

Cite as Det. No. 04-0147, 23 WTD 369 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition For)	<u>D E T E R M I N A T I O N</u>
Correction of Assessment and Denial)	
of Certificate Application of)	
)	No. 04-0147
)	
...)	Registration No. . . .
)	Document No. . . .
)	Audit No. . . .
)	Denial of Distressed Area Tax Deferral Application
)	Special Programs Index No. . . .
)	Docket No. . . .

[1] RULE 24001; RCW 82.60.020: TAX DEFERRAL – DISTRESSED AREA – “QUALIFIED BUILDING” – WAREHOUSE LOCATED AWAY FROM MANUFACTURING FACILITY. “Qualified buildings” must be an “integral and necessary part of a manufacturing . . . operation,” and thus, contiguous to the actual factory, mill, or plant in order to qualify for tax deferral.

[2] RULE 24001; RCW 82.60.020: – TAX DEFERRAL – DISTRESSED AREA – “QUALIFIED MACHINERY AND EQUIPMENT” – LOCATED AWAY FROM MANUFACTURING FACILITY. “Qualified machinery and equipment” must be an an “integral and necessary part of a manufacturing . . . operation,” and thus located at the manufacturing site in order to qualify for tax deferral.

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.

Taxpayer objects to the withdrawal of a chapter 82.60 RCW distressed area tax deferral certificate, and the accompanying assessment of retail sales and use tax, on a warehouse that stored raw materials for Taxpayer's manufacturing facility. . . miles away. Taxpayer additionally objects to the denial of a deferral certificate on a second warehouse co-located with the first warehouse.¹

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

ISSUES:

1. Do refrigerated warehouses built by Taxpayer qualify for tax deferral under the definitions in chapter 82.60 RCW when they were located . . . miles away from Taxpayer's factory?
2. Did the acquisition and installation of refrigeration equipment in the warehouses qualify for tax deferral under chapter 82.60 RCW when the warehouses were located . . . miles away from Taxpayer's factory?

FINDINGS OF FACT:

Bauer, A.L.J -- . . . (Taxpayer) owns and operates an [agricultural product] processing facility whereby raw [agricultural products] are processed into various forms of food products. The processing operation is "manufacturing" as that term is used in the Tax Deferral rule (WAC 458-20-24001), and that issue was conceded in phone conversations with both the Audit Division (Audit) and Special Programs Division (Special Programs) of the Department of Revenue (Department). The processing operation requires a continuous flow of raw [agricultural products] that must be stored in refrigerated warehouses until needed. The building housing the processing facility has only limited space to handle the [agricultural products] that will be processed. Consequently, additional refrigerated storage is required to hold the raw materials [agricultural products] Taxpayer uses for processing. Two such warehouses are required for this purpose.

Taxpayer states it built its refrigerated [agricultural product] warehouses away from the processing facility for two reasons:

- First, the real property on which the processing facility is built is limited in size and building the storage warehouses on site would significantly interfere with the ability to expand the processing facility if required at some future date. In fact, the site is too small to handle the two raw materials storage warehouses in any event.
- Second, significant environmental and health concerns dictate the storage facilities be built off-site. . . . Aside from the potential for contamination, there is also the simple need to keep the grounds around a food processing facility as clean as possible.

The [agricultural product] processing facility operates year around, but the [agricultural products] are harvested only once per year. Consequently, the facility acquires the [agricultural products] when harvested pursuant to a supply agreement with the farmer and stores them as raw materials for use in the processing operation throughout the year. [Agricultural product] leaves are removed at the storage warehouse by conveyance and by another machine at a third location on the way to the processing facility. The [agricultural products] -- without leaves -- arrive in crates at the manufacturing facility where they are then processed.

The raw [agricultural products] used for processing must be stored in a refrigerated warehouse, and cannot sit for an extended length of time in an uncontrolled environment. Without the refrigerated

warehouses, there could be no processing operation because the [agricultural products] would rot. Raw [agricultural products] are moved from the warehouses generally on a daily basis, just as would be done if the warehouses were on the processing facility's site.

