

WAC 458-20-13601 Manufacturers and processors for hire—Sales and use tax exemptions for machinery and equipment. (1) Introduction.

(a) This rule explains the retail sales and use tax exemptions provided by RCW 82.08.02565 and 82.12.02565 for sales to or use by manufacturers or processors for hire of machinery and equipment (M&E) used directly in a manufacturing operation or research and development operation. This rule explains the requirements that must be met to substantiate a claim of exemption. For information regarding the sales and use tax deferral for manufacturing and research/development activities in high unemployment counties, refer to WAC 458-20-24001 and chapter 82.60 RCW. For the high technology business sales and use tax deferral refer to chapter 82.63 RCW.

(b) Effective June 12, 2014, the retail sales and use tax exemptions provided by RCW 82.08.02565 and 82.12.02565 do not apply to:

(i) Sales of machinery and equipment used directly in the manufacturing, research and development, or testing of marijuana; and

(ii) Sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving such machinery and equipment.

(c) Effective August 1, 2015, an ineligible person, as defined in subsection (2)(e) of this rule, does not qualify for the retail sales and use tax exemptions provided by RCW 82.08.02565 and 82.12.02565, unless the taxpayer first used the qualifying machinery and equipment in this state prior to August 1, 2015.

(2) **Definitions.** For purposes of the manufacturing machinery and equipment tax exemptions, the following definitions apply:

(a) **Affiliated group.** "Affiliated group" means a group of two or more entities that are either:

(i) Affiliated as defined in RCW 82.32.655; or

(ii) Permitted to file a consolidated return for federal income tax purposes.

(b) **Cogeneration.** "Cogeneration" means the simultaneous generation of electrical energy and low-grade heat from the same fuel. See RCW 82.08.02565.

(c) **Device.** "Device" means an item that is not attached to the building or site. Examples of devices are: Forklifts, chainsaws, air compressors, clamps, free standing shelving, software, ladders, wheelbarrows, and pulleys.

(d) **Industrial fixture.** "Industrial fixture" means an item attached to a building or to land. Fixtures become part of the real estate to which they are attached and at the time of attachment are classified as real property, not personal property. Examples of "industrial fixtures" are fuel oil lines, boilers, craneways, and certain concrete slabs.

(e) **Ineligible person.** "Ineligible person" means all members of an affiliated group if all of the following apply:

(i) At least one member of the affiliated group was registered with the department of revenue (department) to do business in Washington state on or before July 1, 1981;

(ii) As of August 1, 2015, the combined employment in this state of the affiliated group exceeds forty thousand full-time and part-time employees, based on data reported to the employment security department by the affiliated group; and

(iii) The business activities of the affiliated group primarily include development, sales, and licensing of computer software and services.

(f) **Machinery and equipment (M&E).** "Machinery and equipment" means industrial fixtures, devices, and support facilities, and tangible personal property that becomes an ingredient or component thereof, including repair parts and replacement parts. M&E includes pollution control equipment installed and used in a qualifying operation to prevent air pollution, water pollution, or contamination that might otherwise result from the operation.

(g) **Manufacturer.** "Manufacturer" has the same meaning as provided in chapter 82.04 RCW. Manufacturer also includes a person that prints newspapers or other materials; and effective August 1, 2015, a person engaged in the development of prewritten computer software that is not transferred to purchasers by means of tangible storage media. RCW 82.08.02565, chapter 5, Laws of 2015 3rd sp. sess. (ESSB 6138).

(h) **Manufacturing.** "Manufacturing" has the same meaning as "to manufacture" in chapter 82.04 RCW.

(i) **Manufacturing operation.** "Manufacturing operation" means the manufacturing of articles, substances, or commodities for sale as tangible personal property. 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. The operation includes storage of raw materials at the site, the storage of in-process materials at the site, and the storage of the processed material at the site. The manufacturing operation is defined in terms of a process occurring at a location. To be eligible as a qualifying use of M&E, the use must take place within the manufacturing operation, unless specifically exempted by law. Storage of raw material or other tangible personal property, packaging of tangible personal property, and other activities that potentially qualify under the "used directly" criterion, 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. The statute specifically allows testing to occur away from the site.

