THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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

Opinion No. 5972 (S.C. Ct. App. filed March 1, 2023)

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

v.

South Carolina Department of Revenue ..... Respondent.

APPENDIX FOR PETITION FOR A WRIT OF CERTIORARI

VOLUME III

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S.C. SUPREME COURT

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THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

THE HONORABLE H.W. FUNDERBURK, JR., ADMINISTRATE 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.

RECORD ON APPEAL

VOLUME III

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Logan Mitchell

From: Logan Mitchell
Sent: Tuesday, July 19, 2016 9:51 AM
To: 'Dowl Knight, CPA'
Subject: RE: McEntire Audit

Mr. Knight,

Yes the document you signed to extend the limitation period did expire on May 31, 2016. Per S.C. Code section 12-54-85 the time limitation did not apply to this audit since the taxpayer had 20% understatement of the tax required to be shown on all periods under audit. The taxes in this case may be assessed at any time within 72 months from the date of the first period under audit. This is also stated at the bottom of the Explanation of Assessments which were part of the proposed notice of assessment email attachment.

Please let me know if you have any questions about the appeals process.

Thank you,

Logan Mitchell
Columbia District Auditor
(803)898-5908
mitchel@sctax.org

South Carolina Department of Revenue
Audit Services
Office of General Counsel Tax and Regulatory Division
300-A Outlet Point Blvd.
Columbia, SC 29210
dor.sc.gov

SOUTH CAROLINA
DEPARTMENT OF REVENUE

-----Original Message-----
From: Dowl Knight, CPA [mailto:dowl@adowlknightcpa.com]
Sent: Tuesday, July 19, 2016 9:30 AM
To: Logan Mitchell
Cc: 'Lance Ailshie'
Subject: RE: McEntire Audit

Good morning Logan,

This is the first assessment we have received. I believe that the Statue of Limitations has expired on a portion of the audit period. According to my records, I signed a document to extend the limitation period. That document expired on May 31, 2016.

Furthermore, we are disagreement with DOR's definition of the "manufacturing process" as it pertains to McEntire Produce, Inc. Wes and his manager referenced several cases during our discussions prior to Wes's resignation. In our opinion, none of those cases had facts and circumstances that pertain to a food produce processing process.

Please review the limitation period and make any immediate adjustments to the proposed assessment resulting from your review. We will then proceed with the necessary steps to appeal the assessment.

Thank you,

Dowl

From: Logan Mitchell [mailto:Logan.Mitchell@dor.sc.gov]
Sent: Tuesday, July 19, 2016 8:50 AM
To: Dowl Knight, CPA <dowl@adowlknightcpa.com>
Cc: 'Lance Ailshie' <lance.ailshie@mcentireproduce.com>
Subject: RE: McEntire Audit

Mr. Knight,

Attached is a copy of the use tax proposed assessment for McEntire Produce, Inc. covering the periods of 10/01/2012 - 9/30/2015. I have also attached a copy of Wes Butler's Excel spreadsheet with purchases held as subject to use tax. Please let me know if you have any questions or would like to schedule a conference to discuss the audit results.

Thank you,

Logan Mitchell

Columbia District Auditor

(803)898-5908

mitchel@sctax.org <mailto:mitchel@sctax.org>

South Carolina Department of Revenue

Audit Services

Office of General Counsel Tax and Regulatory Division

300-A Outlet Point Blvd.

Columbia, SC 29210

dor.sc.gov

SCDOR_Logo_FINAL

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

CONSENT TO EXTEND TIME TO ASSESS TAX

FS-93
(Rev. 3/9/00)
2083

McEntire Produce Inc. — [redacted]
Name of Taxpayer(s) — File No.

2040 American Italian Way, Columbia, SC 29209-5084 — [redacted]
Address — SSN/FEI

and the SOUTH CAROLINA DEPARTMENT OF REVENUE previously entered into a written agreement that extended the time for mailing the notice of assessment or refund of any STATE Sales & Use tax due on any return(s) made by or for the period(s) ended 10/01/2012 through 09/30/2015 until 03/31/2016.

By executing this document the parties mutually agree to further extend the time for mailing the notice of assessment or refund of the above referenced tax for the period(s) ended 10/01/2012 through 09/30/2015 until 05/31/2016 in accordance with the provisions of Section 12-54-85(C)(5) of the 1976 South Carolina Code of Laws, as amended.

McEntire Produce Inc
(Name of Taxpayer)

By: [signature]
(Taxpayer, Partner, Corp. Officer, etc.)

POD
(Title)

3/23/2016
(Date)

SOUTH CAROLINA DEPARTMENT OF REVENUE

By: [signature]
(Administrator, Field Services Division)

3/23/16
(Date)

If this waiver is executed on behalf of a corporation, it will be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition, to which the seal, if any, of the corporation must be affixed.

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

CONSENT TO EXTEND TIME TO ASSESS TAX

FS-93
(Rev. 3/9/00)
2083

McEntire Produce Inc. — [redacted]
Name of Taxpayer(s) — File No.

2040 American Italian Way, Columbia, SC 29209-5084 — [redacted]
Address — SSN/FEI

and the SOUTH CAROLINA DEPARTMENT OF REVENUE previously entered into a written agreement that extended the time for mailing the notice of assessment or refund of any STATE Sales & Use tax due on any return(s) made by or for the period(s) ended 10/01/2012 through 09/30/2015 until 01/31/2016.

By executing this document the parties mutually agree to further extend the time for mailing the notice of assessment or refund of the above referenced tax for the period(s) ended 10/01/2012 through 09/30/2015 until 03/31/2016 in accordance with the provisions of Section 12-54-85(C)(5) of the 1976 South Carolina Code of Laws, as amended.

McEntire Produce, Inc
(Name of Taxpayer)

By: _____
(Taxpayer, Partner, Corp. Officer, etc.)

CPA; POA
(Title)

1/26/2016
(Date)

SOUTH CAROLINA DEPARTMENT OF REVENUE

By: _____
(Administrator, Field Services Division)

1/20/2016
(Date)

If this waiver is executed on behalf of a corporation, it will be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition, to which the seal, if any, of the corporation must be affixed.

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

CONSENT TO EXTEND THE TIME TO ASSESS TAX

FS-43
(Rev. 5/25/05)
2024

File No. [redacted]

McEntire Produce Inc. SSN/FEI [redacted]

Name of Taxpayer(s)

2040 American Italian Way, Columbia, SC 29209

Address (Number, Street, City or Town, State, Zip Code)

and the SOUTH CAROLINA DEPARTMENT OF REVENUE consent and agree to the following:

(1) The amount of any STATE Use tax due on any return(s) made by or for the above taxpayer(s) for the period(s) ended 10/1/2012 to 09/30/2015

may be assessed at any time on or before 01/31/2016
(Expiration Date)

This agreement extends the time for mailing the notice of assessment or refund of the above tax pursuant to the provisions of Section 12-54-85(C)(4) of the 1976 South Carolina Code of Laws, as amended.

McEntire Produce, Inc.
(Name of Taxpayer)

BY: [signature]
(Taxpayer, Partner, Officer of Corp., etc.)

POA
(Title)

11/3/2015
(Date)

SOUTH CAROLINA DEPARTMENT OF REVENUE

BY: [signature]
(Administrator, Field Services Division)

11/3/2015
(Date)

If this waiver is executed on behalf of a corporation, it will be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation.

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STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
Proposed Assessment

AS-6
(Rev. 09/23/15)
6376

File Number: 040439757
Letter ID: L0001633023
Date Issued: July 19, 2016

MCENTIRE PRODUCE INC
PO BOX 5817
COLUMBIA SC 29250-5817

Taxpayer:
A Sales & Use Audit of your South Carolina Sales and Use Tax return(s) from 10/01/2012 to 09/30/2015 has been conducted. Enclosed you will find an explanation of our **Proposed Assessment**. Below is a summary of our findings if paid by 08/18/2016:

Tax:	$126,912.90
Penalty:	$0.00
Interest:	$9,337.61
Total:	$136,250.51

Failure to respond to this notice by 10/17/2016 will result in the accrual of additional penalties and/or interest, and further collection action will be taken. Please refer to the reverse side for instructions on how to proceed. Should you have any questions, please do not hesitate to contact this office.

LOGAN MITCHELL, Field Audit
Email: Logan.Mitchell@dor.sc.gov, Phone: +1 (803) 898-5908, Fax: +1 (803) 896-0020
300A Outlet Pointe Blvd, Columbia, South Carolina 29210

This demand for payment is not applicable if you are currently in bankruptcy proceedings under Title 11 of the U.S. Code. Any monies due will be sought in accordance with the provisions of Title 11.

cut along dotted line

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SC DEPARTMENT OF REVENUE
Audit Payment

C-370
(Rev. 08/31/15)
6370

Pay online for free at MyDORWAY.dor.sc.gov.

Vouchers and payments may also be mailed to:

South Carolina Department of Revenue
P O Box 125
Columbia, SC 29214-0030

Media	136416686
File Number	040439757
Filing Period	09/30/2015
Amount Due	$136,250.51
Balance Remitted	

637010151 01 000136416686 00 00 00000000 000136250516

If you agree with the changes detailed on this notice and any enclosed explanations, the balance should be remitted to this office within 30 days from the issue date of this letter to avoid additional penalties and interest, if applicable. To pay by check, please mail your payment **and the voucher** from the front page as addressed on the voucher to ensure proper processing.

If you agree with the Department's determination, but are unable to make full payment at this time, please complete the enclosed Waiver of Restriction on Assessment (SC870) and return it to this office as soon as possible. Upon receipt of this document, a final assessment will be issued.

You may agree with portions of the proposed assessment and disagree with others. The portion of the assessment with which you agree may be paid to avoid additional interest and penalty, and the remainder can be appealed.

If you disagree with part or all of the proposed assessment, you may make an appeal by sending a written protest within **90 days** from the date of this proposed assessment.

Protest forms (C-245) are available online at www.dor.sc.gov, by calling (803) 898-5320 or you may visit any South Carolina Department of Revenue office. You may choose to send a letter rather than using the Form C-245. The letter must contain the following information:

1. Taxpayer's name (individual, corporation, etc.)
2. Taxpayer's identification number (Social Security, Federal Employer Identification, License, etc.)
3. Period for which the tax is proposed
4. Type of tax in dispute (individual income, sales, etc.)
5. All of the reasons you disagree with the proposed assessment

If you have any questions, please call the telephone number shown on the front of this proposed assessment.

TAXPAYER'S BILL OF RIGHTS

- You have the right to apply for assistance from the Taxpayer Rights' Advocate within the Department of Revenue. The advocate or his designee is responsible for facilitating resolution of taxpayer complaints and problems.
- You have the right to request and receive forms, instructions and other written materials in plain, easy-to-understand language.
- You have the right to prompt, courteous service from us in all your dealings with the Department of Revenue.
- You have the right to request and receive written information guides, which explain in simple and nontechnical language, appeal procedures and your remedies as a taxpayer.
- You have the right to receive notices which contain descriptions of the basis for and identification of amounts of any tax, interest and penalties due.

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STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

Explanation of Audit Assessments and Adjustments

AS-21
(Rev. 08/23/15)
6391

File Number: 040439757
Letter ID: L0001531063
Date Issued: July 19, 2016

MCENTIRE PRODUCE INC
PO BOX 5817
COLUMBIA SC 29250-5817

The taxpayer's electronic purchase data was used to conduct the audit. Trial balances were provided by the taxpayer to verify the general ledger account balances. Various purchase invoices were selected for review by the auditor. Upon review, the taxpayer was found to have some use tax due during the audit period. The use tax due was on various non-processing related supplies and equipment purchased during the audit period. This included building supplies, hairnets, gloves, aprons, towels, cleaning supplies, storage containers and storage racks among other items. The taxpayer's electricity was held to be taxable at 10 percent of the total bill to account for electricity used in administrative and break areas as well as electricity used to cool raw material and finished goods storage areas.

FOR AN ADJUSTMENT TO USE TAX
A use tax is imposed on the storage, use, or other consumption in the State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State.
SC Code Section 12-36-1310

Beginning June 1, 2007, an additional sales, use, and casual excise tax equal to one percent is imposed on amounts taxable pursuant to this chapter, except that this additional one percent tax does not apply to amounts taxed pursuant to:
_ Section 12-36-920(A) - accommodations for transients
_ Section 12-36-2110 - items subject to a maximum sales and use tax
_ Section 12-36-910(d)(1) - unprepared food which may be lawfully purchased with United States Department of Agriculture food coupons.
SC Code Section 12-36-1110

Every person storing, using, or otherwise consuming in this State tangible personal property purchased at retail, is liable for the use tax, until the tax is paid to the state.
SC Code Section 12-36-1330

LOCAL SALES & USE TAX
Counties may levy sales and use tax upon referendum approval. Such taxes are to be administered and collected by the SC Department of Revenue in the manner that sales and use taxes are administered and collected pursuant to Chapter 36 of Title 12. For more detailed information refer to SC Information Letter 05-1 of January 6, 2005 and Chapter 10 of Title 4.

INTEREST
Interest on taxes owed and refunds due is computed using the Internal Revenue Service interest rates <*> for underpayment compounded daily. Generally, interest is not paid during the first seventy-five days after filing a request for refund. SC Code Section 12-54-25

EXCEPTION TO TIME LIMITATION FOR ASSESSMENT OF TAXES
Per S.C. Code section 12-54-85, the time limitation did not apply to this audit since the taxpayer had 20% understatement of the total of tax required to be shown on all periods under audit. The taxes in this case may be assessed at any time within 72 months from the date of the first period under audit

1350

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

Explanation of Audit Assessments and Adjustments

AS-21
(Rev. 08/23/15)
6391

File Number: 040439757
Letter ID: L0001531063
Date Issued: July 19, 2016

MCENTIRE PRODUCE INC
PO BOX 5817
COLUMBIA SC 29250-5817

LOGAN MITCHELL, Field Audit
Email: Logan.Mitchell@dor.sc.gov, Phone: +1 (803) 898-5908, Fax: +1 (803) 896-0020
300A Outlet Pointe Blvd, Columbia, South Carolina 29210

1350

Issued: 07/19/16

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
Sales Working Paper Packet

AS-14
(Rev. 10/13/15)
6384

Sales Audit Period Summary

File Number	Period	Tax	Penalty	Interest	Total
040439757	10/31/2012	$1,718.16	$0.00	$212.11	$1,930.27
040439757	11/30/2012	$2,335.69	$0.00	$281.88	$2,617.57
040439757	12/31/2012	$1,845.03	$0.00	$217.52	$2,062.55
040439757	01/31/2013	$3,678.58	$0.00	$423.00	$4,101.58
040439757	02/28/2013	$2,327.37	$0.00	$261.66	$2,589.03
040439757	03/31/2013	$2,401.90	$0.00	$263.38	$2,665.28
040439757	04/30/2013	$2,869.79	$0.00	$306.67	$3,176.46
040439757	05/31/2013	$3,628.22	$0.00	$377.50	$4,005.72
040439757	06/30/2013	$7,656.41	$0.00	$776.27	$8,432.68
040439757	07/31/2013	$3,658.88	$0.00	$360.49	$4,019.37
040439757	08/31/2013	$3,173.22	$0.00	$303.77	$3,476.99
040439757	09/30/2013	$5,261.65	$0.00	$489.71	$5,751.36
040439757	10/31/2013	$3,331.38	$0.00	$300.66	$3,632.04
040439757	11/30/2013	$2,298.54	$0.00	$201.27	$2,499.81
040439757	12/31/2013	$2,059.98	$0.00	$174.74	$2,234.72
040439757	01/31/2014	$2,660.22	$0.00	$218.24	$2,878.46
040439757	02/28/2014	$2,088.66	$0.00	$166.15	$2,254.81
040439757	03/31/2014	$2,963.93	$0.00	$227.73	$3,191.66
040439757	04/30/2014	$3,522.41	$0.00	$261.19	$3,783.60
040439757	05/31/2014	$3,974.00	$0.00	$283.82	$4,257.82
040439757	06/30/2014	$3,338.31	$0.00	$229.71	$3,568.02
040439757	07/31/2014	$5,794.89	$0.00	$382.81	$6,177.70
040439757	08/31/2014	$5,897.30	$0.00	$373.92	$6,271.22
040439757	09/30/2014	$4,407.35	$0.00	$267.65	$4,675.00
040439757	10/31/2014	$5,951.11	$0.00	$345.34	$6,296.45
040439757	11/30/2014	$5,613.67	$0.00	$311.50	$5,925.17
040439757	12/31/2014	$2,210.93	$0.00	$116.60	$2,327.53
040439757	01/31/2015	$3,547.68	$0.00	$177.60	$3,725.28
040439757	02/28/2015	$2,902.53	$0.00	$138.29	$3,040.82
040439757	03/31/2015	$4,106.21	$0.00	$184.70	$4,290.91
040439757	04/30/2015	$2,741.02	$0.00	$119.72	$2,860.74
040439757	05/31/2015	$2,484.38	$0.00	$98.91	$2,583.29
040439757	06/30/2015	$2,332.14	$0.00	$86.74	$2,418.88
040439757	07/31/2015	$6,126.54	$0.00	$211.70	$6,338.24
040439757	08/31/2015	$3,205.05	$0.00	$102.40	$3,307.45
040439757	09/30/2015	$2,799.77	$0.00	$82.26	$2,882.03
		$126,912.90	**$0.00**	**$9,337.61**	**$136,250.51**

This is the final proposed assessment.

1350

Issued:
07/19/16

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
Sales Working Paper Packet

AS-14
(Rev. 10/13/15)
6384

Sales Adjustments Summary

File Number	Period	Gross Reported	Sales Audited	Use Audited	Deductions Reported	Deductions Audited
040439757	10/31/2012	$6,637,167.00	$0.00	$24,545.12	$6,637,167.00	$0.00
040439757	11/30/2012	$5,834,717.00	$0.00	$33,366.93	$5,834,717.00	$0.00
040439757	12/31/2012	$5,697,829.00	$0.00	$26,357.54	$5,697,829.00	$0.00
040439757	01/31/2013	$6,564,658.00	$0.00	$52,551.24	$6,564,658.00	$0.00
040439757	02/28/2013	$5,269,778.00	$0.00	$33,248.09	$5,269,778.00	$0.00
040439757	03/31/2013	$6,221,129.00	$0.00	$34,312.78	$6,221,129.00	$0.00
040439757	04/30/2013	$8,695,380.00	$0.00	$40,996.96	$8,695,380.00	$0.00
040439757	05/31/2013	$10,768,403.00	$0.00	$45,352.73	$10,768,403.00	$0.00
040439757	06/30/2013	$10,206,094.00	$0.00	$95,705.13	$10,206,094.00	$0.00
040439757	07/31/2013	$11,164,843.00	$0.00	$45,735.98	$11,164,843.00	$0.00
040439757	08/31/2013	$9,232,487.00	$0.00	$39,665.26	$9,232,487.00	$0.00
040439757	09/30/2013	$9,495,828.00	$0.00	$65,800.46	$9,495,828.00	$0.00
040439757	10/31/2013	$8,978,389.00	$0.00	$41,642.41	$8,978,389.00	$0.00
040439757	11/30/2013	$7,405,168.00	$0.00	$28,731.72	$7,405,168.00	$0.00
040439757	12/31/2013	$7,623,425.00	$0.00	$25,749.63	$7,623,425.00	$0.00
040439757	01/31/2014	$7,884,130.00	$0.00	$33,252.66	$7,884,130.00	$0.00
040439757	02/28/2014	$7,370,178.00	$0.00	$26,108.37	$7,370,178.00	$0.00
040439757	03/31/2014	$7,375,674.00	$0.00	$37,049.15	$7,375,674.00	$0.00
040439757	04/30/2014	$9,292,433.00	$0.00	$44,030.24	$9,292,433.00	$0.00
040439757	05/31/2014	$9,038,459.00	$0.00	$49,674.99	$9,038,459.00	$0.00
040439757	06/30/2014	$7,719,301.00	$0.00	$41,728.91	$7,719,301.00	$0.00
040439757	07/31/2014	$9,192,991.00	$0.00	$72,436.10	$9,192,991.00	$0.00
040439757	08/31/2014	$7,987,591.00	$0.00	$73,716.35	$7,987,591.00	$0.00
040439757	09/30/2014	$7,452,392.00	$0.00	$55,091.83	$7,452,392.00	$0.00
040439757	10/31/2014	$8,890,739.00	$0.00	$74,388.80	$8,890,739.00	$0.00
040439757	11/30/2014	$6,432,940.00	$0.00	$70,197.81	$6,432,940.00	$0.00
040439757	12/31/2014	$8,220,814.00	$0.00	$27,636.51	$8,220,814.00	$0.00
040439757	01/31/2015	$7,775,034.00	$0.00	$44,346.01	$7,775,034.00	$0.00
040439757	02/28/2015	$7,678,843.00	$0.00	$36,281.57	$7,678,843.00	$0.00
040439757	03/31/2015	$8,539,211.00	$0.00	$51,327.58	$8,539,211.00	$0.00
040439757	04/30/2015	$10,055,900.00	$0.00	$42,462.75	$10,047,700.00	$0.00
040439757	05/31/2015	$9,250,350.00	$0.00	$31,054.67	$9,250,350.00	$0.00
040439757	06/30/2015	$9,323,532.00	$0.00	$29,151.61	$9,323,532.00	$0.00
040439757	07/31/2015	$10,632,165.00	$0.00	$76,581.65	$10,632,165.00	$0.00
040439757	08/31/2015	$8,991,860.00	$0.00	$40,063.10	$8,991,860.00	$0.00
040439757	09/30/2015	$9,980,836.45	$0.00	$34,997.17	$9,980,836.45	$0.00
		$298,880,668.45	**$0.00**	**$1,625,339.80**	**$298,872,468.45**	**$0.00**

This is the final proposed assessment.

1350

Issued:
07/19/16

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
Sales Working Paper Packet

AS-14
(Rev. 10/13/15)
6384

Sales Net Adjustments Summary

File Number	Period	Taxable Reported	Taxable Audited	Understatement
040439757	10/31/2012	$0.00	$24,545.12	$24,545.12
040439757	11/30/2012	$0.00	$33,366.93	$33,366.93
040439757	12/31/2012	$0.00	$26,357.54	$26,357.54
040439757	01/31/2013	$0.00	$52,551.24	$52,551.24
040439757	02/28/2013	$0.00	$33,248.09	$33,248.09
040439757	03/31/2013	$0.00	$34,312.78	$34,312.78
040439757	04/30/2013	$0.00	$40,996.96	$40,996.96
040439757	05/31/2013	$0.00	$45,352.73	$45,352.73
040439757	06/30/2013	$0.00	$95,705.13	$95,705.13
040439757	07/31/2013	$0.00	$45,735.98	$45,735.98
040439757	08/31/2013	$0.00	$39,665.26	$39,665.26
040439757	09/30/2013	$0.00	$65,800.46	$65,800.46
040439757	10/31/2013	$0.00	$41,642.41	$41,642.41
040439757	11/30/2013	$0.00	$28,731.72	$28,731.72
040439757	12/31/2013	$0.00	$25,749.63	$25,749.63
040439757	01/31/2014	$0.00	$33,252.66	$33,252.66
040439757	02/28/2014	$0.00	$26,108.37	$26,108.37
040439757	03/31/2014	$0.00	$37,049.15	$37,049.15
040439757	04/30/2014	$0.00	$44,030.24	$44,030.24
040439757	05/31/2014	$0.00	$49,674.99	$49,674.99
040439757	06/30/2014	$0.00	$41,728.91	$41,728.91
040439757	07/31/2014	$0.00	$72,436.10	$72,436.10
040439757	08/31/2014	$0.00	$73,716.35	$73,716.35
040439757	09/30/2014	$0.00	$55,091.83	$55,091.83
040439757	10/31/2014	$0.00	$74,388.80	$74,388.80
040439757	11/30/2014	$0.00	$70,197.81	$70,197.81
040439757	12/31/2014	$0.00	$27,636.51	$27,636.51
040439757	01/31/2015	$0.00	$44,346.01	$44,346.01
040439757	02/28/2015	$0.00	$36,281.57	$36,281.57
040439757	03/31/2015	$0.00	$51,327.58	$51,327.58
040439757	04/30/2015	$8,200.00	$42,462.75	$34,262.75
040439757	05/31/2015	$0.00	$31,054.67	$31,054.67
040439757	06/30/2015	$0.00	$29,151.61	$29,151.61
040439757	07/31/2015	$0.00	$76,581.65	$76,581.65
040439757	08/31/2015	$0.00	$40,063.10	$40,063.10
040439757	09/30/2015	$0.00	$34,997.17	$34,997.17
		$8,200.00	**$1,625,339.80**	**$1,617,139.80**

This is the final proposed assessment.

1350

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

Waiver of Restrictions on Assessment/Collection

SC-870
(Rev. 12/06/04)
3309

File Number: 040439757
Letter ID: L0001547447
Date Issued: July 19, 2016

MCENTIRE PRODUCE INC
PO BOX 5817
COLUMBIA SC 29250-5817

Increase (Decrease) in Tax, Interest and Penalties:

Type of Tax: Sales and Use Tax
Periods Covered: 10/01/2012 to 09/30/2015
Tax: $126,912.90
Penalty: $0.00
Interest: $9,337.61

This information was prepared by LOGAN MITCHELL. Telephone Number: +1 (803) 898-5908

PLEASE READ THE INSTRUCTIONS ON THE REVERSE SIDE

Consent to Assessment and Collection of Additional Tax or Acceptance of Overassessment:

I have read and understand the instructions on the reverse side. I consent to the assessment and collection of any additional tax and penalties or accept any decrease in tax and penalties shown above, plus any interest provided by law. I understand that by signing this waiver, I consent to the above determination amounts(s) and must pay the additional amounts prior to contesting this matter any further.

Taxpayer's Signature: _____ Date: _____

Spouse's Signature: _____ Date: _____

Corporation Name (if applicable): _____

Signature: _____ Title: _____ Date: _____

GENERAL INFORMATION AND INSTRUCTIONS
SC870 (Rev. 12/6/04)

IMPORTANT: By signing this form, the taxpayer (1) agrees to pay the tax, interest, and penalties stated to be due; and (2) gives up the right to appeal this matter further. Interest and applicable penalties will continue to accrue until the balance due the Department is paid in full. Signing this form does **not** affect your right to file a claim for refund and does not prevent the Department from assessing additional tax found to be due at a later date.
NOTE: If you wish to give up your right to file a claim for refund and prevent the Department from assessing additional amounts at a later date, a SC870AD should be executed in lieu of this SC870.

CLAIM FOR

Executing this document does not prevent you from seeking a refund of State taxes paid. The refund claim must be filed within three years from the date the return was filed, or two years from the date of payment of the tax, whichever is later. See the SC Information Guide about the claim for refund procedure for additional information.

EXECUTING THIS

If this waiver relates to a joint individual income tax return, both husband and wife must sign the waiver.

If the SC870 is executed on behalf of a corporation, the waiver must include the corporation's name as well as the signature and title of the corporate officer executing this document.

If this waiver is associated with an income tax examination of a partnership or "S" corporation, each partner or shareholder must execute a separate form.

If this waiver is signed by someone acting in a fiduciary capacity (e.g. a personal administrator or trustee), Internal Revenue Service Form 56, Notice Concerning Fiduciary Relationship, must accompany this form unless previously provided.

An attorney, CPA or other agent may execute this form on behalf of a client provided such authority is granted in a power of attorney. The power of attorney must accompany this form unless previously provided.

GENERAL

We have an agreement with the Internal Revenue Service which provides for the exchange of tax information. If this change affects returns filed with the Internal Revenue Service, amended federal return(s) may need to be filed.

If you have any questions about this waiver, please contact the preparer.

McENTIRE PRODUCE, INC.
PO BOX 5817
COLUMBIA, SC 29250-5817

July 26, 2016

SC Department of Revenue
Attn: Logan Mitchell – Field Audit
300A Outlet Pointe Blvd.
Columbia, SC 29210

Re: File No. 040439757; EIN 57-0868353
Sales Tax; Tax Period 10-1-12 through 9-30-2015

Dear Ms. Mitchell:

I am in receipt of your notice of proposed assessment dated July 19, 2016. I have enclosed a copy for your reference. Please allow this letter to serve as a formal protest to the proposed assessment. Please also allow this letter to serve as a request for a conference to include myself, you, the SCDOR supervisor responsible for the audit work of Wes Butler (the former SCDOR auditor involved), and Mr. Lance Ailshie, CFO of the taxpayer. We would like to hold the conference at the taxpayer's facility in order for you and the supervisor to tour the plant to gain more insight in to the taxpayer's manufacturing process.

I am protesting the proposed assessment of use tax on items which the Department of Revenue ("DOR") deems to be non-manufacturing items. The taxpayer and I believe the manufacturing process begins with the receipt of the raw product and continues until the finished product is loaded on a truck for shipping to a customer due to Federal safety standards of which the taxpayer must comply. Failure to comply with these standards would jeopardize the taxpayer's business as well as subject it to substantial penalties. Because food safety is paramount to the taxpayer's ability to operate, we believe all aspects of following the safety guidelines are a part of the manufacturing process.

I have enclosed herewith an email thread sent to you on July 19, 2016 and previously sent to Wes Butler on May 3, 2016. The email references a link to FDA standards and also directed Mr. Butler's attention to certain paragraphs pertaining to the necessity of the "Cleanliness" of workers and the facility, which involves the wearing of gloves, hairnets, aprons, etc. to protect against contamination of the produce while it is being processed. Mr. Butler never acknowledged or responded to this information that we provided.

We also disagree with the DOR's position that 10% of the electric bill is for non-manufacturing purposes. We believe that all areas where refrigeration is required are part of the manufacturing process because the FDA mandates that any areas where the raw product, product that is in process, and the finished product must be stored under conditions to protect against contamination and microbial growth. The FDA mandates that fresh-cut produce be stored in areas with a temperature of 41 degrees Fahrenheit or less. Because of this requirement, we believe that only 2% of the company's electric bill relates to non-manufacturing processes. We would like to see the DOR's substantiation for determining its 10% position when we have our conference.

The taxpayer is one of the leading providers of fresh cut produce located in the state of SC. We do not believe that the DOR auditors and supervisor fully understand the guidelines the taxpayer must follow regarding food safety and that the food safety requirements are an integral part of the manufacturing process. In my previous discussions with Wes Butler, he only presented me with facts and circumstances of court cases involving SC Department of Revenue manufacturing processes that have little relevance to the facts and circumstances of the manufacturing processes involving fresh-cut produce.

I look forward to our conference and am in hopes of a resolution to the issues involved in the audit.

Sincerely,
McEntire Produce, Inc.

A Dowl Knight, CPA, POA

NEXSEN|PRUET

Burnet R. Maybank, III
Member
Admitted in SC

September 23, 2016

Logan Mitchell
South Carolina Department of Revenue
300A Outlet Pointe Blvd.
Columbia, SC 29210

RE: McEntire Produce, Inc.
File No. 040439757
Sales Tax Audit – 10/1/12 through 9/30/15

Dear Ms. Mitchell:

Jim Rourke and I have been retained by the above-referenced taxpayer in relation to the above-referenced tax audit. A copy of our Power of Attorney is included under **Tab 1**. Note the taxpayer does not wish to revoke the Power of Attorney of its accountant, A. Dowl Knight. We understand the taxpayer previously filed a protest via letter on July 16, 2016; please consider this correspondence as a supplement to the previously-filed protest.

The following summarizes the taxpayer's position with respect to the exemptions available regarding refrigeration and protective clothing used in the taxpayer's manufacturing process. We look forward to working with you in an effort to resolve this matter.

I. Available Exemptions

a. Machine Exemption (12-36-2120(17))

Electricity used by manufacturers of tangible personal property for sale is exempt from the tax under Code Section 12-36-2120(19). Moreover, under S.C. Regs. § 117-302.4, electricity used to control plant atmosphere as to temperature and/or moisture content, in the quality control of tangible personal property being manufactured for sale, is also exempt from the tax. The Machine Exemption cited above provides the most substantive and useful analysis when determining the scope of the the manufacturing process.

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Nexsen Pruet, LLC
Attorneys and Counselors at Law

The Machine Exemption exempts from sales tax the sale of "machines used in manufacturing . . . tangible personal property for sale." This statute defines "machines" to include:

> the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of the machines and which (a) are necessary to the operation of the machines and are customarily so used, or (b) are necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section.

Id.

S.C. Regs. 117-302.5 provides additional guidance related to the applicability of the Machine Exemption to certain manufacturers. Subsection (B)(1) narrows those machines eligible for the exemption to those "*integral and necessary* to the manufacturing process," such that "the product being manufactured is being manufactured 'for sale'" (emphasis added). The regulations provide a three-part test to determine whether a machine is "integral and necessary" to the manufacturing process:

> (1) The machine is used at a manufacturing facility. . . . It does not apply to machines used at a facility whose purpose is retailing, wholesaling, distributing, or some other non-manufacturing purposes.
> (2) The machine is used in, and serves as an essential and indispensable component part of the manufacturing process, and is used on an ongoing and continuous basis during the manufacturing process. A machine is not part of the manufacturing process merely because it is integral and necessary to the manufacturer.
> (3) The machine must be substantially "used in manufacturing . . . tangible personal property for sale." The statute does not required that the machine be used exclusively for manufacturing; however, incidental manufacturing use will not qualify for the exemption. For purposes of the exemption, more than one-third of a machine's use in manufacturing is substantial.

S.C. Regs. § 117.302.5(B)(1).

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, 650 (Ohio 1952). Only those assets which physically transform raw materials during the manufacturing process into a different form are eligible for the exemption. In other words, "the test is not whether the property is essential to the operation of the plant but whether it is an actual part of the process of manufacture." *Hawes v. Custom Canners, Inc.*, 173 S.E.2d 40 (Ga. Ct. App. 1970).

On the other hand, the Integrated Plant Concept is far 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*, 286 A.D. 446 (N.Y. 1955). In finding that both coal handling and ash disposal equipment fell within the exemption (including the cranes and car dumper that unloaded incoming coal; conveyor belts that moved the coal to the boiler; crushers and sprayers that processed the coal; and slag lines that carried ash from the boiler), the *Niagara* court determined the relevant questions to be:

(1) Is the disputed item necessary to production?
(2) How close, physically and causally, is the disputed item to the finished product?
(3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?

The court found that the crane and car dumper were as essential to production as the generator itself, since a serious breakdown in operation would quickly stop or impair the output of electricity. The court also noted that while some structures may not play as active a role as other parts, "activity is not the test of directness." Instead, "[t]he important thing is that all parts of the plant contribute, continuously and vitally, to production, and they are all integrated and harmonized."

In *Spring Industries, Inc. v. Department of Revenue*, 99-ALJ-17-0153-CC (1999), Chief 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 Rev. 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.

In this case, the refrigeration both immediately before and after the actual processing of the fresh produce is absolutely integral to the overall processing/manufacturing process. Without that refrigeration, it would seriously impair the ability of the taxpayer to efficiently and safely prepare a finished product for sale and distribution. The refrigeration contributes, both "continuously and vitally, to production" and the assembly line production is surely "integrated and harmonized," as described in the Integrated Plant concept above.

Moreover, federal guidelines mandate the refrigeration. According to Section VIII, Part C, Item 3, of the Food and Drug Administration's Guide to Minimize Microbial Food Safety Hazards of Fresh-cut Fruits and Vegetables (enclosed under **Tab 2**), fresh-cut produce is recommended to be stored in areas with a temperature of less than or equal to 41 degrees Fahrenheit. The Food Safety Modernization Act of 2011, Section 117.93, provides even further mandates in that any "Storage and transportation of food must be under conditions that will protect against allergen cross-contact and against biological, chemical (including radiological), and physical contamination of food, as well as against deterioration of the food and the container". Additionally, 21 C.F.R. § 110.80(b) provides:

> (b) Manufacturing operations. (1) Equipment and utensils and finished food containers shall be maintained in an acceptable condition through appropriate cleaning and sanitizing, as necessary. Insofar as necessary, equipment shall be taken apart for thorough cleaning.
>
> (2) All food manufacturing, including packaging and storage, shall be conducted under such conditions and controls as are necessary to minimize the potential for the growth of microorganisms, or for the contamination of

> food. One way to comply with this requirement is careful monitoring of physical factors such as time, temperature, humidity, aw, pH, pressure, flow rate, and manufacturing operations such as freezing, dehydration, heat processing, acidification, and refrigeration to ensure that mechanical breakdowns, time delays, temperature fluctuations, and other factors do not contribute to the decomposition or contamination of food.
>
> (3) Food that can support the rapid growth of undesirable microorganisms, particularly those of public health significance, shall be held in a manner that prevents the food from becoming adulterated within the meaning of the act. Compliance with this requirement may be accomplished by any effective means, including:
>
> > (i) Maintaining refrigerated foods at 45 deg. F (7.2 deg. C) or below as appropriate for the particular food involved.

Since keeping the temperature of this product must be done to prevent contamination of our product, and must be stored (by Congressional Act) in certain areas of plant to prevent cross-contamination (storage racks are the only viable option) then it is considered continuous, on-going and integral to the manufacturing process and therefore exempt. Even once the product is loaded onto our trucks, the 41 degree requirement must be met until it is ready to be sold inside a restaurant. Temperature recorders are required for refrigerated trucks to ensure that the product never went above this requirement at any time while in transit.

Based on the foregoing, the electricity used for refrigeration immediately before and after the literal processing of the produce should be exempt from tax under § 12-36-2120(19) because, consistent with the Machine Exemption, those activities are integral and necessary to the manufacturing process.

II. Protective Clothing for Class 100 Facility (12-26-2120(54))

The Proposed Assessment also assessed use tax on hairnets, gloves, aprons, towels, and other items related to maintaining the physical environment of the processing areas. The taxpayer believes these purchases should be exempt from tax based on the prevailing guidance.

S.C. Code Ann. § 12-36-2120(54) exempts from sales tax the clothing and other attire required for working in a Class 100 or better clean room environment, as defined in Federal Standard 209E. As you may know, Federal Standard 209E was cancelled in 2001 (see Notice of Cancellation filed by U.S. General Services Administration (GSA) enclosed under **Tab 3**). In its place, the governing body recommended, and the GSA adopted in its place ISA 14644-1.

"Class 100" describes the number and size of particles permitted per volume of air in "cleanroom" environments. Class 100 under Federal Standard 209E, which is equivalent to ISO 5, permits 100 particles of 0.5 microns or greater per cubic foot. As described in Section VII, Part B, Item 3 in **Tab 2**, the FDA recommends filtering compressed air that comes into contact with produce to be 0.3 microns.

Although the FDA-recommended environment should be filtered to 0.3 microns, the taxpayer filters its air to 0.1 microns. BRC Global Standards, an industry-leading safety and quality certification program, conducts an annual audit regarding the quality, safety and operational manufacturing standards. From its 2015 annual audit, BRC Global Standards concluded that the taxpayer's "[c]ompressed air used directly in contact with the product contact surfaces is filtered by a series of two filters (first filter 1 micron, second filter 0.1 micron)." This means any compressed air used by the taxpayer meets, and in fact exceeds, the "Class 100 or better" recommendation described by the exemption. The taxpayer's fresh-cut produce is handled in an environment that is applicable to a Class 100 environment, and thus all protective clothing used in that environment should be exempt under § 12-36-2120(54).

III. Pollution Control Exemption (§ 12-36-2120(17))

Finally, in the alternative, we believe the purchases deemed taxable in the Proposed Assessment are exempt under the Pollution Control Exemption provided in § 12-36-2120(17), which exempts all property that is "necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution...." In this case, the purchases at issue are required by federal statute or regulation and protect against pollution through contamination of food. Specifically, 21 C.F.R. § 110.10 requires plant management to take all reasonable measures and precautions regarding the maintenance of a clean facility, including the following:

> (b) *Cleanliness.* All persons working in direct contact with food, food-contact surfaces, and food-packaging materials **shall** conform to hygienic practices while on duty to the extent necessary to protect against contamination of food.

The methods for maintaining cleanliness include, but are not limited to:

> (1) Wearing outer garments suitable to the operation in a manner that protects against the contamination of food, food-contact surfaces, or
> ...
> (3) Washing hands thoroughly (and sanitizing if necessary to protect against contamination with undesirable microorganisms) in an adequate hand-washing facility before starting work, after each absence from the work station, and at any other time when the hands may have become soiled or contaminated.
> ...
> (5) Maintaining gloves, if they are used in food handling, in an intact, clean, and sanitary condition. The gloves should be of an impermeable material.
> (6) Wearing, where appropriate, in an effective manner, hair nets, headbands, caps, beard covers, or other effective hair restraints.

(emphasis added).

Please take some time to review and let me know if you have any questions. We look forward to working with you.

Very truly yours,

Burnet R. Maybank, III

BRM/mw

Enclosures

cc: Rodger Watson
A. Dowl Knight (via electronic mail)
Carter McEntire (via electronic mail)



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STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

POWER OF ATTORNEY AND DECLARATION OF REPRESENTATIVE

SC2848
(Rev. 12/1/11)
3307

Part I Power of Attorney

1 Taxpayer Information (Note: Taxpayer(s) must sign and date this form on page 2, line 8.)

* Taxpayer name(s) and address (Type or print.)	* Social Security number(s)	* Employer Identification number
McEntire Produce, Inc. PO Box 5817 Columbia, SC 29250-5817		57-0868353
		Plan number (if applicable)
	* Daytime telephone number ( )	Email Address

hereby appoint(s) the following representative(s) as attorney(s) - in fact:

2 Representative(s) (Type or print.)

* Name and address of specific individual	
Burnet R. Maybank III 1230 Main Street, Suite 700 Columbia, SC 29201	* Telephone No. (803) 540-2048 Fax No. (803) 727-1472 Check if new: Address ☐ Telephone No. ☐
Name and address of specific individual	
Jim Rourke 1230 Main Street, Suite 700 Columbia, SC 29201	Telephone No. (803) 540-2030 Fax No. (803) 727-1475 Check if new: Address ☐ Telephone No. ☐
Name and address of specific individual	
	Telephone No. ( ) Fax No. ( ) Check if new: Address ☐ Telephone No. ☐

to represent the taxpayer(s) before the SC Department of Revenue for the following tax matters:

3 Tax Matters - A general reference to "All years," "All periods," or "All taxes" is **not** acceptable.

* Type of Tax (Individual, Corporate, Withholding, Sales, etc.)	* Tax Form Number (SC1040, WH1605, ST-3, etc.)	* Year(s) or Period(s) (See Line 3 instructions)
Sales and Use Tax	ST-3	2012-2015

4 Acts Authorized - A representative is an individual authorized to receive and inspect confidential tax information and to perform any and all acts on behalf of the taxpayer with respect to the tax matters described in line 3, including the authority to sign any agreements, consents or other documents. You may not use a Power of Attorney form to authorize a representative to receive refund checks. You may authorize a representative to sign a return ONLY as set forth in South Carolina Code Section 12-2-75.

List any specific additions to or deletions from the acts otherwise authorized in this power of attorney: _____

5 Receipt of Refund Checks - If you want to authorize a representative named in line 2 to receive, **BUT NOT TO ENDORSE OR CASH** refund checks, initial here _____ and list the name of that representative below.

Name of representative to receive refund check(s) ▶ _____

6 **Retention/Revocation of Prior Power(s) of Attorney** - The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the South Carolina Department of Revenue for the same tax matters for years or periods covered by this document.

If you do not want to revoke a prior power of attorney, check here ..... ▶ ☑

YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.

7 **Signature of Taxpayer(s)** - If a tax matter concerns a joint return, **both** husband and wife must sign if joint representation is requested; otherwise, see the instructions for SC2848 concerning signature of taxpayer(s). If signed by a corporate officer, partner, guardian, tax matters partner/person, LLC members, executor, receiver, personal representative, or trustee on behalf of the taxpayer, I certify that I have the authority to execute this form on behalf of the taxpayer.

▶ **The Department will not accept a Power of Attorney that is not signed.**

* Signature	* Date	Title (if applicable)
* 9/20/16		President

* Carter McEntire
Print Name

Signature	Date	Title (if applicable)

Print Name

NOTICES AND COMMUNICATIONS

All Notices and Communications will be sent to the taxpayer only. However, if you are unable to forward a copy to your named representative, you may contact our office for assistance.

Part II Declaration of Representative

I declare that:
- I am authorized to represent the taxpayer(s) identified in Part I for the tax matter(s) specified; and
- I am one of the following:
  - **a** Attorney - a member in good standing of the bar of the highest court of the jurisdiction shown below.
  - **b** Certified Public Accountant - duly qualified to practice as a certified public accountant in the jurisdiction shown below.
  - **c** Enrolled Agent - enrolled as an agent under the Requirements of the US Treasury Department Circular No. 230.
  - **d** Officer - a bona fide officer of the taxpayer organization.
  - **e** Full-Time Employee - a full-time employee of the taxpayer.
  - **f** Family Member - a member of the taxpayer's immediate family (i.e., spouse, parent, child, brother, or sister).
  - **g** Return Preparer.
  - **h** Other, please explain. _____

▶ **The Department will not accept a Declaration of Representative that is not signed.**

I declare that this return and all attachments are true, correct and complete to the best of my knowledge and belief. To wilfully furnish a false or fraudulent statement to the Department is a crime.

* Designation - Insert above letter (a-h)	* Jurisdiction (state)	* Signature	* Date
a	SC		9/20/16
a	SC		9-20-16

* indicates required field.

1350

STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE

POWER OF ATTORNEY AND DECLARATION OF REPRESENTATIVE

SC2848
(Rev. 12/1/11)
3307

Part I Power of Attorney

1 Taxpayer Information (Note: Taxpayer(s) must sign and date this form on page 2, line 8.)

* Taxpayer name(s) and address (Type or print.)	* Social Security number(s)	* Employer identification number
McEntire Produce Inc PO Box 5817 Columbia, SC 29250-5817		57-0868353
		Plan number (if applicable)
	* Daytime telephone number (803) 799-3388	Email Address

hereby appoint(s) the following representative(s) as attorney(s) - in fact:

2 Representative(s) (Type or print.)

* Name and address of specific individual	
A. Dowl Knight, CPA 9357 Two Notch Rd, STE 101 Columbia, SC 29223-6400	* Telephone No. (803) 736-5500 Fax No. (803) 736-5501 Check if new: Address ☐ Telephone No. ☐
Name and address of specific individual	Telephone No. ( ) Fax No. ( ) Check if new: Address ☐ Telephone No. ☐
Name and address of specific individual	Telephone No. ( ) Fax No. ( ) Check if new: Address ☐ Telephone No. ☐

to represent the taxpayer(s) before the SC Department of Revenue for the following tax matters:

3 Tax Matters - A general reference to "All years," "All periods," or "All taxes" is not acceptable.

* Type of Tax (Individual, Corporate, Withholding, Sales, etc.)	* Tax Form Number (SC1040, WH1605, ST-3, etc.)	* Year(s) or Period(s) (See Line 3 instructions)
Sales Tax	ST-3, ST-389	9/2012-8/2015

4 Acts Authorized - A representative is an individual authorized to receive and inspect confidential tax information and to perform any and all acts on behalf of the taxpayer with respect to the tax matters described in line 3, including the authority to sign any agreements, consents or other documents. You may not use a Power of Attorney form to authorize a representative to receive refund checks. You may authorize a representative to sign a return ONLY as set forth in South Carolina Code Section 12-2-75.

List any specific additions to or deletions from the acts otherwise authorized in this power of attorney: _____

5 Receipt of Refund Checks - If you want to authorize a representative named in line 2 to receive, **BUT NOT TO ENDORSE OR CASH** refund checks, initial here _____ and list the name of that representative below.

Name of representative to receive refund check(s) ▶ _____

6 **Retention/Revocation of Prior Power(s) of Attorney** - The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the South Carolina Department of Revenue for the same tax matters for years or periods covered by this document.

If you do not want to revoke a prior power of attorney, check here ..... ▶ ☐

YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.

7 **Signature of Taxpayer(s)** - If a tax matter concerns a joint return, **both** husband and wife must sign if joint representation is requested; otherwise, see the instructions for SC2848 concerning signature of taxpayer(s). If signed by a corporate officer, partner, guardian, tax matters partner/person, LLC members, executor, receiver, personal representative, or trustee on behalf of the taxpayer, I certify that I have the authority to execute this form on behalf of the taxpayer.

▶ **The Department will not accept a Power of Attorney that is not signed.**

Signature	Date	Title (if applicable)
*/ [signature]	*/ 9/23/15	/ President & CEO
*/ Carter McEntire		
Print Name		
Signature	Date	Title (if applicable)
Print Name		

NOTICES AND COMMUNICATIONS

All Notices and Communications will be sent to the taxpayer only. However, if you are unable to forward a copy to your named representative, you may contact our office for assistance.

Part II Declaration of Representative

I declare that:

- I am authorized to represent the taxpayer(s) identified in Part I for the tax matter(s) specified; and
- I am one of the following:
  - a Attorney - a member in good standing of the bar of the highest court of the jurisdiction shown below.
  - b Certified Public Accountant - duly qualified to practice as a certified public accountant in the jurisdiction shown below.
  - c Enrolled Agent - enrolled as an agent under the Requirements of the US Treasury Department Circular No. 230.
  - d Officer - a bona fide officer of the taxpayer organization.
  - e Full-Time Employee - a full-time employee of the taxpayer.
  - f Family Member - a member of the taxpayer's immediate family (i.e., spouse, parent, child, brother, or sister).
  - g Return Preparer.
  - h Other, please explain. _____

▶ **The Department will not accept a Declaration of Representative that is not signed.**

I declare that this return and all attachments are true, correct and complete to the best of my knowledge and belief. To willfully furnish a false or fraudulent statement to the Department is a crime.

* Designation - Insert above letter (a-h)	* Jurisdiction (state)	* Signature	* Date
b	SC		9/28/2015

* Indicates required field.



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Guidance for Industry: Guide to Minimize Microbial Food Safety Hazards of Fresh-cut Fruits and Vegetables

Contains Nonbinding Recommendations

February 2008

Additional copies are available from:
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(Tel) 301-436-1700 (Updated phone: 240-402-1700)
http://www.cfsan.fda.gov/guidance.html

U.S. Department of Health and Human Services
Food and Drug Administration
Center for Food Safety and Applied Nutrition
February 2008

OMB Control No. 0910-0609
Expiration Date: 10/31/2010
See additional PRA statement in section XIII of this guidance.

Contains Nonbinding Recommendations

Guidance for Industry

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Contains Nonbinding Recommendations

Guidance for Industry(1) Guide to Minimize Microbial Food Safety Hazards of Fresh-cut Fruits and Vegetables

Guidance

This guidance represents the Food and Drug Administration's (FDA's) current thinking on this topic. It does not create or confer any rights for or on any person and does not operate to bind FDA or the public. You can use an alternative approach if the approach satisfies the requirements of the applicable statutes and regulations. If you want to discuss an alternative approach, contact the FDA staff responsible for implementing this guidance. If you cannot identify the appropriate FDA staff, call the appropriate telephone number listed on the title page of this guidance.

I. Introduction

The Federal Government provides advice on healthful eating, including consuming a diet rich in a variety of fruits and vegetables, through the *Dietary Guidelines for Americans* and the related MyPyramid food guidance system (Ref. 1, 2). In response, per capita consumption data show that Americans are eating more fresh produce (Ref. 3). With $12 billion in annual sales in the past few years (Ref. 4), the fresh-cut sector of the produce industry is its fastest growing segment. As the fresh-cut produce market continues to grow, the processors of such produce are faced with the challenge of processing an increasing variety and volume of products in a manner that ensures the safety of this produce. From 1996 to 2006, seventy-two foodborne illness outbreaks were associated with the consumption of fresh produce. Of these produce related outbreaks, 25 percent (18 outbreaks) implicated fresh-cut produce (Ref. 5). Many factors may play a role in the incidence and reporting of foodborne illness outbreaks that implicate fresh produce, such as an aging population that is susceptible to foodborne illness, an increase in global trade, a more complex supply chain, improved surveillance and detection of foodborne illness, improvements in epidemiological investigation, and increasingly better methods to identify pathogens (Refs. 6 thru 12).

Processing fresh produce into fresh-cut products increases the risk of bacterial growth and contamination by breaking the natural exterior barrier of the produce (Ref. 6).The release of plant cellular fluids when produce is chopped or shredded provides a nutritive medium in which pathogens, if present, can survive or grow (Ref. 6). Thus, if pathogens are present when the surface integrity of the fruit or vegetable is broken, pathogen growth can occur and contamination may spread. The processing of fresh produce without proper sanitation procedures in the processing environment increases the potential for contamination by pathogens (see Appendix B, "Foodborne Pathogens Associated with Fresh Fruits and Vegetables."). In addition, the degree of handling and product mixing common to many fresh-cut processing operations can provide opportunities for contamination and for spreading contamination through a large volume of product. The potential for pathogens to survive or grow is increased by the high moisture and nutrient content of fresh-cut fruits and vegetables, the absence of a lethal process (e.g., heat) during production to eliminate pathogens, and the potential for temperature abuse during processing, storage, transport, and retail display (Ref. 6). Importantly, however, fresh-cut produce processing has the capability to reduce the risk of contamination by placing the preparation of fresh-cut produce in a controlled, sanitary facility.

This guidance is intended for all fresh-cut produce processing firms, both domestic firms and firms importing or offering fresh-cut product for import into the U.S., to enhance the safety of fresh-cut produce by minimizing the microbial food safety hazards. This guidance does not set binding requirements or identify all possible preventive measures to minimize microbial food safety hazards. We recommend that each fresh-cut produce processor assess the recommendations in this guidance and then tailor its food safety practices to the processor's particular operation. Alternative approaches that minimize microbial food safety hazards may be used so long as they are consistent with applicable laws and regulations.

This guidance primarily addresses microbiological hazards and appropriate control measures for such hazards. However, some chapters in the guidance discuss physical and chemical hazards.

FDA's guidance documents, including this guidance, do not establish legally enforceable responsibilities. Instead, guidances describe the Agency's current thinking on a topic and should be viewed only as recommendations, unless specific regulatory or statutory requirements are cited. The use of the word *should* in Agency guidances means that something is suggested or recommended, but not required.

II. Scope and Use

Fresh-cut Produce: This guidance covers fresh-cut fruits and vegetables that have been minimally processed (e.g., no lethal kill step), and altered in form, by peeling, slicing, chopping, shredding, coring, or trimming, with or without washing or other treatment, prior to being packaged for use by the consumer or a retail establishment. Examples of fresh-cut products are shredded lettuce, sliced tomatoes, salad mixes (raw vegetable salads), peeled baby carrots, broccoli florets, cauliflower florets, cut celery stalks, shredded cabbage, cut melon, sliced pineapple, and sectioned grapefruit.[2] Fresh-cut produce does not require additional preparation, processing, or cooking before consumption, with the possible exception of washing[3] or the addition of salad dressing, seasoning, or other accompaniments. As the fresh-cut produce market continues to evolve, the scope of this guidance may need to be modified to address new or novel types of products.