Warehouse No. 1. Taxpayer timely submitted its application for a tax deferral certificate for the first refrigerated warehouse in the spring of 2002. This application was approved, and Certificate Number . . . was issued.

After this warehouse was completed, the Audit Division (Audit) of the Department of Revenue (Department) reviewed Taxpayer's business records from May 30, 2001 to December 31, 2001. Taxpayer's deferral certificate was withdrawn and the above-referenced assessment of retail sales tax was issued on April 22, 2001 in the total amount of \$. . . , which amount included \$. . . in interest up to the date of the assessment.

Schedule 2 of this audit assessed state and local deferred retail sales tax as follows:

This Schedule asserts Deferred Retail Sales Tax on the construction of the [agricultural product] Warehouse and the purchase and installation of a refrigeration unit at the [agricultural product] Warehouse per WAC 458-20-24001(2)(n). The [agricultural product] Warehouse is located . . . miles away from the [agricultural product]-processing center. A warehouse that is located separate and apart from the [agricultural product]-processing center is not considered integral to the [agricultural product]-processing center.

[WAC 458-20-24001(2)](n) "Qualified buildings" means construction of new structures and expansion or renovation of existing structures for the purpose of increasing floor space or production capacity, used for manufacturing and research and development activities.

"Qualified buildings" are limited to structures used for manufacturing and research and development activities. "Qualified buildings" include plant offices and warehouses if such facilities are essential to or an integral part of a factory, mill, plant, or laboratory. "Office" means space used by professional, clerical, or administrative staff. For plant office space to be a qualified building its use must be essential or integral to the manufacturing or research and development operation. Office space that is used by supervisors and their staff, by technicians, by payroll staff, by the safety officer, and by the training staff are examples of qualifying office space. "Warehouse" means buildings or facilities used for the storage of raw materials or finished goods.

(Emphasis added.)

Warehouse No. 2: Taxpayer submitted an application for a Distressed Area Deferral of sales and use tax on its second warehouse investment project in the spring of 2003, and the application was received by the Department on April 16, 2003. When the Special Programs Division representative learned that this warehouse was located . . . miles from the processing facility, the application was denied by letter dated April 23, 2003, stating:

. . . your investment project will be a warehouse located . . . miles away from your manufacturing facility.

In order for a warehouse to be a qualified structure, it must be an integral part of a factory, mill, or plant used for manufacturing. A warehouse that is not on the same site as the manufacturing facility does not qualify for the deferral.

. . .

In its appeal dated May 19, 2003, Taxpayer stated that no assessment for this warehouse had been issued at the time of the appeal. Taxpayer anticipated that the sales tax owed, absent a deferral, would be approximately \$

ANALYSIS:

[1] Chapter 82.60 RCW establishes a sales and use tax deferral program in certain economically depressed areas of the state. The deferral applies to sales and use taxes imposed on the construction of qualified buildings or acquisition of qualified machinery and equipment. Taxpayer's [agricultural product] processing facility and refrigerated warehouse at issue in this appeal are located in such an area.

"Qualified buildings," for purposes of the chapter 82.60 RCW deferral, are described as:

. . . new structures . . . used for manufacturing . . . , including . . . warehouses or other facilities for the storage of raw materials . . . if such facilities are an essential or an integral part of a factory . . . used for manufacturing

RCW 82.60.020(8) (emphasis added).

"Qualified buildings" are limited to structures used for manufacturing "Qualified buildings" include . . . warehouses if such facilities are essential to or an integral part of a factory, mill, plant. . . . "Warehouse" means buildings or facilities used for the storage of raw materials or finished goods.

WAC 458-20-24001(2)(o) (Rule 24001(2)(o)(emphasis added).

