Cite as Det. No. 07-0324E, 27 WTD 119 (2008)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	F I N A L E X E C
	)	L E V E L D E T E R M I N A T I O N
	)	
	)	No. 07-0324E
. . .	)	
	)	Registration No. . . .
	)	Document Nos. . . . and . . .
	)	Audit Nos. . . . and . . .
	)	Docket Nos. . . . and . . .
	)	

[1] RCW 82.32.060; Rule 229: REFUNDS -- ASSIGNMENTS. A written release from the taxpayer (the purchaser) affirming that any state tax refund belongs to the Contractor (the seller) acts as an assignment of any refund, and thereby the Contractor has satisfied the "refund to taxpayer" requirement of Rule 229(3)(b)(ii).

[2] RCW 82.08.02565; WAC 458-20-13601: EXEMPTIONS — SALES OF MACHINERY AND EQUIPMENT FOR MANUFACTURING, RESEARCH AND DEVELOPMENT — LABOR AND SERVICES FOR INSTALLATION — WATER TREATMENT. A water distribution business is not a "manufacturer," and treatment of raw water by the water distribution business is not a "manufacturing operation" for purposes of the M&E exemption provided for in RCW 82.08.02565(1).

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.

Director's Designee: Jeffrey B. Mahan

Patti Brewer, A.L.J. – Contractor that collected and remitted retail sales tax on the construction of a water treatment facility it built . . . seeks a refund of a portion of the tax remitted. The Contractor maintains that much of the construction qualifies for the sales tax exemption set out in RCW 82.08.02565 for machinery and equipment purchased by a "manufacturer" for use directly in a "manufacturing operation" and that based on its contract with [the purchaser] it is the proper party to obtain the refund. We deny the refund request on the grounds that the

purchaser of the water treatment facility is not a "manufacturer" engaged in a "manufacturing operations" and, therefore, does not qualify for the exemption.[1]

ISSUES

1. Is a contractor that collected and remitted retail sales tax on the amount it billed for construction services entitled to claim a refund of part of the tax collected and remitted based on its agreement with the purchaser that any refund of tax resulting from application of the M&E exemption is to accrue solely to the benefit of the contractor?

2. Does [the purchaser] qualify as a "manufacturer" engaged in a "manufacturing operation" for purposes of the M&E sales tax exemptions set out in RCW 82.08.02565?

3. If the [purchaser], qualifies as a manufacturer engaged in a manufacturing operation, does any of the following equipment or improvements qualify for the M&E exemption?

    a. Sitework Improvements;

    b. Raw Water Intake and Pump Station;

    c. Ozone Generation and Injection Facility;

    d. UV Light Disinfection Facility and Chemical Systems;

    e. Clearwells;

    f. Improvements and modifications to the existing [pump station]/

    g. Operations Building;

    h. Electrical Equipment;

    i. Yard Piping; and

    j. Design Services.

FINDINGS OF FACT

[Taxpayer] is a construction contractor with its principal corporate offices [outside the state]. In April 2001 [the purchaser] hired the Contractor to design and build a water treatment facility . . . .

Construction of the water treatment facility got underway in . . . 2002 and was substantially completed by . . . 2004. The treatment facility . . . uses chlorine, ozone, and UV light technology to treat and purify water . . . . The treatment process involves multiple steps. . . .

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

Contractor and its subcontractors engineered and designed the various elements of the facility, provided general sitework, made various improvements to the existing . . . infrastructure, and constructed the new water treatment facility. Once the construction phase was completed, operation of the facility was turned over to an affiliated company . . . .[2] [The affiliated company] has contracted to operate the facility of behalf of [the purchaser] for a period of at least . . . years.

[The purchaser] provides water, sewer, and solid waste services to [its] customers . . . . [The purchaser] is "public service business" . . . . [A treatment facility] was built and is operated as part of [the purchaser's] "water distribution business" as that term is defined in RCW 82.16.010(4).[3] Gross income derived by [the purchaser] from its water distribution business is exempt from Washington B&O tax. *See* RCW 82.04.310(1).

