THE STATE OF SOUTH CAROLINA
IN THE SUPREME COURT

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. 2023-000973
Opinion No. 5972 (S.C. Ct. App. Filed March 1, 2023)

McEntire Produce, Inc.,. ....Petitioner,

v.

South Carolina Department of Revenue ....Respondent.

BRIEF OF PETITIONER

James P. Rourke (S. C. Bar No. 79879)
Maynard Nexsen, PC
1230 Main Street, Suite 700 (29201)
Post Office Drawer 2426
Columbia, South Carolina 29202
(803) 540-2030
jrourke@maynardnexsen.com

Attorney for Petitioner McEntire Produce, Inc.

RECEIVED
MAY 16 2024
S.C. SUPREME COURT

TABLE OF CONTENTS

PAGE

QUESTIONS PRESENTED 1
STATEMENT OF THE CASE 1
STATEMENT OF FACTS 2
STANDARD OF REVIEW 5
ARGUMENTS 7
I. THE COURT OF APPEALS ERRED IN IGNORING THE EXTENSIVE FINDINGS ESTABLISHED BY THE ALC. 7
II. THE COURT OF APPEALS HAS CREATED A SEASONAL OR "AS NEEDED" EXCEPTION TO THE MACHINE EXEMPTION WHICH IS UNFOUNDED IN STATUTE, CASE LAW, OR REGULATION. 31

TABLE OF AUTHORITIES

Cases

A. O. Smith Corp. v. S.C. Dep't of Health & Envtl. Control, 428 S.C. 189, 833 S.E.2d 451 (Ct. App. 2019) 6
Bailey v. S.C. Dep't of Health & Envtl. Control, 388 S.C. 1, 693 S.E. 2d 426 (Ct. App. 2011).... 7
Be Mi, Inc. v. S.C. Dep't of Revenue, 408 S.C. 290, 758 S.E.2d 737 (Ct. App. 2014).... 6
Charleston County Assessor v. University Ventures, LLC 421 S.C. 1984, 805 S.E.2d 216 (Ct. App. 2017) 8
Chrome Deposit v. Ind. Dep't of State Revenue, 557 N.E. 2d 1110 (Tax Ct. Indiana 1990) 29
Clark v. Aiken County Gov't, 366 S.C. 102, 620 S.E.2d 99 (Ct. App. 2005) 6
Comm'rs of Pub. Works v. S.C. Dep't of Health & Envtl. Control, 372 S.C. 351, 641 S.E.2d 763 (Ct. App. 2007) 6
DIRECTV, Inc. v. S.C. Dep't of Revenue, 421 S.C. 59, 804 S.E. 2d 633 (Ct. App. 2017)......... 7, 8
Hercules Con. & Engineers v. South Carolina Tax Com'n., 280 S.C. 426, 313 S.E. 2d 300 (Ct. App. 1984) 30
Lark v. Bi-Lo, 276 S.C. 130, 276 S.E.2d 304 (1981).... 7
Monroe v. Livingston, 251 S.C. 214, 161 S.E.2d 243 (1968) 21
Niagara Mohawk Power Corp. v. Wannamaker, 144 N.Y.S.2d 458 (N.Y. App. Div. 1955).......9
Olson v. S.C. Dep't of Health & Envtl. Control, 379 S.C. 57, 663 S.E.2d 497 (Ct. App. 2008).... 5
Original Blue Ribbon Taxi Corp. v. S.C. Dep't of Motor Vehicles, 380 S.C. 600, 670 S.E.2d 674 (Ct. App. 2008) 7, 8
Palmetto Alliance, Inc. v. Pub. Serv. Comm'n 282 S.C. 430, 319 S.E. 2d 695 (1984) 8
Risher v. S.C. Dep't of Health & Envtl. Control, 393 S.C. 198, 712 S.E.2d 428 (2011) 6, 8
S.C. Dep't of Revenue v. Sandalwood So. Club, 399 S.C. 267, 731 S.E.2d 330 (Ct. App. 2012).. 8
Se. Res. Recovery, Inc. v. S.C. Dep't of Health & Envtl. Control, 358 S.C. 402, 595 S.E.2d 468 (2004).... 7
Springs Industries, Inc. v. S.C. Dep't of Revenue, Docket No. 99-ALJ-17-0153-CC 14, 23
Taylor v. S.C. Dep't of Motor Vehicles, 368 S.C. 33, 627 S.E.2d 751 (Ct. App. 2006).... 7
Turner v. S.C. Dep't of Health & Envtl. Control, 377 S.C. 540, 661 S.E.2d 118 (Ct. App. 2008) 6