"Qualified machinery and equipment," for purposes of the chapter 82.60 RCW deferral, is described as follows:

(9) "Qualified machinery and equipment" means all new industrial and research fixtures, equipment, and support facilities that are an integral and necessary part of a manufacturing or research and development operation. "Qualified machinery and equipment" includes: Computers; software; data processing equipment; laboratory

equipment; manufacturing components such as belts, pulleys, shafts, and moving parts; molds, tools, and dies; operating structures; and all equipment used to control or operate the machinery.

RCW 82.60.020(9) (emphasis added).

(q) "Qualified machinery and equipment" means all new industrial . . . fixtures, . . . that are an integral and necessary part of a manufacturing . . . operation. . . .

(i) "Industrial fixture" means an item attached to a building or to land. Examples of "industrial fixtures" are fuel oil lines, boilers, craneways, and improvements to land such as concrete slabs. (9) "Qualified machinery and equipment" means all new industrial and research fixtures, equipment, and support facilities that are an integral and necessary part of a manufacturing or research and development operation. "Qualified machinery and equipment" includes: Computers; software; data processing equipment; laboratory equipment; manufacturing components such as belts, pulleys, shafts, and moving parts; molds, tools, and dies; operating structures; and all equipment used to control or operate the machinery.

Rule 24001(2)(q),(i)(emphasis added).

Taxpayer argues that, for purposes of chapter 82.60 RCW's distressed area deferral, its two warehouses and their cooling units fit, respectively, the RCW 82.60.020 and Rule 24001 definitions of "qualified buildings" and "qualified machinery and equipment." Taxpayer argues that neither chapter 82.60 RCW nor Rule 24001 requires a raw materials warehouse to be built adjacent to, or on the same site as, the manufacturing facility itself.

Taxpayer also believes that standard dictionary definitions of the terms "essential" and "integral" do not restrict application of those terms to geographically confined areas. Webster's New World Dictionary, College Edition (1984), defines "essential" as "absolutely necessary, indispensable." The same dictionary publication defines "integral" as "necessary for completeness -- made up of parts forming a whole." If something is essential or integral, it remains essential or integral no matter where it is located.

Taxpayer further asserts that it should not matter that the refrigerated warehouses are located . . . miles away from the processing facility -- the storage is still indispensable and an essential component of the manufacturing process "as a whole," and is therefore integral to the processing facility. Both warehouses are, therefore, essential and integral to the facility.

According to Taxpayer, both the auditor and the Special Programs Division representative involved in these matters have stated that, had the refrigerated warehouses been built adjacent to the processing facility, there would be no question as to their eligibility for the chapter 82.60 RCW distressed area deferral. Yet, because the warehouses are located at a site . . . miles away, the Department deems them to have lost their "essential" or "integral" character even though

they are used for the same purpose and in essentially the same manner as had they been built on-site. That position, according to Taxpayer, is without merit and unsupported by the statute.

Taxpayer believes the Department has incorrectly imported the manufacturing and equipment (M&E) exemption "site" requirement to administer chapter 82.60 RCW's distressed area deferral. Under RCW 82.08.02565(2)(c)(ii),² M&E that "temporarily stores an item of tangible personal property at the manufacturing . . . site" may be considered to be "used directly" in the manufacturing operation and thus be exempt. The term "site," however, is not defined by statute. Subsection (2)(g) of WAC 458-20-13601 (Rule 13601, the M&E rule) repeats the same "manufacturing site" requirement,³ and defines "site" in subsection (2)(j) as the "location where the manufacturing takes place." Excise Tax Advisory 2012-6S.08.12.13601 (ETA 2012),⁴ further addresses the application of the M&E exemption to activities that take place away from the manufacturing site, and describes the term "site" as "immediate adjacent parcels of real property."⁵

In interpreting statutes we must determine legislative intent; and to do so we look first to the language of the statute. *Lacey Nursing v. Department of Rev.*, 128 Wn.2d 40, 53, 905 P.2d 338 (1995). Absent ambiguity, we rely on the plain language of the statute. *Id.* If ambiguous, we engage in statutory construction. *Id.* A statute is ambiguous if it is susceptible to more than one reasonable interpretation. *Western Telepage, Inc. v. City of Tacoma*, 140 Wn.2d 599, 608, 998 P.2d 884 (2000).