The term "manufacturing operation" also includes that portion of a cogeneration project that is used to generate power for consumption within the manufacturing site of which the cogeneration project is an integral part. The term does not include the production of electricity by a light and power business as defined in RCW 82.16.010 or the preparation of food products on the premises of a person selling food products at retail.

(i) Neither duration or temporary nature of the manufacturing activity nor mobility of the equipment determine whether a manufacturing operation exists. For example, operations using portable saw mills or rock crushing equipment are considered "manufacturing operations" if the activity in which the person is engaged is manufacturing. Rock crushing equipment that deposits material onto a roadway is not used in a manufacturing operation because this is a part of the constructing activity, not a manufacturing activity. Likewise, a concrete mixer used at a construction site is not used in a manufacturing operation because the activity is constructing, not manufacturing. Other portable equipment used in nonmanufacturing activities, such as continuous gutter trucks or trucks designed to deliver and combine aggregate, or specialized carpentry tools, do not qualify for the same reasons.

(ii) Manufacturing tangible personal property for sale can occur in stages, taking place at more than one manufacturing site. For example, if a taxpayer processes pulp from wood at one site, and transfers the resulting pulp to another site that further manufactures the product into paper, two separate manufacturing operations exist. The end

product of the manufacturing activity must result in an article, substance, or commodity for sale.

(j) **Marijuana.** "Marijuana" is any product with a THC concentration greater than .03 percent.

(k) **Processor for hire.** "Processor for hire" has the same meaning as used in chapter 82.04 RCW and as explained in WAC 458-20-136 Manufacturing, processing for hire, fabricating.

(l) **Qualifying operation.** "Qualifying operation" means a manufacturing operation, a research and development operation, or a testing operation.

(m) **Research and development operation.** "Research and development operation" means engaging in research and development as defined in RCW 82.63.010 by a manufacturer or processor for hire. RCW 82.63.010 defines "research and development" to mean: Activities performed to discover technological information, and technical and nonroutine activities concerned with translating technological information into new or improved products, processes, techniques, formulas, inventions, or software. The term includes exploration of a new use for an existing drug, device, or biological product if the new use requires separate licensing by the Federal Food and Drug Administration under chapter 21, C.F.R., as amended. The term does not include adaptation or duplication of existing products where the products are not substantially improved by application of the technology, nor does the term include surveys and studies, social science and humanities research, market research or testing, quality control, sale promotion and service, computer software developed for internal use, and research in areas such as improved style, taste, and seasonal design.

(n) **Sale.** "Sale" has the same meaning as "sale" in chapter 82.08 RCW, which includes by reference RCW 82.04.040. RCW 82.04.040 includes by reference the definition of "retail sale" in RCW 82.04.050. "Sale" includes renting or leasing, conditional sale contracts, leases with option to purchase, and any contract under which possession of the property is given to the purchaser but title is retained by the vendor as security for the payment of the purchase price.

(o) **Site.** "Site" means the location at which the manufacturing or testing takes place.

(p) **Support facility.** "Support facility" means a part of a building, or a structure or improvement, used to contain or steady an industrial fixture or device. A support facility must be specially designed and necessary for the proper functioning of the industrial fixture or device and must perform a function beyond being a building or a structure or an improvement. It must have a function relative to an industrial fixture or a device. To determine if some portion of a building is a support facility, the parts of the building are examined. For example, a highly specialized structure, like a vibration reduction slab under a microchip clean room, is a support facility. Without the slab, the delicate instruments in the clean room would not function properly. The ceiling and walls of the clean room are not support facilities if they only serve to define the space and do not have a function relative to an industrial fixture or a device.

(q) **Tangible personal property.** "Tangible personal property" has its ordinary meaning.

(r) **Testing.** "Testing" means activities performed to establish or determine the properties, qualities, and limitations of tangible personal property.