Statutes

S.C. Code Ann. § 1-23-310.... 1
S.C. Code Ann. § 1-23-610.... 6, 8
S.C. Code Ann. § 12-36-2120(17)....*passim*

Other Authorities

21 C.F.R. § 110.80(b) 20
21 C.F.R. § 117.10(b) 30
Connecticut PS 2004(4): Sales and Use Tax Exemption for Safety Apparel.... 31
Massachusetts Directive 99-3: Sales and Use Tax Treatment of Protective Clothing 31
S.C. Rev. Rul. # 89-7 .... 29, 32
S.C. Rev. Rul. #04-7.... 25, 32
S.C. Tax Comm'n Decision 89-82 32
S.C. Tax Comm'n Decision 92-19 32
S.C. Appellate Court Rule 215 2

Regulations

DHEC Regs. § 61-3-301.11(B) 30
S.C. Regs. § 117-302.1 18
S.C. Regs. § 117-302.5 .... passim

QUESTIONS PRESENTED

I. Did the Court of Appeals err in refusing to extend the Machine Exemption to the purchases at issue, which were essential and indispensable to the activities of McEntire Produce, Inc. ("McEntire" or "Petitioner") as a fresh food processor?

II. Did the Court of Appeals err in disregarding the extensive findings of fact of the ALC?

III. Did the Court of Appeals err in creating an "as needed" standard for the Machine Exemption, which is unfounded in case law, statute, or regulation?

STATEMENT OF THE CASE

This matter came before the South Carolina Administrative Law Court ("ALC") in accordance with the Administrative Procedures Act, S.C. Code Ann. §§ 1-23-310 et seq. (2005 & Supp. 2015), for a contested case hearing. McEntire filed a request for a contested case hearing with the ALC on March 7, 2017, to challenge a Department Determination issued by the South Carolina Department of Revenue ("Department" or "DOR") on February 7, 2017. App. pp. 736-45, 1177. In the Department Determination, the Department concluded that the McEntire's purchases of certain supplies and protective clothing were subject to use tax for tax periods October 1, 2012 through September 30, 2015 and were not exempt from use tax under § 12-36-2120(17) (Supp. 2018). App. pp. 736-45.

On November 14 and 15, 2018, the ALC held a two-day contested case hearing. Thereafter, the ALC issued its Final Order on September 6, 2019 ("ALC Order") and determined that the majority of the items at issue, including those items identified as protective clothing, for which the McEntire sought exemptions were exempt from sales and use tax under § 12-36-2120(17), hereinafter referred to as the "Machine Exemption." App. p. 42. The ALC further found that the items designated as protective clothing were also exempt from use tax under a separate provision in § 12-36-2120 (17)(b) commonly referred to as the "Pollution Control Machine Exemption." *Id.*

On September 19, 2019, the Department filed a Motion for Reconsideration, and/or to Alter or Amend. App. pp. 46-72. The ALC issued an order on October 16, 2019, denying the

Department's Motion for Reconsideration. App. pp. 44-45. The Department appealed the Order and the Order Denying McEntire's Motion to Reconsider, Alter or Amend to the Court of Appeals by filing a Notice of Appeal on November 20, 2019.

On appeal, the Court of Appeals reversed both determinations without oral argument pursuant to SCACR 215 in an Order dated March 1, 2023 ("Court of Appeals Order"), finding all of the purchases at issue were subject to use tax. App. pp. 1311-27. In response to the ALC's reversal, McEntire filed a Petition for Rehearing, which was denied by the Court of Appeals on May 18, 2023. App. pp. 1328-1355, 1356. McEntire then filed a Petition for a Writ of Certiorari which was granted by this Court on March 27, 2024.

STATEMENT OF FACTS

McEntire operates in the "specialized and highly-regulated arena of fresh food processing." App. p. 5. The business was formed in South Carolina in 1938. App. p. 158:9-11. It operates as a seasonal business with 600 employees during the summer and 50 in the winter. App. p. 159:3-8. Their major customers include McDonalds, Burger King, Subway and Taco Bell. App. p. 162:13-17. For sales, income, and property tax purposes, Petitioner is taxed as a manufacturer. App. p. 166:1-4.

