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SC Court of Appeals

THE STATE OF SOUTH CAROLINA  
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

THE HONORABLE H.W. FUNDERBURK, JR., ADMINISTRATIVE LAW JUDGE

Case No. 17-ALJ-17-0060-CC  
Appellate Case No. 2019-001933

McEntire Produce, Inc. .... Respondent,  
v.  
South Carolina Department of Revenue..... Appellant.

**RESPONDENT'S PETITION FOR REHEARING**

Pursuant to Rule 221(a) of the South Carolina Appellate Court Rules, Respondent seeks a rehearing of the above-captioned case filed on March 1, 2023 (hereinafter Court of Appeals Order).

The South Carolina Department of Revenue (SCDOR) appealed a decision by the Administrative Law Court (ALC) that held purchases by McEntire Produce, Inc. (McEntire) of certain machines and gear were entitled to the South Carolina partial sales tax exemption under section 12-36-2120(17) of the South Carolina Code (Supp.2022). SCDOR argued that the ALC erred in granting "the machine exemption" and "the pollution control exemption," both found in section 12-36-2120(17), to McEntire's purchases of "machines."

The ALC held a contested case hearing and determined the majority of items for which McEntire sought exemptions were exempt from the use tax under section 12-36-2120(17), referred to as the "machine exemption." In its Order dated September 6, 2019 (ALC Order), the ALC further found items designated as protective clothing were also exempt from the use tax under a

provision in section 12-36-2120(17), commonly referred to as the “pollution control machine exemption.”

The Court of Appeals reversed both determinations. As explained below, the court overlooked and misapprehended several things when it overturned the ALC decision and ruled that as a matter of law, (1) McEntire’s various machines were not exempt under the manufacturer’s sales tax exemption; and (2) certain gear worn by employees required by federal law were not exempted under the pollution control exemption.

Testimony regarding the machinery and the manufacturing process come almost exclusively from Carter McEntire, the CEO, with the Department witnesses providing little. As stated below, neither DOR witness testified that much of the machinery listed below were not exempt based upon their observation of the facility. The DOR Policy Witness, Corey Smith, testified that equipment required by state or federal law for manufacturing would be part of the exempt manufacturing process. R. p. 285:10-25.

## **I. QUESTIONS OF FACT**

### **A. General**

The Court of Appeals Order violates S.C. Code Ann. § 1-23-610(b), which states: “The court may not substitute its judgment for the judgment of the administrative law judge as to the weight of the evidence on questions of fact.”

At issue in this case is whether numerous machines were tax exempt under the South Carolina machine exemption. Given Respondent’s highly regulated fresh food processing, this was a heavily (if not exclusively) a factual determination. Specifically the ALC had to determine for numerous machinery whether each given machine was: (1) a machine that performs some function and produces a certain effect or result; (2) which is integral and necessary; (3) to processing tangible personal property for sale, SC DOR Reg. 117-302.5. Respondent agrees this

is the correct test. The major issue in the Court of Appeals decision was whether the various machinery was “integral” and “necessary,” i.e., an “indispensable item.”

The ALC found as a matter of fact numerous machines were integral and necessary to the manufacturing process. The Court of Appeals substituted its factual judgment for the ALC’s factual determination, reversed, and held each item was not integral and necessary to the manufacturing process.

The Supreme Court and the Court of Appeals have repeatedly addressed when an appellate court should substitute its factual determination for the ALC’s determination. In *DirectTV, Inc. v. Department of Revenue*, 421 SC 59, 8004 S.E.2d 633, 638 (2018) the Court of Appeals stated:

An appellate court should only reverse the ALC’s order if it is unsupported by substantial evidence in the record or contained an error of law. *Original Blue Ribbon Taxi Corp. v. S.C. Dept. of Motor Vehicles*, 380 S.C. 600, 604, 670, S.E.2d 674, 676 (Ct. App. 2008); • • • “Substantial evidence is not a mere scintilla of evidence nor evidence viewed blindly from one side, but is evidence [that], when considering the record as a whole, would allow reasonable minds to reach the conclusion that the agency reached...”

In *Risher v. Department of Health and Environmental Control*, 393 S.C. 198, 712 S.E.2d 428 (2011) the Supreme Court stated added “the possibility of drawing two inconsistent conclusions from the evidence does not prevent an administrative agency’s finding from being supported by substantial evidence.” *Id.* (citing *Palmetto Alliance, Inc. v. Pub. Serv. Comm’n* 282 S.C. 430, 432, 319 S.E. 2d 695, 696 (1984)). Lastly, in *Charleston County Assessor v. University Ventures, LLC* 421 S.C. 1984, 805 S.E. 2d 216, 202 (2017). The Court of Appeals stated:

In reaching a decision in a contested violation matter, the ALC serves as the sole finder of fact in the *de novo* contested case proceeding.” *S.C. Dep’t of Revenue v. Sandalwood So. Club*, 399 S.C. 267, 279, 731 S.E.2d 330, 337 (Ct. App. 2012). “The Rules of Procedure for the Administrative Law Judge Division require that the AL[C] make independent findings of fact in contested case hearings, and the Administrative procedures Act clearly

contemplates that the AL[C] will make [its] own findings of fact in a contested case hearing.” *Reliance Ins. Co.*, 327 S.C. at 534, 489 S.E.2d at 677 (citation omitted). When the evidence conflicts on “an issue, the [c]ourt’s substantial evidence standard of review defers to the findings of the fact-finder.”

## **B. Findings of Fact – Specific Machines**

Accordingly, at issue is whether the ALC’s factual determination that the following machinery was used directly in the manufacturing process was supported by substantial evidence. The Department presented no evidence to the contrary. Apparently the Court of Appeals confused the manufacturing process, and specifically the high care areas. The ALC noted (R. p. 21) that the “Department determined that only certain machines involved in the operations inside the tomato repack room, the packout room, and the cutting room, also known as the high-care area fall within the machine exemption...” It also noted that the “Department contends that the machine exemption should be limited to those machines found directly on the production line which, in this case, primarily equates to operations inside of the cutting room/high-care area of the plant.” *Id.* All sides—DOR, McEntire, and ALC—agreed that machines used in the high-care area were exempt, and the ALC took pains as described below, to factually find when machines were used in the high-care area.