Fresh-cut Produce and Current Good Manufacturing Practice requirements for foods (CGMPs) (21 CFR Part 110) [4]: FDA's regulations in 21 CFR Part 110 establish CGMPs in manufacturing, packing, or holding human food. However, raw agricultural commodities (RACs), as defined in section 201(r) of the Federal Food, Drug, and Cosmetic Act (the Act), are not subject to the CGMP requirements by virtue of the exclusion in 21 CFR 110.19. Section 201(r) defines a raw agricultural commodity as any food "in its raw or natural state...." Fresh-cut fruits and vegetables are not RACs because they are no longer "in [their] raw or natural state" and instead have become "processed food" as that term is defined in the Act. Section 201(gg) of the Act defines a "processed food" as "any food other than a raw agricultural commodity and includes any raw agricultural commodity that has been subject to processing, such as canning, cooking, freezing, dehydrating, or milling." Under 21 CFR 110.3, the definitions in section 201 of the Act apply to Part 110. Thus, fresh-cut fruits and vegetables are appropriately considered "processed foods" and are subject to the CGMPs in Part 110. The conclusion that fresh-cut produce are not RACs is consistent with the preamble to the proposed revisions to the CGMP regulation (44 FR 33238 at 33239, June 8, 1979), which states, when discussing the exclusion for RACs, that such products may be excluded because "food from those commodities is... brought into compliance with the Act at the later stages of manufacturing, processing, packing, or holding." The CGMPs establish food safety practices applicable to processors who manufacture, process, pack, or hold processed food. FDA believes that the recommendations in this guidance complement the CGMPs by suggesting more specific food safety practices for processors of fresh-cut produce.

Fresh-cut Produce and HACCP Systems: A Hazard Analysis and Critical Control Point (HACCP) system is a prevention-based food safety system designed to prevent, reduce to acceptable levels, or eliminate the microbial, chemical, and physical hazards associated with food production (Ref. 6). One strength of HACCP is its proactive approach to prevent food contamination rather than trying to identify and control contamination after it has occurred.

Although HACCP is not currently required for the processing of fresh-cut produce, the United Fresh Produce Association recommends use of HACCP principles, and according to the association, many segments of the fresh-cut produce industry have adopted HACCP principles.[5]

FDA encourages fresh-cut produce processors to take a proactive role in minimizing microbial food safety hazards potentially associated with fresh-cut produce. We recommend that fresh-cut processors consider a preventive control program to build safety into the processing operations for fresh-cut fruits and vegetables. Awareness of the common risk factors discussed in this guidance and implementation of preventive controls determined by a firm to be appropriate to its individual operations will enhance the safety of fresh-cut fruits and vegetables. FDA also recommends that processors encourage the adoption of safe practices (See Chapter IV) by their partners throughout the supply chain, including produce growers, packers, distributors, transporters, importers, exporters, retailers, food service operators, and consumers, to ensure that the processor's efforts will be enhanced.

This guidance begins with a discussion of primary production and harvesting of fresh produce in Chapter IV and continues with recommendations for fresh-cut processing in four areas-- (1) personnel health and hygiene, (2) training, (3) building and equipment, and (4) sanitation operations. Following this discussion, the guidance covers fresh-cut produce production and processing controls from product specification to storage and transport. The final chapters provide recommendations on recordkeeping and on recalls and tracebacks.

III. Definitions

The following definitions apply to this guidance.

Adequate quality water: The determination of adequate quality water is based on its use, where adequate quality water for one purpose is not necessarily adequate for another purpose. (1) Where the water does not become a component of the fresh-cut produce, adequate quality refers to water that is safe and sanitary, at suitable temperatures, and under pressure as needed for all uses; and (2) where the water is used in a manner such that it may become a component of the fresh-cut produce (e.g., when such water contacts components, fresh-cut produce, or any contact surface), adequate quality water refers to water that complies with applicable Federal, State, and local requirements.

Fresh fruits and vegetables: fresh produce that is likely to be sold to consumers in an unprocessed (i.e., raw) form. Fresh produce may be intact, such as whole strawberries, carrots, radishes, or tomatoes, or cut from roots or stems during harvesting, such as celery, broccoli, lettuce, or cauliflower.

Fresh-cut fruits and vegetables or fresh-cut produce: fresh fruits and vegetables for human consumption that have been minimally processed and altered in form by peeling, slicing, chopping, shredding, coring, or trimming, with or without washing, prior to being packaged for use by the consumer or a retail establishment (e.g., pre-cut, packaged, ready-to-eat salad mixes). Fresh-cut produce does not require additional preparation, processing, or cooking before consumption, with the possible exception of washing or the addition of salad dressing, seasoning or other accompaniments.

Food hazard: a biological, chemical, or physical agent that is reasonably likely to cause human illness or injury in the absence of its control.

Pathogen: a microorganism capable of causing human illness or injury.

Processing water: water that is used for post-harvest handling of produce, such as washing, cooling, waxing, or product transport.

Standard Operating Procedures (SOPs): Procedures established by an operator for the day-to-day activities involved in the production of safe and wholesome food.

Sanitation Standard Operating Procedures (SSOPs): Procedures established by an operator for the day-to-day sanitation activities involved in the production of safe and wholesome food.

IV. Primary Production and Harvesting of Fresh Fruits and Vegetables

In general, anything that comes into contact with fresh produce has the potential to contaminate it. Fresh produce may become contaminated at any point along the farm -to-table continuum. The major source of microbial contamination of fresh produce is indirect or direct contact with animal or human feces. Once fresh produce has been contaminated, removing or killing the microbial pathogens is very difficult. Prevention of microbial contamination at all steps in the farm-to-table continuum is preferable to treatment to eliminate contamination after it has occurred.

On the farm, potential contamination avenues include contact with untreated manure used as a soil amendment, contaminated water, infected workers, or conditions in the field or packing facility such as unclean containers and tools used in harvesting and packing, and the presence of animals. In transport, conditions such as unclean floors and walls of the transport vehicle and unclean containers can contribute to contamination with pathogens. Thus, it is important that fresh-cut produce processors be aware of the conditions under which their fresh produce is grown, harvested, packed, and transported. Furthermore, knowing your suppliers and what they are doing to minimize risk of contamination is prudent.

To reduce potential contamination, the 1998 "Guide to Minimize Microbial Food Safety Hazards for Fresh Fruits and Vegetables" (GAPs Guide) (Ref. 15) provides recommendations for growers, packers, and shippers to use good agricultural and good manufacturing practices in those areas over which they have control to prevent or minimize microbial food safety hazards in fresh produce. Potential sources of contamination identified in the GAPs Guide are biosolids and manure, water, field workers, equipment, and containers.

We recommend the following practices to ensure that incoming fresh produce is safe and suitable for processing into fresh-cut product:

- Becoming aware of practices used by your suppliers (i.e., growers, packers, coolers, transporters, etc.)
- Evaluating the practices of your suppliers by a knowledgeable food safety expert
- Accepting produce from suppliers who use GAPs, GMPs or other appropriate practice from the farm to the processing facility
- Using a mechanism to verify the use of food safety practices by your suppliers (e.g., letter of certification or guarantee from a supplier)

V. Personnel

This section provides recommendations regarding personnel of an establishment that processes fresh-cut produce. The recommendations address two major areas: worker health and hygiene, and training.

A. Worker Health and Hygiene

Workers can carry microbial pathogens on their skin, in their hair, on their hands, and in their digestive systems or respiratory tracts. Unless workers understand and follow basic food protection principles, they may unintentionally contaminate fresh produce and fresh-cut produce, food contact surfaces, water supplies, or other workers, and thereby, create the opportunity to transmit foodborne illness. Basic food protection practices related to worker health and hygiene fall into two categories, disease control and cleanliness.

1. Disease Control

FDA recommends that employees with direct access (such as processing, storage, and transport workers) and indirect access (such as equipment operators, buyers, and pest control operators) to the production areas of fresh-cut fruits and vegetables follow good hygienic practices for maintaining personal health and hygiene in order to protect the product from contamination.

FDA recommends the following practices to prevent food, food contact surfaces, and food packaging materials from becoming contaminated with microbial pathogens from an employee with an infectious illness or wound:

- Establishing a company policy that requires employees to report any active case of illness to supervisors before beginning work
- Training supervisors to know the typical signs and symptoms of infectious disease

  We recommend that firms train employees to report to their supervisor any information about personal health status or activities relating to diseases transmitted through food. Such information would include reporting an active case of illness. FDA recommends that supervisors be trained to recognize the symptoms of active infectious disease; these symptoms are vomiting, nausea, diarrhea, and abdominal cramps. We recommend that employees with these symptoms be excluded from any operations which may be expected to result in contamination of fresh or fresh-cut produce or food contact surfaces, including equipment and utensils, until the medical condition is resolved.
- Covering cuts and wounds with a suitable water proof dressing when workers with such injuries are permitted to continue working.

  We recommend that firms maintain an adequate supply of bandages that provide protection from any wound. A wound containing pus (such as an open and draining boil or other infected wound) that is located on a part of the body that could contact fresh produce or fresh-cut produce, processing equipment, or tools, presents a risk of contaminating fresh-cut produce. When a worker in the processing area needs a bandage, we recommend that the firm consider using a bandage that is detectable by a metal detector if there is a metal detector in the processing line. Using detectable bandages will allow the facility to detect when a bandage has fallen into the processing line so that corrective action can be taken.We also recommend that a worker with a wound that cannot be covered to prevent contact with fresh produce or fresh-cut produce, processing equipment, or tools not work with any aspect of fresh produce or fresh-cut produce, processing equipment or tools until the wound has healed.

2. Cleanliness

FDA recommends that employees use the following food protection practices to prevent fresh or fresh-cut produce or food contact surfaces including equipment or utensils from becoming contaminated as a result of poor employee hygiene or inappropriate employee conduct:

- Maintaining adequate personal cleanliness
- Washing hands frequently and effectively and sanitizing hands if needed

  FDA recommends that employees wash their hands before beginning work and after engaging in any activity that may contaminate their hands. FDA's recommendations regarding when employees should wash their hands are reflected in the following list

  1. Before beginning work, especially if the employee has direct contact with fresh produce
  2. Before putting on a new pair of disposable or non-disposable gloves and after removing the gloves
  3. After touching human body parts or anything other than food or food contact surfaces
  4. After using the toilet; after coughing, sneezing, using a handkerchief or tissue
  5. After using tobacco, eating, or drinking
  6. After engaging in any activity that may contaminate hands, such as handling garbage, cleaning chemicals, or incoming produce before it has been washed
  7. After caring for or touching animals
  8. Before returning to a workstation

- Washing and sanitizing non-disposable gloves before starting work, and as needed
- Changing disposable gloves whenever contamination is a possibility

  Improperly used gloves may become a vehicle for spreading pathogens. The use of gloves does not lessen the need for, or importance of, hand-washing and other proper hygiene practices. We recommend that if gloves are used in a facility, the firm develop guidelines for their safe use, sanitation, and changing.
- Wearing appropriate attire on the job

  FDA recommends that employees wear clean clothes and any additional outer items (e.g., hairnets and beard covers, lab coats, aprons, and appropriate footwear) that will help protect fresh and fresh-cut produce from inadvertent contamination during processing.
- Not engaging in certain activities where food may be exposed or utensils are washed

  FDA recommends that employees in food processing areas not engage in activities that could contaminate food, such as eating, using tobacco, chewing gum, or spitting.

B. Training

Training every employee about the CGMPs and preventive controls will help to eliminate or minimize contamination of fresh-cut produce. We recommend that education and training programs be designed to help employees understand what is expected of them and why what is expected is important. We also recommend that company expectations for proper employee hygiene and food protection techniques be clearly communicated to new employees before starting employment and reaffirmed during periodic training programs. There are many materials available to firms to support employee training. We recommend that firms consider whether the language of the training and training materials is appropriate for the employees. Useful materials and information may be found at the **Fight BAC! (http://www.fightbac.org)**® campaign of the Partnership for Food Safety Education, and Gateway to Government Food Safety Information (**http://www.FoodSafety.gov/**) (**http://www.foodsafety.gov/**).

Training employees before they begin work with fresh or fresh-cut produce, at regular intervals, and at a minimum annually provides employees with important information about food safety best practices and company policies. We recommend that firms consider teaching, in the same training session, only a small number of employees at or near their workstation, if the environment permits it, for short periods of time, such as 10-15 minutes per session. The sessions could cover only one topic at a time and could be targeted to specific food safety concerns of that workstation. For example, washing station employees could be trained about appropriate antimicrobial chemical usage, and packaging station employees could be trained about proper handling and cleanliness of boxes and totes. We recommend refresher or follow-up training to reinforce the initial training. Training a few employees at a time can be an effective way to provide refresher training with the least disruption to work.

A firm may wish to post signs and pictorial representations of good practices covered in training as an additional way to reinforce training. We recommend that signs be multilingual and posted in areas close to where the practice is performed. We also recommend that the training provided to employees be documented so there is a record of the training topics covered and which employees completed it.

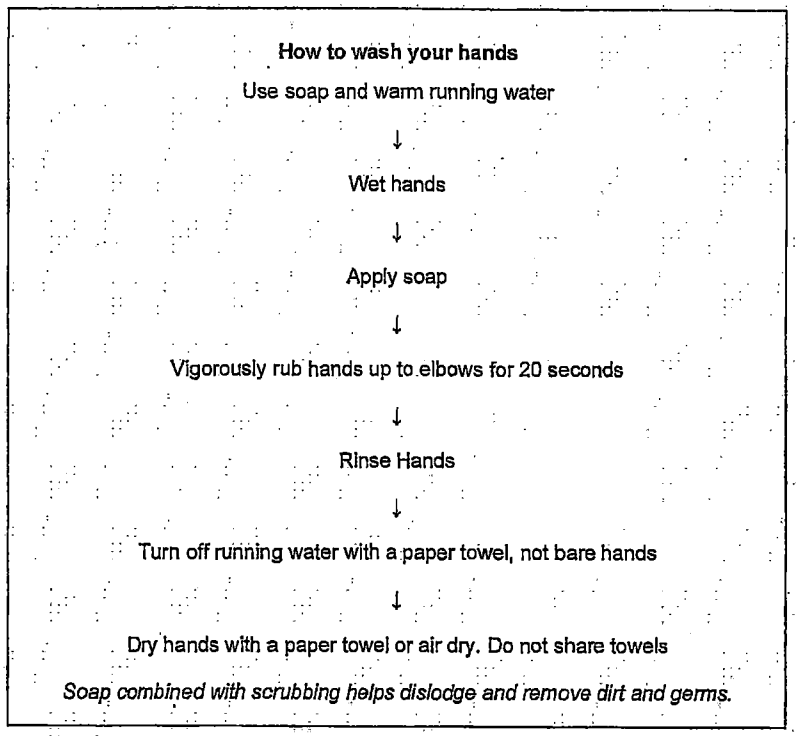
A well-designed training program provides information to help employees apply CGMPs while on the job. We recommend that a fresh-cut produce firm's training program for employees (including temporary, seasonal, and full time employees) include training on the CGMPs for production, maintenance, quality assurance, and quality control with an emphasis on worker health and hygiene; employee roles and responsibilities; and sanitation principles and sanitary practices.

1. Training for Worker Health and Hygiene

We recommend that employees be trained to follow good personal hygiene practices, including the use of proper hand washing techniques, wearing clean clothes and any additional outer coverings (e.g., hairnets and beard covers, disposable gloves, aprons), and appropriate conduct on the job. FDA also recommends that employees be trained on how, when, and to whom to report illness. Hand washing training is particularly important. We recommend that employees be trained about how, when, and why they must properly wash their hands and exposed portions of their arms. We also recommend that employees be taught to wash and sanitize their hands before entering areas where fresh or fresh-cut produce is present.

Figure 1 is an example of an aid that could be used to train employees on the proper technique to use in washing hands:

Figure 1. Example of a training aid on how to wash your hands



2. Training on Employee Roles and Responsibilities

We recommend that employees be trained consistent with the level of complexity of their jobs and that additional training be provided as needed to ensure current knowledge of equipment and process technology.

One goal of a training program is to help workers understand the importance of the tasks for which they are responsible, particularly those tasks that are important to minimizing microbial food safety hazards (such as monitoring the disinfectant level in wash water). We recommend that employees be trained about how to perform these tasks; to be aware of the microbial food safety hazards associated with them; to understand the procedures for monitoring conditions such as the disinfectant level, pH, and the temperature of the wash water, and any associated recordkeeping that the firm chooses to implement; to know the actions that are needed to minimize contamination of the product; and to consult with their supervisors if the established limits (such as the appropriate level of disinfectant in the wash water) are not met.

We recommend that personnel responsible for maintaining equipment that may have an impact on food safety be trained to understand the importance of their role in the production of safe food. Equipment maintenance jobs that may have an impact on food safety include changing water filters, maintaining refrigeration units, treating processing water, and calibrating equipment. We recommend that employees be

trained to identify deficiencies that could affect product safety, to take the appropriate corrective actions (e.g., in-house repairs, contract repairs), and to be able to understand how indirect cross-contamination may occur when proper equipment controls are not maintained.

3. Training on Sanitation Principles and Sanitary Practices

We recommend that employees with cleaning and sanitation duties be trained to understand the principles and methods required for effective cleaning and sanitation, especially as those methods relate to food safety. We recommend that supervisors be trained to identify and promote good sanitary practices.

We also recommend that employees be trained in the proper use of sanitizing agents (sanitizers) and foot foam, foot baths, or spray systems, in proper cleaning and sanitizing steps of the equipment and facility, in proper use of equipment in the production environment, such as hoses and tools, and in the proper use, handling, and storage of chemicals used in sanitation.

Figure 2 is an example of an aid that could be used to train employees on the proper use of sanitizers:

Figure 2. Example of a training aid on proper use of sanitizers

Use sanitizers properly for food safety

Hand sanitizing stations
- After hand washing, sanitize your clean hands with a sanitizer solution
- Allow hands to air dry
- Wash hands and sanitize gloves (disposable or reusable) before wearing
- Re-sanitize your hands after touching non-food contact surfaces

Foot Sanitizer
- When entering any area where fresh produce or fresh-cut produce is present, walk through a foot sanitizer unit

Sanitizer maintenance
- Monitor and change hand and foot sanitizer solutions as needed to maintain effective sanitizer strength, per manufacturer's recommendation

Equipment (whether fixed or free standing), fixtures, floors, walls, and other structures in a processing facility can become a source of microbial contamination if not adequately maintained in sanitary condition. The high humidity and structural niches in a fresh-cut produce processing facility encourage microbial build-up. To prevent fresh-cut produce from becoming contaminated by equipment or other structures in the facility, we recommend that employees be trained on proper cleaning and sanitizing steps within the processing areas.

Figure 3 is an example of an aid that could be used to train employees on the cleaning and maintenance of processing equipment and facilities:

Figure 3. An example of a training aid on cleaning and sanitizing steps within processing areas

Cleaning and sanitizing steps*

1. Remove heavy debris from floors with brooms or shovels and dry clean processing equipment, if needed
2. Pre-rinse the equipment with adequate quality water
3. Clean remaining debris from floor
4. Rinse floor and drains with adequate quality water using a low pressure hose
5. Use dedicated brushes to scrub floor and drains with an effective cleaner, applying adequate quality water as needed
6. Foam and scrub the equipment with an effective cleaner and scrub using dedicated brushes
7. Thoroughly rinse the equipment, floors, and drains with adequate quality water using a low pressure hose
8. Remove excess water from floors

9. Sanitize (according to manufacturer directions) the equipment and floors*

* Work from top down for cleaning and sanitizing activities. Some equipment may need to be disassembled before cleaning and sanitizing followed by reassembly.

In addition to using sanitizers appropriately and cleaning and sanitizing the equipment and facility regularly, proper use of equipment, such as hoses, can also reduce the risk of contamination of fresh and fresh-cut produce. For example, keeping hose nozzles off the floor can help prevent nozzles and employee hands from becoming a source of contamination. We recommend that sections of hose that touch the floor or other unclean surface not make contact with fresh produce, food-contact surfaces, or packaging materials. A retractable hose suspended from the ceiling may help to prevent such contamination. In addition, allowing hose ends to sit in standing water or to be submerged in water tanks could allow back siphonage of water, thereby contaminating the water distribution system.

Further, we recommend that employees be trained to avoid use of high-pressure water hoses to clean floors, walls, and equipment in the processing and packaging areas during production or after production equipment has been cleaned. This practice will help prevent aerosols from contacting processing equipment and food-contact surfaces, product, or packaging materials. Therefore, we recommend that employees be trained on the proper use of cleaning equipment.

VI. Building and Equipment

FDA recommends that the processing facility and its structures (such as walls, ceilings, floors, windows, doors, vents, and drains) be designed to be easy to clean and maintain and to protect the product from microbial, physical, and chemical contamination. For example, designing food contact surfaces to be smooth, nonabsorbent, smoothly bonded, without niches, and sealed would make these surfaces easier to clean and thus, would prevent the harborage of microbial pathogens.

A. Building

Both direct contamination and cross-contamination of produce can be minimized by giving proper attention to physical design, emphasizing proper product flow, using appropriate construction materials, managing facility traffic, and ensuring proper airflow. We recommend that facilities and staging areas be designed to facilitate maintenance and good sanitation practices so that contamination may be controlled throughout receiving, cooling, processing, packing, and storage operations. We also recommend that buildings, fixtures, and equipment be maintained in a condition that will protect fresh-cut produce from potential microbial, chemical, and physical contamination.

1. External/Internal Structures

In general, we recommend limiting access to the facility and to its processing areas, providing adequate space for operations, ensuring adequate drainage of processing and wash water, installing food contact surfaces that are easy to clean and maintain, and designing areas and structures to protect the product and equipment from contamination.

In addition, we recommend the following practices:

- Adequately screening open windows, vents, fans, and similar features to prevent pest (insect, bird, rodent, reptile) entry
- Closing all exterior doors and entrances when not in use and ensuring an adequate seal when exterior doors and entrances are closed
- Properly constructing all walls, ceilings, windows, doors, floors, and overheads (e.g., pipes, air vents, and lights) and maintaining them in good condition (e.g., no cracks, rust, breakage, missing parts, or dips allowing puddles to form) so that they do not harbor pests or pathogens
- Designing properly sloping floors to drains (¼ inch per foot), and sealing and keeping them in good repair so as to provide adequate drainage

- Designing floor drains to prevent the accumulation of water in or around the drains and making drains accessible for cleaning
- Fitting floor drains with seals and grates capable of preventing pest entry
- Using floor flumes with caution due to the potential for water aerosol contamination of the room air and nearby equipment surfaces

  We recommend against the use of a floor flume transfer from the produce cooling and packing operation into or across an area housing fresh-cut produce operations.
- Constructing trench drains for automatic flushing
- Using under-floor drains in fresh-cut produce processing areas
- Designing collection areas for waste stream water to prevent product and equipment contamination
- Designing pipelines to avoid pipe and wall condensation from becoming a source of contamination

  Where overhead condensate cannot be prevented, we recommend that catch pans be utilized, and be cleaned and sanitized on a regular basis.
- Avoiding wood construction materials wherever possible

  If wooden equipment is used (including pallets), we recommend that the equipment be in good condition and well maintained so it is not a source of physical or microbial contamination. Non-wooden construction materials, such as plastic or stainless steel, are preferable for use in processing areas because they reduce the risk of microbial harborage and cross-contamination of final product.
- Using protective guards for light fixtures to prevent broken glass from falling into product

2. Facility Layout

We recommend that a fresh-cut fruit or vegetable processing facility be designed so that incoming raw products never cross paths with or are commingled with finished fresh-cut produce products. Similarly, we recommend maintaining separate raw incoming product, in process, and finished product areas so as to prevent the potential for microbial cross-contamination. Adequate food safety controls, operating practices, and facility design can reduce the potential for contamination by using location and/or flow of humans, product, equipment, and air.

We recommend the following practices that use *location* to reduce the potential for contamination:

- Having rest rooms that open into a location other than a processing area
- Locating the door to the outside in an area other than into a processing area
- Having a microbiology lab that opens into an area other than into a processing area
- Storing in-process and raw produce materials in different rooms
- Establishing dedicated cold rooms for raw product and processed product
- Locating hand washing and sanitizing facilities to facilitate regular and appropriate use by employees
- Locating a disinfectant foot foam, foot bath, or foot spray at all entrances and exits to all production and finished product storage areas.

  We recommend the following practices that use *flow* of personnel, product, equipment, or air to reduce the potential for contamination:
- Having short direct routes for both product and personnel flow
- Designing the plant for one direction of personnel traffic, product, and air flow
- Designing product areas to have traffic patterns that separate raw and finished product using either linear product flow (raw to finished product) or by physical partition

  (Figure 7 in Appendix E is an example of product and personnel flow patterns in a fresh-cut processing plant.)

- Using an air filtration system for central air distribution and airflow that is counter to product flow, so that filtered air moves with a positive pressure from the cleanest areas (e.g., from packaging and finished product storage) toward less clean areas (e.g., the receiving area)

  We also recommend that air intake for the facility be located to minimize contamination of the intake air by:

- Keeping the number of entrances and exits to the processing areas to a minimum
- Restricting the movement of lift trucks, bins, totes, maintenance tools, cleaning implements, clothing, and people from receiving and storage zones to processing and packaging areas

  Color coding bins, totes, clothing, cleaning implements, maintenance tools, and other items (e.g., blue aprons for receiving zones and red aprons for processing and packaging areas) may help achieve separation of traffic and thereby, minimize cross-contamination.

B. Equipment Design, Construction, and Maintenance

We recommend that the processing equipment be designed and constructed to be easy to clean and maintain and to avoid microbial contamination of the fresh-cut product.

1. Equipment Design and Construction

We recommend the following to facilitate cleaning and to help ensure that fresh-cut produce is not contaminated during the processing operation:

- Using smooth, non-absorbent, sealed, and easily cleanable food contact surfaces that are sloped to drain freely and made of durable, non-corrosive, nontoxic materials

  Food contact surfaces include items such as knives, conveyors, belts, chutes, product totes, gloves, tools including shovels and racks, cutting boards, tables, dryers and spinner baskets, and packing scales. We recommend that all food contact surfaces be smoothly bonded (e.g., free of pits, folds, cracks, crevices, open seams, cotter pins, exposed threads, and piano hinges) to avoid harboring pathogens. Where two food contact surfaces meet, we recommend use of a cover over the juncture to prevent food debris from collecting in the crevice and creating an area that is difficult to clean.

- Locating catwalks with open grating so they do *not* pass over areas of exposed fresh or fresh-cut produce or food-contact surfaces
- Designing equipment in the processing area to prevent water collection

  We suggest cautious use of hollow structures, such as catwalk framework, table legs, conveyor rollers, and racks, because they may collect water and debris, and thus, harbor pathogens.

- Elevating food-contact surfaces sufficiently above the floor (with accessibility for cleaning) to prevent contamination from floor splashes
- Installing stationary equipment away from floor drains to allow accessibility to drains for cleaning and to prevent contamination of the equipment

2. Equipment Maintenance

Establishing a preventive maintenance program helps to ensure that all equipment functions as intended. Equipment failure requiring maintenance activities during production may increase the risk of microbial contamination, particularly from *L. monocytogenes* (Ref. 16). Preventive maintenance includes periodic examination and maintenance of equipment such as valves, gaskets, o-rings, pumps, screens, filters, and heat exchanger plates. We recommend that a firm develop appropriate plans of action in case important equipment, such as refrigeration equipment, disinfectant delivery systems, power systems, or alarm systems, malfunctions. We also recommend the following practices:

- Performing maintenance and calibration of equipment by appropriately trained personnel

We recommend that maintenance personnel who work in the processing or packaging areas comply with the hygiene requirements for production employees.

- Installing, calibrating, and maintaining temperature measuring or recording devices as necessary to ensure accuracy
- Frequently sharpening knives, if used, including retractable knives, and disinfecting before use

  We recommend that knives be replaced if damaged or if they cannot otherwise be maintained in a sanitary condition.
- Frequently inspecting cutting blades and belts during processing operations for damage, product residue build up, or cleaning needs

  We recommend that blades be removed and cleaned separately, and remaining equipment parts disassembled (if possible) and cleaned on a regular basis.
- Operating metal detectors in accordance with the manufacturer's instructions and checking for proper functioning at least daily to ensure effective detection of metal and removal of affected product

  We recommend that procedures be in place, such as a the use of metal detectors during packaging operations, to minimize the possibility that metal ends up in finished product packages.
- Calibrating safety control devices that are essential for maintaining the proper level and activity of wash water disinfectant, at a frequency recommended by the manufacturer and documenting this activity on the instrument calibration forms/logs
- Examining air filters for both intake air and compressed air and changing at least as often as the manufacturer specifies, or more frequently if a problem is indicated, such as evidence of filter fouling or perforation

VII. Sanitation Operations

Pathogenic microorganisms may be found on floors, in drains, and on the surfaces of sorting, grading, processing, and packaging equipment. Without appropriate sanitation practices, these surfaces may be a source of microbial contamination.

A. Sanitation Program

We recommend the use of a comprehensive sanitation program developed by a trained employee such as a certified sanitarian to avoid microbial contamination of the product in a fresh-cut processing facility.

We recommend that fresh-cut processors consider using the following practices for their sanitation program:

- Establishing sanitation standard operating procedures (SSOPs), including a cleaning and sanitizing procedure with a regular schedule for all equipment, storage areas, fresh and fresh-cut produce production areas, air systems, and water storage areas

An example of such a schedule is included in Figure 4. When visual inspection or environmental monitoring results for equipment or the facility reveal dirt, food residues, or other debris, we recommend a more frequent cleaning and sanitizing schedule relative to what is shown in Figure 4.

Figure 4. An Example of a Processing Plant Environmental Sanitation Master Schedule[6],[7]

Area	Cleaning/Sanitation Method	Tools	Cleaning Materials	Frequency

Area	Cleaning/Sanitation Method	Tools	Cleaning Materials	Frequency
Area	**Cleaning/Sanitation Method**	**Tools**	**Cleaning Materials**	**Frequency**
Walls	Foam, brush, rinse	Soft nylon brush and High Pressure Hose (when appropriate)	Chlorine-Quaternary ammonium ("quat")-based cleaner	Once/Month Walls adjacent to processing equipment should be cleaned daily
Ceiling	Foam, brush, rinse	Nylon brush, high pressure machine	Chlorine-quat-based cleaner	Once/Month
Floors	Wash, rinse	Hard bristle broom (not straw), floor scrubbers, low pressure hose	Chlorine-quat-or iodine based cleaner	Daily
Doors	Foam, scrub, rinse	Scouring pad, cloth	Chlorine-quat-based cleaner	Once/Week
Plastic curtains	Foam, rinse	Foam and Rinse	Chlorine-quat-based cleaner	Once/Week
Overhead pipes, electrical conduits, structural beams	Foam, brush	Brush, bucket, high water pressure machine	Chlorine-quat-based cleaner	Once/Month
Hoist, overhead light fixtures	Wipe, clean	Cleaning pad	Water, light detergent	Once/Quarter
Refrigeration coils	Rinse, sanitize	High pressure hose	Water, sanitize with quat	Once/Quarter
Chillers	Scouring	Scouring pad	Acid cleaner	As Needed/Audit
Air distribution filters	Soak	Plastic bins	Chlorine-alkaline detergent	Once/Quarter
Drains, trench	Clean, flood, rinse	Soft Nylon brush, 50 gallon container	Chlorine-alkaline detergent, quat or iodine based sanitizer	Daily
Grids	Brush, rinse	Nylon brush, high water pressure machine	Chlorine-alkaline detergent	Daily
Waste, dumpster areas	Foam, brush, rinse	Nylon brush, high water pressure machine	Heavy duty chlorine-based cleaner	Daily
Employee break rooms/bathrooms	Wash, rinse	Nylon brush, sanitary brushes	Chlorine-based soap or quat	Frequently throughout the day
Maintenance areas	Scrub, rinse	Nylon brush	Degreasing agent	Once/Month

- Including as part of the sanitation schedule the name of the employee (and alternate when primary employee is absent) responsible for the activity, the

equipment to be cleaned and how to disassemble it, the frequency of cleaning, procedures for cleaning (including type and concentration of cleaning compound and sanitizer), time and temperature requirements, cleaning solution flow rate (pressure) if applicable, and the name of an employee responsible for verifying the program effectiveness by inspection

- Cleaning the condenser unit, drip pans, and hoses of refrigerators
- Keeping cold storage as dry as possible
- After cleaning and sanitizing, visually inspecting the area cleaned for product residue and conducting routine microbiological tests (conventional or rapid microbiological methods, such as total count or bioluminescence) to verify effectiveness of the cleaning and sanitizing program
- When reassembling sanitized equipment, placing the equipment parts on a sanitary mat and not on the floor
- Cleaning and sanitizing all processing equipment, facility utilities (e.g., air system, water system), and food-contact surfaces after maintenance work and prior to use in production
- Cleaning and sanitizing processing equipment and food-contact surfaces between the processing of different commodities, if appropriate based on risk
- Avoiding cleaning and sanitizing equipment during processing operations to prevent contamination
- Minimizing splashing during the cleaning of floor drains by using an appropriate brush, such as a ¼ inch smaller brush than the diameter of the drain opening, or a splash guard

  For cleaning drains, we recommend using dedicated utensils (color coded and used for cleaning drains only) to minimize the potential for contamination. We also recommend that floor drains not be cleaned during processing operations and that the person who cleaned drains not clean fresh-cut produce food contact surfaces without changing outer garments, and washing and sanitizing his or her hands.
- Regularly inspecting tools for cutting, slicing, and shredding for damage that could impair cleaning and sanitizing them

  We recommend replacing a tool if it cannot be fixed so that it can be adequately cleaned.

1. Cleaning and Sanitizing Chemicals

Cleaning and sanitizing chemicals may be toxic, and should be stored in dry, secure, and ventilated areas away from facility traffic and processing operations. They should be handled by employees trained in the use of such chemicals.

We recommend the following practices in using cleaning and sanitizing chemicals:

- Using adequate quality water for cleaning and sanitizing at temperatures appropriate for the chemicals used
- Using toxic chemicals for cleaning operations in accordance with the manufacturer's instructions and in accordance with relevant Federal, State, and local government regulations
- Clearly labeling toxic chemicals
- Storing toxic chemicals and pesticides in a manner that protects against contamination of food, food-contact surfaces, and food-packaging materials and in accordance with relevant Federal, State, and local government regulations
- Monitoring the effectiveness of cleaning and sanitizing chemicals by visual inspection and environmental testing (especially grooves and niches) for microbial growth

2. Pest Control

We recommend a pest control program be implemented throughout the entire processing facility to eliminate pests (such as rodents, birds, reptiles, and insects) that may harbor or be a vector for a variety of pathogens. As part of the plant's pest

control program, consider frequent monitoring of affected and treated areas to assess accurately the effectiveness of the program. Some helpful physical and chemical controls are recommended below:

- Using window screens, screen doors, and weather stripping for all doors, and air fans at all doorways
- Keeping all exterior doors closed when not in use
- Removing waste products to, and storing waste products in, a location outside the facility
- Removing old, unused equipment from the facility
- Maintaining the exterior grounds surrounding the facility in a manner that will control pest harborage
- Properly storing ingredients, finished product, and food packaging
- Cleaning up spills and produce debris in a timely manner
- Using pesticides, traps, bait, and chemicals that are acceptable for use in a food processing facility and that will not contaminate foods, food ingredients, or food packaging

  Chemical controls should be applied by a licensed pest control operator or according to local regulations.
- Maintaining a map to identify by numbered locations all rodent traps and bait boxes used both inside and outside the processing facility

B. Sanitary Facilities and Controls

1. Employee Changing Facilities and Toilets

We recommend that changing facilities and restrooms be adequate and located in proximity to processing areas, but not so close that they could be a source of contamination. We recommend that restrooms not open directly into processing areas and doors be equipped with self-closing mechanisms or have a maze-type entrance/exit.

2. Hand Washing Facilities

FDA recommends the following practices for employee hand washing facilities:

- Providing a sink, hot and cold running water of adequate quality, effective hand cleaning preparations (e.g., liquid soap), sanitary hand drying devices (such as disposable paper towels), and a waste container
- Installing water control devices (such as knee, foot, or elbow faucet controls) that will protect against contamination of clean hands
- Posting signs that show proper hand washing procedures

We recommend that these signs be posted near the facility entrance, in restrooms, near all hand washing stations, and wherever employees may handle produce, food packaging materials, or food-contact surfaces. We further recommend that these signs be multilingual where some of the workers in the facility are not native English speakers or pictorial where literacy is a concern.

3. Air Quality

Air inside a processing plant can be a vehicle for contamination of food by mold, yeast, dust, or pathogens if not properly controlled. Where fresh and fresh-cut fruits and vegetables are exposed to open air, we recommend that air quality be monitored to ensure that it is of suitable quality.

We also recommend that fresh-cut processors consider the following to maintain appropriate air quality:

- Using positive, negative, and ambient air pressure differentials to direct potential airborne contaminants away from microbially sensitive areas. For example, negative air pressures in raw product areas, microbiology laboratories, and rest

rooms may help to keep air from those areas from flowing into the processing areas. Similarly, positive air pressure can be maintained in areas such as the processing and packaging area.

- If air filtering equipment is used in a fresh-cut processing facility, filters should be performing at manufacturer specified levels of performance
- Filtering compressed air (such as oxygen (O_2), nitrogen (N_2), and carbon dioxide (CO_2) used in modified atmospheric packaging) when such air contacts fresh produce using a 0.3 micron filter (with an efficiency of approximately 75%)

4. Water Supply

Water can be a carrier of microorganisms including pathogens. Adequate quality water is critical in a fresh-cut processing facility because of the absence of a step lethal to pathogens (kill step) in processing the product as well as the presence of factors such as the high degree of product handling, the damage to product during cutting, shredding, etc., and the potential for temperature abuse in processing and storage. We recommend that the water supply in a food processing plant be sufficient for the operations intended and be derived from an adequate source. We recommend that water for operations in the processing facility, such as cleaning and sanitizing the facility and equipment as well as preparing the product for processing, processing the product, and manufacturing ice, be of adequate quality. Where water does not become a component of the fresh-cut produce, we recommend that water be safe and sanitary, at suitable temperatures, and under pressure as needed for all uses. For water that is used in a manner such that the water may become a component of the fresh-cut produce (such as when such water contacts components, fresh-cut produce, or any contact surface), we recommend that water comply with applicable Federal, State, and local requirements.

See Section VIII.C., which provides our recommendations for maintaining water quality used from preparation for processing through processing operations.

We recommend the following practices regarding the water used in a processing facility:

- Complying with applicable Federal, State, and local requirements for water that contacts fresh-cut produce or food-contact surfaces, including water used to make ice

  We recommend that processors protect sources of water and ice from contamination and that ice be manufactured, transported, and stored under sanitary conditions.
- Testing well water, if used, at the site of the well and at the point in the plant most distant from the well on a regular basis to ensure compliance with Federal, State, and local requirements
- Maintaining and inspecting on a routine basis any water charcoal filtering system to prevent it from becoming a source of microbial or physical contamination of water
- Reviewing on a periodic basis water systems to ensure that no cross-connections exist between systems carrying water that is of adequate quality and systems carrying water that is not
- Ensuring that the volume, temperature, and pressure of water is adequate for all operational and clean up demands

5. Environmental Monitoring

FDA recommends an environmental monitoring program designed to detect areas of pathogen harborage and to verify the effectiveness of cleaning and sanitizing programs in preventing cross-contamination. We recommend the following practices:

- Performing environmental sampling on both food contact and non-food contact surfaces (e.g., drains)
- Determining the appropriate target pathogen, test locations, and frequency of sampling

We recommend that the appropriate target pathogen be the most resistant microorganism of public health significance that is likely to occur in fresh-cut produce.

- Focusing environmental monitoring on an indicator organism, such as *Listeria* spp., which indicates microbial contamination but is nonpathogenic and more easily detectable than a target pathogen, such as *L. monocytogenes*
- Establishing a plan for action in the event that a microbiological test indicates the presence of a target pathogen or indicator organism
- Documenting corrective actions and follow-up for all positive microbial test results

VIII. Production and Process Controls

To minimize the potential for the growth of microorganisms and for the contamination of fresh-cut produce, FDA recommends that control measures be in place to prepare, process, package, and store the product.

A. Product Specifications

We recommend that food processors consider developing specifications and controls for all ingredients and components (including raw fruits and vegetables, packaging materials, and gases) that are necessary for production of safe finished product. Specifications provide standards by which a food processor can assess the acceptability of ingredients and components and thus, minimize microbial, chemical, and physical hazards. We recommend, for example, that the fresh-cut processor know as much as possible about the production practices and conditions for the firm's incoming product. The "Guide to Minimize Microbial Food Safety Hazards in Fresh Fruits and Vegetables" (Ref .15) provides useful guidance when reviewing primary production practices.

B. Receipt and Inspection of Ingredients

Opportunities for contamination of fresh produce occur from the field to the processing facility. Loading, transporting, and unloading produce may introduce contaminants. Damaged produce, soil, debris, and pests may all arrive with the produce when it is delivered to the facility. To help ensure the quality of incoming fresh produce, we recommend that the processor carefully inspect the produce upon receipt at the processing facility. We also recommend the following practices:

- Transporting the produce from the field to the processing, packing, or cooling facility as soon as practical after harvest
- Inspecting delivery vehicles carrying fresh produce and other components of the finished product, e.g., cartons, packaging materials, for cleanliness
- Visually inspecting incoming fresh produce for damage, filth, and infestation according to a predetermined sampling plan and rejecting products that do not meet established specifications
- Removing all damaged, moldy, or decomposed product and extraneous matter (such as metal or other foreign material) from in-coming raw ingredients to a designated area
- Retaining information about all incoming ingredients, such as the identity of the grower or supplier, date of harvest, the field, and linking the information on the incoming product with the operation's production records (e.g., when processed, date, shift) for finished product

  This information will be useful in the event a traceback is conducted. See section X in this guide for more information on tracebacks.

C. Specific Processing Steps

1. Preparation for Processing

Appropriate preprocessing of incoming produce can help minimize microbial, chemical, and physical hazards. We recommend that fresh-cut produce processors consider the following activities to help minimize microbial, chemical, and physical hazards in in-coming produce:

- Inspecting fresh produce throughout the processing stream for field contaminants that may not have been noticed during the incoming produce inspection
- Removing from the processing stream damaged or decomposed produce, extraneous matter, and produce that appears to be contaminated by animal feces, fuel, machine grease, or oil
- Removing as much dirt as possible from incoming produce

  We recommend, when appropriate, washing incoming RACs prior to further processing (such as cutting or chopping) to reduce the overall potential for microbial contamination from the surface of intact fruits and vegetables.

2. Processing Water

Water is used extensively in almost all aspects of processing fresh-cut fruits and vegetables, including during cooling, washing, and conveying of produce. Although water may be a useful tool for reducing potential contamination, it may also introduce or spread contaminants. When used for washing, cooling, rinsing, or conveying food, we recommend that water comply with applicable Federal, State, and local requirements.

In a fresh-cut processing operation, water quality changes as the water is used and, thus, maintaining the quality of processing water should be considered. Reusing processing water may present a risk of new or increased number of microbial populations, including human pathogens.

We recommend the following practices:

- Where water is reused in a series of processes, arranging water flow to be counter to the movement of produce through different operations, with the result that as produce is further processed, it is exposed to the cleanest water
- Monitoring and treating processing water for level of disinfectant chemical to ensure the water is maintained in a condition suitable for the application (e.g., washing, cooling, or transporting) and does not become a source of microbial contamination
- Routinely inspecting and maintaining equipment designed to assist in maintaining water quality, such as chlorine injectors, filtration systems, and backflow devices, to ensure efficient operation

  We recommend that ice used on fresh or fresh-cut produce be included in routine water quality testing.

a. Maintaining Water Quality

When used appropriately with adequate quality water, antimicrobial chemicals help minimize the potential for microbial contamination of processing water and subsequent cross contamination of the product. The effectiveness of an antimicrobial agent, as well as the amount that should be used, depends on the treatment conditions, such as water temperature, acidity [pH], water hardness, contact time, amount and rate of product throughput, type of product, water to product ratio, amount of organic material, and the resistance of pathogens to the particular antimicrobial agent. For example, the antimicrobial activity of a chlorine-based disinfectant depends on the amount of hypochlorous acid (also called "free chlorine") present in the water. The amount of hypochlorous acid in the water depends upon the pH of the water, the amount of organic material in the water, and, to some extent, the temperature of the water. If the amount of hypochlorous acid is not maintained when the amount of organic material increases, the antimicrobial agent may lose effectiveness in maintaining water quality. If a fresh-cut processor uses a chlorine containing compound as a disinfectant, we recommend that the processor monitor the processing water for free chlorine or hypochlorous acid concentrations. As another example, the measurement of Oxidation-Reduction Potential (ORP) is used as an indicator of the activity of any antimicrobial agent that is an oxidizer and as a

measure of the agent's effectiveness during processing. Variables that affect antimicrobial activity during processing directly affect the ORP value and may also be used to determine the effectiveness of these oxidizers such as hypoorous acid, hypobromous acid, chlorine dioxide, ozone, and peroxides.

We recommend that fresh-cut processors consider options for maintaining the quality of water most appropriate for their individual operations. Producers may wish to contact a local agricultural extension agent, their chemical supplier, or a food safety consultant for help in deciding what water treatment chemicals to use. In addition, processors may refer to 21 CFR 173.315, "Chemicals used in washing or to assist in the peeling of fruits and vegetables," for additional information about chemicals approved for use in wash water.

We recommend that fresh-cut processors also consider the following regarding water quality maintenance:

- Following the manufacturer's directions for correct mixing of antimicrobial agents to obtain effective concentrations and to minimize safety hazards

  Manufacturers' suggested or allowable levels of antimicrobial chemicals in wash water should not be exceeded.
- Monitoring disinfectant levels frequently in water used for various processing operations to ensure appropriate concentrations are maintained

  Test strips or test kits may be useful for monitoring some disinfectant levels.
- Minimizing the build up of organic material in wash water

  For some operations, filtering recirculating water or using a net to scoop plant material or other debris from tanks may help reduce the build up of organic material.
- Following contact between produce and processing water containing antimicrobial chemicals with a clean water rinse of adequate quality to remove any treatment residues where appropriate and consistent with the manufacturer's directions

b. Washing Fresh Produce

Prior to arriving at the processing facility, RACs may be washed in the field or in a place such as a cooling facility. RACs may also go directly from the field to the processing facility to be washed after receipt. Regardless of where the initial washing of the produce takes place, washing produce can reduce the overall potential for microbial food safety hazards because most microbial contamination is on the surface of the produce. If pathogens are not removed, inactivated, or otherwise controlled at this initial stage, they can potentially spread the contamination to additional produce during processing. Washing RACs before any processing of the produce occurs may reduce potential surface contamination. However, washing, even with disinfectants, can only reduce, not eliminate, pathogens, if present. Washing has little or no effect on pathogens that have been internalized in the produce.

A number of post harvest processes, such as hydrocooling, use of dump tanks, and flume transport utilize a high degree of water-to-produce contact. We recommend that fresh-cut processors use practices to maximize the cleaning potential during these processes and to minimize the potential for cross-contamination.

We recommend the following practices:

- Using a series of washes, if appropriate

  For some operations, a series of washes may be more effective than a single wash. An initial wash treatment may be used to remove the bulk of field soil from produce followed by an additional wash or washes containing an antimicrobial chemical.
- Using appropriate wash methods

  Vigorous washing of produce not easily bruised or injured increases the likelihood of pathogen removal. Different methods may be used to wash different types of produce, including submersion, spray, or both. Regardless of the method used, maintaining the quality of the wash water (see section 2.a. above) is important in order to minimize the potential for contamination.

- Maintaining the efficacy of wash treatments
- Using wash water of an appropriate temperature

  Produce is susceptible to infiltration of wash water if warm produce is placed in water that is cooler than the produce. Such infiltration occurs when the temperature difference creates a pressure differential causing air spaces inside the fruit or vegetable to contract, thereby allowing water to be pulled into the fruit or vegetable. If pathogens are present in the cooling/wash water, they may infiltrate the produce, and subsequent washing will not reduce levels of these pathogens (Refs. 6, 14). Therefore, water used for washing or cooling produce should contain sufficient levels of disinfectant to reduce the potential for pathogens to persist in such water. When it is not practical to reduce the temperature differential between the wash/cooling water and the produce, it is especially important that processors follow practices to minimize pathogens in the water or on the surface of produce. Such practices may include using antimicrobial chemicals in the wash water or using spray type wash treatments instead of submerging produce. Alternatively, produce may be cooled by means other than hydrocooling and then washed with water that is warmer than the produce.

3. Precooling and Cold Storage

Sanitary cold storage of RACs and fresh-cut produce is important to reduce the risk of microbial contamination and potential for subsequent growth. However, most current temperature recommendations for both whole and fresh produce are based on temperatures that maintain quality attributes.[8] Although we recognize that more research needs to be done to identify the types of whole and fresh-cut produce that will support the growth of human pathogens and the temperatures at which this pathogen growth will occur, certain practices can reduce the potential for pathogen growth and contamination during precooling and cold storage.We recommend the following practices to reduce this risk:

- Holding RACs and fresh-cut produce at appropriate cold storage temperatures to reduce the potential for microbial growth
- Preventing condensate and defrost water from evaporator-type cooling systems (e.g., vacuum cooling, cold storage) from dripping onto fresh and fresh-cut produce
- Designing and maintaining forced air cooling to avoid contaminating fresh produce

  In most instances, vacuum cooling or use of fans poses the lowest risk of microbial contamination
- Holding cut melons and any other fresh-cut product determined to need temperature control for safety at ≤ 41° F (≤ 5° C)
- Locating temperature monitoring devices in the warm area of the refrigerator unit (e.g., near the door) and calibrating them on a regular basis
- Inspecting all refrigeration units on a regular basis and keeping them in good operating condition
- Storing similar commodities together (unprocessed product next to unprocessed product and finished product next to finished product) to avoid cross-contamination
- Using an appropriate inventory system to ensure first in first out (FIFO) use and FIFO shipment of raw materials and finished products

4. Washing Fresh-cut Produce: Post-processing Controls

Final washing of fresh produce after cutting, slicing, shredding, and similar fresh-cut processes helps remove some of the cellular fluids that could serve as nutrients for microbial growth. Monitoring the quality of water used in such operations and replacing it at an appropriate frequency as indicated by such monitoring may help prevent the build up of organic material in the water and reduce or prevent cross-contamination of processed produce. We have the following additional recommendations for use after the final wash of processed produce:

- Where appropriate for the product, removing as much excess water as possible from processed produce through draining methods such as spin drying

- Keeping containers used to hold produce (e.g., spin baskets) from direct contact with the floor and away from containers that have had direct contact with the floor (e.g., in cold storage)

D. Packaging

Anything that touches fresh-cut produce has the potential to contaminate it, including the materials used in packaging the finished product.

We recommend the following practices:

- Maintaining an effective system to prevent the use of contaminated, damaged, or defective cartons and totes in order to prevent microbial contamination of the fresh -cut produce during packing operations
- Overseeing incoming materials and gases used in packaging to confirm that they are not damaged or defective and are in appropriate working order
- Rejecting packaging materials that are damaged or contaminated
- Determining the appropriate gas mixtures for products
- Using containers and cartons for their intended purpose only. For example, we recommend against using a carton designated for holding fresh-cut produce to hold tools.
- Storing packaging containers and other packaging materials in a manner so as to protect them from contamination, such as away from pests, dirt, cleaning chemicals, and water condensation from overhead equipment and structures
- Maintaining a program to identify and correct situations where damage to containers may potentially occur
- Labeling all finished fresh-cut produce products with recommended storage instructions (e.g., "Keep Refrigerated") or storage temperature to inform all persons handling the product of the recommended storage conditions

1. Modified Atmosphere Packaging (MAP)

Some packaging controls used for fresh-cut produce affect the environment within the package by reducing the levels of oxygen. Low oxygen levels help maintain the quality of fresh produce and extend shelf-life by slowing respiration and senescence in plant tissues. Oxygen can be reduced passively by using gas permeable films in packaging that result in the natural development of the desired atmosphere; the desired atmosphere is a consequence of the products' respiration as gas diffuses through the film (Ref. 6). Oxygen can also be reduced actively by displacing the mixture of gases in a package with a gas mixture that has a low concentration of oxygen (1-5%). Microorganisms respond differently to the surrounding gases depending on their tolerance. While reduced oxygen and elevated carbon dioxide retard the growth of spoilage microorganisms such as *Pseudomonas spp.*, the same gas conditions may provide growth opportunities for pathogenic microorganisms. At extremely low oxygen levels (< 1%), anaerobic respiration can occur, resulting in tissue destruction that affects product quality and creating the potential for growth of foodborne pathogens such as *Clostridium botulinum* (Ref. 6). It is generally believed, however, that fresh-cut produce will spoil before the toxin becomes a concern (Ref. 6). Non-pathogenic aerobic and facultative microorganisms are present at the time of packaging and persist after packaging.

MAP is only effective in extending shelf-life if used in conjunction with good refrigeration. Elevated temperatures can promote the growth of spoilage organisms and pathogens that may be present. Thus, we recommend that food processors using MAP adhere to strict temperature controls and appropriate shelf-life parameters. Because refrigeration temperatures may not be maintained during distribution of the products or while they are held by retailers or consumers, we also recommend that controls be in place to either prevent increases in temperature, as feasible, or to alert the processor, retailer, or consumer that the product may not be safe to consume. Processors may wish to consider providing product handling guidelines on temperature control and washing to the distributor, retailer, and consumer. Another potential source of contamination of fresh cut produce packed in MAP occurs when the gases, equipment, or packaging materials are not properly maintained. As with

any type of packaging, we recommend that controls be put in place to ensure that the process of packaging the product and the packaging materials themselves do not cause the product to become contaminated.

2. Shelf-life

Fresh-cut fruits and vegetables can cause illness due to contamination with a variety of microorganisms because these products do not undergo any processing to ensure the total elimination of microorganisms that might be present. Some packaging and storage techniques for fresh-cut produce (e.g., MAP, refrigerated storage) may slow the rate of physical deterioration by slowing respiration of the produce. However, if packaging and storage are not properly controlled, pathogens may grow to levels that could render the product unsafe for human consumption. The rate of respiration of fresh produce is inversely related to product shelf-life, which means that a higher respiration rate decreases shelf-life (Ref. 6). Fresh fruits and vegetables that have been cut or otherwise physically altered will have increased respiration, and thus, a shorter shelf-life. To address the risks of increased respiration, we recommend the following practices:

- Communicating (through product labeling) that the consumer should refrigerate the product to prevent product spoilage and the potential for growth of pathogens
- Ensuring that any "use by" date on the product package is validated by studies of the product with respect to microbiological safety

We recommend that records of these data and studies be maintained to document the reliability of the "use by" labeling.