(s) **Testing operation.** "Testing operation" means the testing of tangible personal property for a manufacturer or processor for hire. A

testing operation begins at the point where the tangible personal property enters the testing site and ends at the point where the tangible personal property leaves the testing site. The term also includes that portion of a cogeneration project that is used to generate power for consumption within the site of which the cogeneration project is an integral part. The term does not include the production of electricity by a light and power business as defined in RCW 82.16.010 or the preparation of food products on the premises of a person selling food products at retail. The testing operation is defined in terms of a process occurring at a location. To be eligible as a qualifying use of M&E, the use must take place within the testing operation, unless specifically excepted by law.

(3) **Retail sales and use tax exemptions.** The M&E exemptions provide retail sales and use tax exemptions for machinery and equipment used directly in a manufacturing operation or research and development operation, except for such sales or use relating to marijuana effective June 12, 2014. Sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving qualifying machinery and equipment are also exempt from sales tax, except for such sales or charges relating to marijuana effective June 12, 2014. However, because the exemption is limited to items with a useful life of one year or more, some charges for repair, labor, services, and replacement parts may not be eligible for the exemption. In the case of labor and service charges that cover both qualifying and nonqualifying repair and replacement parts, the labor and services charges are presumed to be exempt. If all of the parts are nonqualifying, the labor and service charge is not exempt, unless the parts are incidental to the service being performed, such as cleaning, calibrating, and adjusting qualifying machinery and equipment.

The exemption may be taken for qualifying machinery and equipment used directly in a testing operation by a person engaged in testing for a manufacturer or processor for hire, with the exception of such testing relating to marijuana effective June 12, 2014.

Sellers remain subject to the retailing B&O tax on all sales of machinery and equipment to consumers if delivery is made within the state of Washington, notwithstanding that the sale may qualify for an exemption from the retail sales tax.

(a) **Sales tax.** The purchaser must provide the seller with an exemption certificate. The exemption certificate must be completed in its entirety. The seller must retain a copy of the certificate as a part of its records. This certificate may be issued for each purchase or in blanket form certifying all future purchases as being exempt from sales tax. Blanket certificates are valid for as long as the buyer and seller have a recurring business relationship. A "recurring business relationship" means at least one sale transaction within a period of twelve consecutive months. RCW 82.08.050 (7)(c).

The form must contain the following information:

- (i) Name, address, and registration number of the buyer;
- (ii) Name of the seller;
- (iii) Name and title of the authorized agent of the buyer/user;
- (iv) Authorized signature;
- (v) Date; and
- (vi) Whether the form is a single use or blanket-use form.

A copy of an M&E certificate form may be obtained from the department's website at dor.wa.gov, or by contacting the department's taxpayer services division at:

Taxpayer Services
Department of Revenue
P.O. Box 47478
Olympia, WA 98504-7478
1-800-647-7706

(b) **Use tax.** The use tax complements the retail sales tax by imposing a tax of like amount on the use within this state as a consumer of any tangible personal property purchased at retail, where the user has not paid retail sales tax with respect to the purchase of the property used. For additional information on use tax see chapter 82.12 RCW and WAC 458-20-178. If the seller fails to collect the appropriate retail sales tax, the purchaser is required to pay the retail sales tax (commonly referred to as "deferred sales tax") or the use tax directly to the department unless the purchase and/or use is exempt from the retail sales and/or use taxes. A qualifying person using eligible machinery and equipment in Washington in a qualifying manner is exempt from the use tax. If an item of machinery and equipment that was eligible for use tax or sales tax exemption fails to overcome the majority use threshold or is entirely put to use in a nonqualifying manner, use tax is due on the fair market value at the time the item was put to nonqualifying use. See subsection (9) of this rule for an explanation of the majority use threshold.