During the periods at issue, McEntire's production primarily involved lettuce, onions, cabbage, tomatoes, and other vegetables. App. p. 2, 160:22-25. Petitioner's "processing" includes receiving, storing, washing, cutting, mixing, and then packaging the produce at its facility. App. p. 2. This production process is critical to reduce or eliminate harmful contaminants because the ultimate customer who eats the fresh produce does not take any preventive steps such as cooking the produce to the extent necessary to kill or eliminate any contaminants. App. 292:24-293:10.

Petitioner's process begins prior to the raw agricultural commodity even entering the facility. App. p. 160:10-15. Petitioner contracts with a grower to harvest the product at a

temperature of around 80-85 degrees. App. p. 5. The first step in the process it to pull the heat from the produce, in an effort to reduce the temperature of the produce below 40 degrees within no more than four hours from the time of harvest. App. pp. 5-6, 192:17-20. This cooling step is essential to Petitioner's process because it slows the respiration rate of the produce, thereby slowing the natural chemical process of ripening the fruit and/or vegetable. App. p. 189:6-11. It also minimizes microbiological growth rate. If the produce is not cooled immediately, then it risks turning brown, soggy, slimy, and inedible. App. p. 194:20-21. Petitioner must be able to demonstrate that the temperature on those trucks was between 33 and 40 degrees. App. p. 193:1-12. Petitioner's customers (primarily large restaurant chains) have extensive contractual requirements in this regard. App. p. 170:6-8.

As soon as the product is unloaded, it enters one of six raw coolers, which also are controlled at 33-40 degrees. App. p. 182:17; p. 187:16-18. Soon thereafter, the produce goes through the Ready to Eat ("RTE") process, where it is sorted, physically inspected, trimmed by hand to remove imperfections or browning, and then conveyed to an industrial cutter that discharges into a flume for washing. App. p. 6-7, 188:21-192:10. Petitioner's flume is a stainless steel bath that utilizes a water-based product to rinse and sanitize the product. App. p. 7. The produce is washed a number of times before it moves to the next step. App. p. 7. After washing, the produce goes through a "de-watering" step, which is essentially an industrial-sized salad spinner. App. p. 49:12-17. This process of washing and de-watering is done in an effort to remove any pollutants or contaminants which were in the produce at the time of delivery to the Petitioner.

The low care area is generally reserved for whole produce, for example whole tomatoes, and involves their ripening, sorting, defect removal, and repackaging but no cutting of the produce. App. p. 183:5-8. The physical cutting of produce releases pollutants, which are present on the

produce at the farm level, and allows them to grow, multiply and spread which is the reason for the high care area. App. p. 306:12-21.

The high care area is reserved for produce that is cut down to a smaller size. App. p. 6. In the high care area, employees are required by state and federal law to wear protective clothing. App. p. 36-38. The employees must also go through a specialized sanitization procedure to limit the introduction of microbes to the high care area. App. p. 216:23-217:5. The room is also positive-pressurized to ensure there is an outflow, as opposed to an inflow, of air. App. p. 311:19-25. That pressurization, as well as filters for both ambient and compressed air touching the produce used to filter the air down to 0.1 microns, help maintain the cleanliness of the environment. App. p. 336:21-24. The overall purpose of these procedures are to protect the produce from human contact and microbial loads, and to protect the produce from pollutants transferable through human contact, microbial growth, and surface contact. App. p. 7. This protective clothing is required by state and federal law to prevent employees from accidentally bringing pollutants (chiefly E. coli) from their clothing into the high care area. App. p. 384:21-25.

In the high care area, the produce is de-watered in a centrifugal dryer and moved on a conveyor belt to a scale, weighed and bagged, and then boxed and labeled for shipping. App. p. 242:24-243:12. In the area, Petitioner is required by state and federal law and customer contractual requirements to meet exacting cleanliness standards to ensure the finished product is both free from harmful microbial growth and meets the stringent standards of its many customers. App. p. 174:6-15.

Once bagged, boxed, and labeled, the produce is stored for a short period of time in a refrigerated cooler, given the fresh nature of its cut produce, and is then shipped on climate-controlled trucks to its customers. App. p. 192:2-10. Petitioner's customers are primarily large

restaurant chains who put the fresh produce on salad bars and into hamburgers, sandwiches, etc. without any additional processing for health purposes, e.g., the produce is not cooked. App. p. 163:1-25. "[W]e do not have a kill step. We do not have a pasteurization step." App. p. 176:13-15. Petitioner's customers also can track the extent to which the produce was kept in a climate-controlled area. App. p. 221:7-15. For example, if the produce is stored for a period of time above 40 degrees, then the customer can simply reject the shipment. App. p. 2232:9-25. Further, to the extent the Food and Drug Administration (or a customer) on audit determined that the produce spent a period of time outside the temperature "safe zone," Respondent could be subject to reprimand, fines, or even plant closure, based on the severity of the violation. App. p. 8. This means temperature and environmental controls permeate the entire production process, from the time the produce is delivered from the farm until the finished product leaves Petitioner's facility. App. pp. 5-8.