E. Transportation and Storage

We recommend that finished fresh-cut product be stored and transported under conditions that will protect the food against physical, chemical, and microbiological contamination. We recommend, if feasible, that raw whole produce not be stored with finished product and finished product be transported in clean, sanitary vehicles. We also recommend the following practices:

- Keeping finished products refrigerated at temperatures appropriate for the product during storage, transportation, and display for sale to minimize the potential for growth of microbial pathogens
- Equipping refrigerated transportation vehicles and storage rooms with accurate temperature measuring devices, preferably including a temperature recording function

  If a recording temperature device is not used, we recommend that a min/max thermometer, i.e., a thermometer that shows the range of temperatures attained over a set time period, be used.
- Shipping fresh-cut produce products on a FIFO basis to minimize storage time
- Ensuring that the equipment in refrigeration vehicles is designed to circulate cold air uniformly throughout the vehicle while taking the load layout into consideration
- Placing fresh-cut produce products in storage facilities and transportation vehicles in a manner that allows for proper air circulation
- Transporting and storing fresh-cut produce products in vehicles and containers that are dedicated to carrying food products and have been treated by a process that is effective in destroying vegetative cells of microorganisms of public health significance
- Inspecting transportation vehicles and containers for debris, soil, and off-odors prior to loading to increase their suitability for transporting fresh-cut produce
- Loading and unloading fresh-cut produce in a manner that minimizes the potential for damage and for microbial contamination

IX. Documentation and Records

We recommend as a general practice that food processors maintain records sufficient to reflect important product information and practices. Such documentation can be helpful to the processor in several ways. First, such records help ensure consistency of processing operations and end-product quality and safety. They are more reliable than human memory, and they are a useful tool to identify operational areas where inconsistencies occur and further employee training may be needed. Second, maintaining adequate documentation and records of processing operations is important if a traceback investigation of product is ever needed. We recommend that records be retained at the processing plant for at least six months after the date that the products were prepared unless a longer retention time is required under a relevant law or regulation. Records are most useful when they begin by including the date and time, name of person(s) who completed the record, and the activity or production station being recorded.

Records that may be kept for most food processing operations include the following:

- Water quality and supply records
- Water treatment and monitoring records
- Employee training records
- Temperature control records
- Equipment monitoring and maintenance records
- Calibration records
- Sanitation records
- Product processing batch records
- Corrective action records
- Pest control records
- Distribution records
- Inspection records (e.g., incoming product, facility, production area)
- Microbiological contamination records (e.g., food contact surfaces, equipment)

X. Traceback and Recall

Traceback is the process of tracking food items, such as fresh-cut produce, back to their source (growers, packers, processor, field and when harvested). The ability to identify the source of a product can serve as an important complement to food safety programs intended to prevent the occurrence of microbial contamination. Information gained from a traceback investigation may also be useful in limiting the impact of an outbreak of foodborne illness and in identifying and eliminating conditions that may have resulted in the produce becoming contaminated. We recommend that fresh-cut processors establish and maintain written traceback procedures to respond to food safety hazard problems when they arise.

We also recommend that fresh-cut processors establish and maintain a current written contingency plan for use in initiating and carrying out a recall. Having procedures in place will enable the recall of any lot of product that may have been implicated in an outbreak or that tested positive for a pathogen and help provide detailed information to assist the investigation of any foodborne illness associated with the product. Recall procedures usually include the name of the contact persons responsible at all times; the roles and responsibilities for the coordination of a recall; the methods to identify (e.g., use of lot codes), locate, and control recalled products; requirements to investigate other possibly affected products which could subsequently be included in the recall; and procedures for monitoring the effectiveness of the recall.

Because a recall may extend to more than one lot of product, we recommend that processors develop a coding system to help identify incoming product sources, individual production lots and to whom each lot is distributed. Use of package and date codes can help link product packages with production times, equipment, and raw ingredient sources and may facilitate recovery of products during a recall.

In the event of a firm-initiated recall, if a firm believes its product is adulterated or otherwise violates the Act, we request that the firm immediately notify the appropriate FDA district office in the state where the processing facility is located. District office locations are provided in 21 CFR 5.115. (See Appendix A for information to include in the notification.)

Produce growers and packers, fresh-cut produce processors, and shippers are encouraged to work with their partners in growing, transporting, distributing, packing, and processing, and with retail sectors to develop technologies that allow identification of fresh-cut produce from the grower to your operation, to the retailer, and to the consumer.

XI. Additional Information

The following are additional resources for information on how to handle food products safely.

On the web:

1. FDA/Center for Food Safety and Applied Nutrition (/Food/default.htm)
2. Fight BAC! (http://www.fightbac.org)®
3. Gateway to Government Food Safety Information (http://www.foodsafety.gov)
4. Centers for Disease Control and Prevention (http://www.cdc.gov/) (CDC)
5. USDA/Food Safety and Inspection Service (http://www.fsis.usda.gov) (FSIS)
6. NACMCF HACCP guidelines (/Food/GuidanceRegulation/HACCP/ucm2006801.htm)

Other resources:

7. Ednet: a monthly electronic newsletter for food safety educators. To subscribe, send an email message to Listserv@foodsafety.gov (mailto:Listserv@foodsafety.gov). Send the message: Subscribe EDNET-L first name last name.
8. FDA's Outreach and Information Center (/AboutFDA/CentersOffices/OfficeofFoods/CFSAN/ContactCFSAN/default.htm): 1.888.SAFEFOOD
9. Code of Hygienic Practices for Fresh Fruits and Vegetables (CAC/RCP 53-2003)
10. General Principles of Food Hygiene (CAC/RCP 1-1969, Rev. 4-2003)

XII. References

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XIII. Paperwork Reduction Act of 1995

This guidance contains information collection provisions that are subject to review by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520).

The time required to complete this information collection is estimated to average 0.067 hour per record for SOP & SSOP maintenance, 40 hours per record for traceback maintenance, 0.067 hour per record for system implementation of a preventive control program comparable to a HACCP system, and 4 hours per record for implementation review of that preventive control program, including the time to review instructions, search existing data resources, gather the data needed, and complete and review the information collection. Send comments regarding this

burden estimate or suggestions for reducing this burden to: Office of Food Safety, Division of Plant and Dairy Food Safety (HFS-317), Center for Food Safety and Applied Nutrition, Food and Drug Administration, 5001 Campus Drive, College Park, MD 20740.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The OMB control number for this information collection is 0910-0609 (expires 10/31/2010).

Appendices

1. Notifying FDA of a Recall
2. Foodborne Pathogens Associated with Fresh Fruits and Vegetables
3. Pathogens Often Transmitted by Food That Has Been Contaminated by Infected Employees
4. Sources of Microbial Contamination
    1. Potential Sources of Microbial Contamination
    2. Examples of Scenarios That May Cause Microbial Contamination of the Product
5. An Example of Product/Personnel Flow Patterns in a Fresh-cut Processing Plant

Appendix A

Notifying FDA of a Recall

In the event of a firm-initiated recall, if a firm believes its product is adulterated or otherwise violates the Act, we request that the firm immediately notify the appropriate FDA district office and that the notification include:

- the identity of the product involved (i.e., an adequate description of the type of food to include brand name and specific variety, date of releasing the food, the lot or code number or other identifier of the implicated product, the quantity and how the food is packaged);
- the reason for the recall and the date and circumstances under which the product deficiency or possible deficiency was discovered;
- an evaluation of the risk associated with the product;
- the total amount of implicated product units processed and the time span of processing;
- the total amount of product in inventory and the total amount of product distributed; the distribution information including the number of direct accounts and, where necessary, the identity of the direct accounts;
- a copy of the firm's recall communication, if any has issued, or the proposed communication if none has issued; the proposed strategy for conducting the recall; and
- the name and telephone number of the firm official who should be contacted concerning the recall

For further FDA guidance on recalls, see 21 CFR sections 7.40-7.59.

Appendix B

Foodborne Pathogens Associated with Fresh Fruits and Vegetables

The U.S. Public Health Service has identified a number of microorganisms associated with foodborne illness that are notable either because of the severity or because of the prevalence of the illness they cause. Foodborne microbial pathogens associated

with the consumption of fresh fruits and vegetables include *Cyclospora cayetanensis*, *Escherichia coli* O157:H7, hepatitis A virus, *Listeria monocytogenes*, Norovirus, *Salmonella* spp., and *Shigella* spp.[9]

- **Cyclospora** infections (cyclosporiasis) are caused by the protozoan *Cyclospora cayetanensis*. The infections are spread by ingestion of food or water contaminated with infected stool. Direct person-to-person transmission is unlikely because excreted oocysts require days to weeks under favorable environmental conditions to become infectious (i.e., sporulate). The natural host for this parasite has not been identified; however, contaminated water used for irrigation and pesticide application and poor worker hygiene have been suggested as the most likely routes of contamination. The infection (cyclosporiasis) is commonly characterized by watery diarrhea, loss of appetite, weight loss, abdominal bloating and cramping, low-grade fever, nausea, vomiting, and fatigue. Relapses and asymptomatic infections can occur. Outbreaks of cyclosporiasis have been linked to fresh raspberries, mesclun lettuce, and basil or basil-containing products. (For more information: *Bad Bug Book*, ***Cyclospora cayetanensis*** **(/Food/FoodborneIllnessContaminants/CausesOfIllnessBadBugBook/ucm122216.htm)**)
- ***E. coli* O157:H7** is a bacterium and one of the enterovirulent strains of *Escherichia coli*. Most *E. coli* strains are nonpathogenic, found in the intestines of all animals, including humans, and function by suppressing harmful bacterial growth. However, there are a minority of strains such as serotype O157:H7 that may cause human illness. *E. coli* O157:H7 is a life-threatening bacterium that produces large quantities of potent toxins that can cause severe damage to the lining of the intestines. Human illness associated with *E. coli* O157:H7 infection may include nonbloody diarrhea, hemorrhagic colitis, hemolytic uremic syndrome (HUS), or thrombotic thrombocytopenic purpura (TTP). Hemorrhagic colitis progresses from abdominal cramps to nonbloody diarrhea to bloody diarrhea. HUS largely affects young children and is the leading cause of acute renal failure in children. TTP is a rare syndrome of *E. coli* O157:H7 infection, which largely affects adults and resembles HUS histology. *E. coli* O157:H7 outbreaks have been associated with meat (especially undercooked or raw hamburger), fresh produce, raw milk, unpasteurized apple juice, coleslaw, and contaminated water (For more information: *Bad Bug Book*, ***Escherichia coli*** **(/Food/FoodborneIllnessContaminants/CausesOfIllnessBadBugBook/ucm071284.htm)**).
- **Hepatitis A virus** may cause a serious, and sometimes fatal, disease. Hepatitis attributed to hepatitis A virus is characterized by sudden onset of fever, malaise, nausea, anorexia, and abdominal discomfort, followed in several days by jaundice. Hepatitis A virus is excreted in fecal material and is transmitted by the fecal-oral route, which include consumption of contaminated food. The most common food sources of Hepatitis A are shellfish and salads, but it may also be transmitted through drinking water. (For more information: *Bad Bug Book*, **Hepatitis A Virus (/Food/FoodborneIllnessContaminants/CausesOfIllnessBadBugBook/ucm071294.htm)**)
- ***Listeria monocytogenes***[10] is a bacterium that causes listeriosis, a serious disease in pregnant women, the elderly, and those with weakened immune systems. *L. monocytogenes* is widespread in the environment (i.e., in soil, water, and decaying vegetation) and has been isolated from domestic animals, humans, raw produce, food processing environments (particularly cool damp areas), and home refrigerators. Outbreaks of listeriosis in the United States have been associated with the consumption of hot dogs, deli or luncheon meats, pate, salami, Mexican-style soft cheeses and butter made with raw milk, and raw vegetables (Ref. 16). (For more information: "**Quantitative Assessment of Relative Risk to Public Health from Foodborne *Listeria monocytogenes* Among Selected Categories of Ready-to-Eat Foods (http://www.foodsafety.gov/~dms/lmr2-toc.html)**")
- **Noroviruses** are a group of related, single-stranded RNA, nonenveloped viruses that cause acute gastroenteritis in humans. Norovirus was recently approved as the official genus name for the group of viruses provisionally described as "Norwalk-like viruses." Norovirus is transmitted by the fecal-oral route most commonly via contaminated water or contaminated foods. Shellfish and salad ingredients are the foods most often implicated in norovirus outbreaks. (For more information: *Bad Bug Book*, **The Norwalk virus family (/Food/FoodborneIllnessContaminants/CausesOfIllnessBadBugBook/ucm071344.htm)**

and *CDC*, Noroviruses (http://www.cdc.gov/ncidod/dvrd/revb/gastro/norovirus.htm))

- **Salmonella** is the second most common cause of foodborne illness (salmonellosis) in the United States and is responsible for millions of cases of illness each year. Typical symptoms of salmonellosis are nausea, vomiting, abdominal cramps, fever, mild diarrhea, and headache; these symptoms usually last 6-48 hours. Salmonella outbreaks have been associated with the consumption of raw and undercooked eggs, undercooked poultry and meat, dairy products made with unpasteurized milk, shrimp, fresh produce, and unpasteurized fruit juice. (For more information: *Bad Bug Book*, ***Salmonella* spp.** (/Food/FoodborneIllnessContaminants/CausesOfIllnessBadBugBook/ucm069966.htm))
- ***Shigella* spp.** Humans are a natural reservoir for *Shigella* spp. The primary means of transmission of the shigella organism is by the fecal-oral route. Most cases of infection by shigella (shigellosis) are attributed to the ingestion of food or water contaminated with fecal matter. Contamination has often been associated with poor personal hygiene of food workers. Typical symptoms include abdominal pain, cramps, diarrhea, fever, vomiting, and blood, pus, or mucus in stools. Shigellosis outbreaks have been associated with shredded lettuce, potato salad, green onions, parsley, cheese, seafood, and poultry (Ref. 19). (For more information: *Bad Bug Book*, ***Shigella* spp.** (/Food/FoodborneIllnessContaminants/CausesOfIllnessBadBugBook/ucm070563.htm))

Appendix C

Pathogens Often Transmitted by Food that Has Been Contaminated by Infected Employees*

A wide range of communicable diseases may be transmitted by infected employees to consumers through contaminated food or food utensils. We recommend that fresh-cut produce firms establish an ongoing program to identify employees who present a risk of transmitting foodborne pathogens to fresh produce or to other employees. Below is a list of the most common pathogens that may be transmitted through food and their associated symptoms.

Pathogen	Symptoms
1. Hepatitis A virus	fever, jaundice
2. *Salmonella typhi*	fever
3. *Shigella* species	diarrhea, fever, vomiting
4. Norwalk and Norwalk-like viruses	diarrhea, fever, vomiting
5. *Staphylococcus aureus*	diarrhea, vomiting

Diarrhea, fever, and vomiting are also symptoms of several other pathogens that could be transmitted by food contaminated by infected employees.

Please refer to the **CDC web site (http://www.cdc.gov/foodsafety/disease.htm)** for further information on foodborne diseases, pathogens, and toxins: *.

Appendix D

Figure 5. Potential sources of microbial contamination

- **Ingredients**
  - Raw produce
  - Fresh-cut produce
- **Packaging materials**
  - Containers, films, lids, trays
- **Processing aids**
  - Compressed air
  - Untreated or inadequately treated wash water
  - Ice
  - Reused processing water

- **Facility environment**
  - Ceilings, overhead structures, catwalks
  - Rubber seals around doors (especially coolers)
  - Drains
  - Walls
  - Standing water
  - Wet insulation in walls or around pipes and cooling units
  - Condensate
  - Vacuum cleaner contents
  - Hand washing areas (sinks) and restrooms
- **Food contact surfaces**
  - Fibrous or porous type conveyor belts
  - Filling or packaging equipment
  - Equipment cleaning tools
  - Slicers, dicers, shredders, blenders,
  - Belts, peelers, collators
  - Containers, bins, tubs, or baskets
  - Hands, gloves, and outerwear
  - Ice makers
  - Utensils
- **Nonfood-contact surfaces**
  - In-floor weighing equipment
  - Hollow rollers for conveyors
  - Trash cans and other such ancillary items
  - Visible bearings within equipment
  - Condensate drip pans
  - Maintenance tools (wrenches, screw drivers, etc.)
  - On/off switches
  - Cracked hoses
  - Equipment framework
  - Wet rusting or hollow framework
  - Poorly maintained compressed air filters
  - Motor housing
  - Forklifts, hand trucks, trolleys, racks
  - Vacuum cleaners and floor scrubbers

Figure 6. Examples of Scenarios That May Cause Microbial Contamination of the Product

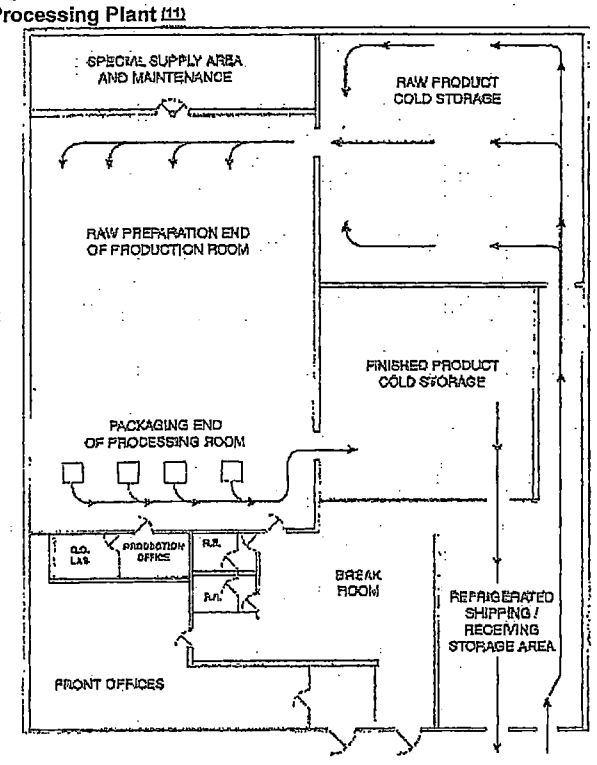
1. A processing line is moved or modified significantly.
2. Used equipment is brought in from storage or another plant and installed into the process flow.
3. An equipment breakdown occurs.
4. Construction or major modifications are made to a fresh-cut produce processing area (e.g., replacing refrigeration units or floors, replacing or building walls, modifications to sewer lines).
5. An employee unfamiliar with the operation and microbial controls has been hired or assigned to work or clean equipment in the processing areas.
6. Personnel who handle fresh produce and fresh-cut produce touch surfaces or equipment that are likely to be contaminated (e.g., floor, trash cans) and do not

change gloves or follow other recommended procedures before handling product.

7. Periods of heavy production make it difficult to change processing water or clean food contact surfaces at the facility as scheduled.
8. A drain backs up.
9. Product is caught or hung up on equipment for an extended period and is not removed during equipment clean-up. Microorganisms may grow in stagnant product and can be a major source of contamination during production. FDA recommends that equipment be modified to eliminate areas where product stops moving along or through a processing line and cannot be readily removed during cleaning.
10. There are frequent product changes on a packaging line which necessitate changing packaging film, labels, forming pockets or molds, line speeds, etc.
11. Personnel are used interchangeably for handling unprocessed produce and finished fresh-cut product.
12. There is increased production requiring wet cleaning of down lines in the same room as lines running product.
13. Equipment parts, tubs, screens, etc. are cleaned on the floor.
14. Waste bins in the processing areas are not properly maintained, cleaned, and sanitized. Personnel handling product may come into contact with these items and then contaminate product and/or product contact surfaces.

Appendix E

Figure 7. An Example of Product/Personnel Flow Patterns in a Fresh-cut Processing Plant (11)



Notes:

[1] This guidance has been prepared by the Division of Plant and Dairy Food Safety in the Center for Food Safety and Applied Nutrition at the U.S. Food and Drug Administration.

[2] Fresh sprouts are raw agricultural commodities and thus, their production is not governed by 21 CFR Part 110. FDA does, however, recommend that sprouting firms employ current good manufacturing practices. Also, FDA has published specific guidance for the production of sprouts. We recommend that producers of sprouts refer to this guidance, "**Reducing Microbial Food Safety Hazards for Sprouted Seeds (/Food/GuidanceRegulation/GuidanceDocumentsRegulatoryInformation/ucm120244.htm)**" (Ref. 13) and "**Guidance for Industry: Sampling and Microbial Testing of Spent Irrigation Water During Sprout Production (/Food/GuidanceRegulation/GuidanceDocumentsRegulatoryInformation/ucm120246.htm)**" (Ref. 14).

[3] For information regarding re-washing of fresh-cut produce, California Department of Health Services Food and Drug Branch "Recommendations from Fresh-cut Produce Re-wash Panel, April 4, 2006." (available in **PDF (http://www.dhs.ca.gov/fdb/local/PDF/Fresh%20cut%20Wash%20Panel%20Backgrounder%20web.pdf)**).

[4] A copy of the **CGMPs in 21 CFR Part 110 (/Food/GuidanceRegulation/CGMP/default.htm)** may be accessed on the Internet.

[5] United Fresh Produce Association: **http://www.unitedfresh.org/ (http://www.unitedfresh.org/)**.

[6]Used with permission from the United Fresh Produce Association (UFPA), *Food Safety Guidelines for the Fresh-cut Produce Industry*, 4th Edition, 2001.

[7] Also, as noted previously in section V.B.3., we recommend that employees be trained to avoid use of high-pressure water hoses to clean floors, walls, and equipment in the processing and packaging areas during production or after production equipment has been cleaned. This practice will help prevent aerosols from contacting processing equipment and food-contact surfaces, product, or packaging materials.

[8] An exception is Chapter 1 of the **FDA Food Code (2005) (/Food/GuidanceRegulation/RetailFoodProtection/FoodCode/ucm2016793.htm)**, which defines potentially hazardous food (PHF) and identifies specific fresh produce (among other foods) that is considered PHF and therefore requires refrigeration at 41°F. Cut melons are considered a PHF.

[9] More information about these and other microbiological pathogens can be found in **FDA's Bad Bug Book (/Food/FoodborneIllnessContaminants/CausesOfIllnessBadBugBook/default.htm)**. See Ref. 17.

[10] For additional information, FDA, the Centers for Disease Control and Prevention, and the U.S. Department of Agriculture (USDA) have developed a ***Listeria* Action Plan (/Food/FoodborneIllnessContaminants/FoodborneIllnessesNeedToKnow/ucm332272.htm)** (Ref. 18) and a *Listeria* risk assessment (Ref. 16).

[11] Used with permission from UFPA, *Food Safety Guidelines for the Fresh-cut Produce Industry*, 4th Edition, 2001.

The above guidance supercedes the previous version issued March 2007.

Federal Register Notice of Availability February 25, 2008

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FED-STD-209E

The U.S. General Services Administration (GSA) released a Notice of Cancellation for FED-STD-209E, Airborne Particulate Cleanliness Classes in Cleanrooms and Clean Zones, on November 29, 2001.

The Federal Standard 209E cancellation is based on the recommendation by IEST Working Group CC100 that FED-STD-209E no longer be maintained. The IEST, assigned by the GSA as the Preparing Activity organization for FED-STD-209E, has recommended that International Standard ISO 14644, Cleanrooms and controlled environments-Part 1: Classification of air cleanliness, and Part 2: Specifications for testing and monitoring to prove continued compliance with ISO 14644-1, supersede FED-STD-209E. ISO 14644-1 and 14644-2 are two parts of a multi-part group of ISO Standards developed by ISO Technical Committee 209 (ISO/TC 209). All ISO/TC 209 Standards may be ordered online through IEST. Click here to enter the IEST Publications Store.

NOTICE OF CANCELLATION FED-STD-209 NOTICE 1
November 29, 2001

FEDERAL STANDARD

AIRBORNE PARTICULATE CLEANLINESS CLASSES
IN CLEANROOMS AND CLEAN ZONES

Federal Standard 209E dated September 11, 1992 is hereby canceled and superseded by International Organization for Standardization (ISO) Standards. International Standards for Cleanrooms and associated controlled environments, ISO 14644-1 Part 1: Classification of air cleanliness; and ISO 14644-2 Part 2: Specifications for testing and monitoring to prove continued compliance with ISO 14644-1. Application for copies of ISO Standards 14644-1 Part 1, and 14644-2 Part 2; may be addressed to the Institute of Environmental Sciences and Technology (IEST), 940 East Northwest Highway, Mount Prospect, IL 60056-3444. Phone: 847-255-1561, Fax: 847-255-1699, Web site: www.iest.org, E-mail: publicationsales@iest.org.

Preparing Activity: GSA-FSS
FSC 3694

(Please note that the IEST address changed after the issuance of the notice. The new address is Arlington Place One, 2340 South Arlington Heights Road, Arlington Heights, IL 60005.)

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DEPARTMENT DETERMINATION

RECEIVED
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NEXSEN PRUET, LLC
COLUMBIA

Taxpayer:

McEntire Produce, Inc.
P.O. Box 5817
Columbia, SC 29250

Periods Involved:

October 1, 2012 through September 30, 2015

Matters in Dispute:

1. Are McEntire Produce, Inc.'s (Taxpayer) purchases of electricity used to refrigerate produce before and after said produce is processed exempt from sales and use tax pursuant to S.C. Code Ann. § 12-36-2120(19) (2014) as electricity used by manufacturers to manufacture tangible personal property for sale?

2. Are the Taxpayer's purchases of certain supplies[1] exempt from use tax pursuant to S.C. Code Ann. § 12-36-2120(17) (Supp. 2016) as machines used in processing tangible personal property for sale or machine parts used in the operation of such machines?

3. Are the Taxpayer's purchases of safety attire[2] exempt from use tax pursuant to S.C. Code Ann. § 12-36-2120(54) (2014) as "clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment?"

4. Are the Taxpayer's purchases of safety attire exempt from use tax pursuant to § 12-36-2120(17) as pollution control equipment?

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[1]The supplies at issue include the following: chemicals used for cleaning; bar code scanners for raw produce; black ink aerosol cans; some blower fans; some brooms; cut wheels, discs, and tools; drug test kits; economy pallet truck and stacking containers used for maintenance; floor drain covers; floor scale used to verify weight of raw produce; floor treatment chemicals; forklift rentals, some batteries, and parts; generator rentals for fruit ripening purposes; some lamps; some mobile computer stands; some oil lubricant for hand trucks and pallet jacks, pallet flow brakes and pallet jacks used in raw material part of warehouse; some plastic shelves for maintenance parts room; power supply for maintenance tools; refrigerator to store samples for quality assurance purposes; safety attire; some squeegees; storage water tanks; strip curtains; tools used for maintenance; some towels; some tripod dollies used for maintenance; some utility carts for maintenance tools; warehouse racks for storage of raw and processed produce; some warning signs and stickers; and some whiteboards in the production offices.

[2]Safety attire includes the following: aprons, some coveralls; earplugs, eyewear, gloves, hairnets, shoe covers, sleeve covers, etc.

Amount in Dispute:

$ 126,912.90 Tax
$ 12,346.23 Interest[3]
$ 139,259.13 Total Amount in Dispute

Determinations:

1. The Taxpayer's purchases of electricity used to refrigerate produce before and after said produce is processed are not exempt from sales and use tax.

2. The Taxpayer's purchases of certain supplies are not exempt from use tax as machines used in processing tangible personal property for sale or machine parts used in the operation of such machines.

3. The Taxpayer's purchases of safety attire are not exempt from use tax as "clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment."

4. The Taxpayer's purchases of safety attire are not exempt from use tax as pollution control equipment.

Relevant Facts:

1. The Taxpayer operates a produce processing facility in Columbia, South Carolina. The Taxpayer processes lettuce, onions, cabbage, tomatoes, and other vegetables (hereinafter "produce") for sale. The Taxpayer's produce processing includes washing, cutting, mixing, and packaging the produce at the Taxpayer's facility. The Taxpayer requires its employees to wear safety attire. In addition to processing the produce, the Taxpayer also stores the produce on storage racks in a refrigerated section of the facility prior to processing and after processing.

2. The Taxpayer has an exemption certificate from the South Carolina Department of Revenue (Department) for its purchases of electricity. The Taxpayer provided that exemption certificate to the seller of electricity.

3. On September 22, 2015, the Department initiated a sales and use tax audit of the Taxpayer for tax periods October 1, 2012 through September 30, 2015.

4. During the audit, the Department reviewed the Taxpayer's purchase invoices and after discussing questionable items with the Taxpayer determined that the Taxpayer failed to report use tax on its purchases of numerous supplies and safety attire. The Department also determined that the Taxpayer failed to properly report sales and use tax on its purchases of electricity for the non-processing portions of the Taxpayer's facility, which included administrative offices and cold storage areas. Specifically, the Department's

[3]Interest is calculated through March 8, 2017, and will continue to accrue until this matter is resolved.

auditor determined that 10% of the Taxpayer's electricity purchases were subject to tax. Accordingly, on July 19, 2016, the Department mailed the Taxpayer a Proposed Assessment showing a total tax due in the amount of $126,912.90.

5. On August 1, 2016, the Taxpayer sent the Department its protest letter. The Taxpayer explained that it believes its purchases of safety attire are exempt from use tax based on Federal safety standards. The Taxpayer also explained that it believes the manufacturing process begins when the Taxpayer receives the raw product and ends when the Taxpayer loads the finished product on trucks for shipment. Based on that belief, the Taxpayer argues that its purchases of electricity for all areas of the facility used for cold storage are exempt from sales and use tax and that all supplies used during that time are exempt from sales and use tax.

6. On August 18, 2016, the Department held a conference with the Taxpayer. During the conference, the Taxpayer reiterated the same arguments it made in its protest letter. However, the Taxpayer did agree that some of the disputed supplies were taxable and agreed to pay the $16,753.30 in tax plus interest due on the purchases of such supplies.[4] The Taxpayer also admitted that approximately 2% of its electricity was used in administrative offices. Despite knowing that at least 2% of its electricity was used for non-exempt purposes, the Taxpayer never remitted sales and use tax on those electricity purchases during the audit period. After attempting to resolve the remaining issues, the Taxpayer elected to have its file forwarded to the Office of General Counsel for Litigation.

[4]The supplies the Taxpayer agrees are taxable include the following: alert orange windsock; aluminum scaffolding for maintenance; bathroom supplies; some blower fans; Bluetooth headsets; some brooms; cable ties; some coveralls; door parts; doors; some drug test kits; emergency battery lighting; employee folders; eyewash stations; some forklift batteries; gate/door openers; some gloves; industrial Ethernet switches; knockout hole punch tools; labels for human resources; some lamps; some mobile computer stands; some oil lubricant for hand trucks and pallet jacks; some plastic shelves used in the maintenance parts room; respirator storage cabinets in the maintenance parts room; security cameras; shelf cabinets in the maintenance room; some squeegees; stacking containers; steel safety rails; storage cabinets; Tig torch body; some towels; some tripod dollies used for maintenance; some utility carts for maintenance tools; vacuum and portable blower; some warning signs and stickers; welding helmets; some whiteboards in the production offices; and yellow warning magnets. As this list demonstrates, the Taxpayer both agrees and disagrees with the Department regarding the taxability of certain items. However, the Taxpayer failed to elaborate on why it believes some squeegees, for example, but not others should be exempt from use tax.

Analysis:

I. The Taxpayer's purchases of electricity used to refrigerate produce before and after said produce is processed are not exempt from use tax.

A sales and use tax is imposed on the "gross proceeds accruing or proceeding from the sale of electricity." See S.C. Code Ann. §§ 12-36-910(B)(2) & 12-36-1310(B)(2) (2014). Thus, in the absence of an exemption, all sales of electricity to the Taxpayer are subject to sales and use tax. Section 12-36-2120(19) provides an exemption for "electricity used by . . . manufacturers . . . to manufacture[5] . . . . tangible personal property for sale." Accordingly, the Taxpayer's purchases of electricity used to manufacture/process tangible personal property for sale is exempt. The remainder of the Taxpayer's electricity purchases, however, is subject to sales and use tax. For example, sales of electricity used in administrative offices, parking lots, and warehouses are not exempt from sales and use tax. See S.C. Code Ann. Regs. 117.302.4. Normally the seller is liable for the sales tax. See S.C. Code Ann. § 12-36-910(A). However, S.C. Code Ann. § 12-36-2510(A)((2)(b) shifts the liability for any tax due from the seller to the purchaser when said purchaser holds an exemption certificate. Accordingly, the Taxpayer, as a purchaser of the electricity who holds an exemption certificate, is liable for the sales and use tax due on its purchases of electricity that are not used to manufacture/process tangible personal property. Thus, the question becomes what percentage of the Taxpayer's electricity purchases is not used to manufacture/process tangible personal property for sale.

The Department determined that 10% of the Taxpayer's electricity purchases were for nonexempt purposes such as providing cold storage for produce before and after processing and supplying power to the administrative offices. It is the Department's understanding that the Taxpayer agrees its electricity purchases used in administrative offices is taxable and is only disputing the Department's denial of the exemption for electricity used for cold storage. In determining whether the electricity used for cold storage was exempt, the Department looked at the plain language in the exemption statute as well as the Department's regulation. Section 12-36-2120(19) exempts only the electricity **used to manufacture or process** tangible personal property. In this case, the Taxpayer's processing activities include washing, cutting, mixing, and packaging produce. That means that only the electricity used in the washing, cutting, mixing, and packaging of the produce is exempt. Keeping produce cold before and after processing does not constitute manufacturing or processing. Thus, electricity used to store produce at a specific temperature does not constitute electricity used to manufacture/process produce. Moreover, Regulation 117-302.4 provides that electricity used to "provide lighting **necessary to the operation of the machines**" and "electricity used to control plant atmosphere . . . in the quality control of tangible personal property **being manufactured**" is exempt but electricity used for any other purpose, such as electricity used in storage warehouses, is not exempt. (Emphasis added). Thus, Regulation 117.302.4 makes it clear that electricity used for anything that is not part of the manufacturing process, such as cold storage, is not exempt from sales and use tax.

[5]For purposes of this exemption, the term "manufacture" includes the activities of processors. See § 12-36-2120(19).

Accordingly, because 10% of the Taxpayer's electricity purchases were for nonexempt purposes, the Taxpayer is liable for the sales and use tax due on 10% of its electricity purchases.[6]

The Taxpayer argues that the analysis applied to the machine exemption – section 12-36-2120(17) – applies to the electricity exemption as well. Section 12-36-2120(17) provides, in part, that "machines **used in manufacturing** [or] processing . . . tangible personal property for sale" are exempt from sales and use tax. (Emphasis added). In construing this statute, courts have determined that the machine exemption applies to more than just machines used in the production line. See Spring Industries, Inc. v. S.C. Dept. of Revenue, Docket No. 99-ALJ-17-0153-CC (S.C. Admin. Law Ct. Nov. 9, 1999); see also Hercules Contractors and Engineers, Inc. v. S.C. Tax Comm'n, 280 S.C. 426, 313 S.E.2d 300 (Ct. App. 1984). The Administrative Law Court (ALC) in Spring Industries determined that because the statute exempts "machines, their parts and attachments when 'used in manufacturing,'" any machinery so used is exempt. Spring Industries, Docket No. 99-ALJ-17-0153-CC. In relying on the Court of Appeals decision in Hercules, the ALC in Spring Industries held the "proper test for the exemption . . . is whether or not the machinery is **'integral and necessary'** to the manufacturing process." Id. (emphasis added). Notably, however, the ALC did not construe the "integral and necessary" test as broadly as the Taxpayer here does. For example, the ALC held that the beam racks that Spring Industries used to store the yarn after it completed a certain level of processing were used for storage purposes only and, thus, were not "essential to nor integral to the production." Accordingly, the ALC Spring Industries held that the beam racks were not exempt from sales and use tax.

Based on the above test for the machine exemption, the Taxpayer argues that its cold storage is integral and necessary to the overall manufacturing process, and therefore, the electricity used for cold storage constitutes electricity used to manufacture tangible personal property. However, the language of the machine exemption and the electricity exemption are not identical. In fact, the electricity exemption is narrower than the machine exemption. While the machine exemption applies to all machines used in manufacturing, which includes all machines that are integral and necessary to the manufacturing process, the electricity exemption applies only to electricity used to manufacture tangible personal property. The General Assembly chose to use the words "used to manufacture" in the electricity exemption as opposed to the words "used in manufacturing." "The language of a tax exemption statute must be given its plain, ordinary meaning and must be strictly construed against the claimed exemption." TNS Mills, Inc., v. S.C. Dept. of Revenue, 331 S.C. 611, 620, 503 S.E.2d 471, 476 (1998) (citing John D. Hollingsworth On Wheels, Inc. v. Greenville County Treasurer, 276 S.C. 314, 278 S.E.2d 340 (1981)). Thus, in giving the language in the electricity exemption its plain, ordinary meaning, the "integral and necessary" test does not apply. Instead, the proper test for the electricity exemption is whether or not the electricity is used to power a machine that makes tangible personal property for sale. Here, the cold storage areas do not make anything. The cold storage areas merely store raw produce prior to processing and finished products prior to shipping. Accordingly, the electricity used to power the cold storage areas is not exempt from sales and use tax.

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[6]10% is the auditor's best estimate. It is entirely possible that more than 10% of the Taxpayer's electricity purchases are for nonexempt purposes. Thus, if it is established that more than 10% of the Taxpayer's electricity purchases are for nonexempt purposes, the Taxpayer will have to report sales and use tax on that nonexempt percentage going forward. The 10% estimate only applies to the audit period.

Even if the "integral and necessary" test did apply to the electricity exemption, the electricity used to power the cold storage areas still would not be exempt. Keeping produce cold before and after it is processed is not "integral and necessary **to the manufacturing process.**" Regulating the temperature of the produce in the cold storage areas may be necessary for the storage process. However, just like the beam racks in Spring Industries were not integral and necessary to the yarn manufacturing process because they were solely used for storage, the electricity used to regulate the temperature of a storage area is not integral and necessary to the produce manufacturing process because its sole use is related to storage. Moreover, while keeping the raw produce and the finished produce at a proper temperature may be necessary for health and safety reasons, the Taxpayer has the ability to wash, cut, mix, and package the produce regardless of the temperature. In other words, the temperature of the plant does not affect the Taxpayer's ability to process the produce. Since the temperature of the plant does not affect the Taxpayer's ability to process the produce, regulating the temperature of the plant is not integral and necessary to the processing of the produce. Accordingly, the electricity used to regulate the plant's temperature is not integral and necessary to the manufacturing process and would not be exempt under that test.

Finally, "[t]he burden is on claimants to prove their rights to an exemption by bringing themselves clearly within the conditions imposed by the statute." TNS Mills, 331 S.C. at 618, 154 S.E.2d at 475 (citing York County Fair Assoc. v. South Carolina Tax Comm'n, 249 S.C. 337, 341, 154 S.E.2d 361, 363 (1967)). The electricity exemption narrowly applies to electricity used to manufacture tangible personal property for sale. If the General Assembly intended for the electricity exemption to be as broad as the Taxpayer would like, the General Assembly could have exempted all electricity used by a manufacturer. However, the General Assembly chose to enact a narrow exemption. Accordingly, only the Taxpayer's purchases that fall squarely within the exemption statute are exempt. Because electricity used for cold storage is not used to manufacture or process tangible personal property for sale, such electricity purchases do not fall clearly within the conditions imposed by the electricity exemption statute and, thus, are not exempt from sales and use tax.

II. The Taxpayer's purchases of certain supplies are not exempt from use tax as machines used in processing tangible personal property for sale or machine parts used in the operation of such machines.

S.C. Code Ann. § 12-36-1310(A) (2014) imposes a use tax on "the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State . . . ." Thus, in the absence of an exemption, all sales of tangible personal property to the Taxpayer, including the sales of the supplies at issue, are subject to use tax.

The Taxpayer believes that "the manufacturing process begins with the receipt of the raw product and continues until the finished product is loaded on a truck for shipping to a customer . . . ." Based on that belief, it appears the Taxpayer is arguing that the supplies at issue are exempt pursuant to § 12-36-2120(17), despite the fact that S.C. Code Ann. Regs. 117-302.5 (2012) makes it clear that the manufacturing process begins with the first processing machine and ends with the machine that discharges the final product. Section 12-36-2120(17) (hereinafter the "machine exemption") exempts machines used in manufacturing/processing tangible personal

property for sale. Included in the definition of "machines" are "the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of the machines and which (a) are necessary to the operation of the machines and are customarily so used . . . ." Id. Courts have determined that the proper test to determine whether a machine or a machine part is exempt from sales and use tax is to determine whether the machine or machine part is integral and necessary to the manufacturing process. See Spring Industries, Docket No. 99-ALJ-17-0153-CC; see also Hercules, 280 S.C. 426, 313 S.E.2d 300. Regulation 117-302.5 incorporates the aforementioned rulings and further elaborates on the machine exemption. The Taxpayer has the burden to prove its right to the machine exemption by bringing itself clearly within the conditions imposed by the machine exemption. See TNS Mills, 331 S.C. at 618, 154 S.E.2d at 475. Thus, the question becomes whether the Taxpayer proved that its purchases of the supplies at issue clearly fall within the conditions imposed by the machine exemption.

Regulation 117-302.5 sets forth several tests to determine whether a machine or machine part is exempt. The first test, which is found in Regulation 117-302.5(B)(1), is based on the Hercules and Spring Industries decisions and sets forth the following test to determine whether a machine or machine part is integral and necessary to the manufacturing process: (1) The machine must be used at a manufacturing facility; (2) The machine must be used in and serve as an essential and indispensable component part of the manufacturing process; (3) The machine must be used on an ongoing and continuous basis during the manufacturing process; and (4) The machine must be substantially used in manufacturing tangible personal property for sale. The Taxpayer failed to establish that any of the supplies at issue satisfy the four part "integral and necessary" test. Accordingly, the Department properly determined that the Taxpayer's purchases of the supplies at issue are taxable.

Regulation 117-302.5(B) also sets forth tests for specific machine parts and attachments, some of which could be pertinent to the supplies at issue if the Taxpayer can satisfy the "integral and necessary" test outlined above. Specifically, Regulation 117-302.5(B)(4) addresses when material handling machinery and/or mechanical conveyances are exempt. Regulation 117-302.5(B)(4) provides, in pertinent part, as follows:

> 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. **Warehouse machinery used only for warehouse purposes, loading and unloading, storing, transporting raw materials and finished products, etc., is subject to the tax**, unless exempt under the provisions of Code Section 12-36-2120(51). 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),[7] 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.

(Emphasis added). The Taxpayer provided no evidence to establish that the relevant supplies at issue serve any purposes other than warehouse purposes. Accordingly, the Department properly determined that such supplies are taxable.

Regulation 117-302.5(B)(5) addresses when chemicals are exempt. Regulation 117-302.5(B)(5) provides, in relevant part, as follows:

> (a) Chemicals, including greases, oils, lubricants, and coolants, used in an exempt manufacturing machine that are essential to the functioning of the exempt machine during the manufacturing process are integral, necessary, and indispensable to the manufacturing process and are exempt as part of the machine.
>
> * * *
>
> (b) Situations in which the chemicals would not qualify as a part under the machine exemption and would therefore be subject to the sales and use tax, include:
>
> (i) Chemicals used to clean non-exempt machines, such as storage tanks.
> (ii) Chemicals used to clean floors, walls, and other parts of the manufacturing facility.
>
> * * *
>
> (iv) Chemicals, greases, oils (motor oils, gear oils, chain oils), lubricants, and coolants used in an exempt manufacturing machine when such items are not integral and necessary to the manufacturing process, such as those that are not essential in ensuring the functioning of the machine during the manufacturing process.

Again, the Taxpayer failed to establish that the chemicals at issue fit clearly within the conditions imposed above. Rather, the evidence suggests that the chemicals at issue are used to clean floors, walls, and other parts of the manufacturing facility. Accordingly, the Department properly determined that the chemicals at issue are taxable.

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[7]The Taxpayer has not claimed that any of the supplies at issue are exempt under subsection (51), therefore the Department will not further elaborate in this exemption.

Finally Regulation 117-302.5(B)(6), (7), and (10) provide that maintenance machines, machines used for storage, and protective clothing are not exempt under the machine exemption. Accordingly, the Department properly determined that all the supplies that fall under one of those three categories are taxable.

In sum, the Taxpayer failed to bring itself clearly within the conditions imposed by the machine exemption. Accordingly, none of the supplies at issue are exempt from use tax.

III. The Taxpayer's purchases of safety attire are not exempt from use tax as "clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment."

As discussed under section II above, the Taxpayer's purchases of supplies, including safety attire, are subject to use tax under § 12-36-1310(A) unless exempt. The Taxpayer argues that if its purchases of safety attire are not exempt pursuant to the machine exemption, then most of its safety attire purchases, such as hairnets, gloves, aprons, coveralls, and towels, should be exempt from use tax pursuant to § 12-36-2120(54) as "clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment."[8] Thus, the question becomes whether the Taxpayer's purchases of safety attire "clearly [falls] within the conditions imposed by the statute." TNS Mills, 331 S.C. at 618, 154 S.E.2d at 475.

Section 12-36-2120(54), the protective clothing exemption, contains two conditions: (1) the Taxpayer must have a Class 100 or better clean room and (2) the safety attire must be required for working in the clean room. The Taxpayer has not established that it meets either of these conditions. First, the Taxpayer notes that the Federal Food and Drug Administration (FDA) recommends that food processors filter their air to 0.3 microns. The Taxpayer claims that it filters its air to 0.1 microns, which is better than what the FDA recommends. However, not only has the Taxpayer not provided documentation to show that it filters its air to 0.1 microns, but such documentation still would not be sufficient for the Taxpayer to satisfy the first condition. In order to qualify as a Class 100 clean room or better, the Taxpayer needs to demonstrate that the amount of particles that are in the air of its plant meet the requirements of being a Class 100 or better clean room. Thus, because the Taxpayer failed to establish that it has a Class 100 or better clean room, the Taxpayer failed to bring itself within the first condition imposed by the protective clothing exemption.

Additionally, the Taxpayer provided nothing to establish that the protective clothing at issue in this case is required for working in a Class 100 or better clean room. In the absence of such evidence, the Taxpayer cannot bring itself within the second condition imposed by the protective clothing exemption. Therefore, the Department properly determined that the Taxpayer's purchases of safety attire are not exempt from use tax pursuant to § 12-36-2120(54).

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[8] In 2001, Federal Standard 209E was cancelled and replaced with International Standards Organization (ISO) 14644-1. Upon information and belief, a Class 100 or better clean room is now classified as a Class 5 or better clean room under ISO 14644-1.

IV. The Taxpayer's purchases of safety attire are not exempt from use tax as pollution control equipment.

As an alternative to the Taxpayer's argument set forth in section III, above, the Taxpayer argues that its purchases of safety attire are exempt pursuant to § 12-36-2120(17) as pollution control equipment. Section 12-36-2120(17) provides an exemption from sales and use tax for machines and its parts and attachments that "are necessary to comply with the order of an agency of the United States or of this State **for the prevention or abatement of pollution of air, water, or noise** that is caused or threatened by any machine used as provided in this section." (Emphasis added). Thus, the question becomes whether the Taxpayer's safety attire is necessary for the prevention or abatement of water, air, or noise pollution.

The Taxpayer provided no evidence that its safety attire prevents or abates any air, water, or noise pollution. In fact, the Taxpayer stated that its safety attire "protect[s] against pollution through contamination of food." Food contamination does not constitute air, water, or noise pollution. Moreover, it is questionable whether food contamination constitutes pollution in general. Accordingly, the Taxpayer's safety attire is not necessary for the prevention or abatement of air, water, or noise pollution. Thus, the Department properly determined that the Taxpayer's purchases of safety attire are not exempt from use tax pursuant to § 12-36-2120(17).

Conclusion:

The Taxpayer operates a food processing plant and purchases various items that are subject to sales and use tax unless otherwise exempt. The Taxpayer argues its purchases of electricity used in its cold storage areas are exempt from sales and use tax pursuant § 12-36-2120(19). However, because the cold storage areas are not used by the Taxpayer to manufacture or process produce, the Department properly determined that such electricity purchases are subject to sales and use tax. The Taxpayer also argues that its purchases of certain supplies, including safety attire, are exempt from use tax pursuant to § 12-36-2120(17). However, the Taxpayer failed to bring itself clearly within the conditions imposed by the statute. Alternatively, the Taxpayer argues that its purchases of safety attire are exempt from use tax pursuant to § 12-36-2120(54) as attire required for working in a Class 100 or better clean room or § 12-36-2120(17) as pollution control equipment. Regarding § 12-36-2120(54), the Taxpayer failed to establish that it has a Class 100 or better clean room and that its safety attire is required for working in such clean room. Regarding § 12-36-2120(17), the Taxpayer failed to establish that its safety attire prevents or abates air, water, or noise pollution and that its safety attire is necessary for such prevention or abatement of pollution. Accordingly, because the Taxpayer failed to bring itself clearly within the conditions imposed by §§ 12-36-2120(17) & (54), the Department properly determined that the Taxpayer's purchases of safety attire are subject to use tax.

February 7, 2017

STATE OF SOUTH CAROLINA

ADMINISTRATIVE LAW COURT

McENTIRE PRODUCE, INC., Petitioner,	)	
vs.	)	Case No.: 17-ALJ-17-0060-CC
SOUTH CAROLINA DEPARTMENT OF REVENUE, Respondent.	)	

DEPOSITION OF DAVID GOMBAS, Ph.D.

DATE: Monday, July 23, 2018

TIME: 10:12 o'clock a.m.

LOCATION: OFFICE OF DAVID GOMBAS
4130 Sunridge Road
Pebble Beach, California 93953

REPORTED BY: THERESA WARD, C.S.R. 9587

A P P E A R A N C E S:

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DAVID GOMBAS, Ph.D.

called as a witness, after having been first duly sworn by the Certified Shorthand Reporter to tell the truth, the whole truth, and nothing but the truth, testified as follows:

(Respondent's Exhibits 1 and 2 marked for identification.)

EXAMINATION BY MS. ACQUAVIVA:

Q Okay. Good afternoon, David. We are here in the matter of McEntire Produce, Inc., Petitioner, versus South Carolina Department of Revenue, Respondent, docket number 17-ALJ-17-0060-CC, and my name is Lauren Acquaviva. I'm an attorney for the South Carolina Department of Revenue, and I will be taking a deposition of -- is it doctor? Are you Dr. Gombas?

A Yeah, Dr. Gombas.

Q -- Dr. Gombas, Dr. David Gombas this afternoon. Also present with me on behalf of the Department is Elizabeth Shields, and here on behalf of McEntire Produce is Bernie Maybank and Jim Rourke. Before I get into the basic deposition questions, just because it is a telephone deposition, Dr. Gombas, you are in California while counsel is all here in South Carolina.

Can you just please, for the record, state who is

in the room with you right now?

A The only person in the room with me is the Court Reporter.

Q Okay. And then -- simple enough. We can get started. Will you just state and spell your name for the record?

A David Gombas, G-o-m-b-a-s.

Q Thank you, Dr. Gombas. Have you ever been deposed before?

A Yes.

Q Have you ever been deposed via telephone before?

A No.

Q Okay. Essentially, it will work the same way, just with the understanding you can't have any friends or people in the room kind of helping you along. It's just you have to answer the questions on your own.

A (Witness nodded in the affirmative.)

Q At any time -- and I do not expect this deposition to last very long. I'm hoping it will be under an hour, but if you need a break for any reason or if the Court Reporter needs a break, and same with anybody in the room here in South Carolina, just let me know, and we will go off the record.

Just be aware that during any breaks that we may take, you cannot speak with anybody about the substance of

the deposition. You can talk to people. You just can't talk about this case and the deposition while we're on break. Do you understand?

A Understood.

Q Okay. As I'm sure you're aware from being deposed before, the Court Reporter is going to be reporting everything that we say, and so in addition to the fact that you're on the phone and we can't see you, your responses need to be verbal so the Court Reporter can write them down and so we have something to hear because we won't be able to see a head nod. Do you understand that?

A Understood.

Q Thank you. During the deposition, if you need clarification, if you need the definition of a word or a phrase or you need anything explained, please ask me for that clarification, other than the Court Reporter or counsel for McEntire. Do you understand that?

A Yes.

Q Okay. Since you are allowed to ask me for clarification, if you don't ask for clarification and you answer my question, I am going to assume that you fully understood my question. Is that fair?

A Yes.

Q Okay. Is there anything that would prevent you from testifying accurately and truthfully today?

A Not my knowledge.

Q Okay. How did you prepare for this deposition?

A I looked online at the FDA's Preventive Controls Rule, Part 117, and FDA's Expiring Good Manufacturing Practices Regulation Part 110, and also U.S. FDA's Food Code and the South Carolina Food Code.

Q Okay. Did you speak to anybody in preparation for the deposition?

A Only to Jim Rourke to understand what the deposition was about.

Q Okay. And based on that conversation, what is your understanding of what this deposition is about?

A Based on my conversation, it has to do with a sales tax question regarding protective clothing being purchased by McEntire Produce and the protective clothing being used for the purpose of preventing contamination of produce within the facility.

Q Okay.

A Is that accurate?

Q That, in a nutshell, is a very basic overview of what the deposition will be about. We may explore some things in more detail to see what you may or may not be knowledgeable of. Obviously, if you have no experience with a certain area, we're not going to waste anybody's time asking you questions about it. But generally, yeah,

we're here to talk about one part of the case, which is just protective clothing.

Are you -- how did you become familiar or come to know of McEntire Produce?

MR. MAYBANK: Let me interrupt you. The protective clothing is literally the only issue we've gone over.

MS. ACQUAVIVA: And so that will be the issue that the deposition will be limited to today, is the protective clothing.

BY MS. ACQUAVIVA:

Q Dr. Gombas, how did you become familiar with McEntire Produce?

A McEntire Produce was a member of the trade association I worked for since 2005.

Q Have you done any work with McEntire Produce in the past?

A Only in terms of my work at the trade association.

Q Okay. And what does your work at the trade association entail?

A I was the food safety expert for the fresh produce industry.

Q Okay. And what -- could you describe what your duties were, kind of what being an expert, what services

you provided, things of that nature?

A Primarily guidance to the industry, working with FDA on regulations and guidance, food safety guidance.

Q Okay. For the record, can you tell me a little bit about your educational background?

A I had -- I got my bachelor's in food science at Rutgers University, my master's in food science at Massachusetts Institute of Technology, and my Ph.D. at the University of Massachusetts in food microbiology.

Q Okay. I am going to ask you about your work experience, but first, just in case -- I imagine it may be very extensive. We'll try to limit that based off of your answer to the next couple of my questions.

What did McEntire Produce hire you to do in this case?

A To be an expert witness in regards to food safety related to protective clothing.

Q How much are you being paid to be an expert witness?

A Honestly, I don't know. I did not give them a price. I told them I would be willing to do this pro bono.

Q Okay. And what is your understanding of what you're being asked to do? What is it that McEntire is looking from you, beyond just the general -- being an expert in food safety related to protective clothing, if

anything?

A I'm not sure that there is anything else. It's to provide my experience as an expert -- to serve as an expert witness in this matter.

Q Okay. So then limited to your current or previous job or experience, can you tell me -- essentially go through your resume, but just limit it to your experience related to food safety and protective clothing, specifically.

