

Cite as Det. No. 15-0156, 34 WTD 586 (2015)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Refund of ) D E T E R M I N A T I O N  
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  )  
  No. 15-0156  
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  )  
  Registration No. . . .  
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RULE 13601, RULE 13501; RCW 82.08.02561, RCW 82.12.02561: RETAIL SALES TAX – USE TAX – M&E – LOGGING – FELLER-BUNCHER. To qualify for the M&E exemption, a majority of the feller-buncher's use must be in a manufacturing operation, not primarily to cut standing trees. Because the logger has not shown that a majority of the use of the feller-buncher was in a manufacturing operation, the logger's feller-buncher does not qualify for the M&E exemption.

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 logger protests a use tax and/or deferred sales tax assessment on his purchase of a feller-buncher used to cut trees. Because the logger did not use the feller-buncher in a manufacturing operation, we deny the petition.<sup>1</sup>

ISSUE

Under RCW 82.08.02561, RCW 82.12.02561, and WAC 458-20-13601 (Rule 13601), was a logger's purchase and use of a feller-buncher used to cut standing trees exempt from sales and use tax as machinery and equipment used in a manufacturing operation?

FINDINGS OF FACT

[Taxpayer] contracts to cut standing timber for harvesters in Washington. On August 13, 2013, the taxpayer purchased a feller-buncher for \$ . . . less the value of a trade-in. He did not pay sales tax on the purchase. The taxpayer used the feller-buncher to cut standing timber. He did not pay use tax on his use of the feller-buncher to the Department of Revenue (Department).

The Department's Audit Division reviewed the taxpayer's books and records for the period from . . . . On March 10, 2015, the Audit Division issued Document No. . . . , which assessed \$ . . . in use tax and/or deferred sales tax on the taxpayer's feller-buncher purchase.<sup>2</sup>

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

The taxpayer paid the assessment and requests a refund of the tax paid on the feller-buncher plus interest. The taxpayer contends that his purchase and use of the feller-buncher is exempt from sales and use tax as machinery and equipment used in a manufacturing operation.

A feller-buncher is a type of harvester used in logging.

[Http://en.wikipedia.org/wiki/Feller\\_buncher](http://en.wikipedia.org/wiki/Feller_buncher) (last visited May 8, 2015). It is a motorized vehicle with an attachment that can rapidly cut and gather several trees before felling them. The feller-buncher performs harvesting functions and consists of a standard heavy equipment base with a tree-grabbing device furnished with a chain-saw, circular saw or a shear - a pinching device designed to cut small trees off at the base. The machine then places the cut tree on a stack suitable for a skidder or forwarder, or other means of transport (yarding) for further processing (e.g., dellimbing, bucking, loading, or chipping). *Id.* While some feller-bunchers have large wheels, the taxpayer's feller-buncher moved on tracks.

The Audit Division encouraged the taxpayer to review its records regarding time spent using the feller-buncher in other activities, including forwarding cut trees for further processing into logs by another contractor. With no documents, the taxpayer relied on his recollection that 40% of his time with the feller-buncher was spent forwarding the logs. During the hearing, the taxpayer reaffirmed that a majority of the feller-buncher's use was to cut standing timber. After the taxpayer cut the standing trees and bunched them into piles, another contractor delimbed, measured, and cut the logs to length. The taxpayer insists that its cutting standing trees and bunching them was part of a manufacturing operation, because further processing could not occur unless the trees were first cut. The Audit Division found that the taxpayer has no records to establish the use or extent of use of the feller-buncher in a manufacturing operation.

## ANALYSIS

In general, all sales in the state of Washington of tangible personal property to consumers are subject to retail sales tax unless the sales are otherwise exempt from taxation. RCW 82.08.020; RCW 82.04.050. Use tax complements the retail sales tax by imposing a tax of like amount upon the privilege of using within this state as a consumer any article of tangible personal property acquired without payment of retail sales tax. *See* RCW 82.12.020(1), (2).

RCW 82.08.02565 exempts retail sales tax on sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation. RCW 82.12.02565 provides the corresponding use tax exemption. Both exemptions are referred to collectively as "the M&E exemption." Specifically, the statutes provide that the retail sales tax and use tax do not apply to "sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation . . ." RCW 82.08.02565(1)(a); RCW 82.12.02565(1)(a). The M&E exemption has four distinct requirements:

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<sup>2</sup> The assessment totaled \$ . . . and included an assessment penalty of \$ . . . and interest of \$ . . . . Use tax and/or deferred sales tax was also assessed on other items, and totaled \$ . . . with an \$ . . . credit for business and occupation (B&O) tax under the extracting classification.

1. The purchaser/user must be a “manufacturer” or “processor for hire;”
2. The purchased/used item must be “machinery and equipment;”
3. The item must be “used directly;”
4. In a “manufacturing operation.”

*See* Det. No. 03-0325, 24 WTD 351 (2005). If any of these elements is missing, the exemption is not available. At issue here is whether the taxpayer used the feller-buncher directly in a manufacturing operation. The Department distinguishes between using equipment to cut trees, which have been felled (manufacturing), and cutting standing trees (extraction).