As detailed below, many of the items at dispute in this audit relate to Petitioner's attempt to combat three potentially serious foodborne microbes – Listeria monocytogenes, E. coli and salmonella. App. p. 277:14-19. All three microbes grow naturally in South Carolina and are present in farms across the country where Petitioner's produce is harvested. App. p. 280:23-282:4. The germ and bacteria can breed in produce if the environment is conducive to that growth. App. p. 399:4-7. Petitioner deals with these pollutants in two scenarios: (1) to prevent the spread of contaminants which are in produce delivered to its facilities; and (2) to prevent employees from introducing such pollutants into the facility from their own clothing and shoes. App. pp. 8-9.

STANDARD OF REVIEW

In an appeal from the decision of an administrative agency, the Administrative Procedures Act provides the appropriate standard of review. *Olson v. S.C. Dep't of Health & Envtl. Control*, 379 S.C. 57, 63, 663 S.E.2d 497, 500-01 (Ct. App. 2008); *Turner v. S.C. Dep't of Health & Envtl.*

Control, 377 S.C. 540, 544, 661 S.E.2d 118, 120 (Ct. App. 2008); *Clark v. Aiken County Gov't*, 366 S.C. 102, 107, 620 S.E.2d 99, 101 (Ct. App. 2005). S.C. Code Ann. § 1-23-610(D) (Supp. 2017) provides the applicable standard:

> (D) The review of the administrative law judge's order must be confined to the record. *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*. The court of appeals may affirm the decision or remand the case for further proceedings; or, it may reverse or modify the decision if the substantive rights of the petitioner have been prejudiced because the finding, conclusion, or decision is:
>
> (a) in violation of constitutional or statutory provisions;
> (b) in excess of the statutory authority of the agency;
> (c) made upon unlawful procedure;
> (d) affected by other error of law;
> (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
> (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

The Court of Appeals defined the standard of review for appeals from the Administrative Law Court in *A. O. Smith Corp. v. S.C. Department of Health and Environmental Control*, 428 S.C. 189, 833 S.E.2d 451, 457-58 (Ct. App. 2019), as follows:

> "A reviewing court may reverse or modify an administrative decision if the findings of fact are not supported by substantial evidence." *Risher v. S.C. Dep't of Health & Envtl. Control,* 393 S.C. 198, 210, 712 S.E.2d 428, 434 (2011). "When the evidence conflicts on an issue, the court's substantial evidence standard of review defers to the findings of the **fact-finder."** *Be Mi, Inc. v. S.C. Dep't of Revenue,* 408 S.C. 290, 297, 758 S.E.2d 737, 740 (Ct. App. 2014). "In determining whether the ALC's decision was supported by substantial evidence, this court need only find that, upon looking at the entire record on appeal, there is evidence from which reasonable minds could reach the same conclusion that the ALC reached." *Engaging & Guarding Laurens Cty.'s Env't (EAGLE),* 407 S.C. at 342, 755 S.E.2d at 448. "[W]e may not substitute our judgment for that of the [ALC] as to the weight of the evidence on questions of fact unless the [ALC's] findings are clearly erroneous in view of the reliable, probative and substantial evidence in the whole record." *Bailey,* 388 S.C. at 5, 693 S.E.2d at 429 (alterations by court) (quoting *Comm'rs of Pub. Works v. S.C. Dep't of Health & Envtl. Control,* 372 S.C. 351, 358, 641 S.E.2d 763, 766-67 (Ct. App. 2007)).