[The purchaser] did not claim the manufacturing and equipment (M&E) exemption on the [treatment facility] project and did not provide Contractor with an exemption certificate during the time the project was underway. In . . . 2005, after the construction phase of the project was completed, Contractor submitted a refund request relating to the January 2001 through December 2001 reporting periods. According to that refund request, Contractor "charged sales tax on all machinery and equipment which was installed at the [treatment] facility. However, a significant portion of that equipment actually qualified for the manufacturer's machinery and equipment . . . exemption." . . . The refund request, which was for "[a]pproximately $. . . ," went on to state that "[o]nce refunded, [Contractor] will reimburse the [purchaser] for the over-charged tax." (*Id.*) However, Contractor has since clarified that it does not intend to refund to [purchaser] any of the amount it receives as a result of its refund petition. Instead, both Contractor and [purchaser] have agreed that under the express terms of the [treatment facility] design and build contract any refund granted by the Department in this appeal will accrue solely to the benefit of Contractor.

The 2001 refund request was referred to the Audit Division, where it was denied. Contractor timely appealed from the denial of its 2001 refund request. Contractor also filed a refund request relating to the January 2002 through December 2002 reporting periods. That refund request, which was also for "approximately $. . . was also denied by Audit. Contractor timely appealed from the denial of its 2002 refund request. The two appeals have been combined for purposes of this Determination.

Contractor did not obtain an Exemption Certificate from [the purchaser] until after it had filed the two appeal petitions that are the subject matter of this Determination. The Exemption Certificate is dated . . . , 2006. The [treatment facility] construction project was substantially completed in mid-2004.

ANALYSIS

[2] Both Contractor and [the affiliated company] are subsidiaries of [a third company].

[3] RCW 82.16.010(4) provides that a "'water distribution business' means the business of operating a plant or system for the distribution of water for hire or sale."

A. Introduction.

RCW 82.08.02565(1) provides a retail sales tax exemption for certain machinery and equipment sold to a manufacturer and "used directly in a manufacturing operation." That section provides in relevant part as follows:

> 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, . . . but only when the purchaser provides the seller with an exemption certificate in a form and manner prescribed by the department by rule.[4]

A similar exemption is found in the use tax statutes. *See* RCW 82.12.02565.[5] These analogous exemptions are often referred to in singular fashion as "the M&E exemption."

As set out in the sales tax statute, the M&E exemption has four specific requirements:

1. The purchaser must be a "manufacturer or processor for hire;"
2. The purchased item must meet the definition of "machinery and equipment;"
3. The purchased item must be "used directly in a manufacturing operation or research and development operation;" and
4. The purchaser must provide the seller with an exemption certificate.

See WAC 458-20-13601.

Accordingly, the exemption is available only to a qualified person (manufacturer or processor for hire) who purchases qualified property (machinery and equipment) for a qualified use (directly in a manufacturing operation or research and development operation), and where the qualified person provides the seller with an exemption certificate in the form and manner prescribed in the Department's administrative rules.[6] If any one of these elements is missing, the exemption is not allowed.

B. Contractor Can Claim the Refund.

[4] The specific information that the purchaser must provide in the completed exemption certificate is set out in WAC 458-20-13601(4)(a).

[5] The use tax exemption set out in RCW 82.12.02565 does not include the exemption certificate requirement.

[6] In prior published Determinations we most often divide the third element ("used directly in a manufacturing or research and development operation") into two parts. *See, e.g.*, Det. No. 99-310, 19 WTD 377, 381 (2000); Det. No. 99-296, 19 WTD 594, 594 (2000); Det. No. 04-0097, 24 WTD 92, 95 (2005). In addition, or prior Determinations have not consistently referred to the exemption certificate requirement when describing the elements of the M&E sales tax exemption. But the statute clearly requires that the purchaser provide the seller with a completed exemption certificate in order to qualify for the exemption. As a result, we include that statutory requirement here.