(4) **Who may take the exemption?** The exemption may be taken by a manufacturer or processor for hire who manufactures articles, substances, or commodities for sale as tangible personal property (excluding marijuana), and who, for the item in question, meets the used directly test and overcomes the majority use threshold. (See subsection (8) of this rule for a discussion of the "used directly" criterion and see subsection (9) of this rule for an explanation of the majority use threshold.) However, for research and development operations, there is no requirement that the operation produce tangible personal property for sale. A processor for hire who does not sell tangible personal property is eligible for the exemption if the processor for hire manufactures articles, substances, or commodities that will be sold by the manufacturer. For example, a person who is a processor for hire but who is manufacturing with regard to tangible personal property that will be used by the manufacturer, rather than sold by the manufacturer, is not eligible. For additional information on manufacturing, processing for hire, or fabricating, see WAC 458-20-136 and RCW 82.04.110. Persons who engage in testing for manufacturers or processors for hire are eligible for the exemption. To be eligible for the exemption, the taxpayer need not be a manufacturer or processor for hire in the state of Washington, but must meet the definition of manufacturer provided in subsection (2)(g) of this rule.

(5) **What is eligible for the exemption?** Machinery and equipment used directly in a qualifying operation by a qualifying person is eligible for the exemption, subject to overcoming the majority use threshold.

There are three classes of eligible machinery and equipment: Industrial fixtures, devices, and support facilities. Also eligible is tangible personal property that becomes an ingredient or component of the machinery and equipment, including repair parts and replacement parts. "Machinery and equipment" also includes pollution control equipment installed and used in a qualifying operation to prevent air pollution, water pollution, or contamination that might otherwise result from the operation.

(6) **What is not eligible for the exemption?** In addition to items that are not eligible because they do not meet the used directly test or fail to overcome the majority use threshold, the following four categories of property are statutorily excluded from eligibility:

(a) **Hand-powered tools.** Screw drivers, hammers, clamps, tape measures, and wrenches are examples of hand-powered tools. Electric powered, including cordless tools, are not hand-powered tools, nor are calipers, plugs used in measuring, or calculators.

(b) **Property with a useful life of less than one year.** All eligible machinery and equipment must satisfy the useful life criterion, including repair parts and replacement parts. For example, items such as blades and bits are generally not eligible for the exemption because, while they may become component parts of eligible machinery and equipment, they generally have a useful life of less than one year. Blades generally having a useful life of one year or more, such as certain sawmill blades, are eligible. See subsection (7) of this rule for thresholds to determine useful life.

(c) **Buildings.** Buildings, other than machinery and equipment that is permanently affixed to or becomes a physical part of a building. Buildings provide work space for people or shelter machinery and equipment or tangible personal property. The building itself is not eligible, however some of its components might be eligible for the exemption. The industrial fixtures and support facilities that become affixed to or part of the building might be eligible. The subsequent real property status of industrial fixtures and support facilities does not affect eligibility for the exemption.

(d) **Building fixtures.** Building fixtures that are not integral to the manufacturing operation, testing operation, or research and development operation that are permanently affixed to and become a physical part of a building, such as utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical. Examples of nonqualifying fixtures are: Fire sprinklers, building electrical systems, or washroom fixtures. Fixtures that are integral to the manufacturing operation might be eligible, depending on whether the item meets the other requirements for eligibility, such as the used directly test.

(7) **The "useful life" threshold.** RCW 82.08.02565 has a per se exception for "property with a useful life of less than one year." Property that meets this description is not eligible for the M&E exemption. The useful life threshold identifies items that do not qualify for the exemption, such as supplies, consumables, and other classes of items that are not expected or intended to last a year or more. For example, tangible personal property that is acquired for a one-time use and is discarded after use, such as a mold or a form, has a useful life of less than one year and is not eligible. If it is clear from taxpayer records or practice that an item is used for at least one year, the item is eligible, regardless of the answers to the four threshold questions. A taxpayer may work directly with the department to establish recordkeeping methods that are tailored to the specific circumstances of the taxpayer. The following steps should be used to determine whether an item meets the "useful life" threshold. The series of questions progress from simple documentation to complex documentation. To substantiate qualification under any step, a taxpayer must maintain adequate records or be able to establish by demonstrating through practice or routine that the threshold is overcome. Catastrophic loss, damage, or destruction of an item does not affect eligibility of machinery and equipment that otherwise qualifies. Assuming

the machinery and equipment meets all of the other M&E requirements and does not have a single one-time use or is not discarded during the first year, useful life should be determined by answering the following questions for an individual piece of machinery and equipment:

(a) Is the machinery and equipment capitalized for either federal tax purposes or accounting purposes?