The ALC also found that the Integrated Plant Concept is the law in South Carolina (see below) and it served to exempt machinery “used before and after the actual production line,” R. p. 22, and specifically those machines which performed a health and safety function. This primarily refers to the climate-controlled low-care area of the plant. There are relatively few items at issue. The ALC Order described the high care area as follows:

As soon as the fresh produce is unloaded from refrigerated trucks at [Respondent]’s plant, it enters one of six raw coolers, which are also maintained between 33-40 degrees. The majority of the plant is divided into two classifications: “low-care” areas and the “high-care” area...

The high-care area is reserved for produce that is cut down to a smaller size and packaged based on customer specifications. When McEntire is ready to process the raw produce, it is moved to the raw feed area where employees utilize a bin dumping conveyance system to move the produce into the cutting room, which is in the high-care area. Once in the cutting room, employees sort, inspect, and trim the produce before it moves along the conveyer belt down to an industrial cutter where it is chopped up according to each customer's specifications. The cutter then discharges into a flume for washing. McEntire's flume is a stainless steel bath that utilizes a water-based product to rinse and sanitize the produce. The produce is washed in this product several times before it moves to the de-watering mechanism, which is essentially an industrial-sized salad spinner. This process of washing and de-watering helps to remove any pollutants or contaminants from the produce...

The high-care area is also positive-pressurized to ensure there is an outflow of air to maintain the cleanliness of the environment. Additionally, both the ambient and compressed air that touches the produce is filtered down to 0.1 microns to ensure the finished product is free from harmful microbial growth and meets the exacting standards required by McEntire's customers...

R. p. 6-7. Below is a discussion of the machinery at issue.

1. Fork Lifts and Pallet Jacks

The Court of Appeals Order states:

SCDOR argues forklifts (along with their respective parts and batteries), pallet jacks, and hand trucks are not machines used in the processing of produce. McEntire asserted they are machines used in the processing of produce to move heavy produce from place to place and to certain lines of production within the facility. However, Regulation 117-302.5(B)(4)(a) provides “[w]arehouse machinery used *only for warehouse purposes*, loading and unloading, storing, transporting raw materials and finished products” are not tax exempt....

Regulation 117-302.5(B)(4)(a) also provides conveyance machines are tax exempt if they “are used substantially to feed raw material into or onto the first processing machine in the manufacturing process area *in addition* to being used in loading, unloading, storing, and transporting raw materials from the warehouse to the manufacturing area, or transporting finished products from the

manufacturing area to the warehouse.” Thus, because the forklifts feed the bin dumping conveyance system and not the first processing machine, they are not tax-exempt conveyance machines. (Emphasis in original and added)

Court of Appeals Order at 10. Respondent agrees with the first paragraph above, machinery used only for warehouse purposes is not exempt. Respondent disagrees with the second paragraph which seems to hold that for machinery to be exempt it must be used in the production process “*in addition*” to warehouse use. By contrast, the ALC Order states:

**(8) Pallet Flow Brakes**

The pallet flow brakes are used on the racks, which hold thousands of pounds of raw produce and finished product. The racks, which transport the produce into the cutting area, are potentially dangerous without the brakes as the pallets can fall off the racks and injure employees. The brakes allow the 1,600 lb. pallets to rotate and flow through the facility at a safe rate. During the audit period, the pallet flow brakes were used in all three tomato coolers *and in the raw cooler area*.

**(9) Hand Trucks and Pallet Jacks, and Oil Lubricant Used Therein**

The majority use of hand trucks and pallet jacks is attributed to moving sliced tomatoes and sack onions from the cold storage area *to the high-care area to feed the in-line* for the cutting process. As a food manufacturer, [Respondent] is required to use food grade oil and grease to maintain both.

**(10) Forklift Rental, Forklift Batteries, Forklift Parts, Forklift Repair Parts....**

Testimony revealed that 90% of [respondent]’s forklifts are used in the climate-controlled areas of the plant to move 800-2,100 lb. pallets of produce into and out of the rack system *and onto the conveyer belt that feeds in to the cutting room. In fact, 75-80% of the forklift usage can be attributed to dumping the product directly onto the conveying system*. Because more than 1/3 of the forklifts are used on an ongoing and continuous basis within the facility and constitute an indispensable component part of the manufacturing process, the **Forklift Rental, Forklift Batteries, Forklift Parts, and Forklift Repair Parts (10)** fall within the definition of “machinery” and qualify for the Machine Exemption.

Testimony also revealed that the majority of the use of **Hand Trucks, Pallet Jacks, and Oil Lubricant Used Therein (9)** could be attributed to moving sliced tomatoes and sack onions from the low-care areas to the cutting room/high-care area *to feed the in-line for the cutting machine. As machines that feed the first processing machine and as material handling machinery used to transport in-process material from one process stage to another* within the integrated plant, the Court finds that these items also fall within the parameters of the Machine Exemption.

R. p. 12, 23-24 (emphasis added). McEntire testified that 80% of the forklifts were used directly in the food processing. R. p. 210:6-10.

Aside from transporting produce from place to place within the facility, the Respondent also uses the forklifts to dump produce onto the conveyor system, which moves the raw produce into the high-care area for processing. R. p. 210:3-5, 252:19-253:15.