The first issue we must decide is whether Contractor is the proper party to be requesting a refund of retail sales taxes paid by [the purchaser]. The procedural requirements for claiming a refund of tax are set out in WAC 458-20-229(3)(b).[7] That Rule provides in relevant part that "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 "taxpayer" is the person that is responsible for payment of the tax. In the present case, [the purchaser] is the "taxpayer" liable for payment of retail sales tax on the construction of the [treatment facility]. *See* RCW 82.08.020 (imposing sales tax on sales at retail); RCW 82.04.050(2)(b) (defining "sale at retail" to include charges made for tangible personal property consumed and labor and services rendered in respect to constructing a new or existing building or other structure for consumers).

Retail sales tax is paid by the purchaser, and the seller collects the tax and holds it in trust until remitting it to the Department. RCW 82.08.050. In the context of retail sales tax paid by a purchaser (taxpayer) to a seller, Rule 229(3)(b)(ii) provides that the taxpayer must first request a refund or credit from the seller before seeking refund directly from the Department. The primary reasons for this procedure is that the seller has the source records to know if retail sales tax was collected on the sale and is generally in a better position to judge the merits of the claim in the first instance. To the extent the seller is unsure as to whether to refund the tax to the taxpayer, the seller "may contact the department and request advice." Rule 229(3)(b)(ii). Once the seller refunds the retail sales tax to the taxpayer, "the seller may request a refund or credit from the department." *Id.*

Rule 229(3)(b)(ii) makes it clear that a seller is not entitled to a refund of retail sales tax unless and until it refunds the tax collected in error to its customers, and then petitions the Department for a refund. In the present case it is undisputed that Contractor did not refund any of the sales tax collected from [the purchaser] back to that taxpayer. However, Contractor asserts that under the specific terms of the [treatment facility] design and build contract, any refund of tax resulting from application of the M&E exemption is to accrue solely to its benefit. Thus, according to Contractor, it may request and receive the sales tax refund based on the unique nature of the contract it entered into with [the purchaser]. [The purchaser] has confirmed that "[a]s a result of the Contract, any refund based on the M&E exemption will accrue solely to the benefit of" Contractor. . . .

[1] We first note that the Department of Revenue was not a party to the contract between Contractor and [the purchaser]. In addition, Rule 229(3)(b)(ii) does not directly address the situations where the taxpayer and the seller agree that any refund is to accrue to the benefit of the seller. However, even though Rule 229(3)(b)(ii) does not contemplate the exact circumstance presented in this appeal, we conclude that Contractor has met the "refund to taxpayer" requirement of Rule 229(3)(b)(ii) by virtue of obtaining a written release from the taxpayer ([the purchaser]) affirming that any refund belongs to Contractor. By agreeing to the release, [the purchaser] has essentially assigned its right to claim the refund to Contractor. It is generally

[7] WAC 458-20-229 (Rule 229) was revised after this determination was issued, but prior to its publication. The procedural requirements for claiming a refund have been changed.

understood in Washington that the right to claim a sales tax refund can be assigned. *See Puget Sound National Bank v. State, Department of Rev.*, 123 Wn.2d 284, 868 P.2d 127 (1994) (absent an express statutory provision to the contrary, a claim for tax refund is assignable). As the assignee of [the purchaser's] right to claim a refund of sales taxes erroneously paid, Contractor "steps into the shoes of the assignor, and has all of the rights of the assignor." *Id.* at 292, 868 P.2d at 132 (*quoting Estate of Jordan v. Hartford Accident & Idem. Co.*, 120 Wn.2d 490, 495, 844 P.2d 403 (1993)).

Having stepped into the shoes of [the purchaser], Contractor is the proper person to file a request for refund with the Department. As a result, we will address the merits of the claim for refund submitted by Contractor.

