

Cite as Det. No. 13-0181, 33 WTD 339 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund and)	<u>D E T E R M I N A T I O N</u>
Correction of Assessment of)	
)	No. 13-0181
)	
...)	
)	Registration No. . . .
)	

[1] RCW 82.08.855, RCW 82.12.855: RETAIL SALES AND USE TAX EXEMPTION – REPLACEMENT PARTS, LABOR AND SERVICES -- QUALIFYING FARM MACHINERY AND EQUIPMENT USED “PRIMARILY” FOR GROWING, RAISING OR PRODUCING AGRICULTURAL PRODUCTS – CLEANING SHED. Replacement parts for a cleaning shed used for cleaning, culling, sizing, and packing potatoes in boxes after their harvest were ineligible for exemption because the shed was not used primarily in growing, raising, or producing the potatoes.

[2] RCW 82.08.855 82.12.855: RETAIL SALES AND USE TAX EXEMPTION -- REPLACEMENT PARTS, LABOR AND SERVICES -- QUALIFYING FARM MACHINERY AND EQUIPMENT USED “PRIMARILY” FOR GROWING, RAISING OR PRODUCING AGRICULTURAL PRODUCTS – FORKLIFTS. Replacement parts for forklifts used on a potato farm for various tasks were ineligible for exemption because they were not used primarily in growing, raising, or producing the potatoes.

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.

Bauer, A.L.J. – A farm that grows potatoes seeks a retail sales tax and use tax exemption for replacement parts and labor for equipment in its cleaning shed and for its forklifts. We deny the petition.¹

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

ISSUE

Under RCW 82.08.855 and RCW 82.12.855, are replacement parts and the labor used in the installation and/or the repair of a farm’s potato cleaning equipment and forklifts exempt from retail sales and use tax?

FINDINGS OF FACT

The Audit Division (Audit) of the Department of Revenue (Department) audited the books and records of [Taxpayer] for the period January 1, 2008 through June 30, 2011 (audit period). As a result, Audit issued the above-referenced assessment on February 21, 2012, in the following amounts:

\$. . .	Use Tax
. . .	Audit Interest
. . .	5% Audit Penalty for Substantial Underpayment
\$. . .	Total Assessed

Of this amount, Taxpayer has paid \$. . . Taxpayer appealed the assessment on June 15, 2012.

Taxpayer farms approximately 240 acres in Washington -- some of it owned and some of it leased. Taxpayer produces a variety of farm/agricultural products that include wheat and mint. Its primary commodity, and the subject of this appeal, are red, yellow, and specialty small (3/4 - 3" in diameter) potatoes, 50% of which are organic, and for which there is a niche market.

All commercially farmed potatoes, regardless of size, are dug out of the ground using custom farm machinery. Digging equipment has conveyor belts that move the potatoes from the ground up and into trucks for removal from the field. This process results in a certain amount of dirt, rock, and grit being loaded into the trucks along with the potatoes.

All potatoes, regardless of size, must be cleaned before being marketed. Taxpayer’s potato production -- in respect to the cleaning function -- is not similar to that of typical potato growers that produce the more standard size of potatoes – those generally greater than 3-4" in diameter (e.g., russets).

The dirt, rock, and grit that must be removed from larger conventional potatoes averages less than 2.0% of their volume when harvested into the trucks. Because of this, and because larger potatoes are generally more durable, trucks can unload them (along with the dirt, rock, and grit) directly into storage facilities without any further process or treatment. These uncleaned potatoes can remain in storage for up to a year until such time they are needed for processing or packing, at which point they will be cleaned. Thus, the natural end to their harvest process is when they are loaded onto trucks in the fields where they are grown.

Dirt, rock, and grit can constitute up to 50% of the content when Taxpayer's smaller potatoes are harvested and loaded onto the farm trucks. Taxpayer's small potatoes are also not as durable as the larger more conventional varieties grown by others, and are more subject to bruising and other damage. As a result, Taxpayer does not have the option of storing its potatoes after the digging process for future processing or packaging, but must remove the dirt, rock, and grit immediately in order to prevent their loss or damage.

To accomplish the cleaning after Taxpayer has dug its potatoes, the farm trucks onto which they have been loaded travel a short distance (not more than three miles from any location) to Taxpayer's washing and cleaning shed. Here Taxpayer unloads the potatoes using both manual and machine labor and run them through a system of washers, scrubbers, shakers, and other specialized equipment designed to remove the dirt, rock, and grit. The dirt, rock, and grit, once removed, is separated out, placed back into the truck, and returned to the field. The potatoes are culled, and those that are unsuitable for sale are sold for cattle feed. The potatoes are sized (some are the size of olives, and others are the size of golf balls) and they are packed. The culling, sizing, and packing is done both manually and with machinery. Immediate cleaning, sizing, and packing operations are required because Taxpayer's potatoes can rapidly deteriorate. They are sold "fresh market," i.e., they are not stored, except for a temporary cold room for less than 24 hours, before they are transported to buyers.