> "Substantial evidence is 'evidence which, considering the record as a whole, would allow reasonable minds to reach the conclusion that the administrative agency reached.' " *Se. Res. Recovery, Inc. v. S.C. Dep't of Health & Envtl. Control,* 358 S.C. 402, 407, 595 S.E.2d 468, 470 (2004) (quoting *Lark v. Bi-Lo,* 276 S.C. 130, 135, 276 S.E.2d 304, 306 (1981)). "Substantial evidence ... is more than a mere scintilla of evidence." *Original Blue Ribbon Taxi Corp. v. S.C. Dep't of Motor Vehicles,* 380 S.C. 600, 605, 670 S.E.2d 674, 676 (Ct. App. 2008). "Substantial evidence is not ... the evidence viewed blindly from one side of the case, but is evidence that, considering the record as a whole, would allow reasonable minds to reach the conclusion the [ALC] reached in order to justify its action." *Fragosa v Kade Constr, LLC,* 407 S.C. 424, 428, 755 S.E.2d 462, 465 (Ct. App. 2013) (quoting *Taylor v. S.C. Dep't of Motor Vehicles,* 368 S.C. 33, 36, 627 S.E.2d 751, 752 (Ct. App. 2006)).

See also DIRECTV, Inc. v. S.C. Dep't of Revenue, 421 S.C. 59, 804 S.E. 2d 633, 638 (Ct. App. 2017) and *Bailey v. S.C. Dep't of Health & Envtl. Control*, 388 S.C. 1, 693 S.E. 2d 426,429 (Ct. App. 2011).

ARGUMENTS

I. THE COURT OF APPEALS ERRED IN IGNORING THE EXTENSIVE FINDINGS ESTABLISHED BY THE ALC.

A. In General

The Court of Appeals Order violates S.C. Code Ann. § 1-23-610(b), which states "[t]he 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 Petitioner's highly regulated fresh food processing, this was a heavily (if not exclusively) a factual determination. Specifically, the ALC had to determine 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, S.C. Regs. § 117-302.5.

After listening to two days of testimony which included complex schematics (*see, e.g.,* App. pp. 491-502) and testimony from McEntire employees and expert witnesses, the ALC found that many, but not all, of the machines at issue in this case met the above test. Then, without the benefit of oral argument, 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 *DIRECTV, Inc. v Department of Revenue*, 421 S.C. 59, 8004 S.E.2d 633, 638 (Ct. App. 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 (Ct App. 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. Specific Findings Contradicted by ALC Order

1. McEntire's Manufacturing Process

At issue is whether the ALC's factual determinations that the machinery at issue qualified as "machines used in manufacturing [or] processing… tangible personal property for sale" was supported by substantial evidence. The Department presented no evidence to the contrary. The Court of Appeals ultimately agreed with the Department's assertion that to be exempt under the Machine Exemption, "a machine does not have to be used directly in the production line but it must be integral and necessary to processing produce." App. p. 1318. The framework utilized by the ALC arguably was even more stringent: to wit, whether "the items at issue fall within the general sales and use tax portion of the Machine Exemption as integral and necessary to the manufacturing process by virtue of being machines substantially used in the facility on an ongoing and continuous basis while serving as an essential and indispensable component part of the manufacturing process." App. p. 23.

The Court of Appeals concluded the ALC erred in relying on *Niagara Mohawk Power Corp. v. Wannamaker*, 144 N.Y.S.2d 458 (N.Y. App. Div. 1955). App. p. 1316. However, to the contrary, while noting "[t]he *Niagara* court held that directness of the activity is not the test" but rather the "test is whether all parts of the plant contribute, continuously and vitally, to production and whether they are all integrated and harmonized," App. p. 22, the ALC's conclusions are based on whether the machinery at issue in this case were "integral" and "necessary" to McEntire's processing of fresh produce. See *id.* The ALC did not expand or draw conclusions based on

Niagara that, for example, material handling equipment should be subject to the Machine Exemption.

In defining the limits of the manufacturing process, the Court of Appeals failed to recognize the impact of the "specialized and highly-regulated arena of fresh food processing." App. p. 5. The ALC found McEntire was "regulated by the Food and Drug Administration (FDA), the South Carolina Department of Agriculture (SCDA), and the South Carolina Department of Health and Environmental Control (DHEC)." App. p. 6. These state and federal agencies "heavily regulate the fresh produce industry and dictate that certain requirements be met so that a product can safely enter the consumer marketplace." App. p. 25. Given the sensitivity and specialized nature of its output (i.e., the food we eat everyday), McEntire's processing requirements are more expansive than those of a traditional manufacturer. According to the ALC, "[i]n essence, without many of these processes, Petitioner would be unable to produce any type of marketable product and would likely be shut down by State and federal agencies in charge of regulating the fresh produce industry." App. p. 23.