C. [The Purchaser] is not a "Manufacturer" Engaged in a "Manufacturing Operation" and, Therefore, Does Not Qualify for the M&E Exemption.

The fundamental objective in statutory interpretation is to ascertain and carry out the legislature's intent. If the statute's meaning is plain on its face, then the court must give effect to that plain meaning as an expression of legislative intent. *State v. J.M.*, 144 Wn.2d 472, 480, 28 P.3d 720, 724 (2001). Plain meaning is discerned from all that the legislature has said in the statute and related statutes which disclose legislative intent about the provision in question. *Department of Ecology v. Campbell & Gwinn L.L.C.*, 146 Wn.2d 1, 11, 43 P.3d 4, 10 (2002). We also must construe the statute so as "to avoid strained or absurd consequences." *Deaconess Medical Center v. Department of Rev.*, 58 Wn. App. 783, 788, 795 P.2d 146, 149 (1990). "To this end, the statute must be read as a whole; intent is not to be determined by a single sentence." *Human Rights Comm'n v. Cheney Sch. Dist. No. 30*, 97 Wn.2d 118, 121, 641 P.2d 163, 164 (1982). *See also Cerrillo v. Esparza*, 158 Wn. 2d 194, 142 P.3d 155, 159 (2006) ("Additionally, while traditional plain language analysis of statutes focused exclusively on the language of the statute, this court recently has also recognized that 'all that the Legislature has said in the statute and related statutes' should be part of plain language analysis.") (*quoting Department of Ecology v. Campbell & Gwinn, L.L.C.*, 146 Wn. 2d 1, 11, 43 P.3d 4 (2002)).

In order to qualify for the M&E exemption, Contractor must first show that [the purchaser] is a "manufacturer" as that term is used in the M&E exemption. The term "manufacturer" is not defined in the exemption statute. However, WAC 458-20-13601(3)(e) explains that for purposes of the exemption the term "manufacturer" has the same meaning as provided in chapter 82.04 RCW. RCW 82.04.110 goes on to define "manufacturer" as "every person who, either directly or by contracting with others for the necessary labor or mechanical services, manufactures . . . for sale or for commercial or industrial use from his or her own materials or ingredients any articles, substances, or commodities."

[2] Under the plain wording of the statute, considering related statutes, we conclude that [the purchaser] is not a "manufacturer" and that the treatment of raw water by [the purchaser] does not qualify as a "manufacturing operation" for purposes of the M&E exemption. [The purchaser] is a water distribution business as that term is defined in RCW 82.16.010(4). As

such, [the purchaser] is subject to the Washington public utilities tax (PUT) and is exempt from the Washington B&O tax on its gross income derived from its water distribution business operations. RCW 82.16.020(1)(g) (imposing PUT on gross income from water distribution business operations); RCW 82.04.310(1) (exempting from the B&O tax business activity subject to the PUT tax). Because [the purchaser] is a water distribution business engaged in water distribution operations, it is not a manufacturer engaged in manufacturing operations.

This conclusion is consistent with the stated legislative intent for the M&E exemption to increase employment in this state's "manufacturing industries" and to enhance the state's "competitive position" vis-à-vis other states for manufacturing jobs. *See, e.g.,* Laws of 1996, ch. 173 and notes following RCW 82.08.02565. A statement of intent can be crucial aid to the interpretation of a statute. *See, e.g., Roy v. Everett*, 118 Wn.2d 352, 356, 823 P.2d 1084 (1992). In contrast to the stated intent to increase manufacturing jobs in Washington, the enactment of the M&E exemption would not increase the competitive position of public utilities distributing water in this state vis-à-vis other states and such activities are not part of this state's manufacturing industries, as discussed below. . . .