DOR Reg. 117-302.5(B)(4) states:

The General rule with reference to material handling machinery and/or mechanical conveyors is that such machinery is subject to the tax to the point *where the materials go into process*. The machine feeding the first processing machine(s) is exempt. The last machine to come within the exemption is that machine which discharges the finished product from the last machine used in the process. *Material handling machinery used for transporting (in process) material from one process stage to another comes within the exemption.... If material handling machinery is customarily used for a dual purpose, that is partly for an exempt purpose and partly for a taxable purpose, and is not otherwise exempt under the provisions of Code Section 12-36-2120(51), the machinery may be purchased free of the tax under the machine exemption (Code Section 12-37-2120(17)) provided the exempt use represents a substantial portion of its use.*

*Id.* (emphasis added). Rev. Rul. #04-7 states:

In *Springs Industries, Inc. v. SCDOR*, 99-ALJ-17-0153-CC, a mezzanine lift designed to carry drums of textile dye to a higher level so that the dye can be gravity fed into the apparatus for the dyeing of cloth is exempt from the tax as a machine used in manufacturing tangible personal property for sale. The court held that the mezzanine lift was integral and necessary to the manufacturing process.

In addition to the mezzanine lift described above and machines previously held as exempt by regulation (see attached), the Department has identified the following conveyances to be exempt.

- Wheeled conveyances known as “print screen truck” used by a textile manufacturer in the movement of print screens from a holding area to the exempt print machines, to the print screen washing machine, and back to the holding area racks after the style or pattern is changed and the print screen is washed. See *Springs Industries, Inc. v. SCDOR*, 99-ALJ-17-0153-CC.
- Warehouse machines (e.g., forklifts) that, in addition to being used in loading, unloading, storing, and transporting raw materials from the warehouse to the manufacturing area, or transporting finished products from the manufacturing area to the warehouse, are also used *substantially* to feed raw material into or onto the first processing machine in the manufacturing process area.

McEntire testified, and the ALC order specifically found as a matter of fact, these machines were substantially used in the high-care area in the manufacturing process. Neither DOR witness testified based upon their observations at the plant these items were not exempt. Specifically, there was no testimony from the DOR that these machines were not used in the manufacturing process.

## 2. Bar Code Scanners

The Court of Appeals Order states:

SCDOR argues record-keeping items, like bar code scanners, black ink aerosol cans, and mobile computer stands, that are used for tracking produce are not machines and, as such, cannot qualify for the machine exemption. McEntire disagrees and states that while the computer stands are not required by law, the checkpoints where the stands are used are required by law. However, Regulation 117-302.5(B)(9) provides: “[a]dministrative machines, furniture, equipment, and supplies, such as office computers used for . . . recordkeeping . . . are not machines.

Court of Appeal Order at 10. McEntire testified and the ALC Order found as a fact that cleaning machines and chemicals were primarily used to clean the high-care area as required by federal law.

By contrast, the ALC Order states:

(1) **Bar Code Scanners**

*Bar code scanners are used to track all produce through the manufacturing process. In the event that contamination is found on any piece of produce, the FDA requires that the product be easily traced back to the farm where it was harvested and forward through the manufacturing process and on to the customer in order to identify the source of the contamination and to prevent its spread. In compliance with federal rules, the produce is scanned at McEntire when it exits the truck, when it enters the cutting area, when leaving the cutting area, and when the finished product is loaded onto a truck for shipment.*

(2) **Black Ink Aerosol Cans**

*The ink in these cans is used to label finished goods. Specifically, the ink goes across a jet ink sprayer to spray a "use-through code" and a "lot code" onto the finished packaging. The lot codes assist in the FDA trace-back process.*

(3) **Mobile Computer Stands**

[Respondent] uses a computer program to track the produce processing operation. The mobile computer stands are used by quality technicians, food safety technicians, and production operators to assist in the scanning and tracking of produce as it moves through the facility. While the stands themselves are not explicitly required by law, the critical care checkpoints at which the stands are used are required.

R. p. 11. The ALC Order also stated:

Because federal law also requires [Respondent] to track the produce not only back to the harvest point, but also during the manufacturing process and forward to the consumer, the **Bar Code Scanners (1), Black Ink Aerosol Cans (2), and Mobile Computer Stands (3)** that are all used in the tracking process are also integral and necessary to McEntire's manufacturing and fall within the Machine Exemption.

R. p. 26. The Court of Appeals Order finds these items were not exempt as they were administrative machines. "Administrative machines" are defined in DOR Reg. 17-302.5(B)(9) which states:

Administrative machines, furniture, equipment, and supplies, such as office computers used for word processing, recordkeeping, employee payroll, customer billing, purchasing, accounting, and

similar purposes, office furniture, office supplies, such as pens, pencils, paper, and similar items, educational material, or items used for the personal comfort, convenience, or use of employees, are not machines used in the process of manufacturing tangible personal property for sale and are not exempt from the tax.

The ALC Order found as a matter of fact that Bar-Code scanners, black ink aerosol cans, and mobile computer stands were used to track produce as required by federal law in the event the produce was subsequently discovered to contain Salmonella, Listeria or E Coli. The Order found they differed from the other administrative materials which are taxable. Reg. 117-302.5(B)(9).

In Reg. 117-302.1(e) the DOR states that “plates attached by the manufacturer to his product for identification purposes” is covered by the machine exclusion. Presumably the vast majority of such plates are not required by federal law (for food safety purposes.) The Regulation also exempts “Recording instruments attached to manufacturing machines.” Reg. 117-302.5(C)(25).

### 3. Warehouse Racks and Blower Fans

The Court of Appeals Order reverses the ALC decision finding that warehouse racks, stacking containers and blower fans were used in the manufacturing process, stating:

#### 4. Warehouse racks, pallet flow brakes, stacking containers, and blower fans:

SCDOR argues warehouse racks, pallet flow brakes, stacking containers, and blower fans *are used for storage/temperature control* and are not machines used in the processing of produce. McEntire argues Regulation 117-302.5(C)(24) finds as exempt: “Machines used to condition air (including humidification systems) for quality control during the manufacturing process of tangible personal property made from natural fibers and synthetic materials.” However, Regulation 117-302.5(B)(7) states that machines used for storage, including racks used to store raw materials or finished goods, are not exempt from sales tax as machines used in manufacturing tangible personal property for sale. Thus, these items are not tax exempt.