Taxpayer's cleaning process is part of a continuous stream of activity that takes them from the field to buyers. Taxpayer differentiates its process from the harvest of larger potatoes (i.e., russet) grown by other farmers. When larger potatoes have left the fields, they are placed in storage for anywhere from a week to up to a year before they are washed and cleaned. Thus, larger potatoes grown by others have a natural break between the digging and cleaning process. Such is not the case with Taxpayer's smaller potatoes, which must be immediately cleaned, culled, packed, and sold.

Taxpayer's cleaning equipment is unique, so its replacement parts are not standard or commercially available and must be modified.

Taxpayer also has five forklifts, four of which are emission-free electric. The five forklifts can be used interchangeably by replacing the bucket, and can thus be used like tractors in addition to other jobs around Taxpayer's farm.

ANALYSIS

RCW 82.08.855² provides:

- (1) The tax levied by RCW 82.08.020 does not apply to the sale to an eligible farmer of:
 - (a) Replacement parts for qualifying farm machinery and equipment;
 - (b) Labor and services rendered in respect to the installing of replacement parts;and

² RCW 82.12.885 is the Revenue Act's corresponding use tax exemption.

- (c) Labor and services rendered in respect to the repairing of qualifying farm machinery and equipment, provided that during the course of repairing no tangible personal property is installed, incorporated, or placed in, or becomes an ingredient or component of, the qualifying farm machinery and equipment other than replacement parts. . . .
- (4) The definitions in this subsection apply to this section. . . .
- (e) "Qualifying farm machinery and equipment" means machinery and equipment used primarily by an eligible farmer for growing, raising, or producing agricultural products.

The Department's Special Notice, updated June 27, 2007, similarly states:

What is qualifying farm machinery and equipment?

Qualifying farm machinery and equipment means machinery and equipment used primarily by an eligible farmer for growing, raising, or producing agricultural products including *farm tractors* and *other farm implements*.

What property and services remain subject to retail sales or use tax?

The purchase or use of the following items and services remain subject to retail sales or use tax, unless some other exemption applies:

- Parts for nonqualifying farm machinery and equipment, including replacement parts for vehicles other than farm vehicles, farm tractors, and other farm implements;

RCW 82.08.855's retail sales tax exemption applies only to replacement parts, labor, and repair of "qualifying farm machinery and equipment." To so qualify, the machinery and equipment must be used "primarily" by an eligible farmer³ for "growing, raising, or producing" agricultural products. RCW 82.08.855(4)(e).

Taxpayer disagrees with Audit's characterization of its cleaning shed activities as a "packing line" operation. Taxpayer concedes that at the end of the washing and cleaning operation, the potatoes are packed in boxes, bags or totes (depending on customers' requirements), but argues that this is not the primary focus of the cleaning shed. Rather, its primary purpose is to remove the rock, dirt, and grit from the potatoes. Taxpayer characterizes its cleaning activity as a continuation of the harvest process, and the culling, sizing, and boxing/packaging activities that take place in the shed as only a byproduct of the cleaning activity. Therefore, Taxpayer argues that the replacement parts in the cleaning shed equipment are eligible for the RCW 82.08.855 and RCW 82.12.855 exemptions.

We disagree. The legislature in a similar statute has drawn a distinction between the production of agricultural products and the packing of those products, the latter of which includes the activities that Taxpayer is performing after the potatoes' harvest -- cleaning, washing, grading, packaging, etc. See RCW 82.04.120 (which treats the "[p]acking of agricultural products,

³ In this case, Taxpayer's status as an "eligible farmer" has not been challenged.

including sorting, washing, rinsing, grading, waxing, treating with fungicide, packaging, chilling, or placing in controlled atmospheric storage” (RCW 82.04.120(2)(d)) separately from “[t]he growing, harvesting, or producing of agricultural products” (RCW 82.04.120(2)(c)). Thus, by the time the potatoes have been harvested and taken from the fields, the “growing, raising, or producing” activities have been completed.

We conclude that Taxpayer’s activities in cleaning and otherwise preparing its potatoes for packaging is not part of “growing, raising, or producing” its potatoes for purposes of the RCW 82.08.855 (retail sales tax) or RCW 82.12.855 (use tax) exemptions on repair parts and labor. Taxpayer’s petition as to its cleaning shed’s replacement parts and/or repairs is denied.

Taxpayer argues that its forklifts should likewise qualify for the exemptions, stating that they are used for a multitude of tasks around the farm, including but not limited to assisting with the planting process by unloading and moving seed to the appropriate location, assisting with repairs of farm equipment (by lifting the tractor, etc, so repairs can be made), assistance with the movement of farm equipment such as irrigation lines, as well as the loading of customer trucks with product.

The test for exemption, however, is not that a piece of equipment is used on the farm, but that it is used “primarily” for “growing, raising, or producing agricultural products.” Although Taxpayer may use its forklifts for certain tasks relative to this purpose, Taxpayer has not documented that any of its forklifts have been used “primarily” for the purpose of “growing, raising, or producing agricultural products” before they leave the field.

We conclude that Taxpayer has not demonstrated that its forklifts are used “primarily” for “growing, raising, or producing agricultural products,” and thus their replacement parts, and labor and services for their replacement and for repairs do not qualify for exemption under RCW 82.08.855 (retail sales tax) or RCW 82.12.855 (use tax).

DECISION AND DISPOSITION

Taxpayer's petition for refund is denied.

Dated this 14th day of June, 2013.