- If the answer is "yes," it qualifies for the exemption.
- If the answer is "no,"

(b) Is the machinery and equipment warranted by the manufacturer to last at least one year?

- If the answer is "yes," it qualifies for the exemption.
- If the answer is "no,"

(c) Is the machinery and equipment normally replaced at intervals of one year or more, as established by industry or business practice? (This is commonly based on the actual experience of the person claiming the exemption.)

- If the answer is "yes," it qualifies for the exemption.
- If the answer is "no,"

(d) Is the machinery and equipment expected at the time of purchase to last at least one year, as established by industry or business practice? (This is commonly based on the actual experience of the person claiming the exemption.)

- If the answer is "yes," it qualifies for the exemption.
- If the answer is "no," it does not qualify for the exemption.

(8) **The "used directly" criteria.** Items that are not "used directly" in a qualifying operation are not eligible for the exemption. The statute provides eight descriptions of the phrase "used directly." The manner in which a person uses an item of machinery and equipment must match one of these descriptions. Examples of items that are not used directly in a qualifying operation are cafeteria furniture, safety equipment not part of qualifying M&E, packaging materials, shipping materials, or administrative equipment. 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 on or interacts with.** It acts on or interacts with an item of tangible personal property. Examples include drill presses, concrete mixers (agitators), ready-mix concrete trucks, hot steel rolling machines, rock crushers, and band saws. Also included is machinery and equipment used to repair, maintain, or install tangible personal property. Computers qualify under this criterion if:

(i) They direct or control machinery or equipment that acts on or interacts with tangible personal property; or

(ii) If they act on or interact with an item of tangible personal property.

(b) **Conveys, transports, handles, or temporarily stores.** It conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site or the testing site. Examples include wheelbarrows, handcarts, storage racks, forklifts, tanks, vats, robotic arms, piping, and concrete storage pads. Floor space in buildings does not qualify under this criterion. Also not eligible under this criterion are items that are used to ship the product or in which the product is packaged, as well as materials used to brace or support an item during transport.

(c) **Controls, guides, measures, verifies, aligns, regulates or tests.** It 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 criterion. Machinery and equipment used to take readings or measurements is eligible under this criterion.

(d) **Provides physical support.** It provides physical support for or access to tangible personal property. Examples include catwalks adjacent to production equipment, scaffolding around tanks, braces under vats, and ladders near controls. Machinery and equipment used for access to the building or to provide a work space for people or a space for tangible personal property or machinery and equipment, such as stairways or doors, is not eligible under this criterion.

(e) **Produces power or lubricates.** It produces power for or lubricates machinery and equipment. A generator providing power to a sander is an example of machinery and equipment that produces such power. An electrical generating plant that provides power for a building is not eligible under this criterion. Lubricating devices, such as hoses, oil guns, pumps, and meters, whether or not attached to machinery and equipment, are eligible under this criterion.

(f) **Produces another item.** It produces another item of tangible personal property for use in the manufacturing operation, testing operation, or research and development operation. Examples include machinery and equipment that make dies, jigs, or molds, and printers that produce camera-ready images.

(g) **Packs.** It places tangible personal property in the container, package, or wrapping in which the tangible personal property is normally sold or transported.

(h) **Is integral to research and development.** It is integral to "research and development" as it is defined in RCW 82.63.010.