Additionally, the ALC found that "... given McEntire's highly regulated business as a fresh produce processor, the machinery and equipment used both before and after the actual production line processing of the fresh produce are integral and necessary not only to the overall manufacturing process, but also to the health and safety functions *imbedded within the manufacturing of fresh produce.*" App. p. 22 (emphasis added). Additionally, in finding the purchases at issue qualified for the Machine Exemption, the ALC specifically identified the unique concerns of a fresh food processor:

> Additionally, the Court finds that other items fall within the Machine Exemption because they are *integral and necessary to the manufacturing process by virtue of maintaining the integrity and safety of the finished food product by preventing its contamination*.… State and federal agencies

> heavily regulate the fresh produce industry and dictate that certain requirements be met so that a product can safely enter the consumer marketplace. As such, *while many of the supplies at issue may not be used directly in the production line, they are integral and necessary to the processing of fresh produce under the Integrated Plant Concept and are integrated and harmonized as continuous and vital elements of production within the McEntire plant.*
>
> *Ever present in [McEntire]'s manufacturing process is the aspect of safety in producing a noncontaminated product, which is the subject of federal guidelines….*
>
> *It is evident that temperature and other environmental controls permeate the entire production process, from the time produce is harvested and delivered form the farms until the finished product leaves the McEntire plant*. In fact, testimony from Carter McEntire revealed that with the help of food safety engineers and experts, *the plant and much of the equipment inside of it was specially designed and built to correlate with the complete and other environmental controls that are required to reduce the possibility of food contamination.*

App. p. 26 (emphasis added). The ALC's findings reflect a more nuanced and accurate representation of the manufacturing process, especially for fresh food processors, which are required to maintain stringent quality control over its perishable product from entry into to exit from its facility. As noted by the ALC and Court of Appeals, the Integrated Plant Concept would grant an exemption under the Machine Exemption for all machines "essential" or "indispensable" to the processors' process. The ALC's findings thus are in line with South Carolina's statutes, guidance and case law in concluding "McEntire's manufacturing operations consist of more than the simple production line manufacturing occurring in the cutting room as determined by the Department." *Id.*

2. Specific Machines and their Uses within the Manufacturing Process

Given the highly fact-intensive nature of this analysis, the following sections recite the Court of Appeals' conclusions with respect to each machine at issue, and then compare the findings of fact and conclusions contained in the ALC Order. In virtually all instances, the Court of

Appeals' conclusions were based on faulty or incomplete characterizations of witness testimony and evidence presented at the ALC.

a. 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.

App. p. 1320 (emphasis in original and added). Petitioner agrees with the first paragraph above: machinery used only for warehouse purposes is not exempt. Petitioner 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 though 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, [Petitioner] 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 [Petitioner]'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.

App. p. 12, 23-24 (emphasis added). Mr. Carter McEntire testified that 80% of the forklifts were used directly in the food processing, App. p. 210:6-10, and the Department did not contradict those representations.

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

S.C. Regs. § 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 12-36-2120(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.

Mr. 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.

b. 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.

App. p. 1320. Mr. 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**
>
> [Petitioner] 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.

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

> Because federal law also requires [Petitioner] 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.

App. p. 26. The Court of Appeals Order finds these items were not exempt as they were administrative machines. "Administrative machines" are defined in S.C. Regs. § 117-302.5(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. S.C. Regs. § 117-302.5(B)(9).

In S.C. Regs. 117-302.1(e) the DOR states that "plates attached by the manufacturer to his product for identification purposes" are covered by the Machine Exemption. Presumably the vast majority of such plates are not required by federal law, but rather used for food safety purposes. The regulation also exempts "[r]ecording instruments attached to manufacturing machines." S.C. Regs. § 117-302.5(C)(25).

c. 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.

App. p. 1321 (emphasis added).

This is not accurate. McEntire's facility is divided into low-care and high-care areas. The schematic used at trial used color coding. The high-care area was colored green or gray. App. p. 185:6-10. Mr. 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.

App. p. 232:3-21.

Accordingly, 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 spoliation 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 [Petitioner] effectively has no product, maintaining the required temperature is essential to [Petitioner]'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, [Petitioner] 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.

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

> [T]estimony from [Petitioner]'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.

App. p. 26 (emphasis added).

Regarding the racks, granted S.C. Regs. § 302.5(B)(7) states that machines used for storage are taxable, but S.C. Regs. § 117-302.5(C)(24) is much more specific. It states that machines used to condition air (including humidification systems) for quality control are 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 spoliation and prevent contamination." App. p. 12.