The legislature's treatment of utilities as separate and apart from this state's manufacturing industries for taxation purposes is long-standing. The B&O tax was first enacted as part of the Revenue Act of 1935. *See* Laws of 1935, ch. 180, Title II. The PUT was created in that same Act. *See Id.* at Title V. Then, as now, the term "manufacturer" was defined within the B&O tax provisions, and the term "water distribution business" was defined within the public utility tax provisions. *See Id.* at Title II, § 5(j); Title V, § 37(d). Furthermore, the Act specifically provided that the B&O tax did not apply to business activity subject to the PUT. *Id.* at Title II, § 11(b) ("The provisions of this title shall not apply to . . . (b) Any person in respect to a business activity with respect to which tax liability is specifically imposed under the provisions of title V of this act.").[8] Thus, it is clear that from the inception of both the public utility tax and the B&O tax the Washington Legislature understood that a "manufacturer" and a "water distribution business" were distinct types of businesses. Manufacturers were (and are) subject to the B&O tax on their [value of products manufactured] , while water distribution businesses were (and are) subject to the PUT on income from water distribution operations.[9]

"The construction of two statutes shall be made with the assumption that the Legislature does not intend to create an inconsistency. Statutes are to be read together, whenever possible, to achieve

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[8] This provision, which is codified at RCW 82.04.310(1), has been amended over the years and currently provides as follows:

> This chapter [chapter 82.04 RCW] shall not apply to any person in respect to a business activity with respect to which tax liability is specifically imposed under the provisions of chapter 82.16 RCW [the public utility tax] including amounts derived from activities for which a deduction is allowed under RCW 82.16.050.

[9] RCW 82.16.060 provides that a PUT business may be taxed under other chapters of Title 82 "with respect to activities other than those specifically within the provisions of this chapter." [The purchaser's] water distribution business is specifically taxable under RCW Ch. 82.16 and it is not taxable as a manufacturer under RCW Ch. 82.04.

a harmonious total statutory scheme . . . which maintains the integrity of the respective statutes." *Peninsula Neighborhood Ass'n v. Department of Transportation*, 142 Wn.2d 328, 342, 12 P.3d 134, 142 (2000) (citations and internal quotations omitted). The Legislature clearly intended to distinguish between a "manufacturer" and a "water distribution company" when it enacted the B&O tax and the PUT. We presume that the Legislature was cognizant of this distinction when it enacted the M&E exemption and that it did not intend to ascribe a different or inconsistent meaning. In the present case, Contractor is taking the position that [the purchaser] qualifies as a "manufacturer" engaged in a "manufacturing operation" for purposes of the sales and use tax M&E exemptions, but not for purposes of the B&O tax and public utility tax. We conclude this reading of the Washington excise tax statutes to be contrary to the rules of construction set out above.

Reading the M&E exemption statute as a whole and in harmony with Washington's other tax provisions, we conclude that the Legislature intended to limit the M&E exemption to just those taxpayers that engage in business as a manufacturer under the B&O tax. In other words, the same set of businesses that qualify as a manufacturer for purposes of the B&O tax qualify as a manufacturer for purposes of the M&E exemption; and businesses that do not qualify as a manufacturer under the B&O tax do not qualify as a manufacturer for purposes of the M&E exemption. Because [the purchaser] is not a manufacturer engaged in a manufacturing operation for purposes of the B&O tax, it does not qualify for the M&E exemption.

In addition, even if we were to find that the term "manufacturer" as used in the M&E exemption was ambiguous and could reasonably be interpreted to include a water distribution company subject to the PUT, the legislative history of the M&E exemption simply does not support that interpretation.[10]

The M&E exemption was enacted into law in 1995. *See* Laws of 1995, 1st Spec. Sess., ch. 3. The legislation (1995 Substitute Senate Bill 5201) was sponsored by a group of Senators that included Senator Albert Bauer and Senator Emilio Cantu. Prior to sponsoring the M&E exemption legislation, Senators Bauer and Cantu had been part of the Advisory Committee appointed to assist the Department of Revenue in crafting the "Manufacturing Tax Study" that was drafted under the authority of 1994 Senate Bill 6573. *See* Laws of 1994, ch. 94. The Manufacturing Tax Study was finalized and issued in December 1994 and recommended several amendments to the Washington sales and use taxes, including a proposal to "exempt from retail sales/use tax purchases of machinery and equipment by manufacturing firms in all areas of the state." Study, p. 8-2. The recommended sales/use tax exemption for machinery and equipment was incorporated into 1995 Substitute Senate Bill 5201.