SCDOR also argues *blower fans used to control the temperature*

*where the produce is being processed are tax-exempt but machines used outside of the manufacturing process are taxable.* Thus, to prove the blower fans are substantially used in processing, *McEntire had to show "more than one-third of the machine's use" was in processing fresh produce* per Regulation 117-302.5(B)(1)(c). McEntire did not provide evidence as to where the blower fans are used except to say they are used in multiple areas. Thus, blower fans are not tax exempt.

Court of Appeals Order at p. 11 (emphasis added).

This is not accurate. The Facility is divided into low-care and high-care areas. The schematic used at trial used color coding. The high-care Class 100 area was colored green or gray. R. p. 185:6-10. McEntire testified: "Q. How do you use a blower fan? A. So within the entire refrigerated part of the facility, we have what are called evaporators. They're part of the refrigeration system that help maintain that temperature range we've been speaking of, 33 to 40 degrees. And they actually pull air across the refrigerator coils and through a filter. We consider that part of the manufacturing process because we have to maintain that temperature range of 33 to 40 all the way through from receiving to raw storage to processing to finished goods storage to shipping. Q. All right. And where would you use the blower fan? A. In every room that you see that is in blue or gray – or green, depending on your color. Here on this schematic. There's refrigeration in every single one of those rooms." R. p. 232:3-21.

The ALC Order states:

(7) Warehouse Racks

*These racks are specially designed to assist in cooling and maintaining the required temperature of the produce during processing to avoid spoilage and prevent contamination.* Since pallets cannot be stacked on top of each other due to cooling limitations, these racks are galvanized to withstand the cold, wet and humid atmosphere inside of the facility and to allow cold air to flow through the rack system and over the individual items of produce so that the temperature does not exceed 40 degrees. Because a temperature of 41 degrees or over means that [Respondent] effectively has no product, maintaining the required temperature is

essential to [Respondent]'s manufacturing process....

(11) Blower Fan

Because the temperature in the facility must be maintained between 33-40 degrees, *blower fans are used to circulate refrigerated air throughout the facility* in both the high-care and low-care areas. Without the blower fans, [Respondent] could not maintain the required temperature in the facility. *Additionally, blower fans are used to prevent unfiltered air from entering the high-care area where air is filtered to an exact standard to maintain an elevated level of sanitation.*

R. p. 12, 13 (emphasis added). The ALC Order also states:

[T]estimony from [Respondent]'s witnesses showed that **Stacking Containers (6), Warehouse Racks (7), Pallet Flow Brakes (8), and the Blower Fan (11)** *all work to maintain the proper temperature within the plant* and also to hold and transport the produce before and after it is cut so that it cannot become adulterated or spoiled during processing, as outlined above in the FDA's Guide to Minimize Microbial Food Safety Hazards of Fresh-cut Fruits and Vegetables and in 21 C.F.R. § 110.80(b). Absent the climate and environmental controls provided by these machines, temperature inside of the plant and the temperature and integrity of the produce itself could not be maintained, resulting in an increased likelihood of contamination and/or adulteration. Without these machines, contamination occurs and McEntire would effectively have no product, thus making them integral and necessary to the manufacturing process.

R. p. 26 (emphasis added).

Regarding the racks, granted Reg. 302.5(B)(7) states that machines used for storage are taxable but Reg. 117-302.5(C)(24) is much more specific. It states that machines used to condition air (including humidification systems) for quality control is exempt. The ALC Order found as a matter of fact that McEntire's racks are "specially designed to assist in cooling and maintaining the required temperature of produce during processing to avoid spoilation and prevent contamination."

Regarding Blower Fans, the Court's Order states that McEntire did not provide evidence where the blower fans are used and thus finds them taxable. By

contrast, the ALC Order found they were used “to circulate refrigerated air throughout the facility in both the high-care and low-care areas [and a]dditionally, blower fans are used to prevent unfiltered air from entering the high-care area.” R. p. 13. Neither DOR witness testified based upon their observations at the plant that these items were not exempt.

#### 4. Water Storage Tanks

The Respondent has large water tanks both inside and outside the facility. R. p. 258:13-14. The outside tank stores chilled water and mixes sanitation chemicals before the water is delivered to the high-care area to wash the produce. R. p. 258:21-259:7. The inside tanks are in the high-care area; they recirculate some of the runoff water so that it can be used again in the processing of produce. R. p. 258:8-9; 259:21-24; and ALC Order at p. 14.

The Court of Appeals Order (p. 12-13) finds:

SCDOR argues water storage tanks are not machines used in the processing of produce. McEntire asserts Regulation 117-302.5(C)(8) holds that “[t]anks which are a part of the chain of processing operations” are exempt.

However, Regulation 117-302.5(B)(7)(b) provides that machines used for storage are taxable, including “[s]torage tanks used to store raw materials, gasses, or water.” McEntire did not present evidence the tanks are used during processing. Thus, they are not tax exempt.

The Court notes that Reg. 117-302.5(C)(8) holds that “tanks which are a part of the chain of processing operations are exempt” but held that “McEntire did not present evidence that tanks are used during processing.” To the contrary, McEntire testified “So water tanks are used throughout the facility but particularly in the high-care area where we wash produce.” R. p. 214:17-18. He also testified “A. There are two 10,000-gallon storage tanks in that room. Q. Okay. And is the water in itself used directly in the manufacturing process? A. Yes. It’s used to wash the produce and sanitize the produce. The water is the conveyance system, and it also is used to dilute the sanitizer within the water. And that sanitizer, in this case, chlorine is used to desanitize the produce.” R. p. 215:21-216:5. Additionally, the ALC Order explicitly found as a fact they were

part of processing. The ALC Order described them as:

(18) **Storage Water Tanks**

[Respondent] has two storage water tanks that store water used all over the facility, primarily in the high-care area. *One tank is used to mix sanitation chemicals with chilled water. This mixture is pumped into the high-care area to wash the produce during the cutting process. The other tank is used to capture, sanitize, and recirculate some of the runoff water so that it can be reused later in the manufacturing process.*

