

Cite as Det. No. 14-0006R, 34 WTD 016 (2015)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

[1] RCW 82.08.02565; RCW 82.04.110: RETAIL SALES TAX – M&E EXEMPTION – DEFINITION OF MANUFACTURER. Taxpayer that purchased cigarette rolling machines for use by its customers on the customers' materials is not a manufacturer for purposes of the M&E exemption and does not qualify for the 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.

Margolis, A.L.J. – A seller of loose tobacco, tubes, and the use of its facilities to roll cigarettes (Taxpayer) petitions for reconsideration of Det. No. 14-0006 on grounds that its purchase of roll-your-own cigarette machines is exempt from use/deferred sales tax as machinery and equipment (M&E) used in a manufacturing operation. We deny the petition.<sup>1</sup>

## ISSUE

Whether Taxpayer's purchase of roll-your-own cigarette machines for use in allowing customers to roll cigarettes is exempt from tax under RCW 82.08.02565.

## FINDINGS OF FACT

As we explained in Det. No. 14-0006 (footnote omitted):

Taxpayer operated a store in . . . Washington where it sold loose tobacco and tubes, and charged its customers for the use of its facilities, including roll-your-own (RYO) cigarette machines, to roll the tobacco and tubes into cigarettes. The Department of Revenue's (Department's) Audit Division (Audit) examined Taxpayer's records for the period May 1, 2010 through December 31, 2011, and assessed Taxpayer \$. . . . The assessment is comprised of a credit for \$. . . in retailing business and occupation (B&O) tax, \$. . . in use/deferred sales tax, \$. . . in cigar tax, and \$. . . in interest.

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

Taxpayer purchased three RYO cigarette machines during the audit period, for a total cost of \$. . . . Taxpayer did not pay retail sales tax or report use tax on these purchases. Audit assessed use/deferred sales tax on these purchases.

The RYO cigarette machines at issue are vending-machine sized devices with touch screens, funnels on top for loose tobacco, and chambers that hold boxes of empty tubes. When the operator touches the start button, the machine packs the loose tobacco into the tubes. Taxpayer explained that its customers bought the materials (tobacco and tubes), pre-paid for use of the machines, and ran the machines themselves. Taxpayer further explained that the machines keep track of the number of cigarettes rolled and download codes purchased from the machine vendor in order to continue functioning, so Taxpayer needed to follow the vendor's rules in order to continue using the machines. The rules were designed to dictate practices under which Taxpayer's customers were making the cigarettes rather than the Taxpayer itself.

Taxpayer advertised prices for boxes of cigarettes as including tobacco, tubes and machine rental, and provided a sample cash register receipt showing a separate line item charge for "Rental," and retail sales tax applied to this charge as well as charges for tobacco and tubes. Taxpayer also provided a point of sale report showing that it made \$. . . in rental income for 2011, and explained that it always collected and remitted retail sales tax on receipts for RYO machine rentals.

Taxpayer initially argued that it purchased the machines for resale. In Det. No. 14-0006, we held that because Taxpayer purchased the machines to use in providing retail services, it purchased the machines for its own use rather than for resale, and was subject to use/deferred sales tax on these purchases. Taxpayer now argues that it is deemed a manufacturer and thus qualifies for the M&E exemption.

## ANALYSIS

All sales of tangible personal property to consumers in the state of Washington are subject to retail sales tax, unless specifically exempt. RCW 82.08.020 and RCW 82.04.050. In general, the use tax applies upon the use in Washington of any tangible personal property the sale or acquisition of which has not been subject to the Washington retail sales tax. In this way, the use tax complements the retail sales tax. WAC 458-20-178 (Rule 178); RCW 82.12.020.

RCW 82.08.02565 provides a tax exemption for sales to a manufacturer of M&E used directly in a manufacturing operation. RCW 82.08.02565(1)(a). RCW 82.12.02565 provides a similar exemption for the use tax. Like all tax exemptions in Washington, the statute is strictly construed in favor of application of the tax and against the person claiming the exemption. *Yakima Fruit Growers Ass'n v. Henneford*, 187 Wn. 252, 258, 60 P.2d 62 (1936); *All-State Constr. Co. v. Gordon*, 70 Wn.2d 657, 425 P.2d 16 (1967). However, this does not mean that exemptions will be read so narrowly that the legislative purpose and intent in enacting the provisions are undermined. *Cherry v. Metro Seattle*, 116 Wn.2d 794, 808 P.2d 746 (1991).

RCW 82.08.02565(d) states that a manufacturer is “a person that qualifies as a manufacturer under RCW 82.04.110.”<sup>2</sup> RCW 82.04.110(1) defines “manufacturer” as follows:

Except as otherwise provided in this section, “manufacturer” means 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.

*See also* WAC 458-20-13601(2)(e).

In this matter, Taxpayer’s customers bought the materials (tobacco and tubes), pre-paid for use of the machines, and ran the machines themselves. Taxpayer did not directly or by contracting with others manufacture the cigarettes for sale, nor manufacture the cigarettes from its own materials or ingredients, so it is not a manufacturer under RCW 82.04.110(1) and RCW 82.08.02565, and does not qualify for the M&E exemption.<sup>3,4</sup> Further, the M&E exemption is available only to taxpayers who report under the manufacturing classification of the B&O tax, and Taxpayer did not report under that classification. *See* Det. No. 07-0324E, 27 WTD 119 (2008).

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 7th day of August, 2014.

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<sup>2</sup> This definition of manufacturer was added in Laws of 2011, ch. 23, § 2. Laws of 2011, ch. 23, § 9 states that section 2 applies both prospectively and retroactively to any tax period open for assessment or refund of taxes.

<sup>3</sup> We recognize that in 2012, 26 USCA § 5702 was amended such that a manufacturer of tobacco products includes any person who for commercial purposes makes available for consumer use a machine capable of making cigarettes.

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<sup>4</sup> We note that the M&E exemption also applies to processors for hire. RCW 82.08.02565(1)(a). Processors for hire are persons who perform labor and mechanical services upon property belonging to others. Rule 13601(2)(h); WAC 458-20-136(3)(a). In this matter, we find that Taxpayer did not perform labor or mechanical services in the production of cigarettes where its customers pre-paid for use of the machines and operated the machines themselves, and thus Taxpayer is also not a processor for hire.