

Cite as Det. No. 05-0151, 25 WTD 127 (2006)

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>
Assessment of)	
)	No. 05-0151
)	
...)	Registration No. . . .
)	Document No. . . .
)	Audit No. . . .
)	Docket No. . . .

RULE 13601; RCW 82.08.02565: RETAIL SALES TAX – EXEMPTION – MANUFACTURING MACHINERY AND EQUIPMENT (M&E) – WEIGH/PRICE MACHINES – PALLET JACKS. Weigh/price equipment (and related replacement parts) and pallet/skid jacks are “used directly” in the taxpayer’s manufacturing operation and qualify for exemption from retail sales tax under RCW 82.08.02565 to the extent they measure and transport, respectively, the taxpayer’s manufactured products.

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.

Breen, A.L.J. – A [food] processor protests the Department of Revenue’s (DOR) denial of the manufacturing machinery and equipment (M&E) retail sales tax exemption for M&E used at one of the taxpayer’s manufacturing sites. We conclude that the M&E is exempt because it is “used directly” in the taxpayer’s “manufacturing operation.”¹

ISSUE

Whether weigh/price equipment (and related replacement parts) and pallet/skid jacks are “used directly” in the taxpayer’s manufacturing operation and qualify for exemption from retail sales tax under RCW 82.08.02565?

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

FINDINGS OF FACT

[Taxpayer] is a vertically integrated grower, manufacturer, and wholesale seller of [food] products. The Department of Revenue's Audit Division (Audit) conducted an examination of the taxpayer's books and records Based on this examination, Audit issued a deficiency assessment The taxpayer contested the taxable status of certain pieces of equipment and replacement parts used in its manufacturing operation. After the issuance of the original assessment, the taxpayer and Audit continued to discuss whether these additional items of tangible personal property should qualify for exemption. . . . Audit made a number of further adjustments that resulted in a credit

The taxpayer's production of [food] products involves [a number of steps to produce] products suitable for sale to grocery stores and distributors. The taxpayer maintains a number of facilities throughout western Washington that contribute to this operation. The taxpayer's main facility is in [Location A]. The taxpayer acquired a facility in [Location B] to increase its overall manufacturing capacity and to add additional product lines. . . . These are the only facilities that have any relevancy to this appeal.

[Initial processing is done at the Location A plant]. The retail packages and the bulk products are then loaded on shuttle trucks for shipment to the taxpayer's [Location B] facility for further processing.

Once the product reaches [Location B], it is temporarily stored in designated coolers while awaiting further manufacturing or customer orders. [Additional processing is done at the Location B facility].

The taxpayer has four distinct product lines flowing through its [Location B] site.² There are two weigh-price stations at this facility. . . . One of the stations weighs and prices [two product lines]. The other [Location B] weigh-price station handles [two product lines -- product A and product B].

Both of the weigh-price equipment labeling stations consist of a scale, computer screen, central processing unit, and two label printers. The order information, including the customer's identity, quantity of the product, and the retail selling price, is transmitted via a computer network by the taxpayer's computer servers in [Location A] to the computers imbedded in the weigh-price equipment in [Location B]. The [product B] necessary to fill the order is retrieved from its designated cooler and rolled into the weigh-price area where the product is placed on a belt that passes over a scale, or in some cases is manually placed on scales. The scale weighs the product and the equipment produces a retail label that integrates the weight of the specific package with information supplied by the taxpayer's computer network. The retail packages bearing these labels are packed in cases and a shipping label is produced and affixed to each case. This shipping label is also composed of information sent from the [Location A] computer equipment,

² . . .

identifying the customer, the quantity and description of the contents, and other shipping information.

