day of October, 1999.