R. p. 14. The ALC Order also stated:

The two **Storage Water Tanks (18)** found in the facility both serve to sanitize the produce as it is being cut and processed in the high-care area and also to maintain cleanliness in other areas of the plant. *One tank mixes sanitation chemicals with chilled water that is sprayed on the produce and on the cutting machine in the cutting room/high-care area during the production line part of the manufacturing process. These tanks are essential to sanitize the produce and to prevent the spread of food contaminants or pollution during the cutting process by reducing the pathogens that may flow between the cutting machines, the produce and the run-off water.*

R. p. 27 (emphasis added). The ALC Order accordingly found as a matter of fact that the tanks were part of the chain of processing operations. Neither DOR witness testified that these items were not exempt. *See Monroe v. Livingston*, 251 S.C. 214, 161 S.E. 2d 243 (1968) (machines used for “spraying, cleaning, candling, grading and packaging the eggs” were exempt).

5. Cleaning Machines

The Court of Appeals Order (p. 12) states:

6. Cleaning machines and floor treatment chemicals:

SCDOR argues cleaning machines (foamers) and floor treatment chemicals are not machines used in the processing of produce. McEntire did not provide evidence regarding the specific processing equipment it cleans with foamers or whether cleaning is necessary to ensure the functioning of the equipment. Regulation 117-302.5(B)(5)(a)(i) provides for a chemical to be exempt, it must be used on an exempt machine on an ongoing and continuous basis and be essential to the functioning of the exempt machine. *Because there*

*was no testimony the chemicals were used on any exempt machines, they are not tax exempt. Regulation 117-302.5(B)(5)(b) also provides chemicals used to clean floors and walls and non-exempt machines, like storage tanks, are not tax exempt. Thus, the floor treatment chemicals are not tax exempt. (Emphasis added)*

The ALC Order described them as follows:

19. **Cleaning Machines**

*Every night, a specific sanitation shift utilizes cleaning machines, called “foamers” to sanitize the machines and surfaces used in the high-care area. [Respondent]’s witness testified that those machines are required by the FDA and that 80% of their use occurs in the high-care area.*

R. p. 14 (emphasis added). The ALC Order also stated:

**Cleaning Machines (19) and Floor Treatment Chemicals (17) are both used in the cutting room/high-care area to sanitize the machines and surfaces directly involved in the production line. [Respondent] testified that 80% of the cleaning machines or “foamers” are required by the FDA to sanitize surfaces in the cutting room nightly. (Emphasis added)**

R. p. 27 (emphasis added).

The Court Order states there was no testimony the cleaning machines and chemicals were used on any exempt machines. By contrast, the ALC Order found as a matter of fact that the machines and chemicals were used to sanitize “the machines ... in the high-care are” and that “both [were] used in the cutting room/high-care area to sanitize the machine and surfaces directly involved in the production line.” *Id.* McEntire testified: “We have an entire shift of sanitation where our sanitation technicians use this machine to take cleaning chemicals and both foam and sanitize the processing equipment.” (R. pp. ----; Tr. p. 88:18-22.) He testified this was required by federal law. R. pp. 229:23-230:1.

Appellant agreed 70% of the floor treatment chemicals and other products were used in the manufacturing process, but contended that 30% was not. R. p. 225:19-226:4. McEntire testified

that the vast majority of the floor treatment chemicals, brooms, and squeegees were used in the manufacturing process—specifically in the high care area. R. p. 224:6-13.

DOR Reg. 117-302.5(C), Other Examples of Exempt Machines, states:

The following are additional examples of machines or machines parts exempt from the tax. \* \* \*

Pressure washing machines and ultrasonic cleaning machines, used to clean exempt manufacturing machines or parts, when the cleaning of the exempt manufacturing machine or part is to ensure the functioning of the exempt machine or part during the manufacturing process or to ensure the quality of the product is maintained.

This Reg. also states at (B)(5):

Chemicals used in an exempt pollution control machine to abate or prevent pollution when such chemicals are integral and necessary to the manufacturing process, such as the treating of wastewater or otherwise preventing or abating pollution, and the use of such chemicals is an ongoing, continuous activity.

Chemicals used to clean the exterior or interior of an exempt manufacturing machine when the cleaning is integral and necessary to the manufacturing process, such as those that are essential in ensuring the quality of the product is maintained, and the use of such chemicals is an ongoing, continuous activity.

DOR Rev. Rule #04-7 states: “Chemicals used to clean the exterior or interior of an exempt manufacturing machine when the cleaning is integral and necessary to the manufacturing process, such as those that are essential in ensuring the quality of the product is maintained, and the use of such chemicals is an ongoing, continuous activity.” It also states: “Pressure washing machines and ultrasonic cleaning machines used to clean exempt manufacturing machines or parts when the cleaning of the exempt manufacturing machine or part is integral and necessary to the manufacturing process and essential in ensuring the functioning of the exempt machine or part during the manufacturing process or essential in ensuring the quality of the product is maintained, and the cleaning is an ongoing, continuous.” Lastly, the Rev. Rule states: “In *Springs Industries*,

*Inc. v. SCDOR*, 99-ALJ-17-0153-CC, the court was asked to determine whether a machine was used in manufacturing or used for maintenance. In that case, the court held that the washing of a textile print screen was done specifically for the purpose of manufacturing a final product. Without the washing of the print screen it would be rendered useless thereby preventing further manufacturing of the final product, and that the print screens could not be continually used without the screen washing machine.

As cited above, McEntire testified and the ALC Order found as a fact that cleaning machines and chemicals were primarily used to clean the high-care area as required by federal law.

#### 6. General Maintenance Tools

The Court of Appeals Order finds:

SCDOR argues the general maintenance tools used to maintain, repair, install, and uninstall equipment are not used on an ongoing and continuous basis and, thus, do not qualify for the machine exemption. Regulation 117-302.5(B)(1)(b) provides a machine is integral and necessary to the manufacturing process *if it is “used on an ongoing and continuous basis during the manufacturing process.”* The evidence demonstrates McEntire uses its maintenance tools on an “as needed” basis. Thus, they are not tax exempt.