Regarding Blower Fans, the Court of Appeals Order states that McEntire did not provide evidence where the blower fans are used and thus finds them taxable. App. p. 1321. 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." App. p. 13. Neither DOR witness testified based upon their observations at the plant that these items were not exempt.

d. Water Storage Tanks

Petitioner has large water tanks both inside and outside the facility. App. 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. App. 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. App. p. 258:8-9; 259:21-24; and p. 14.

The Court of Appeals Order 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.

App. p. 1321-22. The Court notes that S.C. Regs. § 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." App. p. 1322. To the contrary, Mr. McEntire testified that "water tanks are used throughout the facility but particularly in the high-care area where we wash produce." App. p. 214:17-18. He also testified that "[t]here 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." App. 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**
>
> [Petitioner] 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*.

App. 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.

App. 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).

e. Cleaning Machines

The Court of Appeals Order 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)

App. p. 1322. 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. [Petitioner]'s witness testified that those machines are required by the FDA and that 80% of their use occurs in the high-care area*.

App. 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*. [Petitioner] testified that 80% of the cleaning machines or "foamers" are required by the FDA to sanitize surfaces in the cutting room nightly. (Emphasis added)

App. p. 27 (emphasis added).

The Court of Appeals Order states there was no testimony the cleaning machines and chemicals were used on any exempt machines. App. p. 1322. 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.* Mr. McEntire testified "[w]e 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." App. p. 88:18-22. He testified this was required by federal law. App. pp. 229:23-230:1.

The Department agreed 70% of the floor treatment chemicals and other products were used in the manufacturing process, but contended that 30% was not. App. pp. 225:19-226:4. Mr.

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. App. p. 224:6-13.

S.C. Regs. § 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 regulation 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 Revenue Ruling 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, Mr. 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.

f. 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.

App. p. 1322 (emphasis added). By contrast, the ALC Order states:

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

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

> [Petitioner] 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.

App. p. 23 (emphasis added). The Court held that maintenance tools were used on an "as needed" basis and thus were not used on an ongoing and continuous basis. App. p. 1322. By contrast, the ALC Order explicitly found as a matter of fact such tools were used "on an ongoing, continuous basis." App. p. 13. 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.

g. Generator Rentals

The Court of Appeals Order 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").

App. p. 1322-23. The ALC Order states:

> [Petitioner] rents ethylene generators to ripen tomatoes in the tomato cooler area. Tomatoes arrive at the facility in various color stages and [Petitioner] 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.

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

> [Petitioner] 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.

App. p. 24. As discussed more fully below, 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 all twelve months of the calendar year. Neither DOR witness testified based upon their observations at the plant that these items were not exempt.

h. Floor Drain Covers

The Court of Appeals Order 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.

App. p. 1321. 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 [Petitioner] for reuse later in the manufacturing process.

App. 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 [Petitioner]'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. [Petitioner] 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.

App. p. 14.

Mr. McEntire testified that "[w]e 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." App. 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. App. p. 239:8-24. Petitioner 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. App. p. 239:11-15. The Petitioner uses the floor drain system to recapture spilled water so it may reuse the water to wash the produce. App. 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 Petitioner'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. Petitioner uses about 300,000 gallons of water/day and recycles about half of that. App. 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. App. p. 14.

George Lovelace, head of Food Safety at McEntire, testified that the DHEC Water Permit required Petitioner to filter the water before it was discharged back into the City water system. App. 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 S.C. Revenue Ruling #04-7, the Department concluded that "[t]raveling water screens used to filter water from a river, lake, or other water source at a water treatment plant processing water for sale" qualified for the Machine Exemption as manufacturing machines, and thus ruling was incorporated into Department regulations under S.C. Regs. § 117.302.5(C)(2).

i. Coveralls, eyewear, gloves, aprons and hair nets

Significantly, neither the DOR Proposed Assessment (App. p. 675) nor the Department Determination (App. p. 736) alleged that protective clothing was not a "machine." Both documents alleged only that E Coli., Salmonella or Listeria were not "pollution." The Department 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[1] and Connecticut[2] 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 work 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 work by food service industry workers." *See also Chrome Deposit v. Ind. Dep't of State Revenue*, 557 N.E. 2d 1110 (Tax Ct. Indiana 1990 (clothing worn to "prevent contamination of the product during production" qualified under the state's machine exemption, as it was "acquired for direct use in the direct manufacturing of other tangible personal property"). Both states acknowledge that clothing and gear protecting the product being manufactured or processed is distinguishable from more common apparel which protects 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

