

Cite as Det. No. 03-0310, 23 WTD 190 (2004)

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>
Interpretation of)	
)	No. 03-0310
...)	
)	Registration No. . . .
)	Appeal of
)	. . . , 2003 Letter Ruling
)	Docket No. . . .
)	

RULE 13601; RCW 82.08.02565: RETAIL SALES TAX -- M&E -- BAR CODING SCANNER -- SOFTWARE. A manufacturer's purchase of a bar coding scanner system to track and locate inventory (raw materials - finished goods) through its manufacturing process did not qualify for the M&E exemption because it was not used directly in the manufacturing process.

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.

M. Pree, A.L.J. – A plywood manufacturer seeks to exempt its purchase of a barcode labeling system from retail sales tax. The system identifies particular products for forklift operators and directs the operators where to move the products. It also tracks inventory, which enables the taxpayer's purchasing staff to acquire the necessary materials to fill new sales orders. Because the system is not used directly in the manufacturing operation, the retail sales tax applies.¹

ISSUE

Is a bar code labeling system, which conveys information to forklift operators and purchasing agents, used directly in the manufacturing operation so as to qualify for the machinery and equipment (M&E) exemption?

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

FINDINGS OF FACT

. . . (taxpayer) manufactures plywood in Washington. The taxpayer purchases wood veneer from forest products companies. They deliver the veneer to the taxpayer's facility. The taxpayer sands, presses, and glues the veneer together forming plywood, which often varies to meet customer specifications regarding grade, color, and wood type.

The taxpayer's customers include furniture manufacturers, cabinet makers, and distributors who sell the plywood to retailers. Common carriers deliver the plywood from the taxpayer's facility to its customers.

The taxpayer is purchasing a bar coding system (the "system") for the materials used in its manufacturing process. The system includes hardware consisting of scanner, printers, and a personal computer. The system also includes software and training. The system's vendor specified the charges for each component in its bid. The vendor attributed about half the system's total cost of \$. . . to software, one-third to hardware, and the balance for installation and training.

The system tracks both the location and quantity of veneer by type and grade at the taxpayer's manufacturing facility. The system includes software, with which the taxpayer's purchasing manager creates a purchasing order for veneer. The manager sends the order to a forest products vendor. When trucks deliver crates of veneer, the system creates pre-printed bar codes and identification (ID) tags. Forklift drivers attach the codes and tags to the crates as they unload them and place them in inventory.

When a customer orders a certain grade of plywood, a forklift operator finds the appropriate crate using the ID tag. The forklift operator brings the crate to a grader employed by the taxpayer. The grader sorts and stacks the veneer according to customer specifications, then sends the veneer to assembly. After each order is filled, the grader removes the bar code and ID tag. The grader uses the system to update the crate information, and to print a new bar code and ID tag. The process repeats itself until the veneer in the crate is exhausted.

The taxpayer wrote to the Department of Revenue (Department) inquiring whether its purchase of the system qualified for the machinery and equipment (M&E) exemption from retail sales tax. The Department's Taxpayer Information and Education section (TI&E) replied, ruling that the system was not used directly in the manufacturing process because the system did not direct or control M&E that acts or interacts with tangible personal property. The taxpayer appealed, contending the system controls and measures the flow of veneer through its manufacturing process.

ANALYSIS

If the taxpayer's system is "used directly" in the taxpayer's manufacturing operation, the taxpayer's purchase may be exempt from retail sales tax. RCW 82.08.02565 exempts from retail sales tax "sales to a manufacturer . . . of machinery and equipment used directly in a manufacturing operation" See also RCW 82.12.02565 (use tax exemption) and the Department's Rule 13601 (WAC 458-20-13601).

RCW 82.08.02565(2)(c) currently provides:

Machinery and equipment is "used directly" in a manufacturing operation or research and development operation if the machinery and equipment:

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

The taxpayer's bar coding system communicates information through bar codes, ID tags, computer hardware and software. The system does not act upon or interact with the raw materials (wood veneer) or the final product (plywood), nor does it act or interact with other machinery. The system does not convey, transport, or handle the materials. The forklifts perform this function. Similarly, the forklift operators or other employees with different machines control, guide, measure, verify, align, regulate, and test the taxpayer's products and machinery. Graders and forklift operators, not the system, perform the control and measure functions. None of the other "used directly" activities included in RCW 82.08.02565(2)(c)² appear applicable.

Rule 13601(9) provides more detailed discussion and offers examples³ of when machinery and equipment is "used directly" in a manufacturing operation and explains what is not "used directly":

² RCW 82.08.02565(2)(c)(iv)-(viii).

³ 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

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.

The taxpayer's use is administrative in the sense that it tracks inventory. It also communicates information to the forklift drivers and purchasing agents. In Det. No. 99-337, 19 WTD 876 (2000), we denied the exemption from the retail sales and use taxes for communication equipment used to dispatch cement mixers. *See also* Det. No. 99-337, 19 WTD 876 (2000). The taxpayer's bar coding system performs a similar communication function.

We have previously determined that to qualify for the M&E exemptions, laptop computers must: 1) direct or control machinery or equipment that acts upon or interacts with tangible personal property; or, 2) act upon or interact with an item of tangible personal property. Det. No. 00-103, 20 WTD 67 (2001). Computer equipment that only produces the necessary specifications and schematics to enable the shop machinery to be programmed neither directly controls equipment nor interacts with an item of tangible personal property. Accordingly, such computer equipment does not qualify for the M&E exemption. Det. No. 00-104, 20 WTD 75 (2001). Similarly, the taxpayer's bar coding system does not directly control manufacturing machinery or directly transmit information to manufacturing equipment.⁴

We conclude that the taxpayer's system does not fall within any of "used directly" descriptions for its manufacturing process and is not eligible for the M&E exemption.

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

(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 this criteria. Machinery and equipment used to take readings or measurements, such as devices that take readings or probe with sensors, is eligible under this criteria.

Additional examples and descriptions of "used directly" activities are included in Rule 13601(9), none of which match the taxpayer's system.

⁴ Taxpayer's facts are unlike those relating to the automatic transfer of information by software to a router, as discussed in Determination No. 00-104. In that case, the Department acknowledged the software would have qualified for the exemption if the software had been used at least 50% of the time to transfer information to a router, rather than only 10% of the time. *See also* Det. No. 00-103, 20 WTD 67 (2001), allowing the exemption where software was "used directly" in the manufacturing process. Software that automatically makes the joinery equipment cutting settings qualifies for the M&E exemption.

DECISION AND DISPOSITION

We deny the taxpayer's petition.

Dated this 30th day of October, 2003.