A Okay. I've been working in the processed and fresh produce industry since -- well, actually, since 1982. My first training course related to protective clothing was in 1989, when I worked for the National Food Processors Association. I continued working in food safety, particularly in good manufacturing practices. From that point on through the current time, I've worked with FDA on their HACCP regulations, H-A-C-C-P. I've worked with FDA on their revision of the good manufacturing practices regulations. I've worked with the processed and fresh produce industries in training on goods manufacturing practices.

Q Okay. Do you have any familiarity with South Carolina law?

A Not specifically. Not specifically, other than what I read this morning, looking at the South Carolina

Food Code.

Q Okay. Have you testified as an expert previously in food safety as it relates to protective clothing?

A No.

Q Have you testified previously as an expert at all?

A Yes.

Q Okay. And what areas -- area or areas, if more than one, have you been qualified as an expert?

A I'm not sure that qualified is -- that I've ever been qualified, per se. But I was asked to be an expert witness in a -- in a suit against Kraft Foods back in 1993.

Q Okay. Did you testify in court?

A No. That was a deposition.

Q I'm sorry. Could you repeat that?

A That was a deposition. That was not in court.

Q Just a deposition. Okay. Have you testified in court at all as an expert?

A Not in the last 40 years.

Q Okay. Let's see. Do you have any background or experience with pollution control?

A I'm not sure I understand the question.

Q In your experience with food safety, have you had the occasion to deal with or encounter controlling pollution in a processing facility?

A Can you define pollution?

Q Pollution would be anything that, for this case specifically, it would be contaminate air, water, or noise pollution is another example, but I would say dealing with something that is a contaminant. You think of smog coming from coal plants as polluting the air, things of that nature.

A Well, under the definition of pollution as a contaminant, yes.

Q Okay. And can you elaborate on that, your experience in that?

A Yes. As a food safety professional and a microbiologist, much of my advice to the industry related to my work with FDA has to do with microbiological contaminants affecting food, both processed food and fresh produce.

Q Okay. In your experience, is the word "pollution" used or is the word "contaminant" used, or both?

A Both can be used.

Q In your experience, how do you define pollution?

A Any contaminant that may be injurious to -- to the intended audience, to the intended consumer.

Q And how, in your experience -- and again, all of my questions are going to go to food safety -- do you

define contaminants?

A Pretty much the same.

Q Okay. So in your -- in your world, so to speak, with food safety, pollution and contaminants are synonymous. Is that accurate?

A Let me modify my definition of both.

Q Okay.

A I said harmful. It's not -- neither one is necessarily harmful. They're perceived as being -- what's the right word? -- objectionable.

Q Okay. But both would be defined -- both the terms "pollution" and "contaminant" would be defined the same way in your field?

A They can be, yes.

Q You said, "They can be," which suggests to me that there are other ways that the terms can be defined. Can you go through some of those other ways?

A In terms of food safety, no, not really. In other aspects, non-food safety, I'm sure there are, but we're limiting this to food safety.

Q Okay. Would you be able to define the term "pollution" generally, outside of food safety?

A Well, I'm just a food safety expert, so my definition of pollution outside of food safety would be pretty much what the general public would say.

Q Okay. So in other words, your expertise is going to be limited to just food safety?

A I would say that's accurate.

Q Okay. Have you read the sales tax exemption that is at issue in this case?

A No, I have not.

Q Okay. Have you had the opportunity to form an expert opinion in this case?

A Yes.

Q Okay. And what is your expert opinion?

A That protective clothing is a necessary protection against contamination or pollution, in the definition that we've been talking about, in any fresh cut or fresh produce handling facility; likewise, any ready-to-eat food processing facility.

Q Okay. Do you know the specific protective clothing that's at issue in this case?

A I do not.

Q Okay. So as far as -- a broad category of protective clothing is what you're speaking about, correct?

A Yes. This would be clothing that would protect the food from contamination from the worker or the worker environment.

Q And when you think -- since you have not been told what the clothing in the case is, when you talk about

protective clothing, what types of items come to mind? What types of things are you talking about or do you deal with often in the food safety world?

A It would be outer clothing, aprons, sleeves, hair nets, caps, gloves and, in some cases, shoes.

Q Okay. And you said that the protective clothing protects food from contamination, correct?

A Yes.

Q Does it do anything else, or is it used for any other purpose, again, in this context?

A The way protective clothing is used in the food industry is, by definition, clothing that is used to protect the food from contamination.

Q Okay.

A That is its primary purpose. If there is a secondary purpose, that would be facility specific.

Q Okay. I think I know the answer to this next question, but I'm going to ask it just so I'm clear, and I'm going off of a little bit of what I learned from the deposition of some McEntire employees.

Can protective clothing ever be used to protect the employee?

A That's a common misperception by the -- well, actually, no. Protective clothing can be used to protect the employee in situations when they are at hazard from the

environment or equipment. For example, stainless steel gloves might protect a worker who is working with cutting machinery.

Q Okay. And one example that I'm going to give you that came up was protective eyewear, when workers would wear them when cutting onions because I know onions make me cry, and so apparently, it does the same for most of the workers. Is that, in your experience, a common use of protective clothing or protective eyewear?

A It can be, yes, but not for food safety.

Q Can protective eyewear be used for food safety, or is that not a typical item?

A I would have to say that is not a typical item.

Q Okay. So it sounds to me, and correct me if I'm wrong, in the food safety context, protective clothing is limited more to the gloves, anything that would cover hair, so hair net, caps, beard net, and then anything that would cover an employee's clothes, such as boots or apron?

A And gloves.

Q And gloves. Is that a general, fair representation of protective clothing as used in the food safety context?

A Generally, yes.

Q Okay.

A Different --

Q I'm trying to understand where your answers are coming from in relation to some of the items at issue.

A Okay.

Q Let me, since you stated that you have not seen the exemptions that we are talking about, let me read it to you, and I'm going to paraphrase parts of it because it's long. So I'm going to read the portion that's relevant to the case. I will read it as slowly as I can, and if you need me to repeat it or any part of it afterwards because you didn't catch it, just let me know. Okay?

A Okay.

Q So essentially, McEntire is asserting that this protective clothing falls under the following exemption, which is machines used in processing that are necessary to comply with the order of an agency of the United States or of this state, which would be South Carolina, for the prevention or abatement of pollution of air, water or noise that is caused or threatened by any machine used as provided in this section.

Did you absorb most of that, if not all of it?

A Yeah. What is the definition of "machine" in this context?

Q There is no black and white definition of "machine" in this context. One of my questions --

A Yeah. In that case, I interpret "machine" to be,

in this context, protective clothing.

Q Okay. And can you elaborate as to how protective clothing could constitute a machine? How would you define "machine" without using the term protective clothing?

A That's outside of my expertise. I'm just -- since you said there is no definition of "machine," I interpreted it as including protective clothing.

Q Okay.

A If one were to substitute "protective clothing" for "machine" in what you just read to me, that's perfectly reasonable.

Q Okay. So I'm going to kind of -- I've broken the exemption down into some what I consider key components, and I'd like to go over those individually with you so I can understand, and I think we did go over this, but I'm going to start with this premise because it will kind of follow through with the rest of the questions on this issue.

What is the pollution at issue in this case?

A In this case, it would be harmful bacteria or allergens.

Q Harmful bacteria or allergens?

A Yes. Actually, harmful microorganisms or allergens.

Q Okay. And for my understanding, why did you make

that correction? What's the difference between bacteria and microorganisms?

A Typically, the bacteria we worry about are listeria, salmonella and pathogenic E-coli, but there can also be viruses which are not bacteria.

Q So does the term microorganism then include bacteria and viruses?

A Yes.

Q It's broader?

A Yes.

Q Okay. I just wanted to understand why we went from bacteria to microorganisms, so that makes sense.

Okay. And again, I understand that you do not know the specifics of the McEntire plant; is that correct?

A I have been in the plant, but it's been a long time.

Q Okay. I mean you understand how the plant works, generally?

A Generally, yes.

Q Okay. And if it's helpful to you, you do have Respondent's Exhibit 1 and 2 there for you to use as necessary. Respondent's Exhibit 1 is a site plan diagram of the McEntire Produce facility, and Respondent's Exhibit 2 is -- and you probably can explain generally what this is better than I can, but from my memory, it's one of the

HACCP flowcharts. They had several of these for different products. This is the one that McEntire chose to use as an example in explaining the process to me, so that is the one that I provided to you.

And when going through Respondent's Exhibit 2, McEntire used cut lettuce as the example finished product that we were -- we were creating.

A Understood.

Q Okay. If you can answer this question, please do so. If not, then just say you don't have sufficient information to answer or whatever other reason you may have to not be able to answer the question.

You said the pollution at issue is harmful microorganisms or allergens. What machine or machines in the plant, processing machines cause or threaten to cause harmful microorganisms or allergens?

A Again, without a definition of machine, it's difficult to answer the question. But the source of the pollution that we're describing here is the incoming produce, the workers and the water that's used in the facility. As such, any piece of equipment that comes in contact with any of those could be a source of contamination of the produce. Likewise, employees' clothing could be a source of contamination of the produce.

Does that answer your question?

Q It gives me a good start to answering my question and some places to follow up, so I think we can get there a little bit more.

You used the word "equipment." And again, if we look at Respondent's Exhibit 2, when you look through the flow chart, you can see some of the equipment that McEntire uses. So they have cutters, which is -- looks like the first little oval, if you go down from the pentagon that says "raw material." Do you see that oval that says "cutting with optional spray"?

A Yes.

Q So they have a cutting machine which would be a piece of equipment. Would you agree that that would be a piece of equipment?

A Yes.

Q They have a flume. They have kind of a shaking device. They described another device, like a large industrial salad spinner for drying, and they have a metal detector. So that's some of the equipment that they use. And then there's all conveyance equipment, whether it's a conveyor belt or a flume, which apparently conveys the water, which also washes the material.

How, if at all, could any of those pieces of equipment cause or create harmful microorganisms or allergens?

A Any food contact equipment can be a source of contamination, so all the ones you described there except for the metal detector, and again, depending on where the metal detector is situated, all of the food contact surfaces that you talked about can be sources of contamination if not properly controlled.

Q Okay. And can you explain how they could be a source of contamination?

A Well, as I described earlier, the type of pollution we're describing here, the microorganisms, the allergens can be coming in on the fresh produce or from the water that is used in the facility. If not properly controlled, those things can contaminate, pollute the equipment, which in turn can pollute a greater range of food.

Q Okay. When you say -- I'm going to use this as an example -- that the harmful microorganisms can come into the plant on incoming produce, how does the microorganism get on the produce to begin with?

A It is a contaminant, pollutant, if you will, that occurs -- generally occurs in the field. It can come from a number of sources. Animals, people or water are the primary vehicles that FDA has identified.

Q Okay. Generally, where do harmful microorganisms come from or how are they created?

A They can come from other humans. They can come from animals or they can be in the soil itself.

Q Okay. Absent contaminated produce, contaminated workers or contaminated water, how could the machines used in McEntire's plant cause microorganisms to grow?

A It is possible for equipment to serve as a harborage for pathogenic bacteria which can then spread through the facility if not controlled.

Q Can you explain a little bit more or elaborate on how a piece of equipment could -- you used the word "harborage" -- could be a harborage for bacteria?

A Uh-huh. The source of bacteria remains the same, from the produce, from the water, from the workers. It comes into the facility. It is spread in the event of inadequate, good manufacturing practices. It comes in contact with a nitch (sic) in the equipment where it has adequate water and nutrients to grow. That's what I refer to as harborage. From the harborage point, it can then be spread through cross contamination.

Q Okay. Again, talking about the microorganisms or allergens and following along with the statutory exemption, what machines prevent or abate the pollution at issue?

A There are a number of tools that a facility has at its disposal to prevent contamination and to prevent harborage in the facility. Some of those are chemicals.

Others are clothing.

Q Okay. Are there any additional clothing from what you mentioned earlier that would be used to prevent or abate the type of pollution we're talking about, the microorganisms?

A There may be, but on a routine, day to day basis, the ones I described earlier are the ones most commonly used to prevent spread of the pollution.

Q Okay. I'd like to go through each of the examples that you gave. So you had gloves, smocks, aprons, shoe coverings, and then I think you said caps or hair -- hair coverings and beard coverings. If you could go through each of those, and if the answer is the same for all of them, for sake of time, that's fine, too, and if you want to group any together, however it's easiest for you to answer, tell me exactly how the specific pieces of protective clothing prevent or abate the microorganisms.

A The answer will be the same for all of them.

Q Okay. That makes it easy.

A The first role of protective clothing is to substitute for the worker's street clothing so that the worker is not bringing the pollution into the facility on their clothes and so not contacting the food with that pollution.

Within the facility, as contamination may occur

from the produce, the water or the equipment, that they aren't -- by using clean clothing and protective clothing, it minimizes the opportunity to spread the contamination on to a broader range of food.

Q Okay. What South Carolina agency order, if any, requires the prevention or abatement of microorganisms?

A Well, certainly, the South Carolina Food Code. I'm not sure what the proper term of that is, but South Carolina has a regulation that pertains to protective -- that includes a provision for the use of protective clothing to prevent contamination of food. That regulation is based on the FDA's food code, 2017.

Q Do you know the regulation number?

A Not offhand.

Q Okay. What federal agency order requires the prevention or abatement of microorganisms?

A The most relevant regulation is FDA's 21 CFR part 117, subpart B, which describes good manufacturing practices for U.S. food facilities or for facilities that process food for consumption in the U.S.

Q And does that regulation specifically state that microorganisms must be prevented or abated?

A I don't know the specific language, but the Food, Drug and Cosmetic Act says specifically that food shall not be adulterated, and the part 117, subpart B provides

requirements to processing facilities on how to comply with that law.

Q All right. In your experience, has the FDA ever given a certified statement saying that protective clothing is necessary to prevent or abate pollution that's caused or threatened by the operation of other machines used in processing of tangible personal property?

A I'm not aware of the FDA putting out a document like you've just described. However, the FDA, on numerous occasions each year cites facilities for inadequate protective clothing to protect food from contamination. Those can be searched by looking for FDA's 483's or warning letters.

Q You said FDA 483's?

A Yes. That's their report of viol- -- violation's too strong a word -- of conditions that need to be corrected in a facility in order to comply with the law.

Q Okay. Do you consider the FDA to be an agency that's primarily charged with the duty of preventing or abating pollution?

A In the context of which we're speaking, yes.

Q Okay. I apologize. I'm just going through my notes to see if there's anything I need to follow up on.

MS. ACQUAVIVA: I don't think I have any additional questions for you. I'll turn it over to

Mr. Maybank for any cross-examination he may have.

MR. MAYBANK: I'm I'll try not to be duplicative. Some of it will obviously be duplicative.

EXAMINATION BY MR. MAYBANK:

Q What are the primary food-bourne contaminants that cause the majority of sickness or death to consumers?

A In the context of fresh produce, there are three bacteria: Listeria, salmonella, pathogenic E-coli, and there are a couple of viruses, norovirus and hepatitis A. There are also parasites, Cyclospora, cryptosporidium being two of the more common contaminants causing food-bourne illness.

Q Okay. And just for 30 seconds or so, can you tell us your experience with E-coli going back from your days in college and master's of Ph.D. (sic)?

A I did extensive food -- extensive research on pathogenic E-coli, listeria and salmonella in terms of ways of preventing their growth and in killing them in food processing.

Q Okay. And just to speed it up a bit, did you study E-coli in your master's or Ph.D. degree?

A No. Those were studied after -- afterwards, during my work experience.

Q Okay. And how about listeria and salmonella? Would that be the same thing?

A Yes.

Q Okay. So in your work experience, just briefly, and you may have already done this, but tell us your work experience study in E-coli, listeria and salmonella.

A I served as lead or primary researcher on a number of papers that discussed mechanisms preventing survival of those organisms in juice and in fresh produce.

Q And how many years have you studied it?

A I think my first paper on salmonella was in the early 1990s.

Q Okay. And did you study it or review it for today?

A I'm sorry. Say that again.

Q And do you still study it and review materials on it through today?

A Yes.

Q Okay. So Black's Law dictionary, which is a lawyer dictionary, it defines pollution as a presence of harmful substances, either physical or gaseous, within a certain area that causes harm to the surroundings, altering the natural environment upon which it has been excreted.

In your opinion, given that definition, is E-coli pollution?

A It is a physical contaminant that would fit within that definition.

Q Okay. So it's a harmful substance?
A Yes.
Q Okay. Does listeria meet that definition of pollution?
A Yes.
Q And how about salmonella?
A Yes.
Q All right. And let me give you a dictionary definition. This is actually Wikipedia. Wikipedia defines pollution as an introduction of contaminants into the natural environment that causes adverse change.

In your opinion, does E-coli meet that definition of pollution?
A Yes.
Q How about listeria?
A Yes.
Q And how about salmonella?
A Yes.
Q And then dictionary.com defines pollution as an introduction of harmful substances or products into the environment.

In your opinion, does E-coli meet that definition of pollution?
A Yes.
Q Does listeria?

A Yes.
Q Does salmonella?
A Yes.
Q Does E-coli, listeria and salmonella, are they sometimes transmitted through air?
A They can be, but rarely.
Q Okay. And how about water?
A Yes.
Q All right. And then we want to focus for a minute or two on just the cutting function. It says -- let me back up a little bit.
Does fresh produce occasionally have E-coli inside it?
A Yes.
Q Okay. Does fresh produce occasionally have listeria inside it?
A Yes.
Q And does fresh produce occasionally have salmonella inside it?
A Yes.
Q And does the cutting of fresh produce in a facility like McEntire, does it -- does it produce, create a release of E-coli, can it?
A It can. If not properly controlled, the organisms you described can be spread to non-contaminated

produce, either directly, through the water or through other food contact surfaces.

Q Okay. And how about listeria? Does cutting of fresh produce that has listeria inside of it, can it also create a release of listeria?

A Yes, and in the same manner.

Q And how about salmonella, the same question in regards to salmonella?

A Yes, in the same manner.

Q All right. And does protective clothing help prevent the spread of E-coli into the cutting room and inside the fresh -- I'm sorry. Does the protective clothing help prevent the spread of E-coli into the cutting room? And I stress into the cutting room as opposed to the cutting process itself.

A Yes. By replacing the street clothing of the workers, it prevents the contamination entering the cutting room from the outside.

Q Okay. And just run quickly -- we don't need a lengthy explanation, but how does -- how would E-coli happen to come into the cutting room, but for the protective clothing?

A E-coli can come into the cutting room from the street clothing of the workers, on their shoes, on their outer clothing, on their hands.

Q And how -- give us some examples. How would it get into their shoes, for example?

A Well, pathogenic E-coli can be present -- it can be present in the parking lot. It can be present on other surfaces that the workers can come in contact with in their normal routine outside, and if they bring that in on their street clothing, it can then contaminate the equipment. It can contaminate the food. It can contaminate the water within the facility. That's why protective clothing, as we've described, is used in the facilities to replace the street clothing that workers have or to cover the street clothing that workers have so any contamination on that clothing will not contaminate surfaces or the food or the water within the facility.

Q Okay. I've heard of E-coli. I've never heard of listeria. How does one come into contact with listeria?

A Listeria is a natural contaminant present in the soil, so -- it grows in the soil, so anyone who is walking through a field or just walking along the street can come in contact with listeria. In most cases, that's not a harmful exposure, but when it comes in contact with the food, the food can then serve as a growth medium for the listeria and, if consumed by people, can cause illness or death.

Q Okay. And same question with regards to

salmonella. How would the workers outside of the plant come into contact with salmonella?

A Salmonella is more of an animal mediated organism. It doesn't grow in the soil, per se. But once the salmonella is present in the soil, on the produce or in the water, any contact with that can then serve as a carriage.

Q Okay. And switching gears to the cutting room itself, does protective clothing help prevent the spreading of E-coli which was already in the cutting room, from getting -- I'll say that again.

Does protective clothing help prevent the spread of E-coli, which is already in the cutting room, for example, by being in a head of lettuce?

A It can. The clothing itself is not antimicrobial, but if the clothing is changed when it becomes dirty, then yes, any contamination that has gotten onto the clothing from the cutting room would then be removed from the cutting room when the worker changes their protective clothing.

Q Okay. Is protective clothing required by federal law in the cutting room?

A Part 117 requires a facility to take whatever measure necessary to prevent contamination of food, and one of the provisions in that regulation specifies the use of

clean clothing in the facility.

Q Okay. A number of states have state regulations regarding protective clothing in restaurants. Would that same regulation apply to protective clothing in a fresh produce facility?

A It has been used in that way. While the food code specifically applies to retail operations, food service, it had -- that same requirement has been applied to ready-to-eat processing facilities.

Q Okay. And you mentioned you have counselled industry on how to comply with FDA rules and regs?

A Yes.

Q And how many years have you done that?

A Since the 1980s, and most recently, last week.

Q Okay. And just real roughly, how many different industries have you counselled? More than a hundred?

A Well, well over a hundred processing facilities and several dozen -- no, over a hundred fresh cut operations, as well. Sorry, fresh produce operations.

Q Okay. And have you written on E-coli, listeria and salmonella?

A Yes.

Q Have you written anything specific on protective clothing?

A I'm thinking, but I don't recall anything

specific on protective clothing.

Q Okay. But you counselled over a hundred businesses on the role of protective clothing and the spread of E-coli?

A Yes, as part of my guidance on the application of good manufacturing practices.

Q Okay. And what would happen if McEntire couldn't afford the sales tax and didn't buy the protective clothing? Would that be against the law?

A It would be a violation of part 117.

Q Okay.

MR. MAYBANK: That's all I have.

MS. ACQUAVIVA: I just have a couple follow up.

FURTHER EXAMINATION BY MS. ACQUAVIVA:

Q You stated, and please correct me if I'm wrong, I believe, that part 117 addresses the use of protective clothing to prevent contamination of food; is that correct?

A Part 117, I think it's subpart 10 addresses protective clothing for the purposes of preventing contamination of food. It's not in those words, but that is the interpretation of it.

Q Do you know what section, whether it's part 117 or otherwise, that talks about preventing the contamination of the air?

A I don't recall.

Q Okay. And do you know if there is a section or regulation that talks about the prevention of contamination of water?

A Yes.

Q And do you know what section that is?

A It would be in subpart B, along the same subpart as the clothing. It's not 10, specifically, but within subpart B of 117, FDA has requirements regarding the handling and treatment of water.

Q And can you elaborate a little bit more on what the -- what those requirements look like?

A They're specifically on the source of the water and on the plumbing used to distribute the water in the facility.

Q Okay. Can you tell me, assuming that there is some type of microbial contamination already in the facility, inside the plant, how would a plant prevent that microorganism from getting into the air, if at all possible?

A Well, the primary approach to controlling harmful microorganisms that are already in the facility are through proper cleaning and sanitation procedures. Those tend to be focused on the equipment and the processing environment. If those procedures are not adequate, there is the opportunity for microorganisms in the facility to become

aerosolized either through poor cleaning procedures or via the air handling system.

Q So just so I understand correctly, then is the only way to prevent that would be proper cleaning of the equipment?

A That is the primary way of doing it, but all the other things we've talked about are likewise necessary to prevent cross contamination. There is no one treatment that is solely responsible. It is the combination of all of the above to prevent harborage of the organism within the facility or cross contamination of the food on organisms that are introduced to the facility either through the food, the workers, water or the environment.

Q Okay. So protective clothing alone could not prevent contaminants from getting into the air, contaminants that are already inside the facility. Is that -- am I understanding that correctly?

A Protective clothing is one tool necessary to prevent contamination coming into the facility or spreading within the facility.

Q What typically is used to prevent microorganisms from getting into the water? And when I say "getting into the water," I mean the waste water, water that would be leaving the plant? How do facilities typically prevent that?

A Preventing harmful microorganisms from leaving the facility?

Q Yeah, from getting -- from basically having a negative impact on the water outside the facility?

A There are ways. The use of chemicals to destroy microorganisms that are in the water, but I'm not aware if or how many operations actually do that because the focus is on making sure that the water is not a source of contamination in the facility or when it's in contact with the food.

Q So are you saying that the focus is on preventing the water inside from being contaminated?

A Yes, on preventing the water from being a source of contamination in the facility when it is in contact with the food.

Q Okay. And again, assuming that there are already -- there is already some type of contamination inside the facility, how does protective clothing prevent that contamination from polluting the air or water or spreading into the air or water? And again, this would be air or water outside the facility. We're looking at an impact on the environment.

A I'm sorry. I'm missing your point. Are you asking how does protective clothing in the facility protect the air or water outside the facility?

Q Would you agree that air or water inside the facility is eventually going to leave the facility?

A Yes.

Q So if air or water inside the facility gets contaminated and it gets out, that would be then polluting the outside air and water. Is that fair to say?

A Honestly, I have no experience in that matter.

Q Okay. Do you know if processing plants like McEntire take any steps or are there any steps they can take to prevent contaminated air or water in the facility from escaping?

A That's never been my focus, so I don't know.

Q Okay. So is it typically then that, with your focus, you're looking at preventing the air and water in the facility from being contaminated?

A Yes.

Q Okay. So then just looking at in the facility, how does, and again, there's already -- we're assuming there is already some type of contamination inside, you know, on a piece of equipment. How does protective clothing prevent the microorganisms from getting into the water or the air?

A As I said earlier, the protective clothing is not antimicrobial, per se, but if the clothing is changed, replaced as needed to prevent -- whenever it becomes

contaminated, that reduces the risk of the contamination spreading to the food, other equipment, the water and, I guess, to the air.

Q Okay. And again, going back to Respondent's Exhibit 2, do you see how they -- McEntire uses water to move the produce and use it as a conveyance? They also use water, chlorinated water to wash the produce?

A Yes.

Q According to McEntire, that water can splash and spill over and it gets on the floor and then goes into the drain.

A Yes.

Q If produce is already contaminated and it's going through this processing system, it's going through the flume and being cut, water splashing all over the place, how does protective clothing prevent the spread of that contamination?

A Again, the primary purpose of protective clothing is to minimize the risk of contamination coming from outside the facility into the facility on the workers.

Secondarily, in the event that there is contamination in the facility, if it gets onto the worker's protective clothing, changing that clothing as necessary whenever it becomes contaminated is an opportunity to reduce the risk of further spread of the contamination,

whether that contamination came from the produce, the water, other equipment, et cetera.

Q Is there anything else that a facility like this would use to prevent further contamination of the water or air?

A Generally, chemicals, cleaning procedures and protective clothing.

Q Okay. And when you say chemicals, can you explain how that would work, how that would prevent a contaminant that's already kind of -- already on the machines, on the conveyors, in the processing section, how that would work, how they would use a chemical to prevent further contamination?

A In the same way you would use chemicals in your kitchen. You have chemicals for cleaning procedures and you have chemicals for sanitizing procedures. Each is intended to remove the pollutants and prevent them from becoming a source of contamination.

Q And when would this cleaning or treating with chemicals take place, typically?

A Generally, a facility has a time between days or other -- at a frequency they define when the equipment is shut down, the processes are shut down, and cleaning and sanitation occurs.

Q So it wouldn't occur anytime during -- while

actual processing is taking place?

A It can, on demand, and depending on the procedures that a facility has. So that's facility specific.

Q Okay.

MS. ACQUAVIVA: And I don't think I have any other questions.

MR. MAYBANK: Just one.

FURTHER EXAMINATION BY MR. MAYBANK:

Q We mentioned several times "best practices." Is there a bible or FDA definition of "best practices," or is that something just people concentrate and do on their own?

A The current good manufacturing practices is codified in part 117, subpart B.

Q Okay.

MR. MAYBANK: That's all I have.

MS. ACQUAVIVA: Okay, Dr. Gombas. I think we are done. Thank you so much for your time this afternoon or this morning, over by you, I guess.

THE WITNESS: My pleasure.

THE COURT REPORTER: I have a question. Who would like a copy of this?

MR. MAYBANK: We'd like one.

MS. ACQUAVIVA: Yeah, I think we both would.

MR. MAYBANK: We'll waive the reading of it.

MS. ACQUAVIVA: That's their decision. If they waive to read and sign the transcript, you can send me the sealed original and then just one copy, and then I think Mr. Maybank would like one copy.

(Whereupon, the proceedings were concluded at 11:25 o'clock a.m.)

-o0o-

I certify under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date , 2018

David Gombas, Ph.D.

-o0o-

STATE OF CALIFORNIA)
) ss.
COUNTY OF SANTA CLARA)

I, THERESA WARD, a Certified Shorthand Reporter in and for the State of California, hereby certify that the witness in the foregoing deposition,

DAVID GOMBAS, Ph.D.

was by me duly sworn to tell the truth, the whole truth, and nothing but the truth in the within-entitled cause, and that the foregoing is a full, true, and correct transcript of the proceedings had at the taking of said deposition, reported to the best of my ability, and transcribed under my direction.

Date: August 2, 2018

Theresa Ward, C.S.R. 9587

EXHIBIT C

Stipulations of Fact
McEntire Produce, Inc. v. SC DOR
17-ALJ-17-0060-CC

McEntire Produce v. SCDOR
17-ALJ-17-0060-CC
Respondent's Exhibit 1

File Number	Filing Period	Proposed Notice of Assessment	Tax Paid on Filed Returns	% of Understatement	Interest	Total
040439757	10/31/2012	1,718.16	0.00	171816%	238.90	1,957.06
040439757	11/30/2012	2,335.69	0.00	233569%	318.19	2,653.88
040439757	12/31/2012	1,845.03	0.00	184503%	246.11	2,091.14
040439757	1/31/2013	3,678.58	0.00	367858%	479.83	4,158.41
040439757	2/28/2013	2,327.37	0.00	232737%	297.51	2,624.88
040439757	3/31/2013	2,401.90	0.00	240190%	300.27	2,702.17
040439757	4/30/2013	2,869.79	0.00	286979%	350.62	3,220.41
040439757	5/31/2013	3,628.22	0.00	362822%	629.28	4,257.50
040439757	6/30/2013	7,656.41	0.00	765641%	1,444.28	9,100.69
040439757	7/31/2013	3,658.88	0.00	365888%	678.62	4,337.50
040439757	8/31/2013	3,173.22	0.00	317322%	578.94	3,752.16
040439757	9/30/2013	5,261.65	2.00	262983%	949.04	6,210.69
040439757	10/31/2013	3,331.38	0.00	333138%	636.98	3,968.36
040439757	11/30/2013	2,298.54	2.00	114827%	465.83	2,764.37
040439757	12/31/2013	2,059.98	0.00	205998%	411.31	2,471.29
040439757	1/31/2014	2,660.22	0.00	266022%	522.87	3,183.09
040439757	2/28/2014	2,088.66	0.00	208866%	404.78	2,493.44
040439757	3/31/2014	2,963.93	0.00	296393%	565.60	3,529.53
040439757	4/30/2014	3,522.41	0.00	352241%	661.61	4,184.02
040439757	5/31/2014	3,974.00	0.00	397400%	734.42	4,708.42
040439757	6/30/2014	3,338.31	0.00	333831%	607.42	3,945.73
040439757	7/31/2014	5,794.89	0.00	579489%	1,036.60	6,831.49
040439757	8/31/2014	5,897.30	0.00	589730%	1,037.99	6,935.29
040439757	9/30/2014	4,407.35	0.00	440735%	762.41	5,169.76
040439757	10/31/2014	5,951.11	0.00	595111%	1,011.70	6,962.81
040439757	11/30/2014	5,613.67	0.00	561367%	939.01	6,552.68
040439757	12/31/2014	2,210.93	0.00	221093%	362.93	2,573.86
040439757	1/31/2015	3,547.68	0.00	354768%	571.84	4,119.52
040439757	2/28/2015	2,902.53	0.00	290253%	460.11	3,362.64
040439757	3/31/2015	4,106.21	0.00	410621%	638.81	4,745.02
040439757	4/30/2015	2,741.02	642.00	327%	431.15	3,172.17
040439757	5/31/2015	2,484.38	0.00	248438%	372.45	2,856.83
040439757	6/30/2015	2,332.14	0.00	233214%	342.73	2,674.87
040439757	7/31/2015	6,126.54	0.00	612654%	882.48	7,009.02
040439757	8/31/2015	3,205.05	0.00	320505%	452.53	3,657.58
040439757	9/30/2015	2,799.77	0.00	279977%	387.27	3,187.04
		126,912.90	**646.00**		**21,212.42**	**148,125.32**

CHILLICO & Associates LLC

January 7, 2019

The Honorable H.W. Funderburk, Jr.
South Carolina Administrative Law Court
Edgar A. Brown Building
1205 Pendleton St., Suite 224
Columbia, SC 29201

RE: McEntire Produce, Inc. v. South Carolina Department of Revenue
Docket No.: 17-ALJ-17-0060-CC

Dear Judge Funderburk,

Enclosed, please find a copy of the Respondent's Proposed Final Order and Decision in the above-referenced matter. Also enclosed is a proof of service. Should you have any questions or need any additional information, please do not hesitate to contact this office.

Sincerely,

Lauren Acquaviva

Lauren Acquaviva

cc: Burnet R. Maybank, Esq.
Jim Rourke, Esq.
Elisabeth W. Shields, Esq. (via e-mail only)
Jason P. Luther, Esq. (via e-mail only)

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

McEntire Produce, Inc., Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No. 17-ALJ-17-0060-CC **RESPONDENT'S PROPOSED FINAL ORDER AND DECISION**

Appearances:

For the Petitioner: Burnet R. Maybank, III, Esq. and Jim Rourke, Esq.

For the Respondent: Lauren Acquaviva, Esq. and Elisabeth Shields, Esq.

STATEMENT OF THE CASE

This matter comes before the South Carolina Administrative Law Court (the "ALC" or "Court") following McEntire Produce, Inc.'s (the "Petitioner") request for a contested case hearing under S.C. Code Ann. § 12-60-460 (2014). The Petitioner is contesting the South Carolina Department of Revenue's (the "Department" or "Respondent") Determination holding the Petitioner's purchases of certain supplies and protective clothing taxable for tax periods October 1, 2012 through September 30, 2015 (the "Audit Period").

The Department's Determination (the "Determination") concluded that the Petitioner's purchases of certain supplies were not exempt from use tax under S.C. Code Ann. § 12-36-2120(17) (Supp. 2017), and its purchases of protective clothing were not exempt from use tax

under S.C. Code Ann. § 12-36-2120(54) (2014) or § 12-36-2120(17).[1] The Petitioner argues that its purchases of certain supplies are exempt because it claims its processing activities begin when the raw produce is delivered to the plant and ends when the finished product is loaded on its refrigerated trucks for delivery. The Petitioner argues that its purchases of protective clothing are exempt as clothing required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment or, in the alternative, as pollution control machines. The Petitioner also contends that the thirty-six (36) month statute of limitations period applies and, as such, part of the Department's Proposed Assessment falls outside the statute of limitations.

A hearing was held before this Court on November 14 and 15, 2018. At the beginning of the hearing, the parties submitted Stipulations of Fact, which included a list of thirty-five (35) items at issue. After the Petitioner presented its case-in-chief, the Department conceded, based on the testimony presented by the Petitioner, that the Petitioner's purchases of two (2) of the items at issue—refrigerator in quality assurance lab and lamps—are exempt from sales and use tax. Accordingly, the Court must determine whether the Petitioner's purchases of the remaining thirty-three (33) items at issue are exempt from sales and use tax.

ISSUES

The following issues are raised in this proceeding:

1. Are the Petitioner's purchases of certain supplies, listed under "Exhibit A" below, exempt from sales and use tax pursuant to § 12-36-2120(17)?
2. Are the Petitioner's purchases of protective clothing exempt from sales and use tax pursuant to § 12-36-2120(54) or § 12-36-2120(17)?
3. Did the Department timely issue its Proposed Assessment for the Audit Period according to S.C. Code Ann. § 12-54-85(c)(3) (2014)?

[1] As discussed more fully beginning on page 14, the Determination also concluded the Petitioner's purchases of electricity used to refrigerate produce before and after it's processed is taxable, but that issue was resolved prior to the hearing.

STIPULATIONS OF FACT

At the hearing in this matter and pursuant to Rule 25(C) of the Rules of Procedure for the Administrative Law Court (the "ALC Rules"), the parties entered the following written stipulations of fact into the Record:

1. The Petitioner operates a produce processing facility in Columbia, South Carolina. The Petitioner processes lettuce, onions, cabbage, tomatoes, and other vegetables (hereinafter "produce") for sale. The Petitioner's produce processing includes, but is not limited to, washing, cutting, mixing, and packaging the finished produce at the Petitioner's facility.
2. On September 22, 2015, the Department initiated a sales and use tax audit of the Petitioner for tax periods October 1, 2012 through September 30, 2015 (the "Audit Period").
3. During the audit, the Department reviewed the Petitioner's purchase invoices and after discussing questionable items with the Petitioner determined that the Petitioner failed to report use tax on its purchases of numerous supplies and protective clothing. Accordingly, on July 19, 2016, the Department mailed the Petitioner a Proposed Assessment showing a total tax due in the amount of $126,912.90.[2]
4. The supplies that remain at issue are attached to these Stipulations as Exhibit A.

[2]Between the issuance of the Department Determination and the hearing in this matter, the Parties were able to agree upon the taxability of some items in dispute. As such, the amount of disputed tax has been reduced from the amount listed in the Department Determination. Additionally, the Petitioner has paid a portion of the tax due on the items it agrees are taxable. A balance in the amount of $18,636.19 in tax remains. The Petitioner agrees that within thirty (30) days of receiving this Court's Final Order it will remit payment in the amount of $18,636.19 plus interest for the items it agrees are taxable. The Department agrees to provide the Petitioner with the updated interest due when the Petitioner informs the Department that it is prepared to submit its payment. The parties agree that if the Petitioner prevails on its statute of limitations argument described in Paragraph 7, that the $18,636.19 amount of tax due will be reduced based on any periods the Court determines are out of statute.

[Exhibit A]

Supplies at Issue

1. Coveralls
2. Eyewear
3. Floor drain covers
4. Warning signs and stickers
5. Gloves
6. Aprons
7. Hairnets
8. Towels
9. Refrigerator in quality assurance lab
10. Blower fan
11. Lamps
12. Warehouse racks
13. Stacking containers
14. Forklift batteries
15. Forklift parts
16. Forklift repair parts
17. Forklift rental
18. Pallet jack
19. Pallet flow brakes
20. Generator rental
21. Bar code scanner
22. Black ink aerosol cans
23. Cleaning machines
24. Plastic shelves for maintenance parts room
25. Maintenance tools
26. Utility cart for maintenance tools
27. Oil lubricant for handtrucks and pallets
28. Cut wheel and disc maintenance tools
29. Brooms
30. Floor treatment chemicals
31. Squeegees
32. Mobile computer stand
33. White boards in production offices
34. Drug test kits
35. Storage water tank

5. On August 1, 2016, the Petitioner timely protested the Proposed Assessment due to the parties' disagreement as to whether the Petitioner's purchase of protective clothing and other supplies (see Exhibit A) are exempt from use tax.

6. While the parties disagree as to the taxability of the items at issue in the Proposed Assessment, the parties agree that the numerical figures and calculations reflected in the Proposed Assessment are accurate. Accordingly, the parties agree that the amount of tax in dispute is $82,305.83 (plus interest).

7. The Petitioner contends that tax periods October 1, 2012 through May 31, 2013 are time-barred.

8. The Petitioner timely requested a contested case hearing.

9. Dr. Gombas is an expert in the use of protective clothing for food safety purposes.

10. The parties stipulate that the deposition transcript of Dr. David Gombas may be used in these proceedings pursuant to Rule 32(a)(3)(B), SCRCP.

11. The parties stipulate to the admissibility of Petitioner's Exhibits 5, 7 – 8, 10 – 11, 14, 16 – 17, and 19 – 25. These exhibits along with Petitioner's complete Exhibit List are attached to the Stipulations as Exhibit B.

12. The parties stipulate to the admissibility of Respondent's Exhibit 1, which is attached to the Stipulations as Exhibit C.

13. The parties stipulate that if the Court determines that some of the items at issue are subject to tax while other items are exempt, this matter should be remanded back to the Department to calculate the tax and interest due on the items deemed taxable by the Court.

FINDINGS OF FACT

Having observed the witnesses and exhibits presented at the hearing and taking into consideration the burden of persuasion and the credibility of the witnesses, I make the following

findings of fact by a preponderance of the evidence:

McEntire's Operations

The Petitioner operates a produce processing plant. As part of its operation, the Petitioner receives raw produce from farms with which the Petitioner contracts. These contracts contain several requirements to prevent the spread of microbiological contaminants such as Salmonella, Listeria, or E-Coli, which may be present in the raw produce at the time the produce is harvested. Once the produce arrives at the Petitioner's plant, which is maintained at a temperature between 33 and 40 degrees[3] in further effort to prevent the spread of microbiological contaminants, the Petitioner's employees inspect the raw produce, discarding any unusable produce, and sort the produce in preparation for processing. The raw produce then sits in one of the Petitioner's storage coolers until the Petitioner is ready to process the produce. Once the Petitioner is ready to turn the raw produce into its finished product, the Petitioner's employees will move the produce from its respective storage cooler to either the tomato re-pack room or the cutting room. After the raw produce is processed, bagged, and boxed, the finished product is palletized then kept in the finished goods storage area. The finished product remains in the finished goods storage area until it is loaded onto the Petitioner's refrigerated trucks and delivered to the customer.

The Tomato Re-Pack Room

The tomato re-pack room is a "low-care"[4] area where whole tomatoes are packaged by

[3]The following areas of the plant are maintained at a temperature between 33 and 40 degrees: the receiving area, the raw coolers, the tomato coolers, the raw feed area, the Ready-to-Eat area (also called the cutting room or the high-care area), the tomato repack room, the pack-out room, the palletizing room, the finished goods storage rooms, and the shipping area (see Petitioner's Exhibit 8).

[4]Carter McEntire, the Petitioner's President and CEO, testified that the tomato re-pack area is considered a low-care area because the product remains whole; it is not cut and exposed to the environment. Mr. McEntire explained that in a low-care area, employees "are not required to wear

hand according to the customer's specification as to color, size, and weight. Prior to entering the tomato re-pack room, tomatoes that will be re-packed are stored in the tomato coolers while they ripen. Because the Petitioner's customers specify the color tomato they want, the Petitioner has to rent generators on occasion to speed up the tomato ripening to meet the customers' needs. The ripened tomatoes are moved from the tomato coolers into the tomato re-pack room where the tomatoes are sorted and packaged. The packages are then labeled. Finally, the Petitioner's employees move the packaged tomatoes into another cooler to be stored until they are loaded onto the Petitioner's refrigerated trucks for delivery to the customer.

The Cutting Room

The cutting room is a "high-care"[5] area where produce is cut and packaged according to the customer's specifications. When raw produce that will be cut first arrives at the Petitioner's facility, the raw produce is inspected then moved into a storage cooler. When the Petitioner is ready to process the raw produce, the raw produce is moved to the raw feed area where the Petitioner's employees utilize a bin dumping conveyance system to move the produce into the cutting room. Once the produce is in the cutting room, the Petitioner's employees sort, inspect, and trim the produce then place the produce on a conveyor belt. The produce moves down the line to the cutter, which cuts up the produce according to the customer's specifications. Once the produce is cut, it enters the first washing flume, then the dewatering shaker, then the second

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PPG [personal protective gear]. They are required to wear certain items like hairnets." Mr. McEntire did not explain what items are included in "PPG."

[5]Mr. McEntire testified that "[i]n the high-care area . . . [employees] are required to wear all the PPG required by Federal law." In the high-care area, the Petitioner requires its employees to wear hairnets, overshoes, smocks, gloves, and "any other PPG that's required." Mr. McEntire further explained that the purpose of the protective clothing is to "protect the food from the human." Mr. McEntire did not elaborate on the differences between a low-care area and a high-care area.

washing flume, and then the second dewatering shaker. Next, the cut produce passes under a fresh-water rinse, goes into a shaker, and then goes into a dryer basket. From the dryer basket, the cut produce is metered onto a conveyer system where it is conveyed up to a scale. The cut produce is weighed and bagged. The bag is sealed and then run through a metal detector. Once the bagged, processed produce passes through the metal detector, it is boxed, labeled, palletized, and moved into the finished goods storage room. The Petitioner then stores the finished product until its employees load the product onto the Petitioner's refrigerated trucks for delivery to the consumer.

Supplies at Issue

1. Protective Clothing: Gloves, Aprons, and Hairnets.

The Petitioner requires its employees to wear protective clothing in both the low-care and the high-care areas. The Petitioner requires its employees to wear more protective clothing, such as overshoes and smocks,[6] in the high-care area because this is the area where produce is cut and exposed to the environment. The Petitioner's annual budget for purchasing protective clothing for its employees is approximately $100,000 - $150,000 per year. Most of the protective clothing are single use items. Federal law requires produce-processing plants, like the Petitioner's, to develop "good manufacturing practices," which must include the requirement that employees wear certain protective clothing for food safety purposes.

Wayne Bailey, the Petitioner's current food safety director, testified that the Petitioner's "good manufacturing practices," which are set forth in Petitioner's Exhibit 18, requires the wearing of appropriate apparel so that a person in street clothes and street shoes will not or should not come into contact with food-contact surfaces or the produce. In so doing, the Petitioner is protecting the produce from anything that would come from outside the plant. The Petitioner's food safety expert,

[6]Overshoes and smocks are not included in the category of protective clothing at issue in this case.

Dr. David Gombas, testified that the sources of contaminants, or harmful microorganisms, are the employees, the water used in the facility, and the raw produce. The protective clothing protects the produce from the Petitioner's employees. Specifically, it prevents any microbiological contaminants that may be present on the employee from getting into the final product. Protective clothing also helps minimize cross contamination or the spreading of pathogens that may already be present. Ultimately, the purpose of the protective clothing is to protect the consumer by preventing the Petitioner's final product—a food item—from being contaminated with harmful microorganisms.[7]

As stated above, the Petitioner's employees must wear more protective clothing in the high-care area. However, the protective clothing at issue—gloves, aprons, and hairnets—is worn in both the low-care and high-care areas.[8] The Petitioner considers its high-care area to be a clean room. The Petitioner further claims that the protective clothing at issue is required to be worn in a clean room. Tom Lovelace, the Petitioner's executive Vice President, testified that "[e]ach of the air handling units has filtering that filters air to .3 microns. The compressed air that's used to help package the product is filtered to .1 microns." According to Mr. Lovelace, that means the Petitioner has a clean room. Mr. Bailey testified that the Petitioner is audited by the British Retail Consortium (the "BRC") every year, and the BRC auditor looks at the Petitioner's "clean room environment." Mr. Bailey could not say that the BRC certified that the Petitioner had a clean room, though. In fact, none of the Petitioner's witnesses could point to a document certifying that it had a clean room.

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[7]Even the Petitioner's protest letter explains that the purpose of the protective clothing is to protect the produce.

[8]The Petitioner does not maintain any records showing the percentage of protective clothing worn in the high-care area versus the low-care areas.

A review of the 2015 BRC audit report, Petitioner's Exhibit 11, does not mention anything related to whether the Petitioner has a clean room. The report does discuss filtering air, but not in the way the Petitioner's witnesses represented. The report states on page 34 that the "[c]ompressed air used on product contact surfaces is filtered to 0.5 micron." Mr. Lovelace testified the compressed air, which the Petitioner uses when bagging the product, was filtered to .1 microns. Also on page 34, section 4.413 discusses filtered air in high-risk areas and states this requirement is not applicable to the Petitioner. Thus, it appears the BRC auditor did not evaluate the air filtration in the Petitioner's plant. Assuming the BRC auditor did evaluate the air filtration in the plant, the BRC auditor did not determine whether the high-care area is a Class 100 or better as defined in Federal Standard 209E clean room environment, nor did it audit the Petitioner's facility against the Federal Standard 209E clean room requirements.[9] It is apparent that the role of a BRC auditor is not to determine whether a food processing plant has and properly maintains a clean room, but rather to determine whether the plant meets the BRC's standards. In sum, the BRC report contains nothing regarding whether the Petitioner has a Class 100 or better as defined in Federal Standard 209E clean room environment.

2. Floor Drain Covers.

The Petitioner installs floor drain covers inside its facility to keep debris from entering the floor drain system. The Petitioner uses the floor drain system to recapture spilled water so it may reuse the water to wash the produce.

3. Warning Signs and Stickers.

Throughout the facility the Petitioner uses warning signs and stickers to warn employees about certain hazards and to remind employees about certain procedures. Approximately 80% of

[9]Moreover, none of the Petitioner's witnesses could identify all the requirements for qualifying as a Class 100 or better as defined in Federal Standard 209E clean room environment.

the Petitioner's warning signs and stickers are used in what the Petitioner describes as the manufacturing or processing area of the facility, as opposed to an administrative area. However, the Petitioner does not maintain records delineating where or how it uses different warning signs and stickers.

4. Blower Fan.

The Petitioner maintains the temperature in the facility, excluding the administrative areas, between 33 – 40 degrees. As part of the process the Petitioner uses to maintain the temperature, the Petitioner uses blower fans to move refrigerated air throughout the plant.

5. Storage Supplies: Warehouse Racks and Stacking Containers.

The Petitioner uses different types of warehouse racks and containers for storage: flow-through racks, a pushback rack system, and stacking containers. It uses flow-through racks in the storage coolers where palletized raw produce flows through from one side to the other. It also uses a pushback rack system where it places raw produce or finished product onto a carriage that is pushed back or up and out. The warehouse racks help with efficiency and keeping the produce separated. The warehouse racks enable the Petitioner to maintain the temperature of the produce during storage.

The Petitioner also uses stacking containers for storage. When a customer orders more than one product, the product that is finished first must be stored until the other products are finished. The Petitioner uses stacking containers for said storage. For example, a customer may order cabbage made into coleslaw with a separate bag of carrots. In fulfilling that order, the Petitioner would first make separate bags of carrots and place them in the stacking containers. Then the Petitioner would make the bags of cabbage and place them in a master case. Once the master case is filled with bags of cabbage, the Petitioner moves the bags of carrots from the

stacking containers to the master case, seals, labels, and palletizes the case, and then stores the case in the finished goods storage area.

6. Material Handling Supplies: Forklift Batteries, Forklift Parts, Forklift Repair Parts, Forklift Rentals, Pallet Jacks, and Oil Lubricant for Handtrucks and Pallet Jacks.

The Petitioner uses forklifts and pallet jacks to move product from place to place within the facility. However, none are used from the time the first processing machine—the cutter—is fed through the time the final product is discharged from the packing machine. These supplies are mostly used in the palletizing, shipping, finished storage, raw storage, tomato repack, and receive dock areas of the facility to move produce before or after it is processed. The Petitioner does not track where it uses each item.

7. Generator Rental.

The Petitioner rents ethylene generators to speed up the ripening process, which takes place in the tomato cooler area. Tomatoes arrive at the facility in various color stages, and different customers have different color requirements. When necessary, the Petitioner rents generators to speed up the ripening process to get the tomatoes to the color required by the customer.

8. Bar Code Scanners.

A bar code scanner is a hand-held device that the Petitioner uses to read bar codes. Pursuant to Federal law, the Petitioner must be able to trace the product back one step to the grower-shipper and forward one step to the customer's distribution center.[10] As part of the tracing process, the Petitioner uses the bar code scanner to scan the bar code on the product when it enters the facility, when it goes into processing, when it goes to the finished goods storage area, and finally when it goes onto the refrigerated truck.

[10]Mr. McEntire testified that the need for a trace-back arises when a food-borne illness results in sickness or death and the FDA needs to determine the source of the illness.

9. Black Ink Aerosol Cans.

The Petitioner uses black ink aerosol cans when it labels finished cases. Specifically, the ink goes across a jet ink sprayer to spray a "use-through code" and a "lot code" onto the corrugated box. The lot codes assist in the trace-back process.

10. Cleaning Machines—Foamers.

Every night, the Petitioner utilizes cleaning machines, called foamers, to sanitize the processing equipment in the high-care area. The Petitioner did not provide any evidence regarding the specific "processing machines" it cleans with the foamers, whether such cleaning is necessary to ensure the functioning of the equipment, or whether such cleaning ensures that the quality of the product is maintained.

11. Maintenance Tools and Cut Wheel and Disc Maintenance Tools.

The Petitioner uses maintenance tools to maintain, repair, install, and uninstall equipment. The Petitioner uses these tools anytime a machine breaks down in any part of the plant. The cut wheel and disc maintenance tools are used specifically on the cut wheels and discs on the cutting machines.

12. Cleaning Supplies: Brooms, Floor Treatment Chemicals, and Squeegees.

The Petitioner uses different supplies to keep its plant clean. The Petitioner uses brooms to sweep debris off the floor and sometimes off the storage racks, floor treatment chemicals to sanitize the floor primarily in the high-care area, and squeegees to move debris and water off the floor into drains in the high-care area and the raw cooler area. These supplies have no purpose other than to sanitize the facility. These supplies may also be used in the administrative areas of the facility. The Petitioner does not keep records delineating where or how it uses each cleaning supply.

13. Mobile Computer Stand.

The Petitioner uses a computer program to track its produce processing operation. The computers are placed on a mobile computer stand in various parts of the facility so the employees can track the process as the produce moves through the facility.

14. White Boards in Production Offices.

The Petitioner uses white boards to track production efficiency and production yield. For example, employees receive a bonus depending on how fast they produce sliced tomatoes. The white board is used to track the employees' progress.

15. Storage Water Tanks.

The Petitioner has two storage water tanks. One tank is located under a roof outside the refrigerated portion of the facility. The Petitioner uses this tank to mix sanitation chemicals with chilled water, which is later pumped into the high-care area for washing the produce. The second tank is located inside the high-care area and is used to recirculate the cleaning water.

The Department's Audit and Subsequent Events

The Department audited the Petitioner's sales and use tax returns for tax periods October 1, 2012 through September 30, 2015. On July 19, 2016, after reviewing the Petitioner's purchase invoices and discussing questionable items with the Petitioner, the Department mailed and emailed the Petitioner the Proposed Assessment holding the supplies at issue purchased during the Audit Period as taxable. The Department included the entire Audit Period in the Proposed Assessment pursuant to S.C. Code Ann. § 12-54-85(C)(3) (Supp. 2017), which provides for a seventy-two (72) month statute of limitations when "there is a twenty percent understatement of the total of all taxes required to be shown on the return or document."[11] Logan Mitchell, the Department's auditor in

[11]The section of the Proposed Assessment entitled "EXCEPTION TO TIME LIMITATION FOR ASSESSMENT OF TAXES" provided that "[p]er S.C. Code section 12-54-

this case, testified that the Petitioner's lowest percentage of understatement for any given period during the Audit Period was three-hundred and twenty-seven (327) percent, which is significantly greater than twenty (20) percent. Based on that understatement, the Department determined that it had seventy-two (72) months, not thirty-six (36) months, to issue the Proposed Assessment.