RCW 82.60.020(8) defines "qualified buildings" to include warehouses or other facilities for the storage of raw material or finished goods if such facilities are:

. . . an essential or an integral part of a factory, mill, plant . . . used for manufacturing . . .

(Emphasis added.) "Qualified equipment," under RCW 82.60.020(10) must be:

. . . an integral and necessary part of a manufacturing . . . operation . . .

(Emphasis added.) Neither chapter 82.60.RCW nor Rule 24001 explains what the above-emphasized terms mean.

When statutory terms are not defined, the Department turns to their "ordinary dictionary

² A correlating use tax exemption is at RCW 82.12.02565.

³ "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. . . ." (Emphasis added.)

⁴ Issued on March 31, 2003.

⁵ "A site is one of more immediately adjacent parcels of real property. The ownership status of the property is not relevant -- a parcel can be owned, rented, or leased by the manufacturer or processor for hire. Adjacent parcels of real property separated only by a public road comprise a single 'site.' The public road dividing the site is an incidental separation of what would otherwise be one site."

meaning.” *Western Telepage, Inc. v. City of Tacoma*, 140 Wn.2d 599, 609, 998 P.2d 884 (2000).

Webster’s Third New International Dictionary, Unabridged (Webster’s Unabridged Dictionary)⁶ defines, in the context of this case, a “factory” as “a building or collection of buildings with facilities (as power driven machinery) for the manufacture of goods often from raw materials: a place where work is done in the fabricating of goods, wares, or utensils. “Mill” is defined to be “a building or collection of buildings with machinery by which the processes of manufacturing are carried on.” “Plant” is defined to be “a factory or workshop for the manufacture of a particular product.”

A “qualified building” must be an essential or an integral part of a “factory,” “mill,” or “plant.” Physical proximity determines whether a building is part of a factory, mill or plant. Therefore, in order to be “an essential or an integral part of a factory, mill, or plant,” Taxpayer’s warehouses would have to be contiguous to Taxpayer’s [agricultural product] processing facility -- the actual factory, mill, or plant -- in order to qualify for tax deferral.

[2] “Qualified machinery and equipment” must be an “integral and necessary part of a manufacturing . . . operation.” The term “manufacturing operation” is not defined in chapter 82.60 RCW, but it is defined under RCW 82.08.02565(2)(d), the statutes that concerns the M&E exemption that deals with the identical question. In RCW 82.08.02565(2)(d), 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.” Therefore, in order to be an “integral and necessary part of a “manufacturing operation” for purposes of the chapter 82.60 RCW deferral, the refrigeration equipment must also be located at the manufacturing site.

Taxpayer’s interpretations fail to succeed under the plain meaning of both RCW 82.60.020 and Rule 24001 because they focus only on the concepts of “necessary” and “integral,” while failing to take into account what they must be a “necessary” and integral” part of.

Even if we found that Taxpayer’s broad interpretation was also reasonable, rules of statutory construction do not favor Taxpayer in resolving any ambiguity created by two differing interpretations. At issue is an exemption statute. When we interpret exemption provisions, the burden is upon the taxpayer to show the exemption applies and any ambiguity is “construed strictly, though fairly and in keeping with the ordinary meaning of their language, against the taxpayer.” *Simpson Inv. Co.*, 141 Wn.2d 139 at 149-50 (quoting *Group Health Coop. of Puget Sound, Inc. v. Washington State Tax Comm’n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967)).

In construing the exemption provision strictly and against Taxpayer, it would not be entitled to the exemption.

⁶ Following the lead of the Washington Supreme Court, the Appeals Division uses, whenever possible, Webster’s Unabridged Dictionary as its dictionary reference, and Webster’s Collegiate dictionary and other dictionary definitions as secondary sources.

Accordingly, the department's position is affirmed.

DECISION AND DISPOSITION:

Taxpayer's petition is denied in full.

DATED this 28th day of June 2004.