[10] A statute is ambiguous if it is susceptible to more than one reasonable interpretation. *Wingert v. Yellow Freight Sys., Inc.*, 146 Wn.2d 841, 852, 50 P.3d 256, 262 (2002). "If the statute is ambiguous, the courts must construe the statute so as to effectuate the legislative intent." *Id*. (*quoting Whatcom County v. City of Bellingham*, 128 Wn.2d 537, 546, 909 P.2d 1303 (1996)). In doing so, "it is appropriate to resort to aids to construction, including legislative history." *Department of Ecology v. Campbell & Gwinn L.L.C.*, 146 Wn.2d 1, 12, 43 P.3d 4, 10 (2002).

During the floor debate on Substitute Senate Bill 5201, Senator Bauer was asked to clarify the scope of the proposed exemption.

> Senator Cantu: "Senator Bauer, I had the honor of serving with you as a member of the Manufacturing Tax Study Committee last summer that resulted in the recommendation of this legislation. In determining the fiscal impact of the proposal, several assumptions were made regarding the scope of the manufacturing and processing included in the recommendations. The scope of manufacturing and processing was described to include all business activities identified in two-digit Standard Industrial Codes 20 through 39 and those businesses' activities identified in the three digit Standard Industrial Code 737.
>
> "Is it intended that Substitute Senate Bill No. 5201 apply to all business activities identified in two-digit Standard Industrial Codes 20 through 39 and those businesses' activities identified in the three digit Standard Industrial Code 737?"
>
> Senator Bauer: "Yes, Substitute Senate Bill No. 5201 is intended to apply to all business activities identified in two-digit Standard Industrial Codes 20 through 39 and those businesses' activities identified in the three digit Standard Industrial Code 737,"

1995 Senate Journal, Vol. 1, p. 626. A similar Point of Inquiry was held between Representatives Foreman and Van Luven during floor debate in the House. *See* 1995 House Journal, Vol. III, p. 3974.

Senators Cantu and Bauer clarified that the proposed M&E legislation was intended to apply to all business activities that fall within certain Standard Industrial Classifications. The Standard Industrial Classification (SIC) was developed by the federal Office of Management and Budget as a means of analyzing economic data within and between various industries. The SIC is divided into various "Divisions," "Major Groups," "Industry Groups," and finally specific industry classifications. For example, a water supply business falls within Division E (Transportation, Communications, Electric, Gas, and Sanitary Services), Major Group 49 (Electric, Gas, and Sanitary Services), Industry Group 494 (Water Supply), and industry classification 4941 (Water Supply). *See* http://www.osha.gov/pls/imis/sic_manual.html (accessed 7/18/07).

Manufacturing is set out in Division D of the SIC. Within Division D are Major Groups 20 through 39, which constitute the manufacturing industries referred to by Senators Bauer and Cantu during the floor debate of Substitute Senate Bill 5201. Thus, the legislative intent was to create a sales tax exemption that specifically benefited those businesses that operate within Division D (Manufacturing) of the SIC.