Audit concluded that [one of the two weigh/price equipment stations] was being used directly in a manufacturing operation and, thus, eligible for exemption. Audit had concerns, however, about the [second] weigh/price equipment [station] used [to process product A and product B]. During its initial examination, Audit questioned whether the taxpayer's use of this particular piece of equipment qualified the M&E for exemption. Audit's hesitancy related to factual discrepancies underlying whether the majority of the use of the M&E was for a "qualifying" use as required by statute. The taxpayer also requested exemption for replacement parts for the weigh/price equipment. This issue directly turns on the resolution of the eligibility of the M&E for exemption. If we conclude that the weigh/price equipment is exempt, the qualifying replacement parts will also be exempt as long as the replacement parts have a useful life of one year or more and meet all of the other eligibility requirements.

During the appeals process, we requested a number of records and other supporting information relating to the use of the taxpayer's M&E. The taxpayer's testimony, time sheet records, and other relevant information supplied by the taxpayer, such as pictures and site descriptions, demonstrate that approximately 55% of the product processed through the weigh-price station at issue [was related to product A and] approximately 45% [was related to product B].

At various points in the taxpayer's [Location B] manufacturing site, the taxpayer moves the [food] product through the various processing stages with pallet/skid jacks.³ Additionally, after the respective product has been packed in the cases and labeled, it is placed on a conveyor that transports the cases to the loading area, where the cases are placed on pallets and the pallet/skid jacks are further used to load the palletized cases onto trucks for delivery to customers. Audit questioned whether the skid/pallet jacks were eligible for exemption due to concerns regarding whether or not transporting the [product B] items referred to above was an ineligible use and, thereby, make the jacks ineligible for exemption.

ANALYSIS

A long-held principle of Washington taxation is that, while tax statutes generally are interpreted in favor of the taxpayer, exemption statutes are construed strictly against the taxpayer, and the taxpayer has the burden of establishing its eligibility for any exemption. *Sacred Heart Medical Center v. Department of Rev.*, 88 Wn. App. 632, 637, 946 P.2d 409 (1997); *Yakima Fruit Growers Ass'n v. Henneford*, 187 Wash. 252, 258, 60 P.2d 62 (1936); *All-State Constr. Co. v. Gordon*, 70 Wn.2d 657, 425 P.2d 16 (1967). With this principle in mind, we are asked to determine the present taxpayer's entitlement to exemption for the weigh/price equipment, related replacement parts, and the pallet/skid jacks.

³ A pallet or skid jack is a hand-propelled, wheeled platform, equipped with a lifting device for moving palletized unit loads.

RCW 82.08.02565(1) provides an exemption from sales tax for "sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation."⁴ A "manufacturing operation" is defined in RCW 82.08.02565(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.

WAC 458-20-13601(3)(g) (Rule 13601) further defines "manufacturing operation" and provides, in part:

The 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 excepted by law. Storage of raw material or other tangible personal property, packaging of tangible personal property, and other activities that potentially qualify under the "used directly" criteria, and that do not constitute manufacturing in and of themselves, are not within the scope of the exemption unless they take place at a manufacturing site

Excise Tax Advisory 2012-6S.08.12.13601 (ETA 2012-6S) defines "site" as "one or more immediately adjacent parcels of real property." In other words, the manufacturing site is the physical location where the manufacturing operation takes place. Pertinent to this appeal, the taxpayer has two distinct manufacturing sites – the [Location A] facility and the [Location B] facility. Each manufacturing site must stand on its own as a qualifying "manufacturing operation" in order for the M&E used in that facility to be exempt. Det. No. 01-130R, 23 WTD 1 (2004). Here, it is uncontested that both of the taxpayer's facilities at issue are "manufacturing operations" for purposes of the exemption statute. However, the eligibility for exemption of the weigh-price station equipment used to label [product B] and the pallet/skid jacks used at the [Location B] facility are at issue in this appeal.

In respect to the weigh-price equipment that handles [product B] in [Location A] and [product A], Audit concluded that the taxpayer did not sufficiently bear its burden in proving entitlement to the exemption. Specifically, Audit questioned whether the taxpayer's majority use of this particular piece of equipment was qualifying use. Audit reasoned that [product B that was prepared] in [Location A] did not undergo further manufacturing at [Location B]. Thus, Audit questioned the taxpayer's eligibility to exempt the M&E used to weigh/price [product B]. Stated differently, Audit did not consider the taxpayer to have adequately demonstrated its entitlement to the exemption.