Court of Appeals Order at p. 12 (emphasis added). By contrast, the ALC Order states:

[Respondent] uses maintenance tools to maintain, repair, install, and uninstall equipment. In the cold, damp environment of the facility, machinery wears out so quickly that *[Respondent] has thirty (30) fulltime employees working continuously to repair and maintain equipment.*

R. p. 13 (emphasis added). The ALC Order also states:

[Respondent] employs thirty (30) fulltime employees who only work to maintain, repair, install, and uninstall equipment within the facility. Because the processing of fresh produce is regulated by climate control and other environmental controls, the cold and damp conditions inside of the plant cause machinery to constantly require maintenance and repairs. Thus, general ***Maintenance Tools*** that are used to maintain, repair, install, and uninstall exempt machines

*inside of the plant are used on an ongoing, continuous basis and therefore fall within the Machine Exemption.*

R. p. 23 (emphasis added). The Court held that maintenance tools were used on a “as needed” basis and thus were not used on a ongoing and continuous basis. By contrast, the ALC Order explicitly found as a matter of fact such tools were used “on a ongoing, continuous basis.” To state the obvious, maintenance tools – and indeed any machine – are always going to be used only on a “as needed” basis. Neither DOR witness testified based upon their observations at the plant that these items were not exempt.

7. Generator Rentals.

The Court of Appeals Order (pp. 12-13) found:

Finally, SCDOR also argues the generator rentals are not used on an ongoing and continuous basis and, thus, do not qualify for the exemption. McEntire asserted the generators are used to speed up the ripening process and change the colors of the tomatoes and they are not used year-round because some crops do not need ripening. Because they are not used on an ongoing and continuous basis, they are not tax exempt. See Regulation 117-302.5(B)(1)(b) (providing a machine is integral and necessary to the manufacturing process if it is “used on an ongoing and continuous basis during the manufacturing process”).

The ALC Order states:

[Respondent] rents ethylene generators to ripen tomatoes in the tomato cooler area. Tomatoes arrive at the facility in various color stages and [Respondent] uses the generators to produce a chemical that helps to change the color of the tomatoes to meet individual customer specifications. The generators are only used for this purpose, but they are rented only during the portions of the year when tomatoes are in season.

R. p. 20. The ALC Order also states:

[Respondent] also rents ethylene generators to facilitate the tomato ripening process. Because the generators are rented seasonally when needed to complete the manufacturing process. Thus, the Department determined that while the generators do qualify as machines used in the manufacturing process, the generators are only

rented when tomato season dictates their necessity and, therefore, do not meet the “ongoing and continuous basis” standard so as to qualify for the exemption. However, the Court finds that as a manufacturer of seasonal agriculture, the **Generator Rental (20)** during certain seasons to facilitate the manufacture of tomatoes is sufficient to constitute an ongoing and continuous basis so as to qualify for the exemption. In fact, it is the rental of the generators only on an as-needed, seasonal basis that makes their use ongoing and continuous. Otherwise, owning them and letting them sit dormant during the off-season would, under the logic provided by the Department, also disqualify them from the exemption. The seasonal use of equipment to manufacture a variable crop should be considered ongoing and continuous and, as such, the generator rental is integral and necessary to the tomato manufacturing process and falls within the Machine Exemption.

R. p. 24. Many industries—not just agriculture—are seasonally based. The production schedules of many industries vary with the economy, with some production functions slow down or are discontinued during recessions. Many factories shut down an entire month every year for repairs, maintenance, inventory counts, etc. The Court of Appeals Order finds that no machine – not just generator rentals—are tax exempt unless the factory runs continually during the 12 months of the calendar year. Neither DOR witness testified based upon their observations at the plant that these items were not exempt.

#### 8. Floor Drain Covers

The Court of Appeals Order (p. 11) states:

SCDOR argues floor drain covers that keep debris and produce from entering McEntire’s floor drain system are not machines for purposes of the machine exemption. McEntire argues they are integral and necessary to processing produce because they prevent pollution of the waste water and, as such, are exempt. Because drain covers are a “mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function” as provided in Regulation 117-302.5(B)(1), we find they are not tax exempt.

The ALC Order found:

Like the floor treatment chemicals used to sanitize the floors, **Floor**

**Drain Covers (16)** used in the cutting room/high-care area to filter waste water and to separate waste water and possibly contaminated material also fall within the Machine Exemption as integral and necessary to the manufacturing process. By separating the possibly contaminated waste material that falls on the floor during the cutting and trimming process, the stainless steel drain covers prevent pollution of the wastewater that is either sent back to the city sewer system or recycled and treated by [Respondent] for reuse later in the manufacturing process.

R. p. 28. It also stated:

**(16) Floor Drain Covers**

Stainless steel floor drain covers are used in the high-care area and serve as both a filter and a drain in [Respondent]'s recycling of fresh water. These higher quality drains must be used because waste material was previously entering the closed water system and causing adulteration of the water. [Respondent] uses about 300,000 gallons of water per day and recycles about half of that. When water is sprayed onto the produce in the cutting process, runoff goes onto the floor and mixes with debris. Through the drain system, the water is separated from the debris and some flows back to the plant where it is recycled while the rest goes to the city sewer system.

R. p. 14.

McEntire testified that "We have a very extensive stainless steel floor drain system that goes throughout the high care area. It is an expensive floor drain system because it's custom made."

R. p. 239:8-11. The floor drain system is so extensive because the water is strained all the way down to filtered water level and reused to rinse produce. R. p.239:8-24. Respondent installs stainless steel floor drain covers inside the high-care area of its facility to keep debris and product from entering the floor drain system. R. p. 239:11-15. The Respondent uses the floor drain system to recapture spilled water so it may reuse the water to wash the produce. R. p. 239:15-24. Stainless steel floor drain covers are used in the high-care area and serve as both a filter and a drain in Respondent's recycling of fresh water. These higher quality drains must be used because waste material was previously entering the closed water system and causing adulteration of the water.