In light of this legislative history, it is evident that the terms "manufacturer" and "manufacturing operation" as used within the M&E exemption are intended to encompass business operations that would qualify as Manufacturing under the SIC. We do not mean to imply that only businesses whose **primary** SIC falls within Division D can claim the exemption. *See* Manufacturing Tax Study, p. 4-3 and Table 4-4.[11] *See also* RCW 82.16.060; Det. No. 92-183ER, 13 WTD 096, 101 (1993) ("Generally, if a taxpayer engages in activities which are within the purview of two or more tax classifications, it will be taxable under each applicable classification."); *City of Kennewick v. State*, 67 Wn.2d 589, 594, 409 P.2d 138, 140-41 (1965) (A public utility is subject to B&O tax on gross receipts generated from activity not covered under the public utility tax.). However, it is clear that the intent of the Legislature was to limit the exemption to machinery and equipment purchased for use in a business operation that fits within either Division D or Industry Group 737 of the SIC. If a taxpayer is engaged in two or more business operations, one of which constitutes manufacturing under Division D of the SIC, the machinery and equipment purchased for use within that business operation may qualify for the M&E exemption.

In the present case, we have been presented with no evidence to suggest that [the purchaser] is engaged in more than one business operation. Rather, the evidence presented shows that, with respect to the operations of the [treatment facility, the purchaser] is engaged in only one business operation: water distribution. Water distribution falls within Division E, Major Group 49, Industry Group 494 of the SIC. Thus, [the purchaser's] operations fall outside of the industry type that was intended to benefit from the M&E exemption. Moreover, to read the M&E exemption broadly, as the taxpayer suggests, would violate the rule of construction that exemption statutes are to be narrowly construed. *See Budget Rent-A-Car, Inc. v. Department of Rev.*, 81 Wn.2d 171, 174, 500 P.2d 764, 767 (1972).

Based on both our reading of the plain language of the statute and our analysis of the relevant legislative history, we conclude that [the purchaser] is not a manufacturer engaged in a manufacturing operation. Rather, [the purchaser] is a water distribution business engaged in the business of operating a plant or system for the distribution of water for sale to its customers. [The purchaser's] activity in changing raw water into potable water is done in the context of a water distribution business engaged in a water distribution operations, not in the context of a manufacturer engaged in a manufacturing operation. To conclude otherwise would broaden the application of the M&E exemption beyond the intent of the Washington Legislature when it enacted the exemption.

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[11] One drawback of the SIC is that the assignment of an industry code to a particular business only reflects the principal activity of that business. Many taxpayers may engage in more than one business activity, but are instructed to report under the SIC that most closely corresponds to their overall business. Recognizing this drawback, the Department did not rely exclusively on the SIC in determining which businesses qualified as a "manufacturing" business. Rather, in compiling data for the Study, the Department used a database of 14,375 businesses that reported at least 10% of their gross income under the manufacturing B&O tax classification during 1992. Only 10,825 of those businesses reported as primarily falling under an industry code set out in Division D of the SIC.

Contractor does not dispute that [the purchaser] is a water distribution business subject to the PUT. Rather, Contractor asserts that there is no provision in the M&E statute that denies the benefit of the sales tax exemption to all businesses that are subject to the PUT. Contractor points out that the Legislature, in defining the term "manufacturing operations," specifically excluded only one type of PUT taxable activity; namely, the production of electricity by a light and power business. Thus, according to Contractor, the Legislature must have intended the term "manufacturing operation" to include other types of PUT taxable businesses such as water distribution.

RCW 82.08.02565(2)(d), which defines the term "manufacturing operation," specifically provides that the term "also includes that portion of a cogeneration project that is used to generate power for consumption within the manufacturing site of which the cogeneration project is an integral part. The term does not include the production of electricity by a light and power business as defined in RCW 82.16.010 . . . ." (Emphasis added). Contractor reads the express exclusion of "the production of electricity by a light and power business" from the definition of a manufacturing operation as an implied inclusion of all other PUT taxable entities. However, the context of the provision indicates that it was included in order to distinguish between an eligible "cogeneration project that is used to generate power for consumption within the manufacturing site," and ineligible "production of electricity by a light and power business." Thus, the express exclusion of the production of electricity by a PUT taxable light and power business was made part of the statutory definition in order to clarify the meaning of the preceding sentence, not to signify that other types of PUT taxable businesses could qualify.