RCW 82.04.120 establishes that the cutting, delimiting, and measuring of felled, cut, or taken trees is a manufacturing activity, not an extracting activity:

“To manufacture” embraces all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use, and shall include: . . . (3) cutting, delimiting, and measuring of felled, cut, or taken trees;

RCW 82.04.120. [WAC 458-20-13501(2)(c)] elaborates on the statutory standard, and reads: “The cutting into length (bucking), delimiting, and measuring (for bucking) of felled, cut (severed), or taken trees is a manufacturing activity.” *See also* WAC 458-20-136(2)(a) (Rule 136(2)(a)) (“To manufacture” includes . . . “(ii) The cutting, delimiting, and measuring of felled, cut, or taken trees”). The manufacturing activities discussed in RCW 82.04.120, Rule 13501, and Rule 136 involve activities after the trees have been cut and bunched. The taxpayer’s use of the feller-buncher at issue to cut and bunch standing trees is an extraction activity.

Extraction differs from manufacturing by statute. The term “extractor” is defined by statute as:

[E]very person who from the person’s own land or from the land of another under a right or license granted by lease or contract, either directly or by contracting with others for the necessary labor or mechanical services, for sale or for commercial or industrial use . . . fells, cuts or takes timber. . . . “Extractor” does not include persons performing under contract the necessary labor or mechanical services for others . . . .

RCW 82.04.100; *see also* WAC 458-20-13501(2)(b) (“The felling, cutting (severing from the land), or taking of trees is an extracting activity.”); WAC 458-20-135(2) (“The term includes a person who fells, cuts, or takes timber.”)

Persons who perform extracting activities (labor and mechanical services) for timber harvesters are subject to the extracting for hire B&O tax upon the gross income from those services. [RCW 82.04.280(1)(c);] Rule 13501(3). The rule gives the following example of an extractor for hire:

[A] person severing trees owned by a timber harvester is performing an extracting activity, and is considered an extractor for hire with respect to those services. . . .

Extracting activities commonly performed by extractors for hire include, but are not limited to:

- (a) Cutting or severing trees;

Rule 13501(3).

When the taxpayer used the feller-buncher to cut standing timber, the taxpayer was extracting. While the delimiting, measuring, and cutting to length by the other contractor after the trees were cut and bunched may have constituted manufacturing, those were not activities for which the taxpayer used the feller-buncher. The taxpayer primarily used the feller-buncher to cut standing trees.

The taxpayer asserts that it also used the feller-buncher in a manufacturing operation. The taxpayer claims that it also used the feller-buncher to bunch trees into piles. It is not clear how much the taxpayer did this activity or whether this activity was pre-manufacturing bunching or an activity post manufacturing. Machinery and equipment used in a manufacturing operation may have qualifying and nonqualifying use. The requirements of the M&E exemption are only satisfied if the qualifying use satisfies the majority use requirement. Rule 13601(9) discusses the majority use requirement:

Machinery and equipment both used directly in a qualifying operation and used in a nonqualifying manner is eligible for the exemption only if the qualifying use satisfies the majority use requirement. . . . Majority use can be expressed as a percentage, with the minimum required amount of qualifying use being greater than fifty percent compared to overall use.

To determine whether the majority use requirement has been satisfied, the person claiming the exemption must retain records documenting the measurement used to substantiate a claim for exemption or, if time, value, or volume is not the basis for measurement, be able to establish by demonstrating through practice or routine that the requirement is satisfied. Majority use is measured by looking at the use of an item during a calendar year using any of the following: . . . .

Rule 13601(9) explains that use may be measured by time, value volume, or another comparable measure.

To be eligible as a qualifying use of M&E, the use must take place within the manufacturing operation. Rule 13601(2)(g). An extractor may subsequently take an extracted product and use it as a raw material in a manufacturing process. Rule 135(2)(b). A determination of when extracting ends (non qualified use) and manufacturing (qualified use) begins can be made only after a review of all the facts and circumstances. *Id.* Generally, a manufacturing operation begins at the point where the raw materials enter the manufacturing site and ends at the point where processed material leaves the manufacturing site. RCW 82.08.02565(2)(d); Rule 13601(2)(g).

Det. No. 00-138, 20 WTD 167 (2001) involved a taxpayer that manufactured, repaired, and sold logging equipment, including feller-bunchers. The Department's Audit Division assessed taxpayer retail sales tax on taxpayer's sales of such equipment to its customers. We affirmed the assessment as to the feller-bunchers, concluding that the feller-bunchers did not qualify for the M&E exemption because they were used to cut trees, which is an extracting activity, not a manufacturing activity. 20 WTD at 170.

Det. No. 11-0097, 31 WTD 31 (2012) involved a taxpayer that used feller-bunchers for logging. That taxpayer made a similar argument that the feller-buncher was used a majority of the time to sort trees and forward them, so that they could be reached by other forwarding machines. That determination agreed with the prior determination that the feller-bunchers did not process the trees. That taxpayer used its feller-buncher to cut the trees and bunch them into piles so that another machine could remove the logs from the forest. We found that the feller-buncher performed extraction activities, and therefore, was not used directly in a manufacturing operation. 31 WTD at 35.

To qualify for the M&E exemption, a majority of the feller-buncher's use must be in a manufacturing operation. Because the taxpayer has not shown that a majority of the use was in a manufacturing operation, we conclude that the taxpayer's feller-buncher does not qualify for the M&E exemption.

The taxpayer's argument that the feller-buncher must cut the standing trees so they can be manufactured does not distinguish between extracting and manufacturing. An extractor may subsequently take an extracted product and use it as a raw material in a manufacturing process. Rule 135(2)(b). The manufacturing operation does not begin until after the standing trees are cut and bunched. Since the feller-buncher extracts trees, it is not used directly in a manufacturing operation, and taxpayer is *not* exempt from paying retail sales and/or use tax on the feller buncher under RCW 82.08.02565 and RCW 82.12.02565.

#### DECISION AND DISPOSITION

We deny your petition.

Dated this 17th day of June, 2015.