Shortly after the Department emailed the Petitioner's accountant a copy of the Proposed Assessment, the Petitioner's accountant replied, stating he believed the statute of limitations expired on a portion of the audit. The Department responded to the Petitioner's accountant and explained that because the Petitioner understated the tax due by more than twenty (20) percent during each period of the Audit Period, the seventy-two (72) month statute of limitations period applied, not the thirty-six (36) month period. The Department did not receive any additional correspondence from or on behalf of the Petitioner regarding the statute of limitations.

The Petitioner timely protested the Proposed Assessment on August 1, 2016, but did not raise the statute of limitations issue. The Petitioner supplemented its protest letter on September 23, 2016, which also failed to address the statute of limitations issue. The parties held a conference but could not resolve all the issues. On February 7, 2017, the Department issued its Determination finding that the following purchases the Petitioner made during the Audit Period were subject to sales and use tax: (1) electricity used to refrigerate produce before and after said produce is processed; (2) certain supplies, including those listed under "Exhibit A" above; and (3) safety attire/protective clothing. The Petitioner timely requested a contested case hearing on March 7, 2017. Prior to the hearing in this matter, the parties resolved the issues related to the Petitioner's purchases of electricity and all supplies except the thirty-five (35) supplies listed under "Exhibit

85, the time limitation did not apply to this audit since the taxpayer had a 20% understatement of the total of tax required to be shown on all periods under the audit. The taxes in this case may be assessed at any time within 72 months from the date of the first period under audit."

A" above.

CONCLUSIONS OF LAW

General Conclusions

This Court has subject matter jurisdiction in this case pursuant to S.C. Code Ann. §§ 1-23-600(A) (Supp. 2015) and 12-60-460 (2014). The hearing before the ALC is a contested case hearing and is heard de novo. Marlboro Park Hosp. v. S.C. Dep't of Health and Envtl. Control, 358 S.C. 573, 579, 595 S.E.2d 851, 854 (2004). This Court must make its factual findings based on the preponderance of the evidence. See S.C. Code Ann. § 1-23-600(A)(5) (Supp. 2015); see also Anonymous (M-156-90) v. State Bd. of Med. Exam'rs, 329 S.C. 371, 375-78, 496 S.E.2d 17, 19-20 (1998); Nat'l Health Corp. v. Dep't of Health and Envtl. Control, 298 S.C. 373, 379, 380 S.E.2d 841, 844 (Ct. App. 1989). Because the Petitioner is challenging a determination by the Department that the Petitioner's purchases of the supplies at issue are subject to sales and use tax, the Petitioner has the burden of proof. See Ford v. Atl. Coast Line R. Co., 169 S.C. 41, 168 S.E. 143, 167 (1932) ("The general rule is, in the absence of valid statutory enactment to the contrary, that the burden of proof rests upon him who has the affirmative of the issue"); see also Leventis v. Dep't of Health and Envtl. Control, 340 S.C. 118, 132-33, 530 S.E.2d 643, 651 (Ct. App. 2000). This burden requires the Petitioner to prove that the Department's determination is errant by a preponderance of the evidence. See, e.g., Janasik v. Fairway Oaks Villas Horizontal Prop. Regime, 307 S.C. 339, 346, 415 S.E.2d 384, 388 (1992) ("Findings of fact based upon a 'preponderance' of the evidence are those supported by the greatest 'weight, amount, credibility or truth' as reflected by the whole of the evidence before the court, or 'evidence which convinces as to its truth.'").

Applicable Law

It is well-settled law that absent an exemption from use tax, a use tax is imposed on a taxpayer's "storage, use, or other consumption in this State of tangible personal property purchased

at retail for storage, use, or other consumption in this State . . . ." S.C. Code Ann. § 12-36-1310(A) (2014). Moreover, the taxpayer claiming the exemption has the burden to prove its right to the exemption by bringing itself clearly within the conditions imposed by the exemption. See TNS Mills, Inc., v. S.C. Dept. of Revenue, 331 S.C. 611, 618, 154 S.E.2d 471, 475 (1981).

I. S.C. Code Ann. § 12-36-2120(17)—The Machine Exemption

The Petitioner claims its purchases of the supplies at issue,[12] excluding the protective clothing, are exempt from use tax as machines or machine parts used in processing tangible personal property for sale pursuant to S.C. Code Ann. § 12-36-2120(17). I disagree. The proper test to determine whether a machine or a machine part is exempt from sales and use tax is to determine whether the machine or machine part is integral and necessary to the manufacturing process. See Spring Industries, Inc. v. S.C. Dept. of Revenue, Docket No. 99-ALJ-17-0153-CC (S.C. Admin. Law Ct. Nov. 9, 1999); see also Hercules Contractors and Engineers, Inc. v. S.C. Tax Comm'n, 280 S.C. 426, 313 S.E.2d 300 (Ct. App. 1984). S.C. Code Ann. Regs. 117-302.5 (2012) incorporates the aforementioned rulings and sets forth several tests to determine whether a machine or machine part is exempt.

For this Court to determine whether the Petitioner's purchases of the supplies at issue are exempt, the Petitioner, who has the burden of proof in this case, had to present evidence to the Court about the use and purpose of each of the items at issue. The Petitioner failed to present any evidence about the use and purpose of six of the items at issue: coveralls,[13] eyewear,[14] towels,

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[12]See "Exhibit A," supplies numbered 1 – 4 and 8 – 35.

[13]When the Petitioner's witnesses discussed protective clothing they only mentioned gloves, hairnets, and aprons. The witnesses never mentioned coveralls or eyewear, thus I cannot assume that coveralls and eyewear are included in the category of "protective clothing."

[14]See footnote 13.

plastic shelves for maintenance parts room, utility cart for maintenance tools, and drug test kits. Without evidence, the Petitioner cannot meet its burden of proving these supplies fall clearly within the conditions imposed by § 12-36-2120(17) (the "Machine Exemption"). Because the Petitioner presented no evidence about these supplies, I find that the Petitioner's purchases of coveralls, eyewear, towels, plastic shelves for maintenance parts room, utility cart for maintenance tools, and drug test kits are subject to use tax.

The Petitioner did present evidence regarding the use of the remaining supplies at issue. Thus, this Court must examine the evidence and determine whether the Petitioner's purchases of the remaining supplies fall clearly within the conditions imposed by the Machine Exemption. In doing so, this Court must determine whether the supplies at issue are integral and necessary to the manufacturing process at issue—processing produce. After applying Regulations 117-302.5(B)(2)-(10), which specifically address several of the supplies at issue, and Regulation 117-302.5(B)(1), which sets forth general guidance, to the facts in this case, I conclude that the Petitioner failed to prove that the supplies at issue are integral and necessary to processing produce. As such, I conclude that all the supplies at issue are subject to use tax.

A. Regulation 117-302.5(B)(4)—Conveyances.

Regulation 117-302.5(B)(4)(a) states:

> [M]aterial handling machinery [and their parts] . . . [are] subject to the tax up until 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. Warehouse machinery used only for warehouse purposes, loading and unloading, storing, transporting raw materials and finished products, etc., is subject to the tax [unless otherwise exempt].

I find that the Petitioner's material handling supplies (forklift batteries, forklift parts, forklift repair parts, forklift rentals, pallet jacks, and oil lubricant for handtrucks and pallet jacks) constitute conveyances and, thus, fall within Regulation 117-302.5(B)(4). A review of the evidence demonstrates the Petitioner only uses these material handling supplies for warehouse purposes to transport raw produce or finished product within the facility. The Petitioner presented no evidence that these supplies are used to feed the first processing machine or for transporting in process material. Accordingly, I conclude that the Petitioner's purchases of material handling supplies are subject to use tax.

B. Regulation 117-302.5(B)(5)—Chemicals.

Regulation 117-302.5(B)(5) provides that chemicals that are used in an exempt machine on an ongoing and continuous basis and are essential to the functioning of the exempt machine are exempt from use tax. Thus, chemicals that are used on a non-exempt machine, are not used on an ongoing and continuous basis, and/or are not essential to the functioning of an exempt machine are subject to use tax. The Petitioner uses floor treatment chemicals to sanitize the floor of the facility. The floor is not an exempt machine. Even if the floor was an exempt machine, the floor treatment chemicals are not essential to the functioning of the floor. As such, I conclude that the Petitioner's purchases of floor treatment chemicals are subject to use tax.

C. Regulation 117-302.5(B)(6)—Maintenance.

Generally, maintenance machines are not exempt from sales and use tax.

> Machines that [1] are used to maintain non-exempt machines (machines that are not integral and necessary to the manufacturing process), or [2] are not used on an ongoing, continuous basis to maintain exempt manufacturing machines (machines that are integral and necessary to the manufacturing process) are maintenance machines and are not exempt from the tax as machines used in manufacturing tangible personal property for sale.

Regulation 117-302.5(B)(6). Examples of non-exempt maintenance machines include cleaning machines used to clean non-exempt machines, cleaning machines that are not used on an ongoing and continuous basis to maintain an exempt machine, machines used to clean floors and other parts of realty, and machines used to clean an exempt machine when such cleaning is not essential to ensure the functioning of the exempt machine or that the quality of the product is maintained. Id. For reasons explained more fully below, I find that the Petitioner's foamers, maintenance tools, cut wheel and disc maintenance tools, and cleaning supplies (brooms, floor treatment chemicals, and squeegees) are non-exempt maintenance machines.

The Petitioner uses foamers—cleaning machines—every night to sanitize the processing equipment in the high-care area. Thus, the Petitioner established that the foamers are used on an ongoing and continuous basis to clean exempt machines. However, if such cleaning is not essential to ensure the functioning of the exempt machines or that the quality of the product is maintained, then the foamers are subject to the tax. A review of the record demonstrates that the Petitioner failed to prove whether the use of the foamers ensures the functioning of the processing equipment or that the quality of its product is maintained. Absent such evidence, I must find that the Petitioner failed to bring itself clearly within the conditions imposed by the Machine Exemption. As such, I conclude that the Petitioner's purchases of foamers are subject to use tax.

The Petitioner uses maintenance tools and cut wheel and disc maintenance tools to maintain, repair, install, or uninstall equipment only when a machine breaks down. Thus, the Petitioner does not use these tools on an ongoing and continuous basis. Accordingly, I conclude that the Petitioner's purchases of maintenance tools and cut wheel and disc maintenance tools are subject to use tax.[15]

[15]Additionally, the Petitioner failed to establish exactly on which machines it uses the general maintenance tools (the cut wheel and disc maintenance tools are used on the cutter—an

Finally, the Petitioner uses certain cleaning supplies—brooms, floor treatment chemicals, and squeegees—as part of its sanitization process. Specifically, the Petitioner uses these cleaning supplies to sanitize the floor of the plant. Additionally, the Petitioner may use the brooms to sweep debris off the storage racks. In that regard, I find the Petitioner uses these cleaning supplies as maintenance machines. Since the cleaning supplies are used to clean the floor and storage racks (non-exempt machines), the cleaning supplies are not integral and necessary to the manufacturing process. Accordingly, I conclude that the Petitioner's purchases of brooms, floor treatment chemicals, and squeegees are subject to use tax.

D. Regulation 117-302.5(B)(7)—Storage.

Regulation 117-302.5(B)(7) provides:

> Machines used at a manufacturing facility for storage are not exempt from the tax as a machine used in manufacturing tangible personal property for sale. For example, the following machines are for storage and therefore taxable: (a) Racks used to store raw materials or finished goods. (b) Storage tanks used to store raw materials, gasses, or water.

The Petitioner uses warehouse racks to store raw materials and finished goods. The Petitioner uses stacking containers to store a finished product until said product can be transferred into a master case with another finished product. Accordingly, I find that the warehouse racks and stacking containers are for storage, and therefore, I conclude that the Petitioner's purchases of warehouse racks are subject to use tax.

Additionally, the Petitioner has two types of storage water tanks. One type of tank of is used to mix sanitation chemicals with chilled water and hold the cleaning water until it needs to

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exempt machine). Absent evidence establishing the general maintenance tools are used on exempt machines, I must conclude that the Petitioner failed to meet its burden of proof. Thus, even if the Petitioner used the general maintenance tools on an ongoing and continuous basis, the Petitioner's purchases of general maintenance tools would still be subject to use tax.

be pumped into the high-care area. The second type of tank is used to hold recirculated cleaning water. I find that the second type of tank is used only for storage, and therefore, I conclude that the Petitioner's purchases of the second type of storage tank is subject to use tax. While the first type of storage tank may be exempt, the Petitioner failed to present evidence regarding the purchase cost attributable to each type of tank. Absent such evidence, I cannot determine which tank purchases, if any, are exempt. Therefore, because the Petitioner failed to meet its burden of proof, I conclude that all its purchases of storage water tanks are subject to use tax.

E. Regulation 117-302.5(B)(9)—Administrative.

Regulation 117-302.5(B)(9) provides that administrative items "such as office computers used for word processing, recordkeeping, employee payroll, customer billing, purchasing, accounting, and similar purposes, office furniture, office supplies, [and similar items] . . . are not machines used in the process of manufacturing tangible personal property for sale." The Petitioner uses mobile computer stands to hold the computers used to track the manufacturing process. The Petitioner uses white boards to also track the manufacturing process. I conclude that supplies used to track the manufacturing process are administrative items. Specifically, I find that an item used merely to track the manufacturing process is not an essential and indispensable component part of the manufacturing process. Said differently, the Petitioner can process produce—sort, cut, wash, and/or package it—without tracking said process. Therefore, I conclude that the Petitioner's purchases of mobile computer stands and white boards are subject to use tax.

Similarly, I find that the Petitioner's bar code scanners and black ink aerosol cans are administrative items. The Petitioner uses both items to trace from where the produce came and to where the finished product was delivered. This trace forward and trace back procedure amounts to a type of recordkeeping, which is an administrative task. Moreover, tracing the produce is not

essential to processing produce. The produce can be processed without knowing from where it came and to where it was delivered. As such, I conclude that the Petitioner's purchases of bar code scanners and black ink aerosol cans are subject to use tax.

F. Regulation 117-302.5(B)(1)—Machines Generally.

The general test, which is found in Regulation 117-302.5(B)(1), sets forth the following elements to determine whether a machine or machine part is integral and necessary *to the manufacturing process*, not just to the manufacturer: (1) The machine must be used at a manufacturing facility; (2) The machine must be used in and serve as an essential and indispensable component part of the manufacturing process; (3) The machine must be used on an ongoing and continuous basis during the manufacturing process; and (4) The machine must be substantially used in manufacturing tangible personal property for sale. The Regulation further provides that "more than one-third of a machine's use in manufacturing is substantial." After reviewing the remaining supplies at issue, I conclude that the Petitioner's purchases of such supplies are subject to use tax.

The Petitioner is a type of manufacturer that processes produce. Thus, the "manufacturing process" at issue is produce processing. The Petitioner failed to establish that the floor drain covers, warning signs and stickers, blower fans, and generator rentals are integral and necessary to processing produce. While the Petitioner established all these supplies are used at a manufacturing facility, satisfying the first element of the test, the Petitioner failed to establish that these supplies satisfy the remaining elements. In fact, the evidence demonstrates that some of the remaining supplies do not serve as an essential and indispensable component part of processing food, while others are not used on an ongoing and continuous basis during the food processing. When the Petitioner processes produce, it sorts, cuts, washes, and packages the produce. Thus, for

the remaining supplies to be exempt, the Petitioner must prove that the supplies serve as an essential and indispensable component part of processing produce, and that the supplies are used on an ongoing and continuous basis during the process.

The Petitioner uses floor drain covers to keep debris from entering the floor drain system, which is part of the Petitioner's process of recycling the cleaning water. Recycling the cleaning water is not essential to wash the produce as the Petitioner may, and actually does, pump in water to be used in cleaning the produce. Therefore, I conclude that the floor drain covers do not serve as an essential and indispensable component part of the manufacturing process, and the Petitioner's purchases of the floor drain covers are subject to use tax.

The Petitioner uses warning signs and stickers throughout the facility to warn employees about certain hazards and to remind employees about certain procedures. The produce can be sorted, cut, washed, and packaged without warnings. Accordingly, the warning signs and stickers do not serve as an essential and indispensable component part of the manufacturing process. While the warning signs and stickers may be integral and necessary to the Petitioner, they are not integral and necessary to processing produce. Therefore, I conclude that the Petitioner's purchases of warning signs and stickers are subject to use tax.

The Petitioner uses blower fans to move refrigerated air around the plant. Regulation 117-302.5(C)(24) states that "[m]achines 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" are exempt machines. The Petitioner's witnesses testified repeatedly about the importance of keeping the temperature in the plant between 33 and 40 degrees to reduce pathogen growth. The Petitioner's witnesses also testified that the blower fans contribute to keeping the plant temperature between 33 and 40 degrees. However, the exemption only applies

to machines used during the manufacturing process, which in the Petitioner's plant only occurs in the cutting room, tomato repack room, and pack-out room. Accordingly, for the blower fans to be exempt, they would have to be substantially used in the cutting room, tomato repack room, and/or pack-out room. The Petitioner did not provide any evidence regarding where each blower fan was used. Absent such evidence, I cannot determine that any blower fan was used substantially during the manufacturing process.

Additionally, the exemption for machines used to condition air only applies to tangible personal property made from natural fibers and synthetic materials. The Petitioner turns raw produce into a finished product, such as chopped lettuce. In that sense, the Petitioner does not *make* anything. Moreover, the Petitioner presented no evidence that its final products are made from natural fibers and synthetic materials. While the finished product may consist of natural fibers, the Petitioner did not take natural fibers and make a finished product. Assuming, however, I found the Petitioner did take natural fibers—a raw head of lettuce—and make a finished product—chopped lettuce, the regulation uses the word "and" not "or." Thus, the Petitioner would have had to make the chopped lettuce out of a raw head of lettuce *and* synthetic materials. The Petitioner presented no evidence demonstrating it uses any synthetic material to turn raw produce into a finished product. Thus, because the Petitioner failed to prove it uses the blower fans substantially during the manufacturing process and that it makes a product from natural fibers and synthetic materials, I conclude that the Petitioner's purchases of blower fans are subject to use tax.

Finally, the Petitioner rents ethylene generators on an as-needed basis to speed up the tomato ripening. Using a machine "as needed" does not constitute ongoing and continuous use. Tomato ripening is part of the tomato repack operation. Mr. McEntire testified that there are times when the tomatoes are so unripe that the ripening process needs to be sped up. It is on those

occasions that the Petitioner rents the generators. Ordinarily, the tomatoes are left in the tomato coolers to ripen. Accordingly, since ripening is part of the tomato repack operation, and thus, processing produce, any generators used on an ongoing and continuous basis during the ripening stage of the process could be exempt. However, I find that using a machine on an "as needed" basis does not constitute "ongoing and continuous." Thus, because the generators at issue here were not used on an ongoing and continuous basis, I conclude that the Petitioner's generator rentals are subject to use tax.

II. The Protective Clothing.

The Petitioner argues that its purchases of protective clothing—gloves, aprons, and hairnets—are exempt from use tax pursuant to S.C. Code Ann. § 12-36-2120(54) as "clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment" (the "Clean Room Exemption"). The Petitioner argues alternatively that its purchases of protective clothing are exempt from use tax pursuant to S.C. Code Ann. § 12-36-2120(17) as pollution control machines (the "Pollution Control Machine Exemption"). I disagree. As will be discussed below, the Petitioner failed to bring itself clearly within the conditions imposed by either exemption. As such, I conclude that the Petitioner's purchases of protective clothing are subject to use tax.

A. The Clean Room Exemption.

In order for the Petitioner to bring itself clearly within the conditions imposed by the Clean Room Exemption, the Petitioner had to prove that (1) the Petitioner has a Class 100 or better clean room as defined by Federal Standard 209E[16] and (2) the protective clothing at issue is required for

[16]Federal Standard 209E has been replaced with International Standards Organization (ISO) 14644-1. Nonetheless, the General Assembly has not changed the language of the statute. Thus, for the Petitioner to bring itself clearly within the conditions imposed by the Clean Room Exemption, it must prove it has a Class 100 or better clean room as defined by the Federal Standard.

working in the clean room. The Petitioner failed to present sufficient evidence to satisfy either element.

The Petitioner did not present a shred of evidence that it actually has within its facility a Class 100 or better clean room as defined by Federal Standard 209E. The Petitioner's witnesses all testified that the plant has something similar to a clean room. For example, Mr. Carter testified that the FDA requires the Petitioner to maintain a certain level of cleanliness, and those levels of cleanliness meet or exceed Class 100 standards. Thus, according to Mr. McEntire, any room that is clean enough could be a clean room if "you chose to call it that." Similarly, Mr. Bailey testified that the Petitioner uses the terms "high-care" and "clean room" interchangeably. He testified that with what the Petitioner does in the facility "it would be considered a clean room." Finally, Mr. Lovelace confirmed that the BRC does not audit whether the Petitioner's facility satisfies the clean room standards. The 2015 BRC report the Petitioner provided confirms Mr. Lovelace's testimony in that the report does not contain any determination or evaluation relating to whether Petitioner's facility contains a Class 100 or better clean room. In sum, the Petitioner presented no clear evidence regarding the clean room requirements or whether the high-care room is a Class 100 or better clean room as defined by Federal Standard 209E.

Assuming the Petitioner established it has something like a clean room, such is not sufficient for the Petitioner to meet its burden of proof. The Petitioner had to clearly prove that it has a Class 100 or better clean room as defined by Federal Standard 209E, not something similar. Moreover, in addition to proving it has a clean room, the Petitioner had to prove the protective clothing at issue is required to be worn in the clean room. Despite such requirement, the Petitioner only proved that the FDA requires certain protective clothing to be worn in a food processing plant to prevent the product from becoming adulterated. Accordingly, because the Petitioner failed to

prove that it in fact has a clean room as required by § 12-36-2120(54) and that the protective clothing is required to be worn in that clean room, I conclude that the Petitioner's purchases of protective clothing are not exempt from use tax pursuant to the Clean Room Exemption.

B. The Pollution Control Machine Exemption.

Section 12-36-2120(17) provides an exemption from sales and use tax for machines and its parts and attachments that "are necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section." S.C. Code Ann. Regs. 117-302.6 explains that a machine constitutes an exempt pollution control machine if such machine is "installed and operated for compliance with an order of an agency of the United States or of this state to prevent or abate pollution caused or threatened by the operation of other machines used in the . . . manufacturing of tangible personal property." Accordingly, the Petitioner had to prove that (1) the operation of at least one of its machines used in processing causes or threatens to cause pollution of air, water, or noise, (2) a State or Federal agency requires that the pollution be prevented or abated, and (3) the protective clothing is used to prevent or abate the pollution. Because the Petitioner failed to bring itself clearly within the Pollution Control Machine Exemption, I conclude that the protective clothing is not exempt from use tax.

The Petitioner argues that it requires its employees to wear protective clothing to prevent the spread of microbiological contaminants such as E. Coli, Listeria, and Salmonella, and therefore, the protective clothing constitutes a pollution control machine. As a threshold matter, protective clothing does not qualify as a machine according to Regulation 117-302.5(B)(10). Since protective clothing is not a machine, it can never be a "pollution control machine." Nonetheless, assuming for arguments sake that the protective clothing at issue are machines and that overgrowth

of microbiological contaminants constitutes pollution, a review of the evidence demonstrates that the processing machines do not cause or threaten to cause an overgrowth of microbiological contaminants. Rather, the contaminants enter the facility either on the raw produce or on the Petitioner's employees. The contaminants may grow, spread, and contaminate other products because of the processing environment (temperature, moisture, etc.), but not because of the machines used to process food. Thus, because the Petitioner failed to prove that a machine used in processing causes or threatens pollution of air, water, or noise, the Petitioner failed to bring itself clearly within the conditions imposed by the Pollution Control Machine Exemption.

Further, the evidence demonstrates that the protective clothing prevents the product from being contaminated by harmful microorganisms. The purpose of the protective clothing is not to prevent air, water, or noise pollution. Thus, the protective clothing is not actually used to prevent air, water, or noise pollution. Accordingly, even if the processing machines did cause or threaten pollution of air, water, or noise, the protective clothing does not prevent or abate such pollution.

Finally, the Petitioner failed to present any evidence that an order of a State or Federal agency requires the Petitioner to prevent or abate pollution created by the Petitioner's processing machines. The Petitioner only referenced the FDA's requirements related to "good manufacturing practices." While the Petitioner's witnesses testified that the FDA requires that the Petitioner's employees wear protective clothing and that the Petitioner implement measures to prevent food from being adulterated, they did not state that the FDA requires any type of pollution control. Absent evidence of a State or Federal order requiring that the Petitioner prevent or abate pollution caused by its processing machines, I must conclude that the Petitioner failed to meet its burden of proof. Thus, I conclude that the Petitioner's purchases of protective clothing are subject to use tax.

III. Statute of Limitations

The Petitioner argued at the hearing that part of the Audit Period, and thus the Proposed Assessment, falls outside the thirty-six (36) month statute of limitations period, and therefore, is time-barred. The Department responded by asserting that the seventy-two (72) month, not the thirty-six (36) month, statute of limitations period applies in this case pursuant to S.C. Code Ann. § 12-54-85(C)(3). The Petitioner then argued that the Department could not assert at the hearing that the seventy-two (72) month period applies because it did not state such in the Department's Determination. I conclude, for the reasons set forth below, that the Department could assert that the seventy-two (72) month period applies in this case, that it correctly asserted the seventy-two (72) month period applies, and that it issued the Proposed Assessment within the seventy-two (72) month period.

First, I find that, while not required to, the Department did address the statute of limitations in its Determination. The Determination addressed the sales and use tax periods from October 1, 2012 through September 30, 2015. By stating those were the tax periods at issue, the Department implicitly asserted that the entire Audit Period was at issue, and thus not time-barred. Moreover, the Petitioner did not protest the Proposed Assessment on the basis that a portion of the Audit Period was time-barred. The Department cannot address in a department determination every potential argument a taxpayer might make, nor does the Revenue Procedures Act (the "RPA") require such. See S.C. Code Ann. § 12-60-10 et. seq. (2014 & Supp. 2017). Rather, the RPA requires that a department determination use the information provided by the taxpayer in its protest and "explain the basis for the department's determination." S.C. Code Ann. § 12-60-450(E)(2)(b) (2014). Pursuant to § 12-60-450(B), a taxpayer's protest "**must** contain . . . (6) a statement outlining the reasons for the appeal, including law or other authority upon which the taxpayer relies

. . . ." (emphasis added). Because the Petitioner did not even mention in its initial protest letter or supplemental protest letter that part of the Audit Period was time-barred, the Department was not required to specifically address the statute of limitations in the Determination. In fact, by failing to raise the statute of limitations issue in its protest, the Petitioner arguably waived its right to raise the statute of limitations issue during the hearing in this case.

Next, I conclude that the seventy-two (72) month statute of limitations period applies here. Pursuant to S.C. Code Ann. § 12-54-85(A), "[e]xcept as otherwise provided in this section, taxes must be determined and assessed within thirty-six months from the date the return or document was filed or due to be filed, whichever is later." Section 12-54-85(C) provides that "[t]axes may be determined and assessed after the thirty-six month limitation if: . . . (3) there is a twenty percent understatement of the total of all taxes required to be shown on the return or document. The taxes in this case may be assessed at any time within seventy-two months from the date the return or document was filed or due to be filed, whichever is later." Thus, when there is a twenty (20) percent understatement of the total of all taxes required to be shown on the return, the seventy-two (72) month, not the thirty-six (36) month, statute of limitations applies.

In this case, the Petitioner filed zero returns for all periods during the Audit Period except for periods ending September 30, 2013, November 30, 2013, and April 30, 2015, when it paid $2.00, $2.00, and $642.00, respectively, in sales and use taxes. Ms. Mitchell testified that the lowest percentage of understatement for any given period during the Audit Period was 327%, which is significantly greater than 20%. Accordingly, I find the Petitioner understated the total of all taxes required to be shown on all its returns during the Audit Period by at least twenty (20) percent. Therefore, I conclude that the Department had seventy-two (72) months from the later of the dates the returns were filed or due to be filed to issue the Proposed Assessment.

Finally, I find the Department timely issued the Proposed Assessment for the Audit Period. The first return at issue was due on November 20, 2012 and the last return at issue was due on October 20, 2015. Seventy-two (72) months from November 20, 2012, is November 20, 2018, and seventy-two (72) months from October 20, 2015, is October 20, 2021. That means the Department had until November 20, 2018, at the latest, to timely issue the Proposed Assessment for the entire Audit Period. The Department initiated its audit in September 2015 and issued the Proposed Assessment for the Audit Period on July 19, 2016, well within seventy-two (72) months from the date the returns at issue were due. Accordingly, I find that the Department timely issued its Proposed Assessment for the Audit Period and, therefore, the entire Audit Period is properly before this Court.

CONCLUSION

After considering the evidence in the record and the pertinent legal authorities, I conclude, based upon the reliable evidence, that all the Petitioner's purchases during the Audit Period of the supplies and protective clothing discussed herein are subject to use tax. I reject the Petitioner's argument that its manufacturing process begins when the raw produce arrives at the facility and ends when the finished product is loaded onto its refrigerated trucks. I also reject the Petitioner's arguments that its purchases of protective clothing are exempt from use tax as clothing required to be worn in a Class 100 or better clean room as defined by Federal Standard 209E or as pollution control machines.

ORDER

IT IS THEREFORE ORDERED that the Petitioner be assessed $82,305.83 in tax plus applicable interest.

IT IS FURTHER ORDERED that the Petitioner remit the $18,636.19 in tax due on the

items the Petitioner agreed were taxable prior to the hearing plus interest within thirty (30) days of the date of this Order.

AND IT IS SO ORDERED.

H.W. Funderburk
Administrative Law Judge

_____, 2019
Columbia, South Carolina

Respectfully submitted,

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Attorneys for Respondent

Charleston, South Carolina
January 7, 2019

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

McEntire Produce, Inc., Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No. 17-ALJ-17-0060-CC **PROOF OF SERVICE**

The undersigned hereby certifies that she served a copy of the Respondent's Proposed Final Order and Decision in the above-referenced case on the Petitioner's counsel on the date and at the address listed below by depositing a copy in the United States Mail, postage paid:

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January 7, 2018
Charleston, South Carolina

NEXSEN|PRUET

Burnet R. Maybank, III
Member
Admitted in SC

January 7, 2019

VIA U.S. MAIL AND EMAIL
The Honorable H.W. Funderburk, Jr.
South Carolina Administrative Law Court
1205 Pendleton Street, Suite 224
Columbia, SC 29201

Re: McEntire Produce, Inc. v. South Carolina Department of Revenue
Docket No. 17-ALJ-17-0060-CC

Dear Judge Funderburk:

Enclosed please find the original and one copy of Petitioner's Proposed Order together with Certificate of Service. We also emailed Word and PDF copies to Julia Miller today. Kindly file the original and return the clocked copy in the postage-paid return envelope provided.

Thank you for your attention to this matter.

Very truly yours,

Burnet R. Maybank, III

BRM/mw

Enclosure – Petitioner's Proposed Order

cc: Lauren Acquaviva, Esq.
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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

McEntire Produce, Inc., Petitioner, vs. South Carolina Department of Revenue, Respondents.	Docket No.: 17-ALJ-0060-CC **PETITIONER'S PROPOSED ORDER**

I. INTRODUCTION

This matter is before the South Carolina Administrative Law Court on request for a contested case hearing filed by McEntire Produce, Inc., under S.C. Code Ann. §12-60-460 (Supp. 2017). Petitioner challenges the Department of Revenue's Determination that Petitioner is not entitled to several sales tax exemptions.

Petitioner is taxed and classified as a manufacturer. Petitioner alleges the Department misapplied three manufacturer sales tax exemptions with respect to the audit. First, Petitioner alleges the Department applied the machine exemption found in S.C. Code Ann. § 12-36-21210(17) too narrowly in light of the specialized, climate-controlled, and highly regulated nature of Petitioner's food produce processing operations. Second, Petitioner contends the Department has failed to recognize the sales tax exemption available under § 12-36-2120(54) for the "clean room environment" which Petitioner maintains in its production facility. Finally, Petitioner contends that the pollution control exemption found in 12-36-2120(17) applies to purchases of overshoes, boot covers, sanitized smocks, eyewear, coveralls, eyewear, gloves, bump capws, hairnets, beard covers, and aprons (hereinafter collectively referred to as "protective clothing")

designed to ensure that Petitioner's operations do not spread harmful contaminants like E. coli, salmonella, and listeria onto both the finished product and facility outflow.

A hearing was held before the Court on November 14 and 15, 2018.

II. FINDINGS OF FACTS

The parties entered into Stipulations of Fact, which are incorporated herein by reference. In addition, having taken evidence and observed the witnesses and exhibits presented at the hearing and having taken into consideration the burden of proof and the credibility of witnesses, the Court makes the following findings of fact by a preponderance of the evidence:

A. Petitioner's Operations

Petitioner operates in the specialized and highly-regulated arena of fresh food processing. During the periods at issue, Petitioner's production primarily involved lettuce, onions, cabbage, tomatoes, and other vegetables.

Petitioner's "processing" includes receiving, storing, washing, cutting, mixing, and then packaging the produce at its facility. Petitioner called several witnesses who described its fresh food processing in depth. 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 microwaving or cooking the produce to the extent necessary to kill or eliminate any contaminants.

Petitioner's process begins prior to the raw agricultural commodity even entering the facility. Petitioner contracts with a grower to harvest the product when it is about 80-85 degrees, so the first step in the process it to pull the heat from the produce, so that the temperature of the produce is reduced to below 40 degrees within no more than four hours from the time of harvest. 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 in the fruit and/or vegetable. It also minimizes microbiological growth rate. If the produce is not cooled immediately, then it risks turning brown, soggy, slimy, and inedible. Petitioner is required by state and federal regulation, as well as customer requirements, to track the produce as soon as it is loaded into its climate-controlled trucks. Petitioner must be able to demonstrate that the temperature on those trucks was between 33 and 40 degrees. Petitioner's customers (primarily large restaurant chains) have extensive contractual requirements in this regard.

As soon as the product is unloaded, it enters one of six raw coolers, which also are controlled at 33-40 degrees. 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. Petitioner's flume is a stainless steel bath that utilizes a water-based product to rinse and sanitize the product. The produce is washed a number of times before it moves to the next step. After washing, the produce goes through a "de-watering" step, which is essentially an industrial-sized salad spinner. 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 Petitioner.

The low care area is generally is reserved for whole produce, for example whole tomatoes, and involves their ripening, sorting, defect removal, and repackaging but no cutting of the produce. 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.

The high care area is reserved for produce that is cut down to a smaller size. In the high care area, employees are required by state and federal law to wear protective clothing. The employees must also go through a specialized sanitization procedure to limit the introduction of

microbes to the high care area. The room is also positive-pressurized to ensure there is an outflow, as opposed to an inflow, of air. 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. The overall purpose of these procedures are to protect the produce from human contact and microbial loads. 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.

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. 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. The high care meets the filtration requirements of a Class 100 Clean Room environment, which is confirmed by BRC, an independent auditing firm, on an annual basis.

Once bagged, boxed, and labeled, the produce is stored for an extremely 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. 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. Petitioner's customers also can track the extent to which the produce was kept in a climate-controlled area. For example, if the produce is stored for a period of time above 40 degrees, then the customer can simply reject the shipment. 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," Petitioner

could be subject to reprimand, fines, or even plant closure, based on the severity of the violation. Petitioner is annually audited by the FDA in this regard. 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.

As stated below, this production process is designed to prevent foodborne illnesses. Some of the worst outbreaks of such illnesses have occurred in the past few years.

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. The microbes are described as follows:

- **Listeria monocytogenes** is a germ that can cause a serious infection called Listeriosis, which presents as flu-like symptoms. People usually become ill with listeriosis after eating contaminated food. The disease primarily affects pregnant women, newborns, older adults, and people with weakened immune systems. Approximately 80% of those with Listeriosis go into the hospital, and as many as 18% of those infected die.
- **Escherichia coli** (abbreviated as E. coli) are bacteria that can cause diarrhea, urinary tract infections, respiratory illness and pneumonia, and other illnesses. E. coli are pathogenic, meaning they can cause illness, either diarrhea or illness outside of the intestinal tract. The types of E. coli that can cause diarrhea can be transmitted through contaminated water or food, or through contact with animals or persons.
- **Salmonella** is a bacteria that can cause diarrhea, fever, and abdominal cramps between 12 and 72 hours after infection. The illness usually lasts 4 to 7 days. In some cases, diarrhea may be so severe that the patient needs to be hospitalized. In these patients, the Salmonella infection may spread from the intestines to the blood stream, and then

to other body sites. In these cases, Salmonella can cause death unless the person is treated promptly with antibiotics. The elderly, infants, and those with impaired immune systems are more likely to have a severe illness. See The Centers for Disease Control and Prevention website, available at www.cdc.gov.

All three microbes grow naturally in South Carolina and are present in farms across the country where Petitioner's produce is harvested. The germ and bacteria can breed in produce if the environment is conducive to that growth. 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.

At issue are three sales tax exemptions including the machine exemption. The Department contested the machine exemption for the following machinery and equipment:

(1) **Bar Code Scanner and Mobile Computer Stand.** The scanners are used to track all produce through the manufacturing process. Per Petitioner's procedures and to comply with federal rules, the produce is scanned (1) when the produce exits the truck; (2) when it enters the cutting area; (3) when it leaves the cutting area; and (4) when the finished goods enters the truck. This is a federal requirement so that the produce can be tracked (1) back to the farm, and (2) forward to the customer in the event contamination is subsequently found in the produce. The mobile computer stands are used by quality technicians, food safety technicians, and production operators, and assist in the scanning and tracking of Petitioner's process flows

(2) **Forklift, Forklift Parts, Forklift Repair Parts, Forklift Rentals, and Forklift Batteries.** Forklifts are used through the cutting process to move 800 lbs. to 1,600 lbs. bags of raw produce onto the conveyor belt at the beginning of the cutting area. While some of these forklifts are used

temporarily in other areas of Petitioner's operations, at least 1/3 of the use is related to moving produce to the cutting area.

(3) **Warehouse Racks.** These racks are specially designed to assist in cooling and maintaining the temperature of the raw produce and finished product. Pallets cannot be stacked on top of each other due to cooling limitations of the produce. The racks are galvanized, to withstand the cold, wet, and humid area.

(4) **Pallet Flow Brakes.** These 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.

(5) **Storage Water Tanks.** The water tanks are part of the produce wash process, which occurs in the middle of the cutting process. The tanks are part of a self-contained wash process.

(6) **Generator Rentals for Fruit Ripening Purposes.** During the audit period, Petitioner rented generators to power machines used to ripen the tomatoes to a color acceptable to its customers.

(7) **Hand Trucks and Pallet Jacks, and Oil Lubricants Used Therein.** The majority of the use of the hand trucks and pallet jacks are to move sliced tomatoes and sack onions from the cold storage area to the high care to the in-feed line for the cutting process.

(8) **Black Ink for Aerosol Cans.** The ink is used in the ink jet printers which print "Sell By" dates on the finished produce packaging.

(9) **Floor Drain Covers.** Stainless steel floor drain covers are used in the high care area and serve as both a filter and drain. Petitioner utilizes these higher-quality drains in its recycling of the wash water. These drains were selected because material previously was entering the closed wash water system, causing adulteration of the water.

(10) **Plastic Shelves Used in the Lab/Retained Sample Room.** Petitioner holds back at least one bag of each production run and places it on the plastic shelves of the refrigerated area. In the event a customer claimed their product did not last, Petitioner utilized the withheld produce as a control.

(11) **Floor Treatment Chemicals, Brooms, Squeegees, Cleaning Machines.** The floor treatment chemicals inhibits growth of dangerous microbes, and the brooms and squeegees are used specifically in those areas to inhibit such growth. Respondent agreed 70% of the floor treatment chemicals and other products were used in the manufacturing process, but contended that 30% was not. Petitioner testified that the vast majority of the floor treatment chemicals, brooms, and squeegees were used in the manufacturing process.

(12) **Stacking Containers.** Mr. McEntire testified the stacking containers are used in the "work in process" section of the facility to separate processed produce until it is combined. The combination of those products into a bag completes the manufacturing process with respect to those mixed products. Thus, the stacking containers which hold the component pieces of the finished product are an indispensable part of the process by transferring the product along the process.

(13) **Maintenance Tools and Utility Cart.** Mr. McEntire testified the vast majority of the maintenance tools are used to repair machines within the high care area. Moreover, according to Mr. McEntire, utility carts used within the manufacturing area require special care due to the sensitive nature of the high care environment.

(14) **Blower Fan.** Mr. McEntire testified the blower fans are used to circulate refrigerated air throughout the facility, including both the high care and low care areas. Without the blower fans, Petitioner could not maintain the required temperature in its facility.

The Proposed Assessment also contained as taxable cut wheels, discs and nylon slings; refrigerator for self-life processing and lamps but the DOR conceded this equipment qualified as exempt machinery during the trial. The parties also resolved the taxation of electricity, which was part of the original Proposed Assessment. After resolving these issues, the Petitioner and Respondent were able to reduce the amount of sales tax at issue to $82,305.83 plus interest.

III. CONCLUSIONS OF LAW

Based upon the above Findings of Fact, the Court concludes the following as matters of law. The ALC has jurisdiction to hear this contested cases pursuant to S.C. Code Ann. §§ 1-23-600 (Supp. 2017) and 12-60-460.

Burden of Proof and Standard of Review

The standard of proof in this administrative proceeding is a preponderance of the evidence. See *Anonymous v. State Bd. of Med. Exam'rs*, 329 S.C. 371, 496 S.E.2d 17 (1998). In general, the party asserting the affirmative issue in an adjudicatory administrative proceeding has the burden of proof. See *Leventis v. S.C. Dep't of Health & Envtl. Control*, 340 S.C. 118, 133, 530 S.E.2d 643, 651 (2000) (citing 2 Am. Jur. 2d Admin. Law §360 (1994)). Here, Petitioners requested a contested case hearing and, therefore, have the burden of proof to show by a preponderance of the evidence that the Department's tax assessments for the periods at issue were incorrect.

A. Machine Exemption (12-36-2120(17))

1. All machines used within the temperature-controlled portion of the facility are exempt as machines used in the manufacturing process.

S.C. Code Ann. § 12-36-2120(17) exempts from sales tax the sale of "machines used in manufacturing, *processing, agricultural packaging*, recycling, compounding, mining, or quarrying tangible personal property for sale" (emphasis added). "Machines," according to the exemption, "include the parts of machines, attachments, and replacements used, or manufactured for use, on

or in the operation of the machines and which ... are necessary to the operation of the machines and are customarily so used."

In applying these statutes, "[t]he cardinal rule of statutory interpretation is to determine the intent of the legislature." *Jones v. State Farm Mut. Auto. Ins. Co.*, 364 S.C. 222, 230, 612 S.E.2d 719, 723 (2005). Furthermore, "[t]he legislature's intent should be ascertained primarily from the plain language of the statute." *State v. Landis*, 362 S.C. 97, 102, 606 S.E.2d 503, 505 (Ct. App. 2004). "What a legislature says in the text of a statute is considered the best evidence of the legislative intent or will." *Bayle v. S.C. Dep't of Transp.*, 344 S.C. 115, 122, 542 S.E.2d 736, 740 (Ct. App. 2001). "Revenue laws are generally construed in favor of the taxpayer and against the taxing authority." *Clark v. S.C. Tax Comm'n*, 259 S.C. 161, 169, 191 S.E.2d 23, 26 (1972) (internal quotation marks omitted).

The definition of "agricultural packaging" is found in § 12-6-3360, which provides a jobs tax credit for manufacturers and agricultural packagers meeting certain requirements. Section 12-6-3360(M)(16) defines "agricultural packaging" as

> the technology of enclosing or protecting or preserving agricultural products for distribution, storage, sale, and use. Packaging also refers to the process of design, evaluation, and production of packages used for agricultural products. Packaging can be described as a *coordinated system of preparing agricultural goods for transport, warehousing, logistics, sale, and end use.*" (emphasis added).

Here the statute clearly envisions a more expansive concept of "agricultural packaging," to include the transportation and warehousing both before and after the literal packaging. This definition includes the receipt of raw produce and placement of the produce on cooling racks, as well as the offloading labeling and control of the finished packaging to storage and ultimate delivery to customers.

The regulations defining "machine" greatly expand the definition beyond traditional notions of the term. For example, S.C. Code Ann. Regs. 117-302 provides that *patterns* for machinery parts and *chemicals* used in the manufacturing process qualify for the Machine Exemption. S.C. Code Ann. Regs. 117-302 (2013). This definition also includes *attachments* to machines. South Carolina Tax Commission, SC Technical Advice Memorandum #94-3 (Tax) (1994). Further, in Rev. Rul. 13-3, the Department found that even the component parts used to construct a manufacturing machine qualified as a "machine" for purposes of the exemption. In the oft-cited *Hercules Contractors and Engineers v. S.C. Tax Commission*, 280 S.C. 426, 313 S.E.2d. 300 (Ct. App. 1984) decision, the Court of Appeals held that vats and basins used in a wastewater treatment facility which performed no processing were exempt. "Even its railings, walkways and ladders *are required by state and federal law* and are thus necessary to the overall function of the system." *Id.*, 280 S.C. at 430, 313 S.E.2d. at 303. (Emp. added).

So while the definition of a "machine" is broad, the key becomes whether the purchases are "*integral and necessary* to the manufacturing process," such that "the product being manufactured is being manufactured 'for sale'" (emphasis added). S.C. Regs. 117-302.5 provides a three-part test to determine whether a machine is "integral and necessary" to the manufacturing process:

> (1) The machine is used at a manufacturing facility. . . . It does not apply to machines used at a facility whose purpose is retailing, wholesaling, distributing, or some other non-manufacturing purposes.
> (2) The machine is used in, and serves as an essential and indispensable component part of the manufacturing process, and is used on an ongoing and continuous basis during the manufacturing process. A machine is not part of the manufacturing process merely because it is integral and necessary to the manufacturer.
> (3) The machine must be substantially "used in manufacturing . . . tangible personal property for sale." The statute does not required that the machine be used exclusively for manufacturing; however, incidental manufacturing use will not qualify for the exemption. For purposes of

> the exemption, more than one-third of a machine's use in manufacturing is substantial.

S.C. Regs. § 117.302.5(B)(1). Importantly, the machine exemption applies so long as 1/3 of the machine's use is devoted to manufacturing purposes. S.C. Regs. Section 117-302.5 provides that in order to be exempt, the machine must be "*substantially* 'used in manufacturing ... tangible personal property for sale'" (emphasis added). According to that regulation, "[t]he statute does not require that the machine be used exclusively in manufacturing; however, incidental manufacturing use will not qualify for the exemption. For purposes of the exemption, *more than one-third of a machine's use in manufacturing is substantial.*" Section 117-302.5(B)(1)(c). (Emp. added). This means that a piece of machinery like a forklift can serve many purposes within a manufacturing facility and still be eligible for the exemption, so long as the taxpayer can establish that more than 1/3 of its use is for manufacturing.

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, 650 (Ohio 1952). Only those assets which physically transform raw materials during the manufacturing process into a different form are eligible for the exemption. In other words, "the test is not whether the property is essential to the operation of the plant but whether it is an actual part of the process of manufacture." *Hawes v. Custom Canners, Inc.*, 173 S.E.2d 40 (Ga. Ct. App. 1970).

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*, 286 A.D. 446 (N.Y. 1955). In finding that now material handling equipment including both coal handling and ash disposal equipment fell within the exemption (including the cranes and car dumper that unloaded incoming coal; conveyor belts that moved the coal to the boiler; crushers and sprayers that processed the coal; and slag lines that carried ash from the boiler), the *Niagara* court determined the relevant questions to be:

> (1) Is the disputed item necessary to production?
> (2) How close, physically and causally, is the disputed item to the finished product?
> (3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?

The court found that the crane and car dumper were as essential to production as the generator itself, since a serious breakdown in operation would quickly stop or impair the output of electricity. The court also noted that while some structures may not play as active a role as other parts, "activity is not the test of directness." Instead, "[t]he important thing is that all parts of the plant contribute, continuously and vitally, to production, and they are all integrated and harmonized."

In *Spring 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 Rev. 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: In *Hercules*, even purchases of ladders, walkways, and scaffolding were found to be exempt from sales tax under this machine exemption.

The DOR audit held that the machinery and equipment used to move the fresh produce into the manufacturing process were not exempt. There is no dispute that the machinery used in the cutting and processing was exempt.

In this case, given Petitioner's highly regulated business as a fresh food processor, the tools and equipment used immediately before and after the actual processing of the fresh produce is integral to the overall processing/manufacturing process, as well as the health and safety functions. Without the process that occurs in these climate-controlled areas, it would seriously impair the ability of the taxpayer to efficiently and safely prepare a finished product for sale and distribution. The refrigeration itself, as well as the tools and equipment used therein, contributes, both "continuously and vitally, to production" and the assembly line production is surely "integrated and harmonized," as described in the Integrated Plant concept above.

Moreover, federal guidelines mandate all aspects of the refrigeration. According to Section VIII, Part C, Item 3, of the Food and Drug Administration's Guide to Minimize Microbial Food Safety Hazards of Fresh-cut Fruits and Vegetables, fresh–cut produce is recommended to be stored in areas with a temperature of less than or equal to 41 degrees Fahrenheit. The Food Safety Modernization Act of 2011, Section 117.93, provides even further and mandates that any "Storage and transportation of food must be under conditions that will protect against allergen cross-contact

and against biological, chemical (including radiological), and physical contamination of food, as well as against deterioration of the food and the container." Additionally, 21 C.F.R. § 110.80(b) provides:

> (b) Manufacturing operations. (1) Equipment and utensils and finished food containers shall be maintained in an acceptable condition through appropriate cleaning and sanitizing, as necessary. Insofar as necessary, equipment shall be taken apart for thorough cleaning.
>
> (2) *All food manufacturing, including packaging and storage, shall be conducted under such conditions and controls as are necessary to minimize the potential for the growth of microorganisms*, or for the contamination of food. One way to comply with this requirement is careful monitoring of physical factors such as time, temperature, humidity, aw, pH, pressure, flow rate, and manufacturing operations such as freezing, dehydration, heat processing, acidification, and refrigeration to ensure that mechanical breakdowns, time delays, temperature fluctuations, and other factors do not contribute to the decomposition or contamination of food.
>
> (3) Food that can support the rapid growth of undesirable microorganisms, particularly those of public health significance, shall be held in a manner that prevents the food from becoming adulterated within the meaning of the act. Compliance with this requirement may be accomplished by any effective means, including:
>
> > (i) Maintaining refrigerated foods at 45 deg. F (7.2 deg. C) or below as appropriate for the particular food involved. (Emp added.).

Since keeping the temperature of this product at or below 41 degrees must be done to prevent contamination of our product, and must be stored (by Congressional Act) in certain areas of plant to prevent cross-contamination (storage racks are the only viable option) then it is considered continuous, on-going and integral to the manufacturing process and therefore exempt. Even once the product is loaded onto Petitioner's trucks, the 41-degree requirement must be met until it is ready to be sold inside a restaurant. Temperature recorders are required for refrigerated

trucks to ensure that the product never went above this requirement at any time while in transit. In addition to federal law, customer contractual requirements are equally as stringent.

Based on the foregoing, the Department improperly limited the exemption to only those items used in the cutting process. The highly specialized and highly-regulated nature of the food processing industry mandates a more expansive view of the manufacturing process to include activities both before and after the literal processing of the produce. Purchases of these items are exempt from tax under the Machine Exemption (§ 12-36-2120(17)) using the integrated plant theory, which has been adopted by the South Carolina Court of Appeals.

2. Specifically, protective clothing related to maintaining the physical environment of the processing areas also are Exempt under the Machine Exemption

At first blush, protective clothing does not seem to fit the definition of machinery and equipment (any more than the ladders, walkways, and scaffolding in the *Hercules* case). The Department itself acknowledges, however, that protective clothing fits within the machinery and equipment ambit. The Department's published guidance provides that "[p]rotective clothing worn by an employee working in the area in which the manufacturing process occurs does not qualify as a machine and is not exempt from the tax as a machine used in manufacturing tangible personal property for sale under Section 12-36-2120(17)." However, that guidance is intended to apply to protect the worker's own clothing from dirt, paint, oils, etc. which are given off in the manufacturing process. On the other hand, the clothing worn by Petitioner's workers serves a substantively different purpose. Petitioner's gear protects *the produce* from the worker (for the purpose of protecting the ultimate consumer). The gear puts a barrier between the end product – the chopped vegetable – and the workers entering the high care area. The gear is absolutely vital and is required by state and federal law as detailed below to maintain the physical environment

necessary to produce Petitioner's finished product in a safe and unadulterated manner. The Court of Appeals in *Hercules* held that railways, walkways and ladders were exempt under the machine exemption as they were required by state and federal law and thus were necessary, to the overall function of the system. The same applies to Petitioner's protective clothing. The gear creates a physical barrier that maintains the integrity and purity of Petitioner's manufacturing process, is required by state and federal law and thus as described above, must be considered an integral part of that process.

3. The remaining purchases at issue are exempt from tax under the Machine Exemption

The Court finds the following machinery and equipment exempt under the machine exemption as all (1) are used in a manufacturing facility; (2) serve as an essential and indispensable component part of the manufacturing process on an ongoing and continuous basis; and (3) are substantially used (more than one-thirds use) in manufacturing tangible personal property for sale. The Bar Code scanner is required by federal law to track produce, and the mobile computer stands assist in the gathering and analysis of that tracking information. The Forklifts and batteries were substantially used to move 800-1,600 pounds of raw produce into the first step of the manufacturing process – onto the conveyor belt. Mr. McEntire testified that up to 12 of the 30 Forklifts on site are used to feed the manufacturing process. Because these Forklifts are used interchangeably at the site, and because more than 1/3 of the forklifts are required to feed the manufacturing process (which runs nearly continuously), it is reasonable to conclude that each is used at least 1/3 of the time for manufacturing purposes. Therefore, all of the Forklifts are eligible for the exemption. Racks were specifically designed to maintain the temperature of produce at federally mandated levels. Pallet flow breaks performed a significant safety function while moving produce. Water tanks distribute water in the middle of the production process. Generators

were used to ripen tomatoes. Hand trucks were used to move produce in the middle of the production process. Black ink was used to mark the finished products. Petitioner's stainless steel floor drain covers filtered wash water during the water recycling process. The specialized plastic shelves were used to shelve produce in the control sample room. Petitioner's witnesses testified that floor treatment chemicals and cleaning machines were used daily in the manufacturing area. The stacking containers hold the component pieces that compose the finished product of mixed produce, and thus are an indispensable part of the process. Blower fans circulate the chilled air in the facility. Without the blower fans, Petitioner would be unable to maintain the constant temperature required for its manufacturing operations. Finally, maintenance tools and the utility cart holding the tools are used primarily on the exempt machines.

Petitioner's witnesses all testified that the above machinery and equipment were used directly in the manufacturing process and each served an essential and indispensable role. The Department provided no contrary testimony.