Even if we were to conclude, based on taxpayer's argument, that the statute is ambiguous, the legislative history of RCW 82.08.02565(2)(d) still supports our reading of the statutory language. As noted above, the M&E exemption was enacted in 1995. *See* Laws of 1995, 1st Spec. Sess., ch. 3. As originally proposed, the 1995 legislation provided a definition of the term "manufacturing process" and further provided that "[t]he term does not include . . . the production of electricity . . . ." *See* 1995 Senate Bill 5201, p. 4.[12] No distinction was made between the production of electricity by an entity that was subject to the Washington PUT and the production of electricity by an entity not subject to the PUT. The production of electricity simply did not qualify as a "manufacturing process" regardless of who produced the electricity or how it was used. The 1995 Senate Bill was later amended and reintroduced as 1st Engrossed Substitute Senate Bill 5201. 1st Engrossed Substitute Senate Bill 5201 replaced the term "manufacturing process" with the term "manufacturing operation," and further provided that "[t]he term does not include . . . cogeneration or the production of electricity . . . ." *See* 1st Engrossed Substitute Senate Bill 5201, p. 3.[13] Again, no distinction was made between the production of electricity by a PUT taxable entity and a non-PUT taxable entity.

However, as floor debate continued on the Bill, a significant change to the proposed statutory definition was included as part of a comprehensive amendment offered and adopted on May 22,

[12] Available on-line at http://apps.leg.wa.gov/documents/billdocs/1995-96/Pdf/Bills/Senate%20Bills/5201.pdf.
[13] Available on-line at http://apps.leg.wa.gov/documents/billdocs/1995-96/Pdf/Bills/Senate%20Bills/5201-S.E.pdf.

1995. *See* 5/22/95 Senate Amendment to 5201, p. 3.[14] The adoption of this comprehensive amendment resulted in the term "manufacturing operation" being defined to "include that portion of a cogeneration project that is used to generate power for consumption within the manufacturing site of which the cogeneration project is an integral part. The term does not include . . . the production of electricity by a light and power business as defined in RCW 82.16.010 . . . ." Thus, for the first time, the proposed Bill distinguished between an eligible cogeneration project used to generate power for consumption within the manufacturing site and the ineligible production of electricity by a light and power business subject to the PUT. The portion of the statutory definition that states that the production of electricity by a light and power business subject to the PUT does not qualify as a "manufacturing operation" is clearly tied to, and designed to clarify, the proceeding sentence which specifies that a cogeneration project can qualify as a "manufacturing operation."

After careful consideration, we do not agree with Contractor's argument that the express exclusion in RCW 82.08.02565(2)(d) of the production of electricity by a light and power business subject to the PUT signifies that the Legislature intended the term "manufacturing operation" to include other types of PUT taxable businesses such as water distribution. At best, the argument advanced by Contractor points out a possible ambiguity in the M&E statute. But this possible ambiguity is not enough to convince us that a water distribution business subject to the PUT can qualify for the M&E exemption. Rather, we believe that our more comprehensive statutory construction and legislative history analysis supports our finding that persons that qualify as a "water distribution business" under the PUT are not "manufacturers" engaged in a "manufacturing operation."

Because we conclude that [the purchaser] does not qualify for the M&E exemption, we do not address whether any of the specific components of the [treatment facility] system qualify as "machinery and equipment" under the exemption.

DECISION AND DISPOSITION

Contractor's Petition for Refund is denied.

Dated this 21st day of November, 2007.

[14] The proposed amendment to 1995 Substitute Senate Bill 5201 is available on-line at http://apps.leg.wa.gov/documents/billdocs/1995-96/Pdf/Amendments/Senate/5201-S.E%20AAS%205-22-95%20S3506.1.pdf. The 5/22/95 amendment resulted in 2nd Engrossed Substitute Senate Bill 5201, which was subsequently passed by both the Senate and the House and signed into law on June 8, 1995.