Respondent uses about 300,000 gallons of water/day and recycles about half of that. R. p. 325:16-19. When water is sprayed onto the produce in the cutting process, runoff goes onto the floor and mixes with debris. Through the drain system, the water is separated from the debris and some flows back to the plant where it is recycled while the rest goes to the city sewer system. R. p. 14.

George Lovelace, head of Food Safety at McEntire, testified that the DHEC Water Permit required Respondent to filter the water before it was discharged back into the City water system. R. p. 325:11-326:4. The floor drain covers were an integral part of recycling water used directly in the processing process. As such they meet the traditional definition of machine and were part of a coordinated system of preparing agricultural goods for transporting and warehousing.

In Revenue Ruling #04-7, the DOR held that traveling water screens used to filter water from a river or lake were exempt. The Revenue Ruling also states that machines used to remove sawdust from saws in a sawmill are exempt.

**C. Are Coveralls, eyewear, gloves, aprons and hair nets required by State and Federal law “machines?”**

Significantly, neither the DOR Proposed Assessment, R. p. 675, nor the DOR’s Department Determination, R. p. 736, alleged that protective clothing was not a “machine.” Both documents alleged only that E Coli., Salmonella or Listeria were not “pollution.” [Respondent] raised the machine argument for the first time at trial.

McEntire’s employees are required by state and federal law to wear coveralls, eyewear, gloves, aprons and hairnets. The Court of Appeals holds that such items are taxable as “protective clothing” under DOR Regulation 117-302.5(B)(10). The Regulation does not define “protective clothing.” Federal law pertaining to raw food processors, 21 CFR §117.10(b), do not refer to the required items as protective clothing. It refers to “outer garments, gloves, hairnets, headbands, caps, beard covers, or other effective hair restraints.” Similarly, DHEC Regs. 61-3-301.11(B)

require food employees to use gloves, hair restraints, and clothing that covers body hair. The regulations do not refer to them as “protective clothing.”

The distinction between protective clothing for workers versus protective clothing for manufactured products is discussed in Massachusetts and Connecticut sales tax bulletins. The Massachusetts bulletin notes that “the term ‘protective use’ does not refer to clothing designed primarily to protect the product being manufactured, e.g., ‘clean room’ clothing or hats and gloves worn by workers in the food service industry...” Similarly, the Connecticut bulletin notes that “*safety apparel* does not include clothing and equipment intended to protect the product being worked upon, such as clean room clothing or gloves and hairnets worn by food service industry workers.” Both states acknowledge that clothing and gear protecting the product being manufactured or processed is distinguishable from more common apparel protecting the wearer.

The DOR regulation relied upon by the Court of Appeals holds that (1) Protective clothing worn by an employee working in the area where the manufacturing process occurs is taxable; but (2) “clothing and other attire required to work in a Class 100 or better ... clean room environment” is exempt. Although the ALC held that McEntire’s proof of Class 100 or better was dated after the audit, there was no dispute the clothing at issue were the Class 100 gear. The only testimony was that the facility has had a Class 100 clean room environment since it opened in 2006 as required by federal law. R. p. 200:21-201:13.

In S.C. Tax Commission Decision 92-19, the former Tax Commission held that stack liners and ash pond pipes and pumps were exempt. In S.C. Rev. Rul. # 89-7, the DOR opined that a settling basin for a wastewater treatment facility was exempt and therefore purchases of materials such as concrete and steel to build the facility were likewise exempt. In Rev. Rul. #04-7, the DOR states: “Chemicals used in an exempt pollution control machine to abate or prevent pollution

when such chemicals are integral and necessary to the manufacturing process, such as the treating of wastewater or otherwise preventing or abating pollution, and the use of such chemicals is an ongoing, continuous activity.” At issue in S.C. Private Letter Ruling (PLR) # 90-3 was whether concrete, reinforced steel bars and a metallic pool liner were exempt under the pollution control exemption when used to construct a gamma irradiator vault. The ruling held under such facts that the concrete, steel, and liner used to construct the vault were exempt.

In S.C. Tax Commission Decision 89-82 (June 26, 1989), the taxpayer provided radioactive waste management services consisting of processing, transporting and disposing of nuclear waste generated by nuclear power plants. At issue was the sales taxation of liners. The Tax Commission Division staff initially held the liners were subject to sales taxes. The Commission disagreed and found that the liners were exempt notwithstanding their storage function stating:

In reaching this decision, we first note that the liners are machines. The term ‘machine’ has been defined to include ‘every mechanical device or combination of mechanical power and devices to perform some function and produce a certain effect or result.’ *Hercules Con. & Engineers v. South Carolina Tax Com’n.*, 280 S.C. 426, 313 S.E. 2d 300 (S.C. App. 1984).

If chemicals, stackliners, ash pond pipes, concrete and steel and metallic pool liner used to construct a gamma irradiator vault, liners used in radioactive waste management services, storage containers with no moving parts, and the component parts of these products constitute “machines,” then certainly gear worn by employees to prevent pollution are machines.

## **II. *Niagara Mohawk Power Corp v. Wannamaker*, 286 A.D. 446 (N.Y. 1955).**

The Court of Appeals Order states the DOR agrees South Carolina is an integrated plant theory but that the ALC incorrectly relied upon *Niagara Mohawk Power Corp v. Wannamaker*, 144 N.Y.S. 2d 458 (N.Y. App. Div. 1955) as New York’s integrated plant theory is much broader than South Carolina’s. While the ALC cited this decision, it in no way relied upon it.