B. Protective Clothing for Class 100 Facility (12-26-2120(54))

The Proposed Assessment also assessed use tax on protective clothing related to maintaining the physical environment of the processing areas. Petitioner makes substantial purchases of such items on an annual basis. The DOR denied the exemption based upon the Department Determination and the testimony at trial for two reasons: (1) the Petitioner has not established that it met the Class 100 Clean Room requirements; and (2) that protective clothing was required to work in the Clean Room. Petitioner established at trial that the high care area met the Class 100 Clean Room environment and that the protective clothing at issue was required to work in such area. The Department provided no contrary testimony. Accordingly, purchases of protective clothing are also exempt from tax based on the Class 100 facility exemption discussed

below.

S.C. Code Ann. § 12-36-2120(54) exempts from sales tax "clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room *environment*." (emphasis added.) Note that the exemption specifically includes the term "environment". In other words, the exemption does not expressly track the Federal Standard 209E, which uses the term "cleanroom." Therefore, the intent of the statute is to provide a more expansive exemption for environments which have qualities of the Federal Standard 209E. The parties agreed that Federal Standard 209E was cancelled in 2001 (see Notice of Cancellation filed by U.S. General Services Administration (GSA), and ISO 14644-1 was adopted in its place.

"Class 100" describes the number and size of particles permitted per volume of air in "cleanroom" environments. Class 100 under Federal Standard 209E, which is equivalent to ISO 5, permits 100 particles of 0.5 microns or greater per cubic foot.

Although the FDA does not appear to have a micron filtration requirement *per se*, it does require all food processors to establish a written Hazard Analysis Critical Control Point (HACCP) Plan under 21 C.F.R. § 117.130(a)(2) that establishes good manufacturing practices. If a manufacturer does not have a HACCP Plan, then it can be found in violation of Part 117 of the FDA regulations and can be censured, fined, or shut down by the FDA. In all of its published guidance, the FDA recommends filtering both air within a facility and compressed air that comes into contact with produce to at least 0.3 microns in order to remove bacteria and molds. Thus, a fresh food producer like the Petitioner meets the Class 100 standard when it satisfies the FDA filtration level.

ISO industry specialists reference providers of clothing and other supplies which are

required to ensure ISO integrity and compliance. According to Jan Eudy[1] of Controlled Environments Magazine, the following chart is illustrative of the garment configurations for each ISO class of air cleanliness.

Garment system configurations for different classes of air cleanliness.

Apparel Type	Air Cleanliness Classes of ISO 14644-1:1999[1]							
	ISO Class 8	ISO Class 7	ISO Class 6	ISO Class 5	ISO Class 5 Aseptic	ISO Class 4	ISO Class 3	ISO Class 1, ISO Class 2
Inner Suit	AS	AS	AS	R	AS	R	R	R
Hair Cover (Bouffant)	R	R	R	R	R	R	R	AS
Woven Gloves	AS	AS	AS	AS	NR	NR	NR	NR
Barrier Gloves	AS	AS	AS	AS	R	R	R	R
Facial Cover	AS	AS	AS	R	R	R	R	AS
Hood	AS	AS	AS	R	R	R	R	AS
Powered Headgear	AS	AS	AS	AS	AS	AS	AS	R
Frock	R	R	AS	AS	NR	NR	NR	NR
Coverall	AS	AS	R	R	R	R	R	R
Two-Piece Suit	AS	AS	AS	AS	NR	NR	NR	NR
Shoe Cover	R	R	AS	AS	NR	NR	NR	NR
Boot	AS	AS	R	R	R	R	R	R
Special Footwear	AS	AS	AS	AS	AS	AS	AS	AS
Suggested Frequency of Change[2]	2x/week	2x/week	3x/week	1x/day	Per Entry	Per Entry	Per Entry	Per Entry

[1] For correlation of ISO air cleanliness classes to the former FED-STD-209 classes, refer to Table 1 in this document.
[2] Consideration should be given to the effects of seasonal conditions in some geographical areas. Note that the suggestions made are not based on scientific data but instead reflect the collective experience offered by the working group. Individual requirements for change frequency should be determined on a case-by-case basis.
R = Recommended
NR = Not Recommended
AS = Application Specific

[2]

Table 1: IEST-RP-CC003 gowning configurations chart.

Under Class 5 of ISO (formerly FS209E), this chart demonstrates that there is no garment configuration which is "NR," (not required). All of the protective clothing at issue in this audit is either required (R) or application specific (AS). As stated below, federal health and safety law

[1] *See* https://www.cemag.us/article/2015/04/professional-profile-jan-eudy
[2] Jan Eudy, *Cleanroom Garment Selection*, CONTROLLED ENVIRONMENTS (Apr. 14, 2014), https://www.cemag.us/article/2014/04/cleanroom-garment-selection. *See also* BERNER INTERNATIONAL, https://www.berner-safety.de/recommended_cleanroom_clothing_per_cleanroom_classes_en_1415.html.

requires *all* of the protective clothing at issue in this audit, and is thus Application Specific. In addition, Petitioner's witnesses all testified that the Protective Clothing was required in the clean room environment and the Department provided no contrary testimony. Indeed, common sense indicates that it would serve little purpose to filtrate air if Petitioner's employees were releasing E. coli, Listeria, and Salmonella from their hands and clothing onto the produce.

Although the FDA expects air to be filtered to 0.3 microns, the taxpayer filters its ambient air to 0.3 microns and its compressed air to 0.1 microns (see Petitioner's Exhibit 9). BRC Global Standards, an industry-leading safety and quality certification program, conducted annual extensive audits of Petitioner regarding the quality, safety and operational manufacturing standards during the audit period. From its 2015 annual audit of Petitioner, BRC Global Standards concluded that the taxpayer's "[c]ompressed air used directly in contact with the product contact surfaces is filtered by a series of two filters (first filter 1 micron, second filter 0.1 micron)." This means the compressed air used by the Petitioner meets, and in fact significantly exceeds, the "Class 100 or better" described by the exemption, which requires 0.5 microns. The taxpayer's fresh-cut produce is in a Class 100 environment, and all the protective clothing at issue is required in such environment. Accordingly, all protective clothing used in that environment is exempt under § 12-36-2120(54). Taxpayer cannot achieve the required airborne particulate requirement cleanliness as required by ISO 14644-1 (formerly FS209E) without the use of protective safety attire as discussed herein. For the above mentioned reasons, Taxpayer's processing area meets the definition of a "Class 100 or better" clean room as required under S.C. Code Ann. § 12-36-2120(54). Taxpayer is entitled to a sales tax emption on the clothing and other supplies used in conjunction with its clean room.

While a Department Determination is deemed correct, the auditor was not aware the

Petitioner's facility had been certified as a Class 100 Clean Room and she was not aware that protective clothing is required to maintain the Class 100 environment. In addition, she was under the impression that the entire facility had to meet the Class 100 requirement, and not just the high care area where the protective clothing was used. Lastly, the auditor was not aware that the FDA recommends a Class 100 Clean Room environment at a fresh foods processing facility. This was the auditor's first audit of a Class 100 Clean Room.

C. Pollution Control Exemption (§ 12-36-2120(17))

Finally, to the extent the protective clothing is not exempt under either the machine exemption or the Class 100 exemption described above, the purchases deemed taxable in the Proposed Assessment are exempt under the Pollution Control Exemption provided in § 12-36-2120(17), which exempts machines "necessary to comply with the order of an agency of the United States or of this State for the *prevention or abatement of pollution* of air, water, or noise that is *caused or threatened by any machine used* as provided in this section." The pollution control regulation, Regulation 117-302.6 states in relevant part that:

> Frequently, these machines [that are exempt from sales or use tax under S.C. Code § 12-36-2120(17)] cannot be operated when the same pollute beyond regulated levels and in compliance with orders of agencies of the United States or of this state to abate or prevent pollution caused or threatened by the operation of such machines it is necessary to install *other machines that are designed and operated exclusively for the purpose of abating or preventing this pollution.* The purpose of this regulation is to classify the machines, their parts or attachments, as machines used in mining, quarrying, compounding, processing or manufacturing of tangible personal property when the same are installed and operated for compliance with an order of an agency of the United States or of this state to prevent or abate pollution caused or threatened by the operation of other machines used in the mining, quarrying, compounding, processing and manufacturing of tangible personal property. (Emphasis added.)

Regulation 117-302.6 further clarifies that:

> The term "machine" as defined in Section 12-36-2120(17) shall include machines, their parts and attachments, when the same are necessary to comply with the order of an agency of the United States or of this state for the prevention or abatement of pollution that is caused or threatened by any machines used in the mining, quarrying, compounding, processing and manufacturing of tangible personal property.

Thus, the Petitioner, a manufacturer of fresh produce, is exempt from taxes on machines which are necessary to comply with the order of a state or United States agency to prevent or abate pollution that is precipitated by other manufacturing machines used in the process of cutting and bagging fresh produce. From this, the court derives three elements that must be met: (1) a machine that (2) prevents or abates pollution caused by machines used in the manufacturing process and is (3) necessary to comply with the order of an agency. "As a general rule, tax exemption statutes are strictly construed against the taxpayer." *Se.-Kusan, Inc. v. S.C. Tax Comm'n*, 276 S.C. 487, 489, 280 S.E.2d 57, 58 (1981) (citation omitted). This means that "constitutional and statutory language will not be strained or liberally construed in the taxpayer's favor," but neither will the court "search for an interpretation in the [Department's] favor where the plain and unambiguous language leaves no room for construction." *Id.* (citation omitted).

The following summarizes the applicable requirements.

1. **Purchases at issue prevent or abates pollution "caused or threatened by" machines used in the manufacturing process**

    i. **E. Coli, Salmonella, and Listeria are all "pollution."**

The major thrust of the Department Determination was that food contamination and diseases are not "pollution." While the Department Determination is presumptively correct, the DOR auditor testified that she didn't know what the definition of "pollution" was under the statute, and didn't know enough about E. coli, Listeria or Salmonella to determine whether they constituted "pollution." (This was the auditor's first audit of a fresh foods manufacturing facility.) In addition, Corey Smith, the DOR witness from the Policy Section, testified at trial that he considered such

potentially serious (if not fatal) diseases as "pollution."

Section 12-36-2120(17) does not define the word "pollution." Pollution is defined by Black's Law Dictionary as, "[t]he presence of *harmful substances* (*either physical or gaseous*), noise or energy (radiation) within a certain area, that *causes harm* to the surroundings, altering the natural environment around which it has been excreted."[3] Other dictionary definitions are similar. For example, Wikipedia defines "pollution" as "the introduction of *contaminants* into the natural environment that cause adverse change." Wikipedia, *https://en.wikipedia.org/wiki/Pollution* (emphasis added). Dictionary.com defines "pollution" as "1. the act of polluting or the state of being polluted, 2. the introduction of *harmful substances* or *products* into the environment." http://www.dictionary.com/browse/pollution (emphasis added). The DOR auditor agreed at trial with these definitions.

When determining "pollution," it is important to consider not only the harmful microbes at issue (i.e., Listeria, E. coli, salmonella), but also the host/carrier of those microbes. These microbes are typically transmitted through human and animal feces. This means the microbes are being transported when fecal matter lands on or around the produce, and then travels on the produce to the processing facility. Fecal matter can also be transported into the facility on the shoes and feet of employees, particularly those with pets or who live in rural areas with deer and other wild animals. All of Petitioner's control efforts are focused on the prevention or abatement of fecal pollution into the water or air. The Environmental Protection Agency recognizes the significant threat of fecal pollution:

> *Fecal pollution of water from a health point of view is the contamination of water with disease-causing organisms (pathogens) that may inhabit the gastrointestinal tract of mammals, but with particular attention to human fecal sources as the most relevant source of human illnesses globally.* Ingestion of water contaminated with feces is responsible for

[3] Black's Law Dictionary, https://thelawdictionary.org/pollution (emphasis added).

> a variety of diseases important to humans via what is known as the fecal-oral route of transmission. Food, air, soil, and all types of surfaces can also be important in the transmission of fecal pathogens, and thereby implicated in disease outbreaks. Most fecal microorganisms, however, are not pathogenic. Indeed, some are considered beneficial to the host as they can outcompete pathogens for space and nutrients, complement the biochemical potential of the host's gastrointestinal tract, and help in the development of the host immune system. Nonetheless, animal feces can also carry a number of important frank and opportunistic pathogens, capable of inflicting debilitating illnesses and, in some cases, death. In 1998, it was estimated that 2.2 million deaths were associated with diarrhea each year, a good percentage of them due to fecal pollution of water, with the vast majority of victims being children in poor countries (WHO, 2000). This should not be a surprise as it has been estimated that more than 1 billion people worldwide lack access to safe drinking water, and more than 2 billion lack sanitation. Sadly, very little progress has been made in the last 20 years to ameliorate these problems, particularly due to the rapidly increasing global population. *On the contrary, problems associated with fecal pollution of water are likely to worsen in coming decades*, as more people are moving to coastal areas, most people now live in urban centers, many of which have out of control growth rates, and demands for animal meat products are increasing due to current trends in dietary regimes. *Considering that per capita water availability and quantity are diminishing worldwide, it is reasonable to assume that fecal pollution of water is one of the most important and difficult challenges for future generations.* (emphasis added).[4]

Moreover, there is a large amount of case law throughout the United States which categorizes contamination of food as a pollutant with respect to a commercial insurance policy where the term "pollutant" is specifically defined in the *exclusion section* of such policies. The Court of Appeals of Wisconsin held that the term " 'contaminants' as used in [the] pollution exclusion of [a] commercial property insurance policy, included bacteria, and thus the insurance policy excluded coverage *for any losses resulting from bacterial outbreak at insured's food processing facility.*" *Landshire Fast Foods of Milwaukee, Inc. v. Employers Mut. Cas. Co.*, 269 Wis.2d 775, 783, 676 N.W.2d 528, 532 (Ct. App. 2004) (emphasis added). In this case, Landshire,

[4] Santo-Domingo, J.W. and N. Ashbolt, Fecal Pollution of Water, extract available at https://cfpub.epa.gov/si/si_public_record_report.cfm?Lab=NERL&dirEntryId=196784.

a food preparer, delivered sandwiches containing listeria to its client, Great Lakes Naval Training Station commissary. *Id.* At 778, 676 N.W.2d at 529. Once the contamination was discovered, Great Lakes returned all of the contaminated food to Landshire. *Id.* Landshire determined that the food contamination occurred on a meat slicer at their facility. *Id.* At 779, 676 N.W.2d at 529. After this contaminated food incident, Landshire "submitted claims for loss of income, loss of product, sanitizing expenses, and costs related to investigating the source of the bacteria" to their insurance company. *Id.* At 779, 676 N.W.2d at 530. Landshire's insurance policy contained what is commonly referred to as a pollution exclusion. *Id.* At 782, 676 N.W.2d at 531. Landshire's insurance policy specifically stated, "[w]e will *not pay for loss or damage* caused directly or indirectly by any of the following . . . Discharge, dispersal, seepage, migration, release or escape of '**pollutants**' unless the discharge, dispersal, seepage, migration, release or escape is itself caused by . . . .". *Id* (emphasis added). Furthermore, the policy defined pollutants as " 'any solid, liquid, gaseous or thermal irritant or **contaminant**, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." *Id* (emphasis added). The parties in this case disputed the actual scope of the term "contaminant," and specifically whether listeria was a "contaminant." *Id.* at 782-83, 676 N.W.2d at 531. To answer this question, the court looked to *Richland Valley Products, Inc. v. St. Paul Fire & Cas. Co.*, which held that:

> [C]ontamination 'connotes a condition of impurity resulting from mixture or contact with a foreign substance,' that that it means 'to make inferior or impure by mixture; and impairment of impurity; loss of purity resulting from mixture or contact,' a definition the court found consistent with common understand and WEBSTERS NEW INTERNATIONAL DICTIONARY. . . .

201 Wis.2d 161,169-70, 548 N.W.2d 127, 169 (Ct. App. 1996) (quoting *American Casualty Co. of Reading, P.A. v. Myrick*, 304 F.2d 179, 183 (5th Cir. 1962)) (emphasis in original). The court ultimately held that the term "contaminant" in an insurance contract such as the one in dispute in

the case is not susceptible to multiple interpretations. *Landshire,* 269 Wis.2d at 785, 676 N.W.2d at 533. Therefore, the food contamination caused by listeria was a *pollutant* and was thus excludable from an insurance claim by Landshire. *Id.*

South Carolina case law is nearly identical to the states discussed above. For example, in *Helena Chemical Co. v. Allianz Underwriters Ins. Co.*, the Supreme Court of South Carolina held that the pollution exclusion in the plaintiff's policy barred its claims. 357 S.C. 631, 641, 594 S.E.2d 455, 460 (2004). In *Helena*, the Court noted that almost all insurance policies contain an identical pollution exclusion policy. *Id.* The Court went on to state that "pollution arising from ordinary business operations is not covered. *But* if the damage were caused by a 'sudden and accidental' discharge, release, or escape of pollutants, *then the insurers must provide coverage.*" *Id* (emphasis added). Because the Court held that "the *contamination* at the various sites was caused by Helena's routine business operations and was, therefore, not unexpected and accidental," plaintiff fell under the pollution exclusion. *Id.* at 642, 594 S.E.2d at 460.

Here, with Taxpayer's case, even though S.C. Code Ann. § 12-36-2120 *does not* contain a definition of "pollutant," insurance policies throughout the entire country repeatedly and continuously consider contaminants such as bacteria on foods to be a "pollutant" due to its "contaminating" nature. *See also Nova Cas. Co. v. Waserstein*, 424 F.Supp 1325, 1334 (S. D. Fla. 2006) (holding that "living organisms," "microbial populations," "airborne and microbial contaminants," and "indoor allergens" are contaminants and are excluded from coverage under the insurance policies pollution exclusion). Based upon the foregoing, I conclude that E. coli, Listeria, and Salmonella constitute "pollution." In addition, the use of Petitioner's safety attire protects against pollution through the contamination of food.

Taxpayer's primary reason for using such safety attire is to prevent an outbreak of a foodborne illness. An example of the type of outbreak for which Taxpayer is trying to prevent can be illustrated by a recent multi-state outbreak of Listeriosis in packaged salads manufactured by Dole at a processing facility in Springfield, Ohio[5] (The Taxpayer in this matter packages salads). In this Springfield, Ohio outbreak, "[e]pidemiologic and laboratory evidence indicated that packaged salads produced at the Dole processing facility in Springfield, Ohio. . .were the likely source of this outbreak."[6] According to the FDA, "[their] inspection report. . .showed that Dole's tests of surfaces at the plant came back *positive* for Listeria on *nine* separate occasions in 2014 and 2015."[7] This outbreak of Listeria led to the hospitalization of twelve individuals, as well as one *death.*[8] In another instance, "a family-owned farm in Colorado [Jensen Farms] became the focal point of the largest foodborne illness outbreak in the US in 25 years."[9] This outbreak, which was caused by Listeria in cantaloupe, "sickened 146 people in 28 states, killed 30 and caused one pregnant woman to miscarry, according to the Centers for Disease Control and Prevention (CDC)."[10] The Food and Drug Administration determined that this *entire* outbreak could have been prevented if "Jensen Farms had *maintained its facilities in accordance with existing [then] voluntary FDA guidance.*"[11] (FDA rules are no longer voluntary.) Outbreaks of foodborne illness are extremely deadly to individuals of all ages. Preventing pollution from leaching onto/attaching to the food product at Taxpayer's facility is of the utmost importance.

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[5] Centers for Disease Control & Prevention, https://www.cdc.gov/listeria/outbreaks/bagged-salads-01-16/index.html.
[6] *Id.*
[7] NBC News, https://www.nbcnews.com/business/business-news/dole-under-federal-investigation-after-deadly-listeria-outbreak-n565196 (emphasis added).
[8] Reuters, https://www.reuters.com/article/us-usa-listeria-dole/listeria-contaminated-salad-from-dole-food-kills-one-cdc-idUSKCN0V02CE (emphasis added).
[9] Chris Wiant, *The Jensen Farms Cantaloupe Outbreak: How to Avoid Repeating A Tragedy*, Water Quality & Health Council (Jan. 20, 2012), https://waterandhealth.org/disinfect/food_safety/jensen-farms-cantaloupe-outbreak-avoid-repeating-tragedy/.
[10] *Id.*
[11] *Id* (emphasis added). Furthermore, note that this FDA Guidance is no longer voluntary, *see* 21 C.F.R. § 117.

In the food processing industry, there are three primary foodborne illnesses which cause a majority of sickness and death to consumers: 1. Listeria Monocytogenes, 2. E. coli O157:H7, and 3. Salmonella. According to the CDC, "[l]isteriosis is a serious infection caused by the germ *Listeria Monocytogenes.*"[12] The CDC has a webpage specifically dedicated to "Selected Multistate Outbreaks" where the CDC was the lead public health agency.[13] In Taxpayer's industry, E. coli O157:H7 is most commonly transmitted via the transfer of feces.[14] In addition to required hand washing and cleanliness, safety attire such as gloves and shoe/foot covers severely minimize the transfer of such a pollutant from employees to Taxpayer's produce. Lastly, with respect to Salmonella, such dangers of contamination are similar to E. coli O157:H7 (transfer of human or animal feces). The safety attire purchased and used by Taxpayer prevents the pollution of produce at is facility and is a primary reason for Taxpayer's strong food safety record.

Since Taxpayer has demonstrated that the safety attire protects against "pollution," it must also establish that the pollution for which it protects against consists of air, water, or noise. According to the World Health Organization:

> Foodborne illnesses are usually infectious or toxic in nature and caused by bacteria, viruses, parasites or chemical substances entering the body through *contaminated food* or water.
>
> *Foodborne pathogens* can cause severe diarrhoea [sic] or debilitating infections including meningitis.
>
> Chemical contamination can lead to acute poisoning or long-term diseases, such as cancer. Foodborne diseases may lead to long-lasting disability and death. Examples of unsafe food include uncooked foods of animal origin, *fruits and vegetables* contaminated with faeces [sic], and raw shellfish containing marine biotoxins.[15]

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[12] Centers for Disease Control and Prevention, https://www.cdc.gov/listeria/faq.html (emphasis in original).
[13] *See* Centers for Disease Control and Prevention, https://www.cdc.gov/listeria/outbreaks/index.html.
[14] *See also* Foodsafety.gov, *https://www.foodsafety.gov/poisoning/causes/bacteriaviruses/ecoli/index.html.*
[15] World Health Organization, Food Safety-Key Facts (2017), http://www.who.int/news-room/fact-sheets/detail/food-safety (emphasis added).

Such contaminated food, if not disposed of properly, can contaminate the water supply. Taxpayer is the manufacturer in a very large and diverse supply chain. Once product leaves Taxpayer's facility, within a short period of time, due to the spoilage nature of produce, it is disseminated to thousands of businesses throughout the Southeast. If Taxpayer did not prevent the pollution as described above, the ultimate and immediate affects to the water supply of communities throughout the Southeastern United States could be substantial if such pathogen contaminated food is not disposed of properly.

Furthermore, Taxpayer uses three-hundred thousand (300,000) gallons of water per day at its facility, and discharges at least 150,000 gallons into the municipal sewer system daily. Water is the means by which the Petitioner is able to deliver its sanitizing agents to the produce and the facility. Approximately half of that water is recycled, and the other half of the water makes its way through the local sewage system. Taxpayer's use of safety materials directly prevents pollution which could contaminate the water supply at Taxpayer's facility and subsequently enter the counties water supply and/or rivers. After a recent Listeria outbreak in Arizona, the Food and Drug Administration determined that that the root cause was water found in a nearby stream.[16] After an extensive investigation, the Food and Drug Administration concluded that:

> [t]hree samples of irrigation canal water collected by the team were found to contain Ecoli O157:H7 with the same rare molecular fingerprint (using whole genome sequencing (WGS)) as the strain that produced human illnesses (the outbreak strain). These samples were collected from an approximate 3.5-mile stretch of an irrigation

[16] See Cynthia Hubert, *Heading to the American River this Week? Here's where E. Coli Levels are High*, Sacramento Bee, available at https://www.sacbee.com/news/article214295669.html; Sandee LaMotte, *Deadly E. Coli Outbreak in Lettuce Traced to Contaminated Water*, available at https://www.cnn.com/2018/06/29/health/e-coli-romaine-lettuce-outbreak-cause/index.html; AP, *Source of Romaine Lettuce E. Coli Outbreak Identified,* https://www.cbsnews.com/news/source-of-romaine-lettuce-e-coli-outbreak-identified/; Maggie Fox, *Dirty Canal Water May Have Tainted Romaine Lettuce with E. Coli*, available at https://www.nbcnews.com/health/health-news/dirty-canal-water-may-have-tainted-romaine-lettuce-e-coli-n887606; Julia Jacobs, *Officials Identify a Source in the Romaine Lettuce E. Coli Outbreak*, available at https://www.nytimes.com/2018/07/01/us/romaine-lettuce-e-coli-nyt.html.

> canal in the Wellton area of Yuma County that delivers water to several of the farms identified in the traceback investigation as shipping romaine lettuce that was potentially contaminated with the outbreak strain. *This recent news story demonstrates the threat of* ***pollution*** *to area waterways is a significant issue that affects the entire community.* [17]

ii. The pollution described above is "caused or threatened by any machine" used in Petitioner's manufacturing process.

Petitioner's witnesses went into great detail to describe the manufacturing process. In short, when the fresh produce is picked and enters the trucks for transport, it may have one of the contaminants described above either inside or on the surface of the produce. When the produce is cut during the manufacturing process, either by hand or with its mechanized choppers, those contaminants can be released into the air or water, and can essentially transfer to an exposed surface, where it can subsequently contaminate other produce as well as reproduce. (This is described by the FDA as cross-contamination). Additionally, when those pollutants are exposed during the cutting process, Petitioner's water sprayers and flume systems can cause the pollutants to aerosolize – that is, be transferred into tiny droplets of water that are dispersed into the air. The spread of the pollutants also occurs when the produce is dried – both the blowers and the produce dryers (think large salad-spinners) cause potentially polluted water to aerosolize. Use of the uniforms, cleaning chemicals, and other precautions during the manufacturing process helps to ensure that the pollution, which is exacerbated and disturbed from its state while on the produce, does not spread, generally referred to as cross-contamination or cross-contact.

Of interest is SC DOR PLR # 95-8. The taxpayer was an environmental consulting firm that contracted with manufacturing companies to remediate contaminated soil and water beneath

[17] See October 24, 2018 Memorandum to the File on the Environmental Assessment; Yuma 2018 E. coli O157:H7 Outbreak Associated with Romaine Lettuce, available at https://www.fda.gov/ucm/ groups/fdagov-public/@fdagov-afda-orgs/documents/document/ucm624633.pdf.

and surrounding the manufacturer's facilities. The contaminated areas were a direct result of chemical releases from machines used in manufacturing tangible personal property for sale. The taxpayer designed and installed dual vacuum extraction systems to contain and recover contaminants from soil and ground water. The systems were constructed from pumps, tanks, piping, and vacuum extraction devices to remove water and vapor from the ground. By removing the water and vapor, contaminants were removed from the ground so they could be disposed of properly. In addition, the now-clean water could, if needed, be used as a coolant in the manufacturing plant. The taxpayer made all purchases of the component parts that were used to construct these systems.

The PLR held that such purchases fell under the pollution control exemption, stating:

> The [pollution control exemption] regulation does not restrict the exemption to machines that prevent pollution or that reduce the amount of pollution released into the environment. *The clear language of the regulation also allows the exemption for machines used to reduce the amount of pollution already in the environment.* In other words, machines used to "clean up" pollution "caused . . . by the operation of other machines that are used in the mining, quarrying, compounding, processing, or manufacturing of tangible personal property" for sale qualify for the exemption under Code Section 12-36-2120(17). (Emp. added).

iii. The purchases at issue "prevent or abate" the pollution caused by the cutters, sprayers, blowers and other machinery.

The protective clothing at issue is vital to Petitioner's the control and containment of the pollutants described above. Most importantly, the protective clothing serves as a barrier between the high care area – where those pollutants are exposed and dispersed in the air and water – and the outside. Witnesses for Petitioner testified as to the rigorous processes for entering and exiting the high care area. All are designed to ensure that none of the dangerous microbes leave that area. Without the control, Petitioner could spread those microbes outside the facility. By requiring full

dress-down when exiting the clean room, Petitioner is able to contain the pollutants that may have been released from the produce during the manufacturing process.

The protective clothing serves the additional purpose of ensuring those pollutants are not introduced into the clean room environment by Petitioner's employees. Petitioner's manufacturing process results in significant spray-back, as cutters chop the produce, sprayers and wash flumes wash down the produce, and blowers and spinners dry the produce. Through this process, a significant amount of water becomes airborne. Pollutants brought into the room from an unsanitary employee could be released into the air or introduced to water used in Petitioner's manufacturing process.

2. Necessary to Comply with the Order of an Agency

In this case, the purchases at issue are required by the both federal and state regulation and statutes. Prior case law of this Court (which was not challenged by the Department) has established that federal agency regulations satisfy this requirement. *See Duke Energy Corp. v. Department of Revenue*, Docket No. 12-ALJ-17-0031-CC (filed April 28, 2017) (exemption applied to purchase of canister system used to comply with regulations of the U.S. Nuclear Regulatory Commission, an "independent United States agency").

The FDA has established extensive regulations to combat "environmental pathogens," which are those pathogens

> capable of surviving and persisting within the manufacturing, processing, packing, or holding environment such that food may be contaminated and may result in foodborne illness if that food is consumed without treatment to significantly minimize the environmental pathogen.
>
> Examples of environmental pathogens for the purposes of this part include *Listeria monocytogenes and Salmonella spp.* but do not include the spores of pathogenic sporeforming bacteria.

21 CFR § 117.3 (emphasis added). The following summarizes the state and federal agency guidelines requiring the use of the gear at issue.

i. FDA GMP Regulations

Specifically, 21 C.F.R. § 110.10 requires plant management to take all reasonable measures and precautions regarding the maintenance of a clean facility, including the following:

> (b) *Cleanliness.* All persons working in direct contact with food, food-contact surfaces, and food-packaging materials **shall** conform to hygienic practices while on duty to the extent necessary to protect against contamination of food. The methods for maintaining cleanliness include, but are not limited to:
>
> > (1) Wearing outer garments suitable to the operation in a manner that protects against the contamination of food, food-contact surfaces…
> > (3) Washing hands thoroughly (and sanitizing if necessary to protect against contamination with undesirable microorganisms) in an adequate hand-washing facility before starting work, after each absence from the work station, and at any other time when the hands may have become soiled or contaminated.
> > …
> > (5) Maintaining gloves, if they are used in food handling, in an intact, clean, and sanitary condition. The gloves should be of an impermeable material.
> > (6) Wearing, where appropriate, in an effective manner, hair nets, headbands, caps, beard covers, or other effective hair restraints.

Furthermore, 21 C.F.R. § 117.10(b), describes the measures and precautions that firms such as Taxpayer must exercise in order to:

> conform to hygienic practices while on duty to the *extent necessary* to protect *against* allergen cross-contact and against *contamination of food.* The methods for maintaining cleanliness include: (1) *[w]earing outer garments* suitable to the operation in a manner that protects against allergen cross contact and against the *contamination* of food, food contact surfaces, or food-packaged materials. . . (5) [m]aintaining *gloves*, if they are used in *food handling*, in an intact, clean and sanitary condition, (6) [w]earing, where appropriate, in an effective manner, *hair nets, headbands, caps, beard covers,* or other effective hair restraints. . . (9) [t]aking any other necessary precautions to protect against allergen

> cross-contact and against contamination of food, food contact surfaces, or food-packaging materials with microorganisms or foreign substances. . . ."

(emphasis added). Additionally, 21 C.F.R. § 117.80(a)(1) states that:

> [a]ll operations in the manufacturing, processing, packing, and holding of food (including operations directed to receiving, inspecting, transporting, and segregating) must be conducted in accordance with adequate sanitation principles. (2) [a]ppropriate quality control operations must be employed to ensure that food is *suitable* for human consumption and that food-packaging materials are safe and suitable. . . (c)(2) [a]ll food manufacturing, processing, packing, and holding must be conducted under such conditions and controls as are necessary to *minimize* the potential for the growth of *microorganisms, allergen cross-contact, contamination of food,* and deterioration of food. . . (5) [w]ork-in-process and rework *must be handled* in a manner that protects against allergen cross-contact, *contamination, and growth of undesirable microorganisms*. . . (10) [s]teps such as washing, peeling, trimming, cutting, sorting, inspecting, mashing, dewatering, cooling, shredding, extruding, drying, whipping, defatting, and forming must be performed *so as to protect* against allergen *cross-contact* and *against contamination.* Food must be protected from contaminants that may drip, drain, or be drawn into the food.

Finally, according to 21 C.F.R. § 117.37:

> Each plant must be equipped with adequate sanitary facilities and accommodations including:
>
> (a) Water supply. The water supply must be adequate for the operations intended and must be derived from an adequate source. Any water that contacts food, food-contact surfaces, or food-packaging materials must be safe and of adequate sanitary quality. Running water at a suitable temperature, and under pressure as needed, must be provided in all areas where required for the processing of food, for the cleaning of equipment, utensils, and food-packaging materials, or for employee sanitary facilities.

(emphasis added). Based on the foregoing, federal law explicitly requires all clothing at issue in this case.

ii. DHEC Statutes and Regulations

According to S.C. Code Ann. § 39-25-180(H) 39-25-180 (H)

> Good manufacturing practice regulations and their amendments now or hereafter adopted pursuant to the authority of the federal Food, Drug, and Cosmetic Act are the good manufacturing regulations of this State. However, the commissioner may adopt a regulation that prescribes conditions under which good manufacturing processes may be used in this State whether or not in accordance with regulations promulgated pursuant to the federal act.

DHEC has accordingly adopted the Part 110 and Part 117 guidelines stated above which require protective clothing.

Moreover, DHEC also has promulgated Regulation 61-25, which also provides rules and regulations for entities engaged in food production. Produce manufacturers like Petitioner comply with such regulations.

These regulations require the use of gloves, hair nets, and other protective clothing to reduce or eliminate opportunities for cross-contamination, and place responsibility for use on food protection managers. *See* S.C. Regs. 61-25, 2-103.11 (person in charge "shall ensure that … (L) employees are preventing cross-contamination of ready-to-eat food with bare hands by properly using suitable utensils such as deli tissue, spatulas, tongs, single-use gloves, or dispensing equipment"). Section 3-301.11(B) prohibits food employees from contacting exposed, ready-to-eat food with bare hands, and requires use of gloves. Under 2-402.11(B) food employees must wear hair restraints, including hats, hair covering and nets, beard restraints, and clothing that covers body hair. Those restraints must be both designed and worn to effectively keep hair from contacting exposed food, clean equipment, utensils, and linens. *Id.* Accordingly, state law requires all the clothing at issue in this matter.

3. Is Protective Clothing a "machine?"

The Department also alluded to the issue of whether protective clothing were "machines." "The term 'machine' includes every mechanical device or combination of mechanical powers and devices to perform some function and produce a certain effect or result." *Hercules Contractors &*

Engineers, Inc. v. S.C. Tax Comm'n, 28 S.C. 426, 431, 313 S.E.2d 300, 303 (Ct. App, 1984); *see also* S.C. Code Ann. Reg. 117-302.5(B)(1) (2012) (construing "machine" in the context of Clause A of the above subsection). A machine does not need moving parts to qualify for the exemption. *Id.* (citation omitted). While there is no DOR Policy Document on whether protective clothing constitutes a machine for the pollution control exemption, there are several policy documents which provide expansive definitions of "machines."

In S.C. Tax Commission Decision 92-19, the former Tax Commission held that stack liners and ash pond pipes and pumps were exempt as they operated exclusively in the abatement of pollution caused by the production of electricity. In S.C. Rev. Rul. # 89-7, the DOR opined that a settling basin for a wastewater treatment facility was exempt as one part of a single entity used to abate pollution and therefore purchases of materials such as concrete and steel to build the facility where likewise exempt.

At issue in 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 vault was designed and licensed for the purpose of containing gamma radiation. The vault had six foot thick walls with a specialized design to trap radiation. The vault was designed to withstand a direct airplane hit and catastrophic earthquake. The vault itself served no purpose other than to trap radiation, and it performed no processing. 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, 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 liners served three functions: (1) they were first transported to the power plant site where radioactive waste was

place inside them; (2) the liners then processed the waste into a more stable form, thus reducing the likelihood of nuclear accidents; and (3) the liners were then transported to disposal sites where they became permanent storage containers for holding waste. The Tax Commission staff held the liners were subject to sales taxes.

The Tax Commission disagreed, first holding that electricity is considered tangible personal property for sales tax purposes and thus the machine and pollution control exemption are applicable to nuclear generators. The Commission then 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). The evidence presented showed that the liners were more than mere storage tanks. They contained internal devices that processed radioactive waste into a less volatile state. This falls squarely within the definition of a 'machine.' The fact that the liners were subsequently used for storage does not detract from their function as machines. As noted in *Hercules* at page 308, a machine may have an alternate use but it still remains a machine.
>
> There is also adequate evidence indicating the liners abated pollution. Such evidence demonstrated that the processing undergone in the liners was a necessary step in the treatment of radioactive waste produced by power plants. In point of fact, nuclear utilities would not be licensed or allowed to operate without this means of processing nuclear waste. Moreover, the testimony and documentary evidence establishing these points are sufficient to meet the certification requirements of Regulation 117-173.

Lastly, in *Duke Energy, Inc. v. Department of Revenue*, *supra*, the ALC rejected the Department's argument that storage containers which contained spent nuclear fuel were not machines.

If stackliners, ash pond pipes, concrete and steel and metallic pool liner used to construct a gamma irradiator vault, and liners used in radioactive waste management services, and storage

containers constitute "machines," then certainly Petitioner's protective clothing required by state and federal law do as well.

The uncontroverted evidence in this matter demonstrates that the protective clothing are mechanical devices that act to prevent or mitigate contamination. The contamination comes from the machines essential to the production of the fresh produce, namely the cutting machines. Therefore, the court concludes that the protective clothing are machines for purposes of the statute. Furthermore, the court concludes that the protective clothing are used because of pollution produced or potentially caused (exposed) by machines necessary and integral to the Petitioner's manufacturing process.

D. Substantial Understatement

Further, to the extent the sales tax exemptions do not apply, the Proposed Assessment includes taxes outside the statute of limitations.

Petitioner contends that tax periods October 1, 2012 through May 31, 2013 are time-barred. I agree.

Generally, the Department has three years from the date the return is filed to audit and assess sales tax. However, § 12-54-85(C)(3) allows the Department to utilize a six-year statute of limitations if there is a substantial understatement of the total tax required to be shown on the return of at least 20%.

In this case, the Department issued its Proposed Assessment on July 19, 2016, which covered the period beginning October 1, 2012 and ending September 30, 2015. Petitioner appealed the proposed assessment, and the Department issued its Department Determination on March 15, 2017. The Department Determination utilized the longer assessment period, but did not provide its legal justification for that period. The general statute of limitations would have provided for an

assessment period of June 2013-September 2015. This means there are eight months which the Department opened for audit solely pursuant to § 12-54-85(C)(3).[18]

As "the final determination within the department from which a person may request a contested case hearing before the Administrative Law Court," § 12-60-30(10), the Department Determination by statute must "explain the basis for the department's determination." § 12-60-450(D)(2). Thus, the Department should be barred from utilizing a statutory mechanism to extend the assessment period when it fails to reference the basis in the Department Determination. The Department's abandonment of that argument in its Department Determination should limit the audit period at issue to June 30, 2013-September 30, 2015.

ORDER

For the reasons above, the Court finds that Petitioners are entitled to the sales tax exemptions covered above.

IT IS THEREFORE ORDERED THAT the Determination of the Department is reversed.

AND IT IS SO ORDERED.

H. W. Funderburk, Jr.
Administrative Law Judge

_____, 2019
Columbia, South Carolina

[18] Throughout the course of the audit, Petitioner agreed to extend the statute of limitations to October 1, 2012 on a number of occasions. *See* Petitioner's Exhibit 19. Its last extension was signed March 23, 2016 and expired May 31, 2016. The Department auditor acknowledged in an email that the extension did, in fact, expire. *See* Petitioner's Exhibit 17. I find the Petitioner properly preserved this argument when its representative challenged the use of § 12-54-85(C)(3) in the same email chain. *See id.*

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

McEntire Produce, Inc. Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No. 17-ALJ-17-0060-CC **CERTIFICATE OF SERVICE**

I certify that a copy of the foregoing **Petitioner's Proposed Order** was served upon counsel of record for the Respondent via electronic mail and U.S. Mail as shown below this 7th day of January 2019:

Lauren Acquaviva, Esq.
Chillico & Associates, LLC
3850 Bessemer Road
Suite 120
Mount Pleasant, SC 29466

Elisabeth Shields
SC Department of Revenue
P.O. Box 12265
Columbia, SC 29211-9979

Melinda White

South Carolina Administrative Law Court (SC ALC)

Request for Contested Case Hearing FORM

Mail to: 1205 Pendleton St., Suite 224, Columbia, SC 29201

Last Name:	First:	Middle:	☐ Mr. ☐ Mrs.	☐ Miss ☐ Ms.	Docket No. (To Be Completed by ALC)
McEntire Produce, Inc.					

Mailing Address:	City:	State and Zip:
P.O. Box 5817	Columbia	SC 29250

Home Number:	Work Number:	Cell Number:	*E-Mail Address:

*By providing your e-mail address, you consent to receive court orders and notices via electronic transmission

REPRESENTATION

Are you representing yourself? ☐ Yes ☒ No

Are you represented by an Attorney? ☒ Yes ☐ No

Name of Attorney: Burnet R. Maybank, III/Jim Rourke

Attorney Mailing Address:	City, State and Zip:
Nexsen Pruet LLC P.O. Drawer 2426	Columbia, SC 29202

Attorney Work Number and Cell Number:	Attorney E-Mail Address:
803-540-2048 803-960-3024	bmaybank@nexsenpruet.com; jrourke@nexsenpruet.com

CASE INFORMATION

Name of Agency that Issued the Decision: Department of Revenue
(Example – Dept. of Revenue, Dept. of Insurance, DHEC)

In order to have your case processed, **you must attach the agency decision.** Is it attached?:
☒ Yes ☐ No

If no, please explain:

Date the decision was issued: February 7, 2017

Date the decision was received: February 9, 2017

MAR 2017 RECEIVED S.C. Dept. of Rev. OGC for Litigation

Please provide a brief statement regarding why the hearing is being requested and the relief sought:

Petitioner McEntire Produce, Inc. contests the Department's Determination that its purchases of electricity, certain supplies, and safety attire are subject to sales and use tax. Petitioner requests this Court determine that the purchases identified in the attached Department Determine are exempt from sales and use tax pursuant to various exemptions available under S.C. Code Ann. § 12-36-2120.

Payment via ☐ Check ☐ Money Order ☐ Cash for $ (applicable **filing fee pursuant to** ALC Rule 71) is being submitted today to the Administrative Law Court via ☐ U.S. Postal Service ☐ Hand-delivery

X Your Signature or Signature of Attorney

March 7, 2017
Date

PROOF OF SERVICE (MUST BE COMPLETED)

Your Name: Jim Rourke Date: March 7, 2017 City: Columbia State: SC

I hereby certify that on the date and place listed above, I served a copy of the foregoing Request for Contested Case Hearing **on all other parties** to this matter by depositing the same in the United States Mail, postage paid, and addressed as follows (use the reverse side for any additional names):

Name and/or Agency Name	Address	City, State and Zip
South Carolina Department of Revenue	300A Outlet Pointe Blvd	Columbia, SC 29210
Lauren Acquaviva	300A Outlet Pointe Blvd.	Columbia, SC 29210

FILED
MAR 07 2017
SC ADMIN LAW COURT

X Your Signature or Signature of Attorney

March 7, 2017
Date

Attention: All cases filed in the Administrative Law Court are subject to the Rules of Procedure found at the Court's website www.scalc.net or from the Clerk of Court. Failure to follow these rules may result in dismissal of your case.

THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

THE HONORABLE H.W. FUNDERBURK, JR., ADMINISTRATE 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.

CERTIFICATE OF COUNSEL

Pursuant to Rule 210(g), SCACR, the undersigned certifies that this Record on Appeal contains all material proposed to be included by the above-referenced parties and not any other material.

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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., ADMINISTRATE 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.

FINAL BRIEF OF APPELLANT

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STATEMENT OF ISSUES ON APPEAL

I. DID THE ADMINISTRATIVE LAW COURT ERR BY GRANTING "THE MACHINE EXEMPTION" AND "THE POLLUTION CONTROL MACHINE EXEMPTION," BOTH FOUND IN S.C. CODE ANN. § 12-36-2120(17) (SUPP. 2018), TO THE RESPONDENT'S PURCHASES OF ITEMS THAT ARE NOT "MACHINES?"

II. DID THE ADMINISTRATIVE LAW COURT ERR BY GRANTING "THE MACHINE EXEMPTION" TO THE RESPONDENT'S PURCHASES OF MACHINES THAT ARE NOT "USED IN PROCESSING TANGIBLE PERSONAL PROPERTY FOR SALE?"

STATEMENT OF THE CASE

This matter came before the 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 Produce, Inc., ("Respondent") filed a request for a contested case hearing with the ALC on March 7, 2017, in case number 17-ALJ-17-0060-CC to challenge a Department Determination issued by the South Carolina Department of Revenue ("Department" or "Appellant") on February 7, 2017. (R. pp. 736-745, 1177; Req. for Contested Case Hr'g; Dep't Determination pp. 1-10). In the Department Determination, the Department concluded that the Respondent's purchases of certain supplies and protective clothing were subject to use tax for tax periods October 1, 2012 through September 30, 2015 (the "Audit Period") and were not exempt from use tax under S.C. Code Ann. § 12-36-2120(17) (Supp. 2018). (R. pp. 736-745; Dep't Determination pp. 1-10).

On November 14 and 15, 2018, the ALC held a contested case hearing. Thereafter, the ALC issued its Final Order on September 6, 2019, and determined that the majority of the items, including those items identified as protective clothing, for which the Respondent sought exemptions were exempt from use tax under § 12-36-2120(17), hereinafter referred to as the "Machine Exemption." (R. p. 42; Order p. 42) (The ALC's Final Order will be referred to, hereinafter, as the "Order"). 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) commonly referred to as the "Pollution Control Machine Exemption." (R. p. 42; Order p. 42). Because the ALC held certain items taxable, the ALC remanded the matter to the Department, instructing the Department to calculate the tax and interest due on the items the ALC deemed taxable. (R. p. 42; Order p. 42).

On September 19, 2019, the Department filed a Motion for Reconsideration, and/or to Alter or Amend. (R. pp. 47-71; Mot. to Recons. pp. 1-25). The Respondent did not file a response to the Department's Motion. (R. p. 44-45; Order Denying Mot. to Recons.). The ALC issued an order on October 16, 2019, denying the Department's Motion for Reconsideration. (R. pp. 44-45; Order Denying Mot. to Recons.). The Department appealed the Order and the Order Denying Respondent's Motion to Reconsider, Alter or Amend on November 20, 2019.[1] (See Appellant's Notice of Appeal).

STATEMENT OF FACTS

A. The Respondent's Operations.

The Respondent operates a fresh produce processing facility in Columbia, South Carolina, for processing lettuce, onions, cabbage, tomatoes, and other vegetables (hereinafter "produce") for sale. (R. pp. 2, 6; Order pp. 2, 6). As a fresh produce processor, the Respondent is 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"). (R. p. 6; Order p. 6). The Respondent's produce processing includes washing, cutting, mixing, and packaging the fresh produce at the facility. (R. p. 2; Order p. 2).

The Respondent purchases raw produce from third-party growers. (R. p. 5; Order p. 5). Once the produce is harvested from the growers' locations, the Respondent transports the produce to its facility via climate-controlled trucks, maintaining the temperature inside the trucks between 33 and 40 degrees. (R. p. 6; Order p. 6). Once the produce arrives at the Respondent's facility,

[1]While the ALC filed its Order Denying Respondent's Motion to Reconsider, Alter or Amend on October 16, 2019, the Department did not receive it until October 22, 2019. Therefore, pursuant to Rule 203(b)(6), SCACR, the Department timely filed its Notice of Appeal.

the produce is unloaded into one of six raw coolers, which the Respondent also maintains at a temperature between 33 and 40 degrees. (R. p. 6; Order p. 6).

The majority of the plant is divided into two areas: the "low-care" areas and the "high-care" areas. (R. p. 6, 500-502; Order p. 6; Respondent's Exhibit 8). The low-care areas involve the ripening, sorting, defect removal, repackaging, and storage of produce. (R. p. 6; Order p. 6). The low-care areas are generally reserved for either whole produce or produce that the Respondent has cut and packaged and is awaiting shipment out of the facility. (R. p. 6; Order p. 6). Areas of the Respondent's plant designated as low-care areas include the receiving area, the raw coolers, the tomato coolers, the raw feed area, the tomato repack room, the pack-out room, the palletizing room, the finished goods storage rooms, and the shipping area. (R. p. 6; Order p. 6). The Respondent does not cut any produce within the low-care areas. (R. p. 6; Order p. 6).

The Respondent only cuts produce into smaller pieces and packages the cut produce in the high-care area. (R. p. 6; Order p. 6). When the Respondent is ready to cut raw produce, it moves the produce to the raw feed area and then into the cutting room, which is within the high-care area. (R. p. 6; Order p. 6). There, employees sort, inspect, and trim the produce before it moves along the conveyor belt down to an industrial cutter where the produce is cut and chopped according to each customer's specifications. (R. pp. 6-7; Order pp. 6-7). The cutter then discharges the produce into a washing flume, which is a stainless-steel bath where the produce is rinsed and sanitized. (R. p. 7; Order p. 7). Once the produce is washed, it moves to the de-watering mechanism, which is essentially an industrial-sized salad spinner. (R. p. 7; Order p. 7).

After the produce is cut, washed, and dried in the high-care area, it is then metered onto a conveyor system where it is weighed and bagged. (R. p. 8; Order p. 8). Each bag is sealed and

run through a metal detector before it is moved into low-care areas to be boxed, labeled, palletized, and stored until shipped to customers. (R. p. 8; Order p. 8).

At all times, not just during processing, the produce must remain at a temperature between 33 and 40 degrees in accordance with contracts between the Respondent and its customers as well as in accordance with regulations by the FDA, SCDA, and DHEC. (R. p. 8; Order p. 8). Any violations of these contracts or regulations by the Respondent could result in the Respondent's customers refusing the products, as well as potential reprimands, fines, or facility closure by the regulatory agencies. (R. p. 8; Order p. 8).

B. <u>The Supplies at Issue</u>.

The parties stipulated to the supplies at issue in this case. (R. pp. 4-5; Order pp. 4-5). Of those items, the ALC determined that several of these items are exempt from use tax under the Machine Exemption "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." (R. p. 23; Order p. 23). Those items include: cut wheel and disc maintenance tools; general maintenance tools; conveyances, such as forklift rentals and their various batteries and parts, as well as hand trucks, pallet jacks, and oils and lubricants used therein; and rented ethylene generators. (R. pp. 23-24; Order pp. 23-24).

The ALC further determined that several other items in dispute are exempt from use tax under 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." (R. p. 24; Order p. 24). Those items include: items for storage and temperature control, such as stacking containers, warehouse racks, pallet flow brakes, and blower fans; recordkeeping items, such as bar code scanners, black ink aerosol cans, and mobile computer

stands; protective clothing, such as coveralls, eyewear, gloves, aprons, and hairnets; storage water tanks; cleaning machines (foamers) and floor treatment chemicals; and floor drain covers. (R. pp. 24-28; Order pp. 24-28).[2]

C. The Department's Sales and Use Tax Audit and Assessment.

On September 22, 2015, the Department initiated an audit of the Respondent's sales and use tax returns for the tax periods within the Audit Period. (R. p. 2; Order p. 2). On July 19, 2016, after reviewing the Respondent's purchase invoices and discussing questionable items with the Respondent, the Department issued a Proposed Assessment, finding that the supplies at issue were subject to use taxes, which the Respondent had not paid. (R. pp. 737-738; Dep't Determination pp. 2-3).

The Respondent timely protested the Proposed Assessment on August 1, 2016. (R. p. 738; Dep't Determination p. 3). In its protest letter, the Respondent argued that its purchases of protective clothing were exempt from use tax based on Federal safety standards. (R. p. 738; Dep't Determination p. 3). The Respondent further argued that, because the manufacturing process begins when the Respondent receives the raw produce and ends when the Respondent loads the finished product on trucks for shipment, all of the supplies at issue are used in the manufacturing

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[2]Other items in dispute included towels, plastic shelves for the maintenance parts room, drug test kits, and a utility cart for maintenance tools. (R. pp. 4-5; Order pp. 4-5). However, the ALC noted that the Respondent did not offer any testimony regarding the purpose of these items in its facility. (R. p. 19; Order p. 19). As such, the ALC determined that the Respondent failed to meet its burden of proof relating to these items and upheld the Department's Determination that these items are taxable. (R. p. 19; Order p. 19).

Also among the items in dispute at the hearing were brooms, squeegees, white boards in production offices, and warning signs and stickers. (R. pp. 4-5; Order pp. 4-5). For reasons more detailed in the ALC's Order, the ALC correctly determined that these items are not integral and necessary to the manufacturing of fresh produce and, thus, did not qualify for the Machine Exemption. (R. pp. 28-29; Order pp. 28-29).

process and, thus, are exempt. (R. p. 738; Dep't Determination p. 3).

On February 7, 2017, the Department issued its Determination finding that the Respondent's purchases during the Audit Period of the supplies at issue, including protective clothing, were subject to use tax. (R. pp. 736-745; Dep't Determination pp. 1-10). The Respondent timely requested a contested case hearing with the ALC. (R. p. 1; Order p. 1). Prior to the hearing in this matter, the parties resolved the issues related to the Respondent's purchases of electricity and all other supplies except the supplies listed under "Exhibit A" of the parties' Stipulations of Facts, which the ALC incorporated in its Order. (R. pp. 4-5; Order pp. 4-5).

STANDARD OF REVIEW

In an appeal from the decision odministrative 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, 500-501 (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 decision by the ALC in this case is "affected by [an] error of law" and is in violation of statutory and regulatory provisions. Resolution of the issues in this case depends upon the rules of statutory construction and when construing a statute, the cardinal rule is to ascertain the intent of the legislature. Georgia-Carolina Bail Bonds, Inc. v. County of Aiken, 354 S.C. 18, 22, 579 S.E.2d 334, 336 (Ct. App. 2003). "All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute." Id. at 23, 579 S.E.2d at 336. The words of the statute "must be given their plain and ordinary meaning without resort[ing] to subtle or forced construction to limit or expand [the statute's] operation." Hitachi Data Sys. Corp. v. Leatherman, 309 S.C. 174, 178, 420 S.E.2d 843, 846 (1992) (internal citations omitted).