Pursuant to statute, M&E must be "used directly" in a manufacturing operation in order to be eligible for the exemption. There are eight "used directly" tests. The third "used directly" test provides that equipment is "used directly" in a manufacturing operation if it: "Controls, guides,

⁴ RCW 82.12.02565 provides a corresponding exemption from use tax.

measures, verifies, aligns, regulates, or tests tangible personal property at the site or away from the site.” RCW 82.08.02565(2)(c)(iii) (emphasis added). The weigh-price equipment at issue falls under the “measure” component of this test. Weighing is included within an ordinary understanding of the term “measure.” . . .⁵

A further condition of the exemption is that the majority of the use of the M&E must be a “qualifying use,” *i.e.*, where the M&E is used directly in a manufacturing operation. Rule 13601(10). As stated above, approximately 55% of the product processed through this weigh/price station is connected to the [product A] line with approximately 45% of the product being the [product B line]. Even assuming that the weighing and pricing of the [product B] items at [Location B] is a nonqualifying use, the facts demonstrate that the majority use of the equipment was for weighing and pricing [product A] that clearly [underwent] further manufacturing at [Location B]. Rule 13601(10) provides that when M&E is used both for qualifying and nonqualifying uses, the M&E will be exempt as long as the majority of use is qualifying use. Based on the time sheet records and other relevant information provided during the appeal process, the weigh/price equipment at issue overcomes the majority use threshold and is properly exempt under a dual use analysis. The taxpayer has met its burden of establishing its entitlement to the exemption on the weigh/price equipment. Correspondingly, we also conclude that the taxpayer has met its burden of establishing its entitlement to the exemption on the related replacement parts as long as the parts have a useful life of one year or more and meet all of the other eligibility requirements in Rule 13601.

The second “used directly” test provides that equipment is used directly in a manufacturing operation if it: “Conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site or testing site.” The pallet jacks at issue fall squarely under the “convey/transport” components of this test. The taxpayer uses the jacks to convey and/or transport pallets through the various stages of its manufacturing process, including loading the pallets onto trucks at the end of the manufacturing process.

Even if we were to deem the use of the jacks related to conveying/transporting the [product B] items as a nonqualifying use, the overwhelming majority of the use of the jacks is qualifying use. The taxpayer uses the jacks to convey/transport pallets from the refrigeration unit to all four of the taxpayer’s product lines, three of which are clearly manufacturing. The taxpayer then further utilizes the jacks to convey/transport product through the process on all four lines. Finally, the taxpayer uses the jacks to move the product to the shipping area and then onto the taxpayer’s delivery trucks. The jacks never leave the taxpayer’s [Location B] manufacturing site. At all times, the taxpayer utilizes the jacks in its manufacturing operation.

⁵ “Measure” means “to ascertain the quantity, **mass**, extent, or degree of in terms of a standard unit or fixed amount usually by means of an instrument or container marked off in the units” Webster’s International Dictionary 1400 (3rd Ed. 1993). [Emphasis supplied.] “Mass” is “**the property of a body** that is a measure of its inertia, that is commonly taken as a measure of the amount of material it contains, **that causes a body to have weight in a gravitational field**, that along with length and time constitutes one of the fundamental quantities on which all physical measurements are based. . . .” *Id* at 1388 (emphasis supplied).

Accordingly, we conclude that the pallet/skid jacks qualify for exemption because the overwhelming majority of use of the pallet/skid jacks is a qualifying use. The taxpayer has met its burden of establishing its entitlement to the exemption on the pallet/skid jacks.

DECISION AND DISPOSITION

The taxpayer's petition is granted. We remand this matter to the Audit Division to adjust the assessment in accordance with this decision.

Dated this 19th day of July, 2005.

STATE OF WASHINGTON DEPARTMENT OF REVENUE