Generally, states follow one of two distinct lines of authority when determining what qualifies as machinery used in manufacturing: (1) the Integrated Plant Concept or (2) the “Ohio Rule”. *See generally* Hellerstein, *State Taxation*, at § 14.05. The more restrictive Ohio Rule defines “manufacturing” as “essentially a transformation or conversion of material or things into a different state or form from that in which they originally existed.” *Nat’l Tube Co. v. Glander*, 105 N.E.2d 648 (Ohio 1952). Only assets which physically transform raw materials during the manufacturing process into a different form are eligible for exemption. On the other hand, the Integrated Plant Concept is less restrictive. As the name implies, machinery shall be eligible for the exemption if it performs an essential or indispensable function in the taxpayer’s manufacturing operations, regardless of whether it actually causes a physical change. This test is derived from *Niagara Mohawk Power Corp. v. Wanamaker*.

In *Springs Industries, Inc. v. Department of Revenue*, 99-ALJ-17-0153-CC (1999), Chief Administrative Law Judge Kittrell acknowledged that Professor Walter Hellerstein, author of the above-cited treatise on state taxation, testified that South Carolina is classified as an “integrated plant theory state.” In an unpublished opinion, the Court of Appeals affirmed the finding. It noted that although the Department urged the court to “interpret the term ‘machines used in manufacturing’ to include only items that are part of a production line,” this position was “inconsistent with the result in *Hercules Contractors and Engineers, Inc. v. South Carolina Tax Commission*, 280 S.C. 426, 313 S.E.2d 300 (1984)] and the language in [§ 12-36-2120(17)] that only requires a machine to be ‘used in manufacturing,’ rather than ‘used directly in manufacturing,’ as the [Department] suggests.” *S.C. Dep’t of Revenue v. Springs Indus., Inc.*, 2003-UP-029 (Ct. App. 2003). Thus, South Carolina law provides that so long as the equipment in question performs an essential function in the taxpayer’s manufacturing operations, it will qualify for the machine

exemption to the sales tax. To reiterate: The Court of Appeals in *Hercules* held that machinery and its various parts and attachments are exempt if they are “integral and necessary to the operation of the system as a whole.” In determining the entire facility to be exempt, the Court stated that “even its railings, walkways and ladders, which were required by state and federal laws and therefore ‘necessary to the overall function’ of the system were exempt.” *Id.* at 430, 313 S.E.2d at 303.

As a result of the *Hercules* and *Springs Industries* decision, the DOR issued S.C. Rev. Rul. #04-7 and Regulation 117-302.5 to conform with these decisions. S.C. Rev. Rul. #04-7 states:

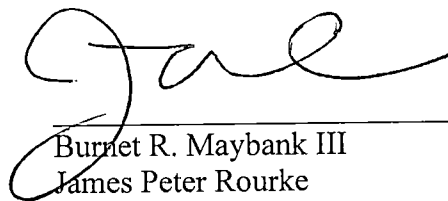
Previously, the Department adhered to the “Production Line Theory” in determining what machinery was used in manufacturing. Under this theory, items were found to be exempt only if “used directly” in manufacturing process. Based upon the recent court decisions, the “Production Line Theory” will no longer be used. Instead, the court mandated machinery is exempt if such machinery is “integral and necessary” to the manufacturing process. This change is generally less restrictive than the Department’s prior interpretation. As such, some machines that the Department would previously have held subject to the tax are exempt.

*Hellerstein* notes at ¶ 14.05[2][d] that “In addition to the New York ... courts, state courts in ...South Carolina ..., have also indicated their embrace of the integrated plant doctrine.”

### CONCLUSION

For all of the above reasons, Respondent requests that its Petition for Rehearing be granted and that the Court rehear and amend its decision reversing the ALC decision.

March 16, 2023



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*Attorneys for Respondent McEntire Produce, Inc.*

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THE STATE OF SOUTH CAROLINA  
In The Court of Appeals

MAR 16 2023

SC Court of Appeals

\_\_\_\_\_  
The Honorable H.W. Funderburk, Jr., Administrative Law Judge

\_\_\_\_\_  
Case No. 17-ALJ-17-0060-CC  
Appellate Case No. 2019-001933  
Opinion No. 5972  
\_\_\_\_\_

McEntire Produce, Inc. ....Respondent,

v.

South Carolina Department of Revenue, .....Appellant.

\_\_\_\_\_  
**PROOF OF SERVICE**  
\_\_\_\_\_

I do hereby certify that I have served on this 16<sup>th</sup> day of March, 2023 the Respondent's Petition for Rehearing in connection with the above-captioned matter by causing a copy of the same to be electronically mailed to Elisabeth W. Shields at [Elisabeth.Shields@dor.sc.gov](mailto:Elisabeth.Shields@dor.sc.gov), Attorney for Appellant.

*Melinda White*

\_\_\_\_\_  
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Jim Rourke, J.D., LL.M (Tax)  
Member

March 16, 2023

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SC Court of Appeals

**VIA HAND DELIVERY**

The Honorable Jenny Abbott Kitchings  
Clerk, South Carolina Court of Appeals  
1220 Senate Street  
Columbia, SC 29201

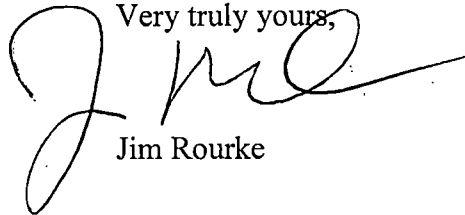
Re: McEntire Produce Inc. v. South Carolina Department of Revenue  
Case No. 17-ALJ-17-0060-CC  
Appellate Case No. 2019-001933  
Opinion No. 5972

Dear Ms. Kitchings:

Enclosed please find the original and seven copies of *Respondent's Petition for Rehearing*, along with a \$50.00 filing fee. Please file the original and return one file-stamped copy to our courier. Also enclosed is a proof of service, showing that opposing counsel have been served with this petition.

Thank you for your consideration in this matter.

Very truly yours,



Jim Rourke

JR/mw

Enclosures

cc: Elisabeth Shields, Esquire

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- Columbia**
- Greensboro
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- Hilton Head
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- Raleigh

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