Furthermore, "[t]he language of a tax exemption statute must be given its plain, ordinary meaning and must be strictly construed *against* the claimed exemption." CareAlliance Health Services v. S.C. Dep't of Revenue, 416 S.C. 484, 488, 787 S.E.2d 475, 477 (2016) (citing TNS Mills, Inc. v. S.C. Dep't of Revenue, 331 S.C. 611, 620, 503 S.E.2d 471, 476 (1998)) (emphasis added). "In construing statutory language, the statute must be read as a whole, and sections which are part of the same general statutory law must be construed together and each one given effect." TNS Mills at 620, 503 S.E.2d at 476. Further, "[t]he Court must presume the legislature did not intend a futile act, but rather intended its statutes to accomplish something." Id.

Finally, "[t]he construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons." Brown v. S.C. Dep't of Health & Envtl. Control, 348 S.C. 507, 515, 560 S.E.2d 410,

414 (2002) (quoting Dunton v. S.C. Bd. of Examin'rs in Optometry, 291 S.C. 221, 223, 353 S.E.2d 132, 133 (1987)); See also Nucor Steel v. S.C. Pub. Serv. Comm'n, 310 S.C. 539, 543, 426 S.E.2d 319, 321 (1992) (recognizing that where an agency is charged with the execution of a statute, the agency's interpretation should not be overruled without cogent reason).

ARGUMENT

I. THE ADMINISTRATIVE LAW COURT ERRED BY GRANTING "THE MACHINE EXEMPTION" AND "THE POLLUTION CONTROL MACHINE EXEMTPION," BOTH FOUND IN S.C. CODE ANN. § 12-36-2120(17) (SUPP. 2018), TO THE RESPONDENT'S PURCHASES OF ITEMS THAT ARE NOT "MACHINES."

South Carolina imposes a use tax on "the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State . . . ." S.C. Code Ann. § 12-36-1310(A) (2014). However, exempt from the use tax are "the gross proceeds of sales, or sales price of . . . *machines* used in manufacturing, processing . . . recycling, compounding, mining, or quarrying tangible personal property for sale." § 12-36-2120(17) (emphasis added).[3] In order to qualify for the Machine Exemption, the item for which the exemption is sought must be a "machine." By improperly broadening the meaning of the term "machine," the ALC incorrectly granted the Machine Exemption to items that are not, by law, "machines."

A. The ALC incorrectly broadened the meaning of the term "machine" as used in the Machine Exemption.

The ALC erred by broadening the term "machine" beyond its plain meaning in the Machine

[3]As noted by the ALC, the legislature added to the list of exempt uses found in the Machine Exemption the term "agricultural packaging" in July 1, 2016, which was after the Audit Period. (R. p. 19, footnote 8; Order p. 19, footnote 8). The above quote of § 12-36-2120(17) is a reflection of the Machine Exemption as it was written during the Audit Period. As will be more fully discussed herein, the ALC improperly relied on the addition of this term "agricultural packaging" when broadening the Machine Exemption.

Exemption. In so doing, the ALC incorrectly determined that items such as protective clothing, aerosol cans, mobile computer stands, and floor drain covers were "machines" for purposes of the exemption. A "machine" is "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ." S.C. Code Ann. Regs. 117-302.5(B)(1) (2012). Items such as protective clothing, aerosol cans, mobile computer stands, and floor drain covers are neither mechanical devices nor are they a combination of mechanical powers, parts, attachments, or devices. Therefore, these items cannot qualify as "machines."

In determining that the term "machine" is broad for purposes of the Machine Exemption, the ALC cited Hercules Contractors and Engineers v. S.C. Tax Comm'n, 280 S.C. 426, 313 S.E.2d 300 (1984), where the Court of Appeals held that the vats, basins, railings, walkways, and ladders of a waste treatment facility were exempt under the Machine Exemption. (R. p. 20; Order p. 20). However, these items treated by the Court of Appeals as exempt can easily be distinguished from the non-mechanical items the ALC found exempt. In Hercules, the Court found that the entire waste treatment facility was a machine. Id. at 431, 313 S.E.2d at 304. Therefore, the vats, basins, tanks, pumps, etc., which had no use apart from the waste treatment facility, were exempt *as parts of that machine*. Id. (emphasis added).

That is not the case here because, unlike the waste treatment facility, the Respondent's whole plant is not a machine. The question is not whether the protective clothing, for example, is integral to the operation of the Respondent's plant as a whole, but whether the protective clothing is an integral part of an exempt machine. None of the items to which the ALC applied the machine exemption are integrated into the Respondent's plant. They are each distinct items, and the analysis of whether they are "machines" must be independent of their connection to the plant.

Furthermore, the Hercules Court found that the vats and basins of the waste treatment facility, unlike other buildings, "have utterly no use apart from the machine of which they are an integral part." Id. On the other hand, in this case, each of the Respondent's witnesses testified as to how the purpose of the Respondent's protective clothing was not integral to the operation of any of the machines in the Respondent's plant, but was to prevent the contamination of the Respondent's final product. (R. p. 249, lines 17-22, p. 299, lines 16-18, p. 302, lines 18-23, p. 314, lines 3-13, p. 356, lines 13-16, p. 373, line 19-p. 374, line 4; Hr'g Tr. pp. 108:17-22, 158:16-18, 161:18-23, 173:3-13, 215:13-16, 232:19-233:4). Thus, by admission of the Respondent's own witnesses, the purpose of the Respondent's non-mechanical items the ALC found exempt have nothing to do with any exempt machines within the Respondent's facility. For example, the ALC found aerosol cans to be exempt. (R. p. 26; Order p. 26). The Respondent's CEO and President, Carter McEntire, testified that the black ink aerosol cans label finished cases of produce for tracking purposes. (R. p. 220, lines 2-16; Hr'g Tr. p. 79:2-16). Again, the purpose of this non-mechanical item has nothing to do with an exempt machine, as opposed to the vats and basins in the Hercules case, where the Court found that such items had no other purpose but to be parts of an exempt machine. Hercules at 431, 313 S.E.2d at 304.

As an additional justification for its broad interpretation of "machine," the ALC referenced S.C. Code Ann. Regs. 117-302.5 (2012) (hereinafter referred to as the "Machine Exemption Regulation"), stating that "[t]he regulations defining 'machine' expand the definition beyond traditional notions of the term" in that "[the Regulation] provides that patterns for machinery parts and chemicals used in *the manufacturing process* qualify for the Machine Exemption." (R. p. 20; Order p. 20) (emphasis added). However, these specific provisions within the Machine Exemption Regulation are limiting the term to only those items that are integral and necessary to the

functioning of an *exempt machine*, and solely for this reasoning are such items integral and necessary to the manufacturing process. See Regulation 117-302.5(5)(a) ("Chemicals, including greases, oils, lubricants, and coolants, *used in an exempt manufacturing machine* that are essential to the functioning of the exempt machine during the manufacturing process are integral, necessary, and indispensable to the manufacturing process and are exempt as part of the machine") (emphasis added). Accordingly, as stated earlier, the determination as to whether items constitute a "machine" for purposes of the Machine Exemption is not made based on whether the item is an integral part of the manufacturing process, but rather whether it is integral to the function of an already exempt machine.[4]

B. Record keeping items used for tracking produce are not "machines" and, as such, cannot qualify for the Machine Exemption.

The ALC found that bar code scanners, black ink aerosol cans, and mobile computer stands, all of which the Respondent uses to track the produce as required by law, were exempt from use tax. (R. p. 26; Order p. 26).

The Respondent's bar code scanners are hand-held devices that the Respondent uses to trace the produce backwards one-step to the grower-shipper and forward one-step to the customer's distribution center.[5] (R. p. 205, line 22-p. 206, line 2; Hr'g Tr. pp. 64:22-65:2). This trace-back

[4]In an effort to justify its expansion of "machine," the ALC cited to the Department's S.C. Rev. Rul. # 13-3, noting that "the Department found that the component parts used to construct a manufacturing machine qualified as a "machine" for purposes of the exemption." (R. p. 20; Order p. 20). The Machine Exemption is not the issue in S.C. Rev. Rul. # 13-3. Rather, # 13-3 deals with S.C. Code Ann. § 12-36-2120(51) (2014), which is for material handling systems and material handling equipment. The ALC's reliance on #13-3 was improper because this is a completely different exemption.

[5]Mr. McEntire testified that the need for a trace-back arises when a food-borne illness results in sickness or death and the FDA needs to determine the source of the illness. (R. p. 206, lines 12-17; Hr'g Tr. p. 65:12-17).

system is required by federal law. (R. p. 205, line 24; Hr'g Tr. p. 64:24). The Respondent scans raw produce when it enters the facility, when the raw produce goes into processing, when it then goes into the finished goods area, and lastly when the produce goes from the finished goods section onto the refrigerated delivery trucks. (R. p. 206, lines 2-9; Hr'g Tr. p. 65:2-9).

The Respondent also uses black ink aerosol cans as part of this tracking process. (R. p. 220, line 25-p. 221, line 4; Hr'g Tr. pp. 79:25-80:4). Specifically, the ink goes across a jet ink sprayer to spray a "use-through code" and a "lot code" onto a finished case of produce in the pack-out and repack areas of the Respondent's facility. (R. p. 220, lines 10-16; Hr'g Tr. p. 79:10-16). In basic terms, the black ink aerosol cans label finished cases. (R. p. 220, lines 2-7; Hr'g Tr. p. 79:2-7).

The Respondent uses a computer program to track its produce through the processing stages. (R. p. 236, line 24-p. 237, line 1; Hr'g Tr. pp. 95:24-96:1). The Respondent places computers on mobile computer stands in various parts of the facility so the employees can more easily track the process as the produce moves through the facility. (R. p. 237, lines 1-9; Hr'g Tr. p. 96:1-9).

Regulation 117-302.5(B)(9) specifically provides that administrative items such as *items used for recordkeeping* are not "machines used in processing tangible personal property for sale." (Emphasis added). An item used merely to track the produce throughout the stages of processing is used for recordkeeping. While recordkeeping may be legally required (much like all taxpayers are legally required to keep certain records for tax purposes), that does not transform the items used for recordkeeping into exempt machines. Moreover, none of these recordkeeping items are integral to the functioning of an exempt machine. Accordingly, the ALC erred in finding such items to be exempt.

C. Floor drain covers are not "machines" and, as such, cannot qualify for the Machine Exemption.

The ALC determined that the floor drain covers the Respondent purchases and uses within its plant are exempt from use tax under the Machine Exemption. (R. p. 28; Order p. 28). The 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, lines 11-15; Hr'g Tr. p. 98:11-15). The Respondent uses the floor drain system to recapture spilled water so it may reuse the water to wash the produce. (R. p. 239, lines 15-24; Hr'g Tr. 98:15-24).

The description provided by the Respondent of the floor drain covers does not fall within the meaning of a "machine," as the floor drain covers are neither mechanical devices nor are they a combination of mechanical powers, parts, attachments, or devices. To meet the Machine Exemption, the item for which the exemption is sought must be a "machine"—a "mechanical device or combination of mechanical powers, parts, attachments and devices . . . ." See Regulation 117-302.5(1). A floor drain cover that keeps debris and produce from entering into the Respondent's floor drain system is not a mechanical device or a part of a mechanical device and, as such, is not a "machine" for purposes of the Machine Exemption.[6]

[6]The ALC found that the floor drain covers the Respondent purchases and uses within its plant are integral and necessary to processing produce because they prevent pollution of the waste water and, as such, are exempt. (R. p. 28; Order p. 28). However, this determination is not supported by the facts in this case. The evidence suggests the floor drain covers, which prevent waste material from entering the plant's floor drain system, are integral and necessary to *the Respondent's plant.* The floor drain system allows the Respondent to recapture and recycle the water it uses *in* the plant in order to reduce its sewer outflow. (R. p. 239, lines 8-18; Hr'g Tr. 98:8 – 18). Mr. McEntire testified that "we consider that a part of our process because we're recapturing that water . . . [a]nd it's important to recapture that water so we can reuse it to wash produce later . . . ." (R. p. 239, lines 18-22; Hr'g Tr. 98:18-22). Mr. McEntire's testimony does not support a finding that the Respondent uses these floor drain covers during processing or to prevent pollution. Rather, his testimony supports a finding that the Respondent uses these floor drain covers so it can filter and reuse water for its own benefit.

D. Protective clothing worn by employees is not a "machine;" thus, protective clothing cannot qualify for the Machine Exemption.

The ALC disregarded numerous South Carolina Regulations that limit what can and cannot be exempt from use tax under § 12-36-2120(17). One of the more troubling findings reached by the ALC is its determination that protective clothing worn by the Respondent's employees are "machines" for purposes of the exemptions found in § 12-36-2120(17). As discussed in more detail below, this determination is in direct contradiction to South Carolina law. But for the ALC's incorrect conclusion that the Respondent's protective clothing are "machines," the ALC would have been unable to conclude that the same were exempt under both the Machine Exemption and the Pollution Control Machine Exemption.

i. The Respondent requires its employees to wear certain protective clothing within its facility for food safety purposes.

The Respondent requires its employees to wear gloves, aprons, hairnets, coveralls, and eyewear (collectively referred to as "protective clothing") in its facility.[7] (R. p. 15; Order p. 15). Pursuant to Federal and State law, the Respondent requires its employees to wear more protective clothing in the high-care area than in the low-care area, because that is where the produce is cut.

As will be discussed herein, the Machine Exemption Regulation states that tanks that store water are taxable. See Regulation 117-302.5(B)(7)(b). If tanks that store water prior to processing and pipes that move necessary water into a plant to be used in processing are taxable (see Regulation 117-302.5(B)(4)(b)), it follows that items used to filter the water *after* processing are also taxable.

[7]Mr. McEntire testified that the Respondent's employees also wear bump caps, headbands, smocks, plastic arm sleeves, and overshoes as additional items of protective clothing. (R. p. 15, footnote 6, p. 200, lines 10-14; Hr'g Tr. p. 59:10-14; Order p. 15, footnote 6). However, the only items characterized as "protective clothing" that were in dispute at the hearing were gloves, aprons, hairnets, coveralls, and eyewear. (R. p. 4, p. 15, footnote 6; Order pp. 4, 15, footnote 6). Mr. McEntire confirmed during the hearing that this list of items were the only items of protective clothing in dispute. (R. p. 247, line 17-p. 248, line 3; Hr'g Tr. pp. 106:17-107:3).

(R. p. 7; Order p. 7). Most of the Respondent's protective clothing items are single use items, but other items, such as smocks and overshoes, are washed and reused daily. (R. p. 198, line 12-p. 199, line 3; Hr'g Tr. pp. 57:12-58:3).

Wayne Bailey, the Respondent's food safety director, testified that the Respondent is particularly concerned about three specific food-borne illnesses in the processing of fresh produce: Listeria monocytogenes ("Listeria"), Salmonella, and E. coli (hereinafter collectively referred to as "pathogens"). (R. p. 277, lines 12-19; Hr'g Tr. p. 136:12-19). As these pathogens may be present at the farms from which the Respondent receives its fresh produce, these pathogens may enter the Respondent's facility through the produce. (R. pp. 280-282; Hr'g Tr. pp. 139-141). The Respondent's employees could also bring these pathogens into the Respondent's facility if, for example, these pathogens are present on the employees' shoes or hands and then the employee does not take the appropriate steps before entering the Respondent's high-care areas. (R. p. 284, lines 8-20; Hr'g Tr. p. 143:8-20).[8]

Based on the above, Mr. Bailey testified that the Respondent's "good manufacturing practices" and the FDA require the wearing of appropriate apparel so that a person in street clothes and street shoes does not come into contact with food-contact surfaces or the produce within the Respondent's facility. (R. p. 276, lines 11-12, p. 297, lines 3-17, p. 299, lines 14-15, 18-19; Hr'g Tr. pp. 135:11-12, 156:3-17; 158:14-15, 18-19). In so doing, the Respondent is attempting to protect *the produce* from outside contamination, such as the above-listed pathogens, either by cross contamination from aerosolized pathogens exiting contaminated produce once it is cut or by an

[8]The Respondent's food safety expert, Dr. David Gombas, also testified that the sources of contaminants, or pathogens, are the employees and the raw produce itself, as well as the water used in the facility. (R. p. 367, lines 15-18, p. 379, line 21-p. 380, line 3; Hr'g Tr. pp. 226:15-18, 238:21-239:3).

employee's personal clothing on which such pathogens are potentially present. (R. p. 297, lines 17-19, p. 302, lines 9-15, p. 304, lines 5-11, p. 306, lines 3-17, p. 324, lines 16-20; Hr'g Tr. p. 156:17-19, 161:9-15, 163:5-11, 165:3-17, 183:16-20). Ultimately, the purpose of the protective clothing is to protect the Respondent's final product—a food item—from contamination. (R. p. 249, lines 17-22, p. 299, lines 16-18, p. 302, lines 18-23, p. 314, lines 3-13, p. 356, lines 13-16, p. 373, line 19-p. 374, line 4; Hr'g Tr. pp. 108:17-22, 158:16-18, 161:18-23, 173:3-13, 215:13-16, 232:19-233:4). But, while protective clothing may prevent harmful pathogens from contaminating the Respondent's produce if such pathogens are present on the Respondent's employees, it cannot prevent the harmful pathogens from entering the facility through contaminated produce. (R. p. 324, line 21-p. 325, line 3; Hr'g Tr. pp. 183:21-184:3).

ii. The Machine Exemption Regulation explicitly states that protective clothing is not a "machine;" thus, protective clothing cannot qualify for the Machine Exemption.

The Respondent sought to have its purchases of protective clothing exempt from use tax under the Machine Exemption. As discussed above, in order to be exempt under the Machine Exemption, the item sought to be exempt must be a machine. See § 12-36-2120(17). However, Regulation 117-302.5(B)(10) specifically states that "**[p]rotective clothing** worn by an employee working in the area in which the manufacturing process occurs **does not qualify as a machine and is not exempt from the tax as a machine used in manufacturing tangible personal property for sale under Section 12-36-2120(17).**" (Emphasis added).[9]

[9]The Regulation goes on to say, "[h]owever, 'clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment' is exempt under the provisions of [S.C. Code Ann. §] 12-36-2120(54) [(2014)]." Regulation 117-302.5(B)(10). In this case, the Respondent did seek to have its purchases of protective clothing exempt from use tax under the exemption referenced in this provision, also known as the "Clean Room Exemption," found in § 12-36-2120(54). (R. p. 40; Order p. 40). However, the ALC correctly determined that the Respondent did not meet its burden of proof regarding this issue and,

The plain reading of this Regulation is clear—protective clothing can never be considered a machine for purposes of the Machine Exemption. Because protective clothing can never be considered a "machine" for purposes of the Machine Exemption, protective clothing can never be exempt from use tax as a machine used in processing or manufacturing. As the ALC pointed out, "[w]hat a legislature says in the text . . . is considered the best evidence of the legislative intent or will." (R. p. 20; Order p. 20) (quoting Bayle v. S.C. Dep't of Transp., 344 S.C. 115, 122, 542 S.E.2d 23, 26 (1972)). By approving the language set forth in Regulation 117-302.5(B)(10), the General Assembly clearly never intended for protective clothing to be considered "machines" for purposes of the exemption in § 12-36-2120(17). Thus, to conclude that protective clothing is a "machine" for purposes of the Machine Exemption in light of Regulation 117-302.5(B)(10) is an error of law.

The ALC attempted to distinguish the protective clothing in this case from the regulation by finding that the clothing is "not used to protect the employee from hazards incurred during the manufacturing process." (R. p. 27; Order p. 27). However, the regulation is not limited to protective clothing used to protect the employees. Rather, the regulation provides that protective clothing *in general* is taxable unless it falls under the exemption set forth in S.C. Code Ann. § 12-36-2120(54) (2014). "The language of a tax statute must be given its plain ordinary meaning in the absence of an ambiguity therein." Beach v. Livingston, 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1966). To get to the result reached by the ALC goes beyond the plain ordinary meaning of the words in the regulation and requires the addition of language so that the regulation would read "clothing worn to *protect* an employee working in the area in which the manufacturing process

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as such, could not conclude that the Respondent's purchases of protective clothing qualify for the Clean Room Exemption. (R. p. 41; Order p. 41).

occurs." This reading violates the plain meaning rule and, thus, is improper.

iii. Because the Machine Exemption Regulation explicitly states that protective clothing is not a "machine," protective clothing also cannot qualify for the Pollution Control Machine Exemption.

The Respondent also sought to have its purchases of protective clothing exempt under the Pollution Control Machine Exemption, which is also found in § 12-36-2120(17). (R. p. 1; Order p. 1). Specifically, the Pollution Control Machine Exemption provides an exemption from sales and use tax for *machines, machine parts, and attachments* that "are necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section." Section 12-36-2120(17). S.C. Code Ann. Regs. 117-302.6 (2012) explains that a machine constitutes an exempt pollution control machine if such machine is "installed and operated for compliance with an order of an agency of the United States or of this state to prevent or abate pollution caused or threatened by the operation of other machines used in the . . . manufacturing of tangible personal property."

Accordingly, the Respondent had the burden to prove that (1) the operation of at least one of its machines used in its processing of fresh produce causes or threatens to cause pollution of air, water, or noise; (2) a State or Federal agency requires the prevention or abatement of such pollution; and (3) the machine for which this exemption is sought is installed and/or operated to prevent or abate the pollution caused or threatened to be caused by one of its machines used in processing. For the following reasons, the Respondent failed to meet its burden on these elements, and the ALC erred in finding that the Respondent met its burden.

a. <u>The Respondent failed to show that any of the machines within its facility cause or threaten to cause pollution of air, water, or noise.</u>

The ALC determined that food contamination constitutes pollution of air and water because

the bacteria that contaminates the food "could contaminate the air inside the facility and the water supply both at the plant and in the municipal water system and/or rivers." (R. p. 35; Order p. 35). Assuming food contamination constitutes pollution of the air and/or water, that means the Respondent only satisfied part of the first element.[10] The Respondent still needed to prove that a machine within its facility caused or threatened to cause such food contamination.

The ALC found that machines in Respondent's facility cause "pollution" through "direct contact with harmful microbes and through cross-contamination." (R. p. 31; Order p. 31). The ALC seemed to rely on the fact that, since cutting produce *may* release contaminant already present in the produce, the cutting machine caused or threatened to cause pollution of the air or water. If this were true, then any processing machine that could cut an employee causing him to bleed, and thus possibly release a pre-existing contaminant, would arguably cause or threaten pollution of the air or water. Clearly, the legislature did not intend for the phrase "cause or threaten to cause" to be construed so broadly, especially since exemption statutes are to be strictly construed against the exemption. Rather, the plain reading of the Pollution Control Machine Exemption is that a processing machine must *create or result* in pollution or threaten to do so, and not merely have the

[10]The Department does not agree that food contamination constitutes pollution. While bacteria could become a pollutant, food poisoning, for example, is not pollution. Moreover, the ALC's reliance on the definition of pollution as used in commercial insurance policies is misplaced. It is well-settled under South Carolina law that courts construe insurance contracts "against the party who prepares them and liberally in favor of the insured [i.e., in favor of the person seeking coverage]." S.C. State Budget & Control Bd. v. Prince, 304 S.C. 241, 245–246, 403 S.E.2d 643, 646 (1991). Exemption statutes, as previously stated, are to be construed strictly against the exemption, i.e., strictly construed against the person or entity seeking the exemption. See CareAlliance Health Services., 416 S.C. 484, 787 S.E.2d 475. Thus, the term "pollution" when used in an insurance contract must be liberally construed in favor if the insured while the same term when used in a tax exemption must be strictly construed against the one seeking the exemption. Clearly these two rules of statutory construction conflict. Because a court will construe the term pollution more broadly in insurance cases, reliance on such cases when construing the term pollution in a tax exemption statute is misplaced.

potential to release a pre-existing contaminant.

Here, neither the cutting machine (nor any other processing machine) creates or results in bacteria contaminating the Respondent's produce, or even the water or air. If the cutting machine releases contaminants, that means the produce was already contaminated. Thus, the produce itself causes or threatens to cause contamination, not the machine. The machine is, in fact, one-step removed from the source of the "pollution," i.e., the bacteria in the contaminated food. Further, the only other source of contamination, namely the Respondent's employees, is not caused by the cutting machine, nor does the cutting machine threaten to cause such contamination—the employees cause or threaten to cause the contamination. Accordingly, the Respondent failed to prove that a machine used in processing produce causes or threatens to cause pollution of the air or water.

b. The Respondent failed to show that any of the Federal or State regulations it relied on requires the use of protective clothing to prevent or abate pollution.

Even if the ALC properly concluded that a processing machine caused or threatened to cause pollution of the air or water, which the Department disputes, the Respondent still failed to prove that a State or Federal agency requires that such pollution be prevented or abated. In its Order, the ALC found that State and Federal regulations require the Respondent to use protective clothing to prevent or abate pollution. (R. pp. 36-39; Order pp. 36-39).

While the Respondent may be required to use protective clothing for *food safety purposes*, the State and Federal regulations relied on by the Respondent do not require the Respondent to use protective clothing in order to *prevent or abate pollution of the air or water*. In fact, the regulations relied on by the Respondent and cited in the Order are wholly unrelated to the prevention or abatement of air or water pollution. None of the regulations cited even mention air or water pollution. Rather, the regulations pertain to the prevention of food contamination for food safety

purposes. As such, assuming one or more of Respondent's processing machines cause or threaten to cause air or water pollution, the Respondent failed to prove that it is required by a State or Federal agency to use protective clothing in order to prevent or abate said air or water pollution. [11]

c. The Respondent failed to show that it installed or operated any machine to prevent or abate pollution.

Lastly, even though it is a subpart within § 12-36-2120(17), the Pollution Control Machine Exemption still requires that the item for which the exemption be sought is a *machine*—a machine which is installed or operated for the purpose of preventing or abating pollution caused by another machine fitting within the Machine Exemption. As previously addressed, protective clothing, per the Machine Exemption Regulation, cannot be considered "machines," either for purposes of the Machine Exemption or the Pollution Control Machine Exemption. Accordingly, because the Machine Exemption Regulation clearly states that protective clothing cannot be considered machines for purposes of exemptions sought under § 12-36-2120(17), by law, protective clothing cannot be "machines installed or operated" to prevent or abate pollution. Thus, the ALC's

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[11]The ALC's Order creates a new rule that anything legally required for a manufacturing facility to operate is integral and necessary to manufacturing tangible personal property for sale and, therefore, is exempt pursuant to the Machine Exemption. (R. pp. 25-27; Order pp. 25-27). However, if the general Machine Exemption already exempted anything legally required for a plant to operate, the Pollution Control Machine Exemption would be unnecessary.

Using the ALC's reading of the Machine Exemption, the items that the ALC designated as "pollution control machines," i.e., protective clothing, are integral and necessary to the functioning of the plant as a whole because they are legally required and, therefore, would be exempt without the Pollution Control Machine Exemption. Thus, if the Machine Exemption was supposed to be applied so broadly, the Pollution Control Machine Exemption would be rendered superfluous and unnecessary. Statutes are not to be construed in a manner that renders any portion superfluous. See Duvall v. S.C. Budget & Control Bd., 377 S.C. 36, 42, 659 S.E.2d 125, 128 (2008) ("The Court must presume the Legislature intended its statutes to accomplish something and did not intend a futile act."); State v. Sweat, 386 S.C. 339, 351, 688 S.E.2d 569, 575 (2010) ("A statute should be so construed that no word, clause, sentence, provision or part shall be rendered surplusage, or superfluous." (quoting In re Decker, 322 S.C. 215, 219, 471 S.E.2d 462, 463 (1995))).

determination that the protective clothing worn by the Respondent's employees was used to prevent or abate pollution of air and water was an error of law, as the item which is installed or operated to prevent or abate pollution of air or water *must* be a *machine*.

The ALC's erroneous determination that the protective clothing worn by its employees are "machines" is critical because, as discussed, the protective clothing can *only* qualify for the exemptions at issue if the clothing is first determined to be a "machine." By ignoring the Machine Exemption Regulation, which states that protective clothing *cannot* be "machines," the ALC created a new, expansive, nearly limitless application of the two exemptions. If the ALC's interpretation is correct, then any clothing or protective items worn by any person who is merely *operating* an exempt machine would now be considered an exempt component of that machine for sales and use tax purposes. Clearly, by approving the Machine Exemption Regulation, the Legislature did not intend for the Machine Exemption and the Pollution Control Machine Exemption to be interpreted so broadly.

II. THE ADMINISTRATIVE LAW COURT ERRED BY GRANTING "THE MACHINE EXEMPTION" TO THE RESPONDENT'S PURCHASES OF MACHINES THAT ARE NOT "USED IN PROCESSING TANGIBLE PERSONAL PROPERTY FOR SALE."

Even if an item is a "machine," the machine must be "used in processing tangible personal property for sale" to qualify for the Machine Exemption. § 12-36-2120(17). The Department determined that certain items for which the Respondent sought exemptions from use tax under the Machine Exemption fell outside the Respondent's manufacturing process and, as such, were not machines used in processing tangible personal property for sale. (R. p. 736-745; Dep't Determination).

The ALC incorrectly concluded that the Department's interpretation of the manufacturing process was too restrictive under the Machine Exemption. (R. p. 21; Order p. 21). A statute must

be construed in light of "the purpose of the whole statute" and "the policy of the law." Enos v. Doe, 380 S.C. 295, 305, 669 S.E.2d 619, 623 (Ct. App. 2008). Thus, to properly construe the Machine Exemption and apply the law to the facts in this case, the Machine Exemption and the Machine Exemption Regulation must be read in conjunction. Further, as stated above, the relevant statute and regulation must be strictly construed *against* the claimed exemption. CareAlliance at 488, 787 S.E.2d at 477. By failing to acknowledge the limitations to the Machine Exemption set forth in the Machine Exemption Regulation, the ALC improperly expanded the meaning of "used in processing" for purposes of the Machine Exemption.

A. South Carolina utilizes a *limited* integrated plant theory when determining what constitutes machines "used in processing."

The ALC correctly noted that South Carolina abandoned the strict production line theory and adopted an integrated plant theory as it relates to the Machine Exemption.[12] (R. p. 21; Order p. 21). South Carolina courts have recognized that South Carolina uses an integrated plant theory for the purpose of applying the Machine Exemption. See Anonymous Corp. v. S.C. Dep't of Revenue, 1999 WL 1094323 (S.C. Admin. Law. Judge Div., November 9, 1999), aff'd S.C. Dept. of Revenue v. Springs Indus., Inc., 2003-UP-029 (Ct. App. 2003) (hereinafter referred to as "Spring Industries"); and Anonymous Taxpayer v. S.C Dep't of Revenue, Docket No. 02-ALJ-17-0350-CC (S.C. Admin. Law. Judge. Div. July 8, 2003). In response to these decisions, the Department issued S.C. Rev. Rul. # 04-7 and proposed amendments to the Machine Exemption

[12]The ALC commented that "[g]enerally, 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.'" (R. p. 21; Order p. 21) (referencing Hellerstein, State Taxation, at ¶14.05). The Ohio Rule is typically narrower than the Integrated Plant Concept (R. p. 21; Order p. 21) (referencing The Youngstown Building Material & Fuel Co. v. Bowers, Tax Commr., 167 Ohio St. 363, 149 N.E.2d 1 (1958)), but the General Assembly narrowed South Carolina's application of the Integrated Plant Concept by regulation.

Regulation, which the legislature ultimately adopted. See Regulation 117-302.5. Thus, the Machine Exemption Regulation in use during the Audit Period in this case established a *limited* integrated plant theory.

However, instead of relying on South Carolina's limited integrated plant theory reflected in the Machine Exemption Regulation, the ALC applied the integrated plant theory used in New York. Niagara Mohawk Power Corp. v. Wannamaker, 144 N.Y.S.2d 458 (N.Y. App. Div. 1955). New York's integrated plant theory is not a reflection of South Carolina's integrated plant theory. Rather, New York's integrated plant theory is much broader. Therefore, the ALC found certain items exempt from use tax contrary to specific provisions of the Machine Exemption Regulation. Accordingly, the reliance by the ALC on any other integrated plant theory rather than the limited theory set forth in our Machine Exemption Regulation was an error.

B. The ALC incorrectly expanded what it means to be "used in processing."

By failing to apply the limitations to South Carolina's integrated plant theory set forth in the Machine Exemption Regulation, the ALC improperly broadened what it means to be "used in processing." As it relates to this case, the ALC determined that "processing" includes everything that happens inside the facility, excluding the administrative area, relating to the Respondent's overall operations. (R. pp. 22-23; Order pp. 22-23). In doing so, the ALC disagreed with the Department's longstanding interpretation of "processing," asserting that the Department's interpretation was more restrictive (like the production line theory) than an integrated plant theory adopted by South Carolina courts. (R. pp. 21-23; Order pp. 21-23). The ALC incorrectly labeled the Department's interpretation of "processing" in this case as too restrictive; rather, the Department's interpretation comes from applying the Respondent's operations to South Carolina's more limited version of the integrated plant theory, which is established by the Machine Exemption

Regulation.

i. The Department's interpretation of "used in processing" and its application to this case.

During the Audit Period, the Machine Exemption stated that the gross proceeds of sales, or sales prices of machines used in manufacturing, processing, recycling, compounding, mining, or quarrying tangible personal property for sale are exempt from sales and use tax. Section 12-36-2120(17). The Machine Exemption Regulation defines what machines qualify for the Machine Exemption: "[a] machine qualifies for the [Machine Exemption] if the machine is integral and necessary to the manufacturing process . . . ." Regulation 117-302.5. Thus, to be an exempt machine, the item in dispute must: (1) be a machine, which includes every mechanical device or combination of mechanical powers, parts, attachments and devices that perform some function and produce a certain effect or result; (2) which is integral and necessary; (3) to processing tangible personal property for sale.

Thus, the processing of tangible personal property, i.e., fresh produce, in the Respondent's plant must begin when the Respondent performs some act on the produce that is intended to result in packaged cut produce or packaged sorted tomatoes and end when the produce is packaged for sale. The activities necessary to turn raw produce into cut produce are sorting, cutting, washing, and packaging said produce. Similarly, the activities necessary to sort and repackage whole tomatoes are sorting and packaging. Accordingly, the Machine Exemption exempts those machines that are integral and necessary to the sorting, cutting, washing, and packaging of produce.

ii. The Machine Exemption Regulation supports the Department's interpretation of "used in processing" and its application to this case.

The Machine Exemption Regulation supports the Department's interpretation of "used in

processing" and its application to the Respondent's operations. The Machine Exemption Regulation specifically states: "[a] machine is not a part of the manufacturing process merely because it is integral and necessary to the manufacturer. For example, *machines used for warehouse, distribution, or administrative purposes are integral and necessary to the manufacturer, but not part of the manufacturing process*." Regulation 117-302.5(B)(1)(b) (emphasis added). Additionally, the regulation explains that generally, conveyances/material handling machines,[13] chemicals, maintenance machines, storage machines, administrative machines, and protective clothing are not integral and necessary to processing tangible personal property for sale. See Regulation 117-302.5(B). Thus, according to the Machine Exemption Regulation, "processing" does not include: moving raw or finished product; cleaning the processing area; maintenance; storage[14]; or administrative activities.

While one might assume that every "machine" used until the point a product becomes marketable is integral and necessary, the Machine Exemption Regulation makes it clear this is not the case. The Machine Exemption Regulation draws clear boundaries around what is "processing" for purposes of the Machine Exemption.

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[13]An exemption specific to material handling machines used in the operation of a manufacturing facility, as opposed to in processing tangible personal property for sale, can be found in § 12-36-2120(51). The existence of and the language used in subsection (51) demonstrates there is a difference between a machine being *used in the operation of a manufacturing facility* to support the overall manufacturing process and a machine being *used in manufacturing tangible personal property for sale*.

[14]The Machine Exemption Regulation narrows the meaning of processing even further when it explains that "[r]acks and tanks used to store a finished product while it cures" are not integral and necessary to processing. Regulation 117-302.5(B)(7)(c). The logical inference to be drawn from this example is that while an item is sitting on a storage rack waiting to become marketable, that item is not being processed and, thus, the storage rack is not being used in processing. Accordingly, the Machine Exemption Regulation demonstrates that in this case, "processing" occurs only while the produce is being sorted, cut, washed, and packaged, not while it is being stored or transported throughout the storage areas of the plant.

iii. The usual and customary meanings of terms within the Machine Exemption Regulation support the Department's interpretation of "used in processing" and its application to this case.

"When faced with an undefined statutory term, the court must interpret the term in accord with its usual and customary meaning." Strother v. Lexington County Recreation, 332 S.C. 54, 62, 504 S.E.2d 117 (1998); See also Hughes v. Western Carolina Sewer Auth., 689 S.E.2d 638, 386 S.C. 641 (S.C. App., 2009). In doing so, our Supreme Court has looked to the dictionary definition of an undefined term. See Murphy v. S.C. Dep't of Health & Envt'l Control, 396 S.C. 633, 641, 723 S.E.2d 191, 195 (2012).

As previously stated, a machine qualifies for the Machine Exemption if it is "integral and necessary" to, in this case, the processing of fresh produce. See Regulation 117-302.5. The Machine Exemption Regulation further states that, to be considered "integral and necessary," a machine must be "used in, and serve as an *essential and indispensable* component part of the manufacturing process . . . ." Regulation 117-302.5(B)(1)(b).

While the Machine Exemption Regulation does not define "essential" or "indispensable," the common dictionary definitions for both terms provide that something is "essential" or "indispensable" if it is "absolutely necessary" or "of the utmost importance." Merriam-Webster Dictionary, http://www.merriam-webster.com/dictionary/indispensable, http://www.merriam-webster.com/dictionary/essential. Further, the Machine Exemption Regulation does not, nor does any other relevant statute or regulation, define "processing." However, other states with similar undefined terms have relied on dictionary definitions and provide guidance here.

For example, in Tetra Tech EC, Inc. v. Wis. Dep't of Revenue, the Supreme Court of Wisconsin analyzed a statute that imposed a tax "for the 'processing' of river sediments into waste sludge, reusable sand, and water." 914 N.W.2d 21, 28 (Wis., 2018). The Wisconsin Supreme

Court explained that "[t]he *noscitur a sociis* canon of construction (literally, 'it is known from its associates') instructs that '[w]hen two or more words or phrases are listed together, the general terms . . . may be defined by the other words and understood in the same general sense.'" Tetra Tech EC, Inc., 914 N.W.2d at 60. The other words listed with "processing" in the Tetra Tech case were fabricating, printing, and producing. In relying on the aforesaid maxim and the definition of "processing" from the Oxford Dictionary, the Wisconsin Court determined the proper meaning of the term "processing" encompasses "the performance of a mechanical or chemical operation on tangible personal property, a task that can be completed without transforming the property into a new product, or adding anything to it that was not already there." Id. at 61.

When applying these definitions, South Carolina's Machine Exemption exempts the Respondent's purchases of (1) machines (as defined above), (2) which are used in, serve as an essential, indispensable, and are an absolutely necessary or important component part of, (3) the performance of some mechanical or chemical operation on fresh produce to be sold. See Regulation 117-302.5(B)(1). Thus, once all "machines" are identified, the issue becomes which of those machines are integral and necessary to the performance of some mechanical or chemical operation on tangible personal property to be sold, because only those machines are subject to the exemption. See Regulation 117-302.5(B)(1)(b).

The mechanical or chemical operation on tangible personal property conducted at the Respondent's facility is the sorting, cutting, washing, and packaging of produce. Accordingly, not every activity that occurs within the Respondent's facility is "processing." It follows then that not every machine in the facility serves as an essential and indispensable component part of processing fresh produce to be sold. While the ALC was correct that a machine does not have to be used directly in the production line to be exempt, the machine must be integral and necessary to

processing produce as defined above, not to the operation of the Respondent's entire plant.

Thus, in the context of the Respondent's operations, a machine at the Respondent's plant qualifies for the Machine Exemption only when it is *absolutely necessary* to the actual process of sorting, cutting, washing, and packaging of fresh produce. Based on this, it is of no consequence that the Respondent's operations are heavily regulated by Federal and State laws; that fact merely demonstrates that the activities prior to and after the sorting, cutting, washing, and packaging of fresh produce are absolutely necessary and important *for the Respondent* to continue operating.[15]

When applying the appropriate standard and strictly construing the exemption statute against the Respondent, it is clear that the activities that occur prior to and after the actual sorting, cutting, washing, and packaging of produce (i.e., air quality control, storage, material handling) are not absolutely necessary because the sorting, cutting, washing, and packaging of fresh produce can be done without such activities. Thus, these activities are not considered a part of the "processing" of fresh produce and the associated machines or items do not qualify for the Machine Exemption to the use tax.

iv. The ALC incorrectly relied on the addition of "agricultural packaging" to the Machine Exemption as evidence of legislative intent as the Machine Exemption was written during the Audit Period.

In 2016, after the Audit Period, the General Assembly added the term "agricultural packaging" to the list of exempt uses under the Machine Exemption. The ALC incorrectly interpreted this addition to mean that "the legislature intended this manufacturing process to be much broader than the production line definition espoused by the Department." (R. p. 22, footnote

[15]The ALC incorrectly relied on the Federal and State regulations the Respondent must follow regarding food safety in determining that "the machinery and equipment used both before and after the actual production line processing of 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." (R. p. 22; Order p. 22).

9; Order p. 22, footnote 9). Again, the Department did not utilize a production line theory but rather a limited integrated plant theory as required by the Machine Exemption Regulation.

Moreover, the fact the legislature added "agricultural packaging" as an exempt use is not an indication that the General Assembly had intended such a use to be included in the previous version of the Machine Exemption. On the contrary, the addition indicates that those activities *were not* exempt prior to the 2016 statutory change. Generally, "[w]hen a statute is amended, there is a presumption that the legislature intended to change the existing law." Duvall v. S.C. Budget & Control Bd., 377 S.C. 67, 80-81, 716 S.E.2d 877, 884 (2011).

Here, when the General Assembly amended the Machine Exemption to include "agricultural packaging" as an exempt use, it stated in the enacting legislation that this was "[a]n act . . . to amend [the Machine Exemption], as amended, relating to exemptions from the state sales tax, *so as to exempt machines used in agricultural packaging*." 2016 S.C. Acts No. 256 § 427 (effective June 8, 2016) (emphasis added). Thus, according to the Act, the purpose of the amendment was to make agricultural packaging an exempt use, not to clarify any legislative intent on the exempt uses previously codified. Therefore, the ALC incorrectly used the statutory amendment as a basis for its flawed decision.

Finally, contrary to the ALC's assertion, the addition of the term agricultural packaging does not mean that the terms "manufacturing" or "processing" should be construed broadly. The addition simply means that, after the effective date of the amendment, exempt machines include those machines that are integral and necessary to agricultural packaging. Further, the addition of the term "agricultural packaging" does not change the meaning of "manufacturing" and "processing" (or any of the other terms in the statute), nor does the fact that the General Assembly chose to define "agricultural packaging" for purposes of a tax credit change the definition of the

terms manufacturing or processing as used in the Machine Exemption.

C. <u>The conveyances at issue are not machines used in processing tangible personal property for sale</u>.

The Respondent uses forklifts (along with their respective parts and batteries), pallet jacks, and hand trucks to move produce from place to place and to certain lines of production within the facility. (R. p. 209, lines 1-2, p. 218, lines 13-25, p. 254, lines 9-12; Hr'g Tr. p. 68:1-2, 77:13-25; 113:9-12). The Respondent uses these supplies mostly in the palletizing, shipping, finished storage, raw storage, tomato repack, and receiving dock areas (i.e., the low-care areas) of the facility to move produce. (R. p. 209, lines 6-9, p. 219, lines 3-6; Hr'g Tr. pp. 68:6-9, 78:3-6).

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, lines 3-5, p. 252, line 19-p. 253, line 15; Hr'g Tr. pp. 69:3-5, 111:19-112:15). Mr. McEntire testified that roughly twenty-five (25) percent of the Respondent's forklifts are used to put raw produce onto the conveyor system. (R. p. 256, lines 13-18; Hr'g Tr. p. 115:13-18). However, the Respondent does not have a method of tracking the use of its forklifts, except for the fact of knowing that the Respondent does not use any of its forklifts in the high-care area. (R. p. 209, lines 5-6, p. 255, lines 18-20, p. 256, lines 19-21; Hr'g Tr. 68:5-6, 114:18-20, 115:19-21).

The Respondent's pallet jacks are electric hand trucks that can lift pallets and move them from place to place. (R. p. 218, lines 13-16; Hr'g Tr. p. 77:13-16). While similar, the pallet jacks cannot perform all the same functions as a forklift. (R. p. 254, lines 7-22; Hr'g Tr. p. 113:7-22). Thus, the Respondent does not use its pallet jacks to transfer produce onto a conveying mechanism like the forklifts. (R. p. 254, line 23-p. 255, line 2; Hr'g Tr. pp. 113:23-114:2).

The Respondent uses a food-grade oil and a food-grade grease to lubricate its hand trucks

and pallet jacks in order to maintain the hand trucks and pallet jacks and keep them in good, working order. (R. p. 219, line 22-p. 220, line 1; Hr'g Tr. pp. 78:22-79:1).

i. The Respondent's conveyances do not fit within the conveyances that are deemed exempt under the Machine Exemption Regulation.

The ALC found that these various conveyances and their respective batteries, parts, and oils and lubricants are exempt from use tax under the Machine Exemption. (R. p. 24; Order p. 24). The Machine Exemption Regulation provides that the following conveyances serve as an essential and indispensable component part of processing: (1) conveyance machines feeding the first processing machine; (2) conveyance machines moving in-process materials; and (3) conveyance machines discharging the finished product from the last processing machine. See Regulation 117-302.5(B)(4)(a).

The limitations set by this regulation demonstrate that not all conveyances used in manufacturing or processing are considered essential and indispensable component parts of manufacturing or processing tangible personal property for sale. Only those specifically identified within the Machine Exemption Regulation are considered essential and indispensable. Logically, this is because processing machines could not perform their intended function without machines that feed materials into the processing machines, move in-process materials from one processing machine to another, and discharge the finished product. The processing machines could, however, perform their intended functions without machines that move materials around a storage area.

Further, the conveyances must still satisfy the general Machine Exemption test, meaning they must be substantially used in processing (as opposed to storage, for example) and must be used on an ongoing and continuous basis (not "as needed"). See Regulation 117-302.5(B)(1). This means that, even if a conveyance is found to be the machine feeding the first processing machine, it still will not qualify for the exemption if it is not used on an ongoing and continuous basis.

Based on the Department's interpretation of "processing," the first processing machine in the Respondent's plant is in the high-care area where the produce is sorted, inspected, trimmed, and placed onto a conveyor belt leading to the cutter. (R. pp. 6-7; Order pp. 6-7). Mr. McEntire explained this process as follows: "Once we take the lettuce out of the raw product area, we dump it through a bin dumping conveyance system, and it enters the high-care area. **In that first step,** we sort it, trim it, and remove any defects. And then it continues conveying up to a cutting area." (R. p. 189, lines 12-17; Hr'g Tr. p. 48:12-17) (emphasis added). Thus, the bin dumping conveyance system is the conveyance that feeds the first processing machine. The forklifts feed the bin dumping conveyance system and, therefore, do not feed the first processing machine. (R. p. 210, lines 3-5, p. 252, line 19-253, line 15; Hr'g Tr. pp. 69:3-5, 111:19-112:15). As such, the forklifts are not exempt.

The evidence further demonstrates that the remaining conveyance machines are used in the "palletizing, shipping, finished storage, raw storage, tomato repack area, and receiving dock." (R. p. 219, lines 4-6; Hr'g. Tr. 78:4-6). Thus, no conveyance machines are used to feed the first processing machine or to move in-process material. Some conveyance machines appear to be used to discharge the finished product in the palletizing area or move in-process material within the tomato repack area, but the Respondent did not keep a record of how often it used these items for these exempt purposes. (R. p. 209, lines 5-6, p. 255, lines 18-20, p. 256, lines 19-21; Hr'g Tr. 68:5-6, 114:18-20, 115:19-21). Accordingly, the Respondent presented no evidence to demonstrate that more than one third of the conveyance machines were used for those exempt purposes.[16] Therefore, the ALC erred in finding that such machines were exempt.

[16]Regulation 117-302.5 provides that a "machine must be substantially 'used in manufacturing . . . tangible personal property for sale.'" Further, "more than one-third of a machine's use in manufacturing is substantial." Id. Therefore, in order to receive the exemption

D. <u>The items used for storage/temperature control are not machines used in processing tangible personal property for sale</u>.

The Respondent uses two primary types of warehouse racks: a flow-through rack and a pushback rack system. (R. p. 210, lines 15-21; Hr'g Tr. p. 69:15-21). It uses flow-through racks in the storage coolers where palletized raw produce flows through from one side of the cooler to the other. (R. p. 210, lines 16-18; Hr'g Tr. p. 69:16-18). It uses the pushback rack system where the Respondent places raw produce or finished produce onto a carriage that is pushed back several spaces or up and out. (R. p. 210, lines 18-24; Hr'g Tr. p. 69:18-24). These racks help with efficiency, keeping the produce separated, and maintaining the temperature of the produce during storage. (R. p. 210, line 24-p. 211, line 2; Hr'g Tr. pp. 69:24-70:2).

The Respondent uses pallet flow brakes on the racks in the raw cooler areas. (R. p. 12, p. 213, lines 18-22; Order p. 12; Hr'g Tr. p. 72:18-22). Specifically, the pallet flow brakes slow down the speed of the pallets as they travel down the flow-through pallet system. (R. p. 213, lines 12-13; Hr'g Tr. p. 72:12-13).

The Respondent also uses stacking containers for storage in the "work in progress" section of the facility to store processed produce until the Respondent can combine it with other processed produce. (R. p. 12; Order p. 12). For example, the Respondent combines cabbage and carrots to make coleslaw. (R. p. 12, p. 233, line 24-p. 234, line 2; Hr'g Tr. pp. 92:24-93:2; Order p. 12). The Respondent uses the stacking containers to store cut carrots until the cabbage is processed and ready to be combined to be made into coleslaw. (R. p. 12; Order p. 12).

The Respondent uses blower fans in both the high and low-care areas to move refrigerated

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for the above-listed conveyances, the Respondent had to demonstrate that more than one-third of the conveyances' uses were dedicated to the processing portions of the facility; however, the Respondent failed to provide such evidence.

air in order to maintain the mandated temperature level and to also filter any airborne contaminates. (R. p. 250, lines 9-23; Hr'g Tr. p. 109:9-23).[17]

i. The storage and temperature control items are not used in processing fresh produce for sale.

The ALC found that stacking containers, warehouse racks, pallet flow brakes, and the blower fans used by the Respondent "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 . . . ." (R. p. 26; Order p. 26) (Emphasis added). Regarding the stacking containers, warehouse racks, and pallet flow brakes, the testimony presented demonstrates that these items are used only to store produce. (R. p. 12, p. 210, line15-p. 211, line 2, p. 213, lines 12-13 and 18-22; Order p. 12; Hr'g Tr. pp. 69:15-70:2, 72:12-13, 18-22). The Machine Exemption Regulation specifically 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. Regulation 117-302.5(B)(7).

Thus, while the Respondent might have purchased these specific items for reasons besides just storing produce, i.e., maintaining the temperature of the produce during storage, that is a need found necessary to the Respondent for food safety purposes and not necessary to the processing of produce. As emphasized above, the ALC noted that these items are used "before and after" the cutting of fresh produce. Thus, based on the Department's interpretation of "processing" discussed above, these items fall outside of the processing of fresh produce.

Further, regarding the blower fans, Regulation 117-302.5(C)(24) provides that "[m]achines

[17]The ALC states in its Order that the Respondent could not maintain the required temperature within its facility without these blower fans. (R. p. 13; Order p. 13). However, the record is void of any evidence to support this finding of fact.

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" are exempt. (Emphasis added). Thus, any machines used to control the temperature where the produce is being processed would be exempt, but machines used outside of the manufacturing process would be taxable. The logic here is the same as for the items discussed above—the *processing* machines cannot perform their intended function without the temperature control machines because the product would be compromised during the processing. Importantly, if the temperature control item is being used during storage as opposed to during processing, the temperature control item cannot be an integral part of the *processing* of fresh produce.

The Respondent's witnesses testified repeatedly about the importance of keeping the temperature within the facility between 33 and 40 degrees. (R. p. 176, lines 13-20, p. 185, lines 18-20, p. 192, line 2-p. 193, line 12, p. 211, line 24-p. 212, line 4, p. 214, lines 2-6, p. 232, lines 11-21; Hr'g Tr. pp. 35:13-20, 44:18-20, 51:2-52:12, 70:24-71:4, 73:2-6, 91:11-21). The Respondent's witnesses also testified that the blower fans contribute to keeping the plant temperature between 33 and 40 degrees. (R. p. 250, lines 9-23; Hr'g Tr. p. 109:9-23). The Machine Exemption Regulation clearly states that any quality control item used to condition air is exempt only *if used during the processing of tangible personal property*. Accordingly, for the blower fans to be exempt, the Respondent had to show that it used the blower fans substantially in the processing areas of the facility, which includes the areas of the facility where produce is sorted, cut, washed, and packaged. However, the Respondent did not provide any evidence as to where the blower fans are used except to say that they are used in both the high-care and low-care areas (R. p. 250, lines 9-23; Hr'g Tr. p. 109:9-23). In order to prove that the blower fans are substantially used in processing, the Respondent had the burden to show that "more than one-third of the

machine's use" was in processing fresh produce. See Regulation 117-302.5(B)(1)(c). The Respondent failed to provide any evidence that would indicate that more than one-third of the blower fans' uses were within the processing areas. As such, the Respondent failed to prove that it substantially used the blower fans during the manufacturing process.

Because the storage items are explicitly taxable according to the Machine Exemption Regulation, the ALC erred in finding such items to be exempt from use tax.

E. The water storage tanks are not machines used in processing tangible personal property for sale.

The Respondent has large water storage tanks both inside and outside the facility. (R. p. 258, lines 13-14; Hr'g Tr. p. 117:13-14). 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, line 21-p. 259, line 7; Hr'g Tr. pp. 117:21-118:7). 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. 14, p. 258, lines 8-9, p. 259, lines 21-24; Hr'g Tr. p. 117:8-9, 118:21-24; Order p. 14).

The ALC found these storage water tanks exempt from use tax. (R. p. 27; Order p. 27). However, Regulation 117-302.5(7), as discussed above, provides that machines used for storage are taxable, including "(b) [s]torage tanks used to store raw materials, gasses, *or water*." (Emphasis added). The storage water tanks at the Respondent's facility merely store water that is later used in processing. The Respondent failed to present any evidence that these tanks are used during processing. The *water* from the tanks may be used during processing, but the tanks themselves merely serve as storage tanks and, thus, are taxable.

Further, Regulation 117-302.5(B)(4)(b) provides that "(iii) Piping leading to and from storage tanks [and] (iv) Piping, pumps, and well connections installed for use by a manufacturer **to supply the manufacturing plant with water necessary for the manufacture of tangible**

personal property" are taxable. (Emphasis added). Mr. McEntire conceded that the Respondent does "mix sanitation chemicals [in the storage tank] **before** it's delivered to the processing area." (R. p. 258, line 25-p. 259, line 2; Hr'g Tr. 117:25 – 118:2) (emphasis added). Certainly, if the pipes that take the water from the tank to the processing area are taxable because they are outside of the manufacturing process, then the tanks, which are another step removed from the manufacturing process, must be taxable. In sum, while the storage water tanks maybe be integral and necessary to the Respondent's operations, they are not integral and necessary to processing produce for sale. As such, the ALC erred in finding such items to be exempt.