---

[1] Massachusetts Directive 99-3: Sales and Use Tax Treatment of Protective Clothing, *available at* https://www.mass.gov/ directive/directive-99-3-sales-and-use-tax-treatment-of-protective-clothing

[2] Connecticut PS 2004(4): Sales and Use Tax Exemption for Safety Apparel, *available at* https://portal.ct.gov/DRS/ Publications/Policy-Statements/2004/PS-20044-Sales-and-Use-Tax-Exemption-for-Safety-Apparel.

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. App. 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 where 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. THE COURT OF APPEALS HAS CREATED A SEASONAL OR "AS NEEDED" EXCEPTION TO THE MACHINE EXEMPTION WHICH IS UNFOUNDED IN STATUTE, CASE LAW, OR REGULATION.

In applying the Machine Exemption to Petitioner's purchases of maintenance tools, the Court of Appeals plainly rejected the substantial testimony of Petitioner and the ALC's own findings, in concluding the Machine Exemption did not apply because "[t]he evidence demonstrates McEntire uses its maintenance tools on an 'as needed' basis." App. p. 1322.

To demonstrate how this is a new standard or requirement, we must look to the ALC's characterization of the use of those maintenance tools. The ALC's Order states:

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

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

> [Petitioner] 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.

App. p. 23 (emphasis added). The ALC thus found Petitioner had 30 full time employees and that those employees work "continuously" to maintain Petitioner's machines.

The Court of Appeals then rejected the ALC's factual findings that 30 full time employees

were working on a continuous basis on general maintenance and found:

> 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.

App. p. 1322 (emphasis added).

The Court held that maintenance tools were used on an "as needed" basis and thus were not used on an "ongoing and continuous" basis. By contrast, the ALC Order explicitly found as a matter of fact such tools were used "on an ongoing, continuous basis." App. p. 23. Read literally, the Court of Appeals Order renders virtually all machinery and equipment subject to sales taxes for the simple reason that every machine and equipment is used on an "as needed" basis.

In the same vein, the Court of Appeals extended this newly-constructed "as needed" standard to manufacturers operating on a seasonal basis. As a fresh food processor, Petitioner by definition works on a seasonable basis, although crops are processed on a yearly basis from California and Mexico. There are a number of fresh food processors in South Carolina, and they are vital to South Carolina's agricultural economy. In addition to selling salads and produce to grocery stores, they sell fresh food to multiple restaurants for inclusion in their dishes. The Court of Appeals Order holds that equipment used on a seasonal basis is not exempt.

The ALC found that for Petitioner,

> 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.

App. p. 24. By contrast, the Court of Appeals Order 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").

App. p. 1322-23.

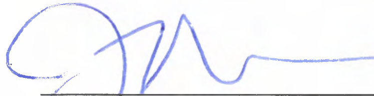
Read literally, the Court of Appeals Order renders virtually every machine used by agricultural processors subject to sales taxes, as they are all used on a seasonal basis. Many, if not virtually all, agricultural industries work on a seasonal basis, not just fresh food processors. In sum, the imposition of these standards of use are unfounded in statute, regulation or case law. If the Department were to prevail in this case, it essentially would render the Machine Exemption inapplicable to manufacturers in this state.

CONCLUSION

In its role as trier of fact, the ALC heard the testimony of McEntire's witnesses, reviewed a number of technical schematics detailing the flow of produce through McEntire's manufacturing process, and even examined protective clothing utilized in that process. After thorough review and consideration of the evidence presented, the ALC determined the purchases at issue in this case were "machines" that were "integral and necessary" to McEntire's manufacturing process. Then, close to five years following that presentation, the Court of Appeals disregarded those

findings in favor of its own. For all of the above reasons, Petitioner requests that this Court reverse the decision of the Court of Appeals and find the purchases at issue qualify for exemption for sales and use tax pursuant to S.C. Code Ann. § 12-36-2120(17) and related guidance.

Respectfully submitted,



James P. Rourke
Maynard Nexsen, PC
1230 Main Street, Suite 700 (29201)
Post Office Drawer 2426
Columbia, South Carolina 29202
Telephone: (803) 540-2030
Fax: (803) 727-1475
jrourke@maynardnexsen.com

Attorney for Petitioner McEntire Produce, Inc.