(9) **The majority use threshold.**

(a) **M&E used both in a qualifying and nonqualifying manner.** Machinery and equipment used both directly in a qualifying operation and also in a nonqualifying manner is eligible for the exemption only if the qualifying use satisfies the majority use requirement. Examples of situations in which an item of machinery and equipment is used for qualifying and nonqualifying purposes include: The use of machinery and equipment in manufacturing and repair activities, such as using a power saw to make cabinets in a shop versus using it to make cabinets at a customer location; the use of machinery and equipment in manufacturing and constructing activities, such as using a forklift to move finished sheet rock at the manufacturing site versus using it to unload sheet rock at a customer location; and the use of machinery and equipment in manufacturing and transportation activities, such as using a mixer truck to make concrete at a manufacturing site versus using it to deliver concrete to a customer. 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:

(i) **Time.** Time is measured using hours, days, or other unit of time, with qualifying use of the M&E the numerator, and total time

used the denominator. Suitable records for time measurement include employee time sheets or equipment time use logs.

(ii) **Value.** Value means the value to the person, measured by revenue if both the qualifying and nonqualifying uses produce revenue. Value is measured using gross revenue, with revenue from qualifying use of the M&E the numerator, and total revenue from use of the M&E the denominator. If there is no revenue associated with the use of the M&E, such as in-house accounting use of a computer system, the value basis may not be used. Suitable records for value measurement include taxpayer sales journals, ledgers, account books, invoices, and other summary records.

(iii) **Volume.** Volume is measured using amount of product, with volume from qualifying use of the M&E the numerator and total volume from use of the M&E the denominator. Suitable records for volume measurement include production numbers, tonnage, and dimensions.

(iv) **Other comparable measurement for comparison.** The department may agree to allow a taxpayer to use another measure for comparison, provided that the method results in a comparison between qualifying and nonqualifying uses. For example, if work patterns or routines demonstrate typical behavior, the taxpayer with the department's approval can satisfy the majority use test using work site surveys as proof.

(b) **Bundling similar M&E into classes.** Each piece of M&E does not require a separate record if the taxpayer can establish that it is reasonable to bundle M&E into classes. Classes may be created only from similar pieces of machinery and equipment and only if the uses of the pieces are the same. For example, forklifts of various sizes and models can be bundled together if the forklifts are doing the same work, as in moving wrapped product from the assembly line to a storage area. An example of when not to bundle classes of M&E for purposes of the majority use threshold is the use of a computer that controls a machine through numerical control versus use of a computer that creates a camera ready page for printing.

(c) **Industry-wide standards.** Typically, whether the majority use threshold is met is decided on a case-by-case basis, looking at the specific manufacturing operation in which the item is being used. However, for purposes of applying the majority use threshold, the department may develop industry-wide standards. For instance, the aggregate industry uses concrete mixer trucks in a consistent manner across the industry. Based on a comparison of selling prices of the processed product picked up by the customer at the manufacturing site and delivery prices to a customer location, and taking into consideration the qualifying activity (interacting with tangible personal property) of the machinery and equipment compared to the nonqualifying activity (delivering the product) of the machinery and equipment, the department has determined that concrete trucks qualify under the majority use threshold. Only in those limited instances where it is apparent that the use of the concrete truck is atypical for the industry would the taxpayer be required to provide recordkeeping on the use of the truck to support the exemption.

[Statutory Authority: RCW 82.32.300 and 82.01.060(2). WSR 16-07-046, § 458-20-13601, filed 3/14/16, effective 4/14/16. Statutory Authority: RCW 82.32.300, 82.01.060(2), 82.04.120, 82.04.213, 82.04.260, 82.04.4266, 82.08.02565, 82.12.022, and 82.12.02565. WSR 15-01-005, § 458-20-13601, filed 12/4/14, effective 1/4/15. Statutory Authority: RCW 82.32.300, 82.01.060(2), 82.08.02565, and 82.12.02565. WSR 08-14-024, § 458-20-13601, filed 6/20/08, effective 7/21/08. Statutory

Authority: RCW 82.32.300. WSR 00-11-096, § 458-20-13601, filed 5/17/00, effective 6/17/00.]