F. The floor treatment chemicals and cleaning machines (foamers) are not machines used in processing tangible personal property for sale.

The Respondent utilizes cleaning machines, called foamers, to foam and sanitize the "processing equipment" in the high-care area. (R. p. 229, lines 14-22; Hr'g Tr. p. 88:14-22). The Respondent did not provide any evidence regarding the specific "processing equipment" it cleans with these foamers, whether cleaning is necessary to ensure the functioning of the equipment, or whether cleaning ensures the quality of the product. The only evidence the Respondent provided regarding its use of the foamers is that federal law requires the cleaning done by the foamers.[18] (R. p. 229, line 23-p. 230, line 1; Hr'g Tr. pp. 88:23-89:1).

The Respondent uses floor treatment chemicals to sanitize the floor in the high-care area and certain low-care areas in certain situations. (R. p. 14, p. 224, lines 8-13; Hr'g Tr. p. 83:8-13; Order p. 14). The Department's audit relating to chemicals included more than floor treatment

[18]In its Order, the ALC stated that the FDA requires these particular machines. (R. p. 14; Order p. 14). However, Mr. McEntire only testified that the cleaning the foamers perform, and not necessarily the foamers themselves, are required. (R. p. 229, line 23-p. 230, line 1; Hr'g Tr. pp. 88:23-89:1).

chemicals. (R. p. 736, footnote 1, p. 743; Dep't Determination p. 1 (footnote 1), 8). However, the only remaining chemicals in dispute at the time of the hearing were floor treatment chemicals. (R. p. 5; Order p. 5). The floor treatment chemicals serve no purpose other than to sanitize the Respondent's facility. (R. p. 258, lines 4-10; Hr'g Tr. p. 117:4-10).

The ALC found that the floor treatment chemicals purchased by the Respondent are exempt. (R. p. 27; Order p. 27). 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. See Regulation 117-302.5(B)(5). When testifying about the chemicals at issue, Mr. McEntire stated these chemicals are used "to sanitize the floor and keep the floor clean . . . ." (R. p. 224, lines 10-11; Hr'g Tr. p. 83:10-11). He also testified that these chemicals serve no other purpose than to sanitize the facility. (R. p. 258, lines 4-10; Hr'g Tr. 117:4–10). The floor in the Respondent's facility is not an exempt machine and there was no testimony that the Respondent uses these particular chemicals on any exempt machines. Therefore, the ALC erred in concluding that these chemicals are exempt.

Furthermore, the Respondent uses the "foamers" every night to foam and sanitize the "processing equipment" in the high-care area. (R. p. 229, lines 14-22; Hr'g Tr. p. 88:14-22). Thus, the Respondent established that it uses the foamers on an ongoing and continuing basis. However, as discussed below, in order for a maintenance machine to be exempt, it must be used to maintain an *exempt machine* on an ongoing and continuous basis, as this would indicate that the maintenance machine serves as an essential and indispensable component part of processing produce to be sold. The Respondent did not provide any evidence that the machines on which the foamers were used would not function without the cleaning conducted by the foamers. Thus, while the Respondent's use of the foamers may be required by Federal law (R. p. 229, line 23-p. 230, line 1; Hr'g Tr. pp.

88:23-89:1), this fact does not mean that the use of the foamers is essential and indispensable to the processing of produce. Rather, it is an indication that the Respondent's use of the foamers is necessary to the Respondent's operations. As such, the ALC incorrectly determined that the foamers are exempt.

G. The maintenance tools at issue are not used on an ongoing and continuous basis, and thus, do not qualify for the exemption.

The Respondent uses general maintenance tools to maintain, repair, install, and uninstall equipment. (R. p. 13; Order p. 13). The Respondent uses these tools anytime a machine breaks or requires care in any part of the facility. (R. p. ; Hr'g Tr. p. 94:13-21). For example, if one of the Respondent's machines breaks down due to water intrusion, the Respondent has designated maintenance employees who use these tools to fix the machine. (R. p. 235, lines 2-7 and 25-p. 236, line 9; Hr'g Tr. pp. 94:2-7, 25-95:9).[19] Further, the Respondent uses the cut wheel and disc maintenance tools to maintain the cut wheels and discs within the produce cutting machines in the high-care area. (R. p. 19; Order p. 13).

The ALC determined that these tools are exempt from use tax. (R. p. 23; Order p. 23). A machine qualifies for the Machine Exemption, meaning that it is a machine "used in processing tangible personal property for sale," if it is "integral and necessary to the manufacturing process." Regulation 117-302.5(B)(1). There are several factors to consider when determining if a machine is "integral and necessary," one of them being whether the machine is "used on an ongoing and

[19]In its Order, the ALC stated that the Respondent's designated maintenance employees are "constantly" working on repairing machines due to the environment of the Respondent's facility. (R. p. 13, p. 23; Order pp. 13 and 23). However, while Mr. McEntire testified that its machines have a "fair amount" of break downs and "many other issues," the record is void of any indication that the Respondent is "constantly" using these maintenance tools. (R. p. 236, lines 4-6; Hr'g Tr. p. 95:4-6).

continuous basis during the manufacturing process." Regulation 117-302.5(B)(1)(b).

Generally, maintenance machines are not exempt from sales and use tax. The Machine Exemption Regulation provides that "[m]aintenance machines used at a manufacturing facility are not exempt from the tax as a machine used in manufacturing tangible personal property for sale." Regulation 117-302.5(B)(6). Further, "[m]achines that are used to maintain non-exempt machines . . . or are not used on an ongoing, continuous basis to maintain exempt manufacturing machines . . . are maintenance machines and are not exempt from the tax . . . ." Id.

Thus, according to the Machine Exemption Regulation, in order for a maintenance machine to be exempt, it must be used to maintain an exempt machine on an ongoing and continuous basis. In other words, a maintenance machine used on an exempt machine on an ongoing and continuous basis serves as an essential and indispensable component part of processing produce to be sold because without ongoing and continuous maintenance, the exempt machine would not work.

In this case, the evidence demonstrates that the Respondent only uses its maintenance tools on an "as needed" basis. (R. p. 235, lines 13-21; Hr'g Tr. p. 94:13-21). First, there is no evidence in the record that these maintenance tools are "machines" as defined by the Machine Exemption Regulation. Second, even if they are "machines," "as needed" is not "ongoing and continuous." If a machine is only used "as needed," it logically cannot serve as an essential and indispensable component part of processing produce to be sold since the machine being maintained by the maintenance machine obviously works without maintenance for most of its operational existence. As such, the ALC erred in finding that such maintenance tools are exempt.

H. The generator rentals the Respondent uses in its facility are not used on an ongoing and continuous basis, and thus do not qualify for the exemption.

Tomatoes arrive at the Respondent's facility in various color stages, and different customers have different color requirements. (R. p. 216, line 16, lines 21-25, p. 217, lines 1-2;

Hr'g Tr. pp. 75:16, 21-25, 76:1-2). When necessary, the Respondent rents ethylene generators to speed up the ripening process and change the color of the tomatoes to a certain color stage, per a customer's request. (R. p. 216, lines 17-25; Hr'g Tr. p. 75:17-25). The Respondent rents these generators when the repack manager determines that a generator is needed based on color of the available crop of tomatoes. (R. p. 257, lines 13-18; Hr'g Tr. p. 116:13-18). The generators are not needed year-round. (R. p. 257, line 12; Hr'g Tr. p. 116:12).

The Respondent must use the generators on an "ongoing and continuous basis" for the generators to be considered integral and necessary to the processing of fresh produce. See Regulation 117-302.5(B)(1)(b). However, renting and using a generator to ripen tomatoes "when necessary" or "as needed" is not using them on an "ongoing and continuous basis." It is only on the occasions when the Respondent's tomato repack manager says a generator is needed that the Respondent rents these generators. (R. p. 257, lines 13-16; Hr'g Tr. p. 116:13-16). The logical inference, then, is that there are times when crops of tomatoes come into the Respondent's facility that are already at the desired color and the generators are not needed, or that the natural ripening that occurs in the low-care area is sufficient for the ripening of a particular crop. (R. p. 6; Order p. 6). As such, the evidence indicates that these generators are not used on an "ongoing and continuous basis."

The ALC determined that the Respondent's rental of these generators are exempt from use tax. (R. p. 24; Order p. 24). Specifically, the ALC determined that, because tomato crops are variable, and the Respondent rents generators on a seasonal basis, then the rental of generators on an as-needed, seasonal basis to process a variable crop makes the Respondent's use of the generators "ongoing and continuous." (R. p. 24; Order p. 24). As the evidence infers, there are crops of tomatoes that arrive at the Respondent's facility that do not need the ripening assistance

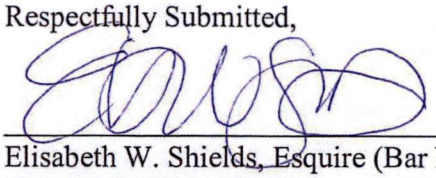
of one of these generators. Thus, even during the seasons that tomatoes are harvested, there are crops that arrive at the Respondent's facility which do not need to be ripened by a generator. It is only when a crop arrives at the facility and the Respondent has a specific order from a customer regarding the color of a crop of tomatoes that the Respondent rents and uses a generator to ripen the tomatoes to the customer's desired color. (R. p. 216, line 21-p. 217, line 15; Hr'g Tr. pp. 75:21-76:15). Therefore, the ALC erred in determining that the Respondent's rental and use of these generators are used on an "ongoing and continuous basis."

CONCLUSION

In this case, the ALC improperly expanded the Machine Exemption and disregarded the limitations set forth in the Machine Exemption Regulation when determining whether the Respondent's purchases of the items in dispute qualified for the exemptions within § 12-36-2120(17). In doing so, the ALC's Order is based on an error of law and goes against the plain language of the Machine Exemption, the Pollution Control Machine Exemption, and the Machine Exemption Regulation. As such, the Court should reverse the ALC's findings and hold that the items for which the Respondent sought exemptions are taxable.

[Signature on following page]

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June 2, 2020

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THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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

CASE NO. 17-ALJ-17-0060-CC
APPELLATE CASE NO. 2019-001933

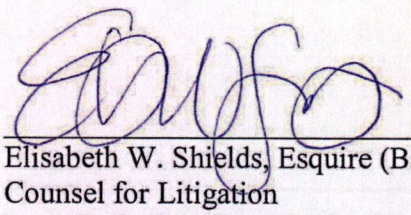
McEntire Produce, Inc., ...Respondent,

v.

South Carolina Department of Revenue, ...Appellant.

CERTIFICATE OF COUNSEL

The undersigned certifies that this Final Brief complies with Rule 211(b), SCACR.



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

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I. STATEMENT OF ISSUES ON APPEAL

A. DID THE ADMINISTRATIVE LAW COURT ERR BY GRANTING "THE MACHINE EXEMPTION" AND "THE POLLUTION CONTROL MACHINE EXEMPTION," BOTH FOUND IN S.C. CODE ANN. § 12-36-2120(17) (SUPP. 2018), TO THE RESPONDENT'S PURCHASES OF ITEMS THAT ARE "MACHINES?"

B. DID THE ADMINISTRATIVE LAW COURT ERR BY GRANTING "THE MACHINE EXEMPTION" TO RESPONDENT'S PURCHASES OF MACHINES THAT ARE "USED IN PROCESSING TANGIBLE PERSONAL PROPERTY FOR SALE?"

II. STATEMENT OF THE CASE

This matter came before the 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 Produce, Inc., ("Respondent") filed a request for a contested case hearing with the ALC on March 7, 2017, in case number 17-ALJ-17-0060-CC to challenge a Department Determination issued by the South Carolina Department of Revenue ("DOR," "Department," or "Appellant") on February 7, 2017. (R. pp. 1177, 736-745; Req. for Contested Case Hr'g, Dep't Determination pp. 1-10) In the Department Determination, the Department concluded that the Respondent's purchases of certain supplies and protective clothing were subject to use tax for tax periods October 1, 2012 through September 30, 2015 (the "Audit Period") and were not exempt from use tax under § 12-36-2120(17) (Supp. 2018). (R. pp. 736-45; Dep't Determination pp. 1-10)

On November 14 and 15, 2018, the ALC held a contested case hearing. Thereafter, the ALC issued its Final Order on September 6, 2019, and determined that the majority of the items, including those items identified as protective clothing, for which the Respondent sought exemptions were exempt from use tax under § 12-36-2120(17), hereinafter referred to as the "Machine Exemption." (R. p. 42; Order p. 42) (The ALC's Final Order will be referred to, hereinafter, as the "Order"). 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) 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. (R. pp. 46-72; Mot. to Recons. pp. 1-25) The ALC issued an order on October 16, 2019, denying the Department's Motion for Reconsideration. (R. pp. 44-45; Order Denying Mot. to Recons.) The Department appealed the Order and the Order Denying Respondent's

Motion to Reconsider, Alter or Amend on November 20, 2019.

III. STATEMENT OF FACTS

Respondent was started in South Carolina in 1938 and the facility under audit is the only facility. (R. p. 158; Tr. p. 16, lines 1, 22-24) It is a seasonal business with 600 employees during the summer and 50 in the winter. (R. p. 160; Tr. p. 18, lines 3-8) Their major customers include McDonalds, Burger King, Subway and Taco Bell (R. p. 162; Tr. p. 21, lines 13-17) It purchases produce from farmers in California, Florida, Georgia, South Carolina, Michigan and Ohio. (R. p. 165; Tr. p. 24, lines 1-5) For sales, income, and property tax purposes, Respondent is taxed as a manufacturer.

Respondent operates in the specialized and highly-regulated arena of fresh food processing. During the periods at issue, Respondent's production primarily involved lettuce, onions, cabbage, tomatoes, and other vegetables.

Respondent's "processing" includes receiving, storing, washing, cutting, mixing, and then packaging the produce at its facility. Respondent called several witnesses who described its fresh food processing in depth. 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 microwaving or cooking the produce to the extent necessary to kill or eliminate any contaminants.

Respondent's process begins prior to the raw agricultural commodity even entering the facility. Respondent contracts with a grower to harvest the product when it is about 80-85 degrees, so the first step in the process it to pull the heat from the produce, so that the temperature of the produce is reduced to below 40 degrees within no more than four hours from the time of harvest. This cooling step is essential to Respondent's process because it slows the respiration rate of the produce, thereby slowing the natural chemical process of

ripening in the fruit and/or vegetable. It also minimizes microbiological growth rate. If the produce is not cooled immediately, then it risks turning brown, soggy, slimy, and inedible. Respondent is required by state and federal regulation, as well as customer requirements, to track the produce as soon as it is loaded into its climate-controlled trucks. Respondent must be able to demonstrate that the temperature on those trucks was between 33 and 40 degrees. Respondent's customers (primarily large restaurant chains) have extensive contractual requirements in this regard.

As soon as the product is unloaded, it enters one of six raw coolers, which also are controlled at 33-40 degrees. 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. Respondent's flume is a stainless steel bath that utilizes a water-based product to rinse and sanitize the product. The produce is washed a number of times before it moves to the next step. After washing, the produce goes through a "de-watering" step, which is essentially an industrial-sized salad spinner. 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 Respondent.

The low care area is generally is reserved for whole produce, for example whole tomatoes, and involves their ripening, sorting, defect removal, and repackaging but no cutting of the produce. 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.

The high care area is reserved for produce that is cut down to a smaller size. In the

high care area, employees are required by state and federal law to wear protective clothing. The employees must also go through a specialized sanitization procedure to limit the introduction of microbes to the high care area. The room is also positive-pressurized to ensure there is an outflow, as opposed to an inflow, of air. 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. The overall purpose of these procedures are to protect the produce from human contact and microbial loads. 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.

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. In the area, Respondent 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.

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. Respondent'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. "[W]e do not have a kill step. We do not have a pasteurization step." (R. p. 176; Tr. p. 35, lines 13-15) Respondent's customers also can track the extent to which the produce was kept in a climate-controlled area. For example, if the produce is stored for a period of time above 40 degrees, then the customer can simply reject the shipment. 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. Respondent is annually audited by the FDA in this regard. 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 Respondent's facility. (R. pp. 5-8; Order pp. 5-8) The facility has had a Class 100 clean room environment since it opened in 2006 as required by state and federal law. (R. pp. 200-01; Tr. p. 59, line 21–p. 60, line 13)

As detailed below, many of the items at dispute in this audit relate to Respondent's attempt to combat three potentially serious foodborne microbes – Listeria monocytogenes, E. coli and salmonella. The microbes are described on the CDC website as follows:

1. **Listeria monocytogenes** is a germ that can cause a serious infection called Listeriosis, which presents as flu-like symptoms. People usually become ill with listeriosis after eating contaminated food. The disease primarily affects pregnant women, newborns, older adults, and people with weakened immune systems. Approximately 80% of those with Listeriosis go into the hospital, and as many as 18% of those infected die.

2. **Escherichia coli** (abbreviated as E. coli) are bacteria that can cause diarrhea, urinary tract infections, respiratory illness and pneumonia, and other illnesses. E. coli are pathogenic, meaning they can cause illness, either diarrhea or illness outside of the intestinal tract. The types of E. coli that can cause diarrhea can be transmitted through contaminated water or food, or through contact with animals or persons.

3. **Salmonella** is a bacteria that can cause diarrhea, fever, and abdominal cramps between 12 and 72 hours after infection. The illness usually lasts 4 to 7 days. In some cases, diarrhea may be so severe that the patient needs to be hospitalized. In these patients, the Salmonella infection may spread from the intestines to the blood stream, and then to other body sites. In these cases, Salmonella can cause death unless the person is treated promptly with antibiotics. The elderly, infants, and those with impaired immune systems are more likely to have a severe illness.

All three microbes grow naturally in South Carolina and are present in farms across the

country where Respondent's produce is harvested. The germ and bacteria can breed in produce if the environment is conducive to that growth. Respondent 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. (R. pp. 8-9; Order pp. 8-9)

IV. 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, 500-501 (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 standard of review for appeals from the Administrative Law Court was recently stated by the Court of Appeals in *A. O. Smith Corp. v. S.C. Department of Health and Environmental Control*, 428 SC 189, 833 S.E.2d 451, 457-58 (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 (2017) and *Bailey v. S.C. Dep't of Health & Envtl. Control*, 388 S.C. 1, 693 S.E. 2d 426,429 (2011).

V. ARGUMENT

A. THE ADMINISTRATIVE LAW COURT DID NOT ERR BY GRANTING THE MACHINE EXEMPTION TO RESPONDENT'S PURCHASES.

1. The ALC Did Not Broaden the Meaning of the Term "Machine" as Used in the Machine Exemption.

a. All machines used within the temperature-controlled portion of the facility are exempt as machines used in the manufacturing process.

S.C. Code Ann. § 12-36-2120(17) exempts from sales tax the sale of "machines used in *manufacturing, processing, agricultural packaging*, recycling, compounding, mining, or quarrying tangible personal property for sale" (emphasis added). (As stated above, Respondent is classified as a manufacturer for all state tax purposes. (R. p. 166; Tr. p. 25, lines 1-4)) "Machines," according to the exemption, "include the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of the machines and which ... are necessary to the operation of the machines and are customarily so used." § 12-36-2120(17).

In applying these statutes, "[t]he cardinal rule of statutory interpretation is to determine the intent of the legislature." *Jones v. State Farm Mut. Auto. Ins. Co.*, 364 S.C. 222, 230, 612 S.E.2d 719, 723 (2005). Furthermore, "[t]he legislature's intent should be ascertained primarily from the plain language of the statute." *State v. Landis*, 362 S.C. 97, 102, 606 S.E.2d 503, 505 (Ct. App. 2004). "What a legislature says in the text of a statute is considered the best evidence of the legislative intent or will." *Bayle v. S.C. Dep't of Transp.*, 344 S.C. 115, 122, 542 S.E.2d 736, 740 (Ct. App. 2001). "Revenue laws are generally construed in favor of the taxpayer and against the taxing authority." *Clark v. S.C. Tax Comm'n*, 259 S.C. 161, 169, 191 S.E.2d 23, 26 (1972) (internal quotation marks omitted).

Respondent is an agricultural packager. The definition of "agricultural packaging" is found in § 12-6-3360, which provides a jobs tax credit for manufacturers and agricultural packagers meeting certain requirements. Section 12-6-3360(M)(16) defines "agricultural packaging" as

> the technology of enclosing or protecting or preserving agricultural products for distribution, storage, sale, and use. Packaging also refers to the process of design, evaluation, and production of packages used for agricultural products. Packaging can be described as a *coordinated system of preparing agricultural goods for transport, warehousing, logistics, sale, and end use*." (emphasis added).

Here the statute clearly envisions a more expansive concept of "agricultural packaging," to include the transportation and warehousing both before and after the literal packaging. This definition includes the receipt of raw produce and placement of the produce on cooling racks, as well as the offloading labeling and control of the finished packaging to storage and ultimate delivery to customers. Therefore, the ALC did not err in including those activities within Respondent's overall manufacturing process.

b. The Court did not Err in Ruling the Purchases at Issue Involved Machinery and Equipment which was "Integral and Necessary" to the Manufacturing Process.

The ALC Order (R. p. 22; Order p. 22) found:

> In this case, the Court finds 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. Without the processes that occur in the climate-controlled low-care areas of the plant, [Respondent] would be unable to safely and efficiently produce a finished product for sale and distribution. These processes contribute continuously and vitally to the plant's overall production and are also integrated and harmonized into the activities that occur

> directly in the production line, as conceived in the Integrated Plant Concept.

The ALC Order also stated (R. pp. 25-26; Order pp. 25-26) as follows:

> In this case, it is evident that temperature and other environmental controls permeate the entire production process, from the time the produce is harvested and delivered from 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 plan and much of the equipment inside of it was specially designed and built to correlate with the climate and other environmental controls that are required to reduce the possibility of food contamination. (Trial Tr., p. 60:1-13).

S.C. Regs. § 117-302.5 provides a three-part test to determine whether a machine is "integral and necessary" to the manufacturing process:

> (1) The machine is used at a manufacturing facility. . . . It does not apply to machines used at a facility whose purpose is retailing, wholesaling, distributing, or some other non-manufacturing purposes.
> (2) The machine is used in, and serves as an essential and indispensable component part of the manufacturing process, and is used on an ongoing and continuous basis during the manufacturing process. A machine is not part of the manufacturing process merely because it is integral and necessary to the manufacturer.
> (3) The machine must be substantially "used in manufacturing . . . tangible personal property for sale." The statute does not required that the machine be used exclusively for manufacturing; however, incidental manufacturing use will not qualify for the exemption. For purposes of the exemption, more than one-third of a machine's use in manufacturing is substantial.

S.C. Regs. § 117.302.5(B)(1). Only subpart (2) is at issue in this case. Importantly, the Machine Exemption applies so long as 1/3 of the machine's use is devoted to manufacturing purposes. S.C. Regs. § 117-302.5 provides that in order to be exempt, the machine must be "*substantially* 'used in manufacturing ... tangible personal property for sale'" (emphasis added). According to that regulation, "[t]he statute does not require that the machine be used

exclusively in manufacturing; however, incidental manufacturing use will not qualify for the exemption. For purposes of the exemption, *more than one-third of a machine's use in manufacturing is substantial.*" § 117-302.5(B)(1)(c). (Emp. added). This means that a piece of machinery like a forklift can serve many purposes within a manufacturing facility and still be eligible for the exemption, so long as the taxpayer can establish that more than 1/3 of its use is for manufacturing.

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, 650 (Ohio 1952). Only those assets which physically transform raw materials during the manufacturing process into a different form are eligible for the exemption. In other words, "the test is not whether the property is essential to the operation of the plant but whether it is an actual part of the process of manufacture." *Hawes v. Custom Canners, Inc.*, 173 S.E.2d 40 (Ga. Ct. App. 1970).

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*, 286 A.D. 446 (N.Y. 1955). In finding that now material handling equipment including both coal handling and ash disposal equipment fell within the exemption (including the cranes and car dumper that unloaded incoming coal; conveyor belts that moved the coal to the boiler; crushers

and sprayers that processed the coal; and slag lines that carried ash from the boiler), the *Niagara* court determined the relevant questions to be:

> (1) Is the disputed item necessary to production?
> (2) How close, physically and causally, is the disputed item to the finished product?
> (3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?

The court found that the crane and car dumper were as essential to production as the generator itself, since a serious breakdown in operation would quickly stop or impair the output of electricity. The court also noted that while some structures may not play as active a role as other parts, "activity is not the test of directness." Instead, "[t]he important thing is that all parts of the plant contribute, continuously and vitally, to production, and they are all integrated and harmonized."

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." *Hercules*, 280 S.C. 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.

The DOR audit held that the machinery and equipment used to move the fresh produce into the manufacturing process were not exempt. There is no dispute that the machinery used in the cutting and processing was exempt.

In this case, as described more fully below, given Respondent's highly regulated business as a fresh food processor, the tools and equipment used immediately before and after the actual processing of the fresh produce is integral to the overall processing/manufacturing process, as well as the health and safety functions. Without the process that occurs in these climate-controlled areas, it would seriously impair the ability of the taxpayer to efficiently and safely prepare a finished product for sale and distribution. The refrigeration itself, as well as the tools and equipment used therein, contributes, both "continuously and vitally, to

production" and the assembly line production is surely "integrated and harmonized," as described in the Integrated Plant concept above.

Moreover, federal guidelines mandate all aspects of the refrigeration. According to Section VIII, Part C, Item 3, of the Food and Drug Administration's Guide to Minimize Microbial Food Safety Hazards of Fresh-cut Fruits and Vegetables, fresh–cut produce is recommended to be stored in areas with a temperature of less than or equal to 41 degrees Fahrenheit. Regulations promulgated pursuant to the Food Safety Modernization Act of 2011, Section 117.93, provide even further requirements, mandating that any "[s]torage and transportation of food must be under conditions that will protect against allergen cross-contact and against biological, chemical (including radiological), and physical contamination of food, as well as against deterioration of the food and the container." 21 C.F.R. § 117.93. Additionally, 21 C.F.R. § 110.80(b) provides:

> (b) Manufacturing operations. (1) Equipment and utensils and finished food containers shall be maintained in an acceptable condition through appropriate cleaning and sanitizing, as necessary. Insofar as necessary, equipment shall be taken apart for thorough cleaning.
>
> (2) *All food manufacturing, including packaging and storage, shall be conducted under such conditions and controls as are necessary to minimize the potential for the growth of microorganisms*, or for the contamination of food. One way to comply with this requirement is careful monitoring of physical factors such as time, temperature, humidity, aw, pH, pressure, flow rate, and manufacturing operations such as freezing, dehydration, heat processing, acidification, and refrigeration to ensure that mechanical breakdowns, time delays, temperature fluctuations, and other factors do not contribute to the decomposition or contamination of food.
>
> (3) Food that can support the rapid growth of undesirable microorganisms, particularly those of public health significance, shall be held in a manner that prevents the food from becoming adulterated within the meaning of the act. Compliance with this

> requirement may be accomplished by any effective means, including:
>
> > (i) Maintaining refrigerated foods at 45 deg. F (7.2 deg. C) or below as appropriate for the particular food involved. (emphasis added.).

This regulation applies to Respondent and is mandatory. (R. p 166; Tr. p. 25, lines 19-25) Since keeping the temperature of this product at or below 41 degrees must be done to prevent contamination of our product, and must be stored (by Congressional Act) in certain areas of plant to prevent cross-contamination (storage racks are the only viable option) then it is considered continuous, on-going and integral to the manufacturing process and therefore exempt. Even once the product is loaded onto Respondent's trucks, the 41-degree requirement must be met until it is ready to be sold inside a restaurant. Temperature recorders are required for refrigerated trucks to ensure that the product never went above this requirement at any time while in transit. In addition to federal law, customer contractual requirements are equally as stringent.

The DOR Policy witness, Corey Smith, testified that equipment required by state or federal law would be part of the manufacturing process. (R. p. 426; Tr. p. 285, lines 10-25)

Based on the foregoing, the Court did not err in expanding the exemption beyond those items used only in the cutting process. The highly specialized and highly-regulated nature of the food processing industry mandates a more expansive view of the manufacturing process to include activities both before and after the literal processing of the produce. Purchases of these items used in the manufacturing process are exempt from tax under the Machine Exemption.

2. Respondent's Proposed Definition of "Machine" is Contrary to its Published Regulations and Guidance.

The thrust of the DOR's case is that the many various items which the ALC held were exempt, especially protective clothing, were not "machines." The DOR states that to be a

"machine" the item must be a "mechanical device" or a "combination of mechanical powers, parts, attachments or devices," e.g., Appellant's Brief at p. 14. However, contrary to this narrow definition, regulations promulgated by the Department and the Department's own published guidance have consistently taken an expanded view of what constitutes a "mechanical device" or "combination of mechanical powers, parts, attachments or devices" going back at least thirty years. For many of these items, the property itself does not does not obtain its "mechanical" nature until viewed in the entirety of the manufacturing operation.

a. Department Regulations

The regulations defining "machine" greatly expand the definition beyond traditional notions of the term. S.C. Regs. § 117-302 lists the following as machines. Clearly, they are not a "mechanical device" or a "collection of mechanical powers, parts [or] attachments:"

- "odorants purchased by gas companies" (§ 117-302.1(b)(a))
- "chemicals such as soda ash, alum, chlorine, etc., used in treating water for sale" (§ 117-302.1(b)(b))
- "refrigerants used by manufacturers to produce ice for sale" (§ 117-302.1(b)(c))
- "plates attached by a manufacturer to his product for identification" (§ 117-302.1(b)(e))
- "chemicals, greases, oils, lubricants and coolants" (§ 117-302.5(B)(5)(a))
- "chemicals used to clean the exterior or interior of an exempt machine" (§ 117-302.5(B)(5)(a)(iii))
- "chemicals used to prevent corrosion" (§ 117-302.5(B)(5)(a)(iv))
- "Traveling water screens" (§ 117-302.5(C)(2))
- "Tanks" (§ 117-302.5(C)(8))
- "Patterns" (§ 117-302.5(C)(9))
- "Boiler Tubes" (§ 117-302.5(C)(15))
- "insulation for pipe coverings, tank coverings, and boiler insulation" (§ 117-302.5(C)(30))
- "Parts or attachments to machines" (§ 117-302.5(B)(2)).

Based on the foregoing, the Department's proposed definition in this case is contrary to its own promulgated regulations.

b. Department's Published Guidance

Petitioner has also expanded the definition of "machine" in a number of published rulings and decisions. For example, in S.C. Tax Commission Decision 92-19, the former Tax Commission held that stack liners and ash pond pipes and pumps were exempt as they operated exclusively in the abatement of pollution caused by the production of electricity. In S.C. Rev. Rul. # 89-7, the DOR opined that a settling basin for a wastewater treatment facility was exempt as one part of a single entity used to abate pollution and therefore purchases of materials such as concrete and steel to build the facility where likewise exempt.

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 vault was designed and licensed for the purpose of containing gamma radiation. The vault had six foot thick walls with a specialized design to trap radiation. The vault was designed to withstand a direct airplane hit and catastrophic earthquake. The vault itself served no purpose other than to trap radiation, and it performed no processing. 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 liners served three functions: (1) they were first transported to the power plant site where radioactive waste was place inside them; (2) the liners then processed the waste into a more stable form, thus reducing the likelihood of nuclear accidents; and (3) the liners were then transported to disposal sites where they became permanent storage containers for holding waste. 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). The evidence presented showed that the liners were more than mere storage tanks. They contained internal devices that processed radioactive waste into a less volatile state. This falls squarely within the definition of a 'machine.' The fact that the liners were subsequently used for storage does not detract from their function as machines. As noted in *Hercules* at page 308, a machine may have an alternate use but it still remains a machine.
>
> There is also adequate evidence indicating the liners abated pollution. Such evidence demonstrated that the processing undergone in the liners was a necessary step in the treatment of radioactive waste produced by power plants. In point of fact, *nuclear utilities would not be licensed or allowed to operate without this means* of processing nuclear waste. Moreover, the testimony and documentary evidence establishing these points are sufficient to meet the certification requirements of Regulation 117-173. (Emphasis added)

(Similarly, food processing plants are not allowed to operate without protective clothing.)

Most recently, in S.C. Rev. Rul. 13-3, the Department found that the component parts used to construct a manufacturing machine qualified as a "machine" for purposes of the exemption.

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 Petitioner's attempt to impose a strict "mechanical" requirement is contrary to its own guidance.

3. Substantial Evidence Supports the ALC's Conclusions that the Purchases at Issue are Exemption under the Machine Exemption.

a. Recordkeeping Items Used for Tracking Produce are "Machines" and, as such, Qualify for the Machine Exemption.

The ALC found that bar code scanners, black ink aerosol cans, and mobile computer stands, all of which the Respondent uses to track the produce as required by law, were exempt from use tax. (R. p. 26; Order p. 26) The Respondent's bar code scanners are hand-held devices that the Respondent uses to trace the produce backwards one-step to the grower-shipper and forward one-step to the customer's distribution center. (R. pp. 205-06; Tr. p. 64, line 22–p. 65, line 2) This trace-back system is required by federal law. (R. p. 205; Tr. p. 64, line 24) The Respondent scans raw produce when it enters the facility, when the raw produce goes into processing, when it then goes into the finished goods area, and lastly when the produce goes from the finished goods section onto the refrigerated delivery trucks. (R. pp. 206, 11; Tr. p. 65, lines 2-9, Order p. 11)

The Respondent also uses black ink aerosol cans as part of this tracking process. (R. pp. 220-21; Tr. p. 79, line 25–p. 80, line 4) Specifically, the ink goes across a jet ink sprayer to spray a "use-through code" and a "lot code" onto a finished case of produce in the pack-out and repack areas of the Respondent's facility. (R. p. 220; Tr. p. 79, lines 10-16) In basic terms, the black ink aerosol cans label finished cases. (R. pp. 220; Tr. p. 79, lines 2-7) "The Lot Codes assist in the FDA trace-back process." (R. pp. 11; Order p. 11)

The Respondent uses a computer program to track its produce through the processing stages. (R. pp. 236-37; Tr. p. 95, line 24–p. 96, line 1) The Respondent places computers on mobile computer stands in various parts of the facility so the employees can more easily track the process as the produce moves through the facility. (R. pp. 237; Tr. p. 96, lines 1-9) "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; Order p. 11)

These machines are a federal requirement so that the produce can be tracked (1) back to the farm, and (2) forward to the customer in the event contamination is subsequently found in the produce. Mr. McEntire testified that the need for a trace-back arises when a food-borne illness results in sickness or death and the FDA needs to determine the source of the illness. (R. pp. 206, 220-21; Tr. p. 65, lines 12-17 and p. 79, line 23–p. 80, line 15) Clearly these are "protecting or preserving agricultural products for distribution, storage, sale and use," and a part of a "coordinated system of preparing agricultural goods for transporting, warehousing, logistics, sale and end use." § 12-6-3360(M)(16).

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).

b. Floor Drain Covers are "Machines" and, as such, Qualify for the Machine Exemption.

The ALC determined that the floor drain covers the Respondent purchases and uses within its plant are exempt from use tax under the Machine Exemption. (R. pp. 28; Order p. 28) 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; Tr. p. 98, lines 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; Tr. p. 98, lines 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; Tr. p. 98, lines 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; Tr. p. 98, lines 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 per day and recycles about half of that. (R. p. 325; Tr. p. 184, lines 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; Order 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. pp. 325-26; Tr. p. 184, line 11–p. 185, line 4) These expensive 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. *Id.* at 8.

c. The Conveyances at Issue (Fork Lifts, Pallet Jacks and Lubricants) are Machines Used in Processing Tangible Personal Property for Sale.

The Respondent uses forklifts (along with their respective parts and batteries), pallet jacks, and hand trucks to move heavy produce (600 to 2,000 pounds) from place to place and to certain lines of production within the facility. (R. pp. 208-09, 218, 254; Tr. p. 67, line 12–p. 68, line 2, p. 77, lines 13-25, p. 113, lines 9-12) McEntire testified that 80% of the forklifts were used directly in the food processing. (R. p. 210; Tr. p. 69, lines 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. pp. 210, 252-53; Tr. p. 69, lines 3-5, p. 111, line 19–p. 112, line 15)

The ALC Order (R. p. 12; Order p. 12) describes these as follows:

> **(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**
>
> Forklifts are used throughout the facility, except in the high-care area. While some may be used outside of the actual building structure, 90% are used within the facility. The forklifts used in the facility move the produce from place to place. Specifically, they are used to move 800 – 1,600 lb. bags of raw produce onto the conveyor belt at the beginning of the cutting area.

The ALC found that these various conveyances and their respective batteries, parts, and oils and lubricants are exempt from use tax under the Machine Exemption. (R. p. 24; Order

p. 24) The ALC Order states that "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 a processer of fresh produce, Respondent is required to use food grade oil and grease to maintain these items. 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." (*Id.*) In addition they were obviously part of a "coordinated system of preparing agricultural goods for transporting, warehouse, logistic, sale and end use." § 12-6-3360(M)(16). In Revenue Ruling #04-7, pp. 9-10, the Department states that "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 are exempt as machines used in manufacturing" (emphasis in original).

The Revenue Ruling also noted that wheeled conveyances, known as print screen trucks, which were used to move print screens from the holding area to the print machines were exempt. Neither DOR witness testified these items were not exempt.

d. The Items used for Storage/Temperature Control are Machines Used in Processing Tangible Personal Property for Sale.

Respondent uses two primary types of warehouse racks: a flow-through rack and a pushback rack system. (R. p. 210; Tr. p. 69, lines 15-21) It uses flow-through racks in the storage coolers where palletized raw produce flows through from one side of the cooler to the

other. (R. p. 210; Tr. p. 69, lines 16-18) It uses the pushback rack system where the Respondent places raw produce or finished produce onto a carriage that is pushed back several spaces or up and out. (R. pp. 210; Tr. p. 69, lines 18-24) These racks help with efficiency, keeping the produce separated, and maintaining the temperature of the produce during storage. (R. pp. 210-11; Tr. pp. 69, line 24–p. 70, line 2) "So what happens to the lettuce before it enters the cutting room it is stood in a rack system and that rack system is specifically designed to keep the product separated enough to allow air to flow across the storage container...." (R. p. 194; Tr. p. 53, lines 11-14) "The rack system enables us to maintain that [proper] temperature." (R. p. 212; Tr. p. 71, lines 1-6) The ALC Order (R. p. 12; Order p. 12) describes them as follows: "These racks are specifically 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 [Respondent] effectively has no product, maintaining the required temperature is essential to [Respondent]'s manufacturing process."

In *Department of Revenue v. State Contracting & Stone Co., Inc.* 599 S.W.2d 166 (KY. Ct. App. 1977), the Court held that Storage bins were exempt from use tax where bins contained blending units which concluded manufacturing process of asphalt.

Hellerstein, State Taxation ¶ 14.05[2][d] states:

> "A number of other state courts and administrative tribunals have adopted the New York court's integrated plant approach to the delineation of machinery or equipment directly used in manufacturing...

> Under that [integrated plant] view, the Missouri court has held that a manufacturer of charcoal briquettes was exempt from sales tax on its purchase of conveyors and storage bins used to (1) remove the railroad cars starch used in the manufacturing of the briquettes; (2) store the starch in storage bins; and (3) convey it to the processing area.

The Respondent uses pallet flow brakes on the racks in the raw cooler areas. (R. pp. 12, 213; Order p. 12; Tr. p. 72, lines 18-22) Specifically, the pallet flow brakes slow down the speed of the pallets as they travel down the flow-through pallet system. (R. p. 213; Tr. p. 72, lines 12-13) The ALC Order (R. p. 12; Order p. 12) notes:

> **(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 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.

The Respondent also uses stacking containers for storage in the "work in progress" section of the facility to store processed produce until the Respondent can combine it with other processed produce. (R. p. 12; Order p. 12) For example, the Respondent combines cabbage and carrots to make coleslaw. (R. pp. 233-34, 12; Tr. p. 92, line 24–p. 93, line 2, Order p. 12) The Respondent uses the stacking containers to keep cut carrots until the cabbage is processed and ready to be combined to be made into coleslaw. (R. p. 12; Order p. 12) "The combining of these component pieces into a bag to be sealed, labeled, and palletized completes the manufacturing process with respect to the mixed product." (*Id.*)

The Respondent used blower fans in both the high and low-care areas to move refrigerated air in order to maintain the mandated temperature level and to also filter any airborne contaminates. (R. p. 250; Tr. p. 109, lines 9-23) The blower fans are used to maintain

the temperature and they have a filtration system designed to remove pollution or contaminants that are in the area. (R. p. 250; Tr. p. 109, line 9–p. 110, line 20) The ALC states in its Order that:

> **(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. 13; Order p. 13)

In Reg. 117-302.3, the Regulation states "This exemption [for fuel] applies to fuel used to control plant atmosphere as to temperature and/or moisture content, in the quality control of tangible personal property being manufactured or processed for sale." The Regulation also 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." S.C. Regs. § 117-302.5(C)(24). Neither DOR witness testified that items were not exempt.

e. The Water Tanks are Machines Used in Processing Tangible Personal Property for Sale.

The Respondent has large water tanks both inside and outside the facility (R. p. 258; Tr. p. 117, lines 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. pp. 258-59; Tr. p. 117, line 21–p. 118, line 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. pp. 258-59, 14; Tr. p. 117, lines 8-9, p. 118, lines 21-24, Order p. 14) McEntire testified, "So water tanks

are used throughout the facility but particularly in the high care area where we wash produce." (R. pp 214; Tr. p. 73, lines 17-20) The water is "used to wash and sanitize the produce." (*Id.*)

The ALC found these water tanks exempt from use tax. (R. p. 27; Order p. 27) The ALC order noted that "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. As such, [Respondent]'s storage water tanks minimize the potential for the growth of microorganisms, prevent the contamination of food, and are integral and necessary to the processing of fresh produce and fall with the Machine Exemption." (*Id.*)

In Revenue Ruling #04-7, the DOR summarized the *Springs* decision to hold that washing was an exempt function. The Revenue Ruling states at p. 7:

> In *Springs Industries, Inc. v. SCDOR*, 99-ALJ-17-0153-CC, the court held that the washing of a textile print screen was done specifically for the purpose of manufacturing a final product, that without washing the print screen 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. In addition, the print screen washing machine was located close to the production line machinery. As such, the court further held that the print screen washing machine was integral and necessary to the manufacturing process, was not a maintenance or repair machine, and was, therefore, exempt..."

S.C. Regs. § 117-302.5(C)(8) holds that "Tanks which are a part of the chain of processing operations" are exempt. 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.)

f. The Floor Treatment Chemicals and Cleaning Machines (Foamers) are Machines used in Processing Tangible Personal Property for Sale.

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. 229; Tr. p. 88, lines 18-22) He testified this was required by federal law. (R. pp. 229-30; Tr. p. 88, line 23–p. 89, line 1)

floor treatment chemicals inhibits growth of dangerous microbes, and the brooms and squeegees are used specifically in those areas to inhibit such growth. Appellant agreed 70% of the floor treatment chemicals and other products were used in the manufacturing process, but contended that 30% was not. (R. pp. 225-26; Tr. p. 84, line 19–p. 85, line 4) Respondent 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; Tr. p. 83, lines 6-13)

The Respondent utilizes cleaning machines, called foamers, to foam and sanitize the processing equipment in the high care area (R. p. 229; Tr. p. 88, lines 14-22) Federal law requires cleaning to be done by foamers. (R. pp. 229-30; Tr. p. 88, line 23–p. 89, line 1) The Respondent also uses floor treatment chemicals to sanitize the floor in the high care area. (R. p. 224; Tr. p. 83, lines 8-13) The ALC Order described these as follows:

> **17. Floor Treatment Chemicals**
>
> The floor treatment chemicals are used primarily in the high-care area to sanitize the floor. The Department previously agreed that an exemption was available for the 70% of the treatment chemicals that were used in the high-care area during the manufacturing process but did not allow the exemption for the remaining 30%.

19. Cleaning Machines

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

The ALC (R. pp. 27-28; Order pp. 27-28) determined these items were exempt for the following reason:

> **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. Therefore, those machines are used on an ongoing and continuous basis and fall under the exemption as integral and necessary to the manufacturing process. The Department previously conceded that the 70% of the floor treatment chemicals used in the high-care area were integral and necessary to the manufacturing process and, thereby, exempt. In concluding that the manufacturing process occurs in other areas of the plant outside of the high-care area, the Court finds that of the remaining 30% of the floor treatment chemicals disallowed by the Department, any percentage used to clean the actual plant, as opposed to the administrative/office area, should also fall within the Machine Exemption as integral and necessary to the manufacturing process.

In Revenue Ruling #04-7, the DOR held that pressure washing machines and ultrasonic cleaning machines used to clean machines were exempt. Neither DOR witness testified that the cleaning chemicals or machines were not exempt.

g. The Maintenance Tools at Issue are Used on an Ongoing and Continuous Basis, and Thus Qualify for the Machine Exemption.

The ALC Order (R. p. 13; Order p. 13) found that "[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."

Moreover, according to Mr. McEntire, utility carts used within the manufacturing area require special care due to the sensitive nature of the high care environment. The ALC Order (R. p. 23; Order p. 23) stated that "Because the processing of fresh produce is regulated by climate control and other environmental controls, the cold and damp conditions inside the plan cause machinery to constantly require maintenance and repairs. Thus, general **Maintenance Tools (12)** 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."

Neither DOR witness testified these items were not exempt. *See In re LaFarge Midwest/Martin Tractor Co., Inc.* 271 P.3d 732 (Kan. 2012) (Taxpayer was entitled to sales tax exemption for the repair and replacement parts and accessories it purchased for loaders and haulers used at its cement plant.) *See also Idaho State Tax Com'n v. Haener Bros., Inc.,* 121 Idaho 741, 828 p.2d 304 (1992) (repair parts and equipment used to make repairs to heavy construction equipment that was primarily and directly used in production process was exempt from tax, since repair of manufacturing and production equipment was one segment of continuing and integrated production process).

h. The Generator Rentals the Respondent Uses in its Facility are Used on an Ongoing and Continuous Basis, and Thus Qualify for the Machine Exemption.

Tomatoes arrive at the Respondent's facility in various color stages, and different customers have different color requirements. (R. pp. 216-17; Tr. pp. 75, line 16, lines 21-25, p. 76, lines 1-2) When necessary, the Respondent rents ethylene generators to speed up the ripening process and change the color of the tomatoes to a certain color stage, per a customer's request. (R. pp. 216; Tr. p. 75, lines 17-25) The Respondent rents these generators when the

repack manager determines that a generator is needed based on color of the available crop of tomatoes. (R. p. 257; Tr. p. 116, lines 13-18) The generators are not needed year-round. (R. p. 257; Tr. p. 116, line 12)

The Department argues that Respondent must use the generators on an "ongoing and continuous basis" for the generators to be considered integral and necessary to the processing of fresh produce and that renting and using a generator to ripen tomatoes "when necessary" or "as needed" is not using them on an "ongoing and continuous basis." The DOR argues that there are times when crops of tomatoes come into the Respondent's facility that are already at the desired color and the generators are not needed, or that the natural ripening that occurs in the low-care area is sufficient for the ripening of a particular crop. (R. p. 6; Order p. 6) and therefore these generators are not used on an "ongoing and continuous basis."

The ALC determined that the Respondent's rental of these generators are exempt from use tax. (R. p. 24; Order p. 24) Specifically, the ALC determined that, because tomato crops are variable, and the Respondent rents generators on a seasonal basis, then the rental of generators on an as-needed, seasonal basis to process a variable crop makes the Respondent's use of the generators "ongoing and continuous." (*Id.*). Neither DOR witness testified that the generators were not exempt.

B. THE ALC DID NOT ERR IN FINDING PURCHASES OF PROTECTIVE EQUIPMENT QUALIFIED FOR BOTH THE MACHINE EXEMPTION AND THE POLLUTION CONTROL EXEMPTION.

The ALC found that purchases of "protective clothing"[1] qualified under both the Machine Exemption and the Pollution Control Exemption, which exempts which exempts

[1] The ALC defined "protective clothing" as "Coveralls, Eyewear, Gloves, Aprons, and Hairnets." (R. p. 26; Order p. 26)

machines "necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section." They are also exempt as part of the agricultural packaging exemption.

Thus, Respondent, a manufacturer of fresh produce, is exempt from taxes on machines which are necessary to comply with the order of a state or United States agency to prevent or abate pollution that is precipitated by other manufacturing machines used in the process of cutting and bagging fresh produce. From this, four elements must be met: (1) a machine that (2) prevents or abates pollution (3) caused by machines used in the manufacturing process and is (4) necessary to comply with the order of an agency.

1. Protective Clothing Qualifies as a "Machine" for Purposes of the Machine Exemption and Pollution Control Exemption.

Significantly, neither the DOR Proposed Assessment (R. pp. 675-83) nor the DOR's Department Determination (R. pp. 736-45) alleged that protective closing was not a "machine." Both documents alleged only that E Coli., Salmonella or Listeria were not "pollution." Petitioner raised the machine argument for the first time at trial.

At first blush, protective clothing does not seem to fit the definition of machinery and equipment (any more than the ladders, walkways, and scaffolding in the *Hercules* case, or chemicals in a machine. *See* S.C. Regs. § 117-302.5(B)(5)). The Department itself acknowledges, however, that protective clothing fits within the machinery and equipment ambit. The Department's published guidance provides that "[p]rotective clothing worn by an employee working in the area in which the manufacturing process occurs does not qualify as a machine and is not exempt from the tax as a machine used in manufacturing tangible personal property for sale under Section 12-36-2120(17)." However, that guidance is intended to apply

to protect the worker's own clothing from dirt, paint, oils, etc. which are given off in the manufacturing process. On the other hand, the clothing worn by Respondent's workers serves a substantively different purpose. Respondent's protective gear protects *the produce* from the worker (for the purpose of protecting the ultimate consumer). The protective gear puts a barrier between the end product – i.e., the chopped vegetable – and the workers entering the high care area. The protective gear is absolutely vital and is required by state and federal law as detailed above to maintain the physical environment necessary to produce Respondent's finished product in a safe and unadulterated manner.

The distinction between protective clothing for workers versus protective clothing for manufactured products is discussed in Massachusetts[2] and Connecticut[3] 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

[2] 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

[3] 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.

distinguishable from more common apparel which protects the wearer.

The Court of Appeals in *Hercules* held that railways, walkways and ladders were exempt under the machine exemption as they were required by state and federal law and thus were necessary, to the overall function of the system. The same applies to Respondent's protective clothing. The gear creates a physical barrier that maintains the integrity and purity of Respondent's manufacturing process, is required by state and federal law and thus as described above, must be considered an integral part of that process.

The Department repeatedly argues that protective clothing are not "machines." While there is no DOR Policy Document on whether protective clothing constitutes a machine for the pollution control exemption, as noted *supra* pp. 11-13, the Department has issued guidance expanding the definition of "machine" to products such as liners, bins, scaffolding, chemicals, tanks, another other products which only assume their "mechanical" nature once viewed in context of the entire manufacturing operation.

The uncontroverted evidence in this matter demonstrates that the protective clothing are mechanical devices that act to prevent or mitigate contamination. The contamination comes from the machines essential to the production of the fresh produce, namely the cutting machines.

2. The Protective Clothing Prevents or Abates E. Coli, Salmonella, and Listeria, which are "Pollution."

a. Respondent Established the Contaminants are "Pollution."

The major thrust of the Department Determination was that food contamination and diseases are not "pollution." The Department Determination states that "food contamination does not constitute air, water or noise pollution. Moreover, it is questionable whether food contamination constitutes pollution in general." (Respondent contends that E. Coli, Listeria

and Salmonella – which causes food contamination – are pollution.) While the Department Determination is presumptively correct, the DOR auditor testified that she didn't know what the definition of "pollution" was under the statute, (R. p. 468; Tr. p. 327, lines 12-14) and didn't know enough about E. Coli, Listeria or Salmonella to determine whether they constituted "pollution." (This was the auditor's first audit of a fresh foods manufacturing facility.) (R. p. 475; Tr. p. 334, lines 11-13) Both of the DOR witnesses, however, agreed with the Black's Law and dictionary definitions of "pollution." (R. pp. 435, 468-68; Tr. pp. 294, line 17–p. 295, line 17, Tr. p. 327, line 22–p. 328, line 10)

Interestingly, the Auditor testified that if she had been given at the audit "the name of the State or federal agency requiring it [protective clothing required by the FDA] and the type of pollution [E coli, Salmonella, Listeria]" she would have granted the exemption. (R. pp. 458-59; Tr. pp. 317, line 20–p. 318, line 5) She further testified she was not aware at the time of the audit that state and federal law required protective clothing. (R. pp. 475; Tr. p. 334, lines 3-5)

However, Corey Smith, the DOR witness from the Policy Section, agreed that pollution is something that is a hazard, and that something that would kill you would typically be considered pollution, as well as contamination that would cause miscarriage, or send someone to the hospital. He also testified that E Coli. "can be a source of pollution." (R. pp 431-32; Tr. p. 290, line 20–p. 291, line 24)

Section 12-36-2120(17) does not define the word "pollution." "Pollution" is defined by The Law Dictionary as, "[t]he presence of *harmful substances* (*either physical or gaseous*), noise or energy (radiation) within a certain area, that *causes harm* to the surroundings, altering

the natural environment around which it has been excreted."[4] Black's Law Dictionary, Eleventh Edition, defines "pollution" as "[t]he harmful addition of a substance or thing into an environment; esp., the introduction of man-made products, esp. waste products, into a natural area." Other dictionary definitions are similar. For example, Wikipedia defines "pollution" as "the introduction of *contaminants* into the natural environment that cause adverse change." Wikipedia, *https://en.wikipedia.org/wiki/Pollution* (emphasis added). Dictionary.com defines "pollution" as "1. the act of polluting or the state of being polluted, 2. the introduction of *harmful substances* or *products* into the environment." http://www.dictionary.com/browse/pollution (emphasis added). The DOR auditor agreed at trial with these definitions. The ALC Order described the testimony of Dr. David Gombas, McEntire's expert witness in the area of food safety and protective closing as follows:

> Dr. Gombas defines "pollution" as any contaminant that may be injurious to the intended consumer. In the context of food safety, Dr. Gombas testified that the terms "pollution" and "contaminant" are used interchangeably and that "protective clothing is a necessary protection against contamination or pollution...in any fresh cut or fresh produce handling facility; likewise, any ready-to-eat food processing facility." (Trial Tr., p. 231:21-232:1) ... Moreover, when asked whether the major foodborne illnesses associated with fresh produce (Salmonella, E. coli, and Listeria) constitute "pollution" as defined by Black's Law Dictionary, Wikipedia and dictionary.com, Dr. Gombas answered in the affirmative and confirmed that all three of the harmful substances meet the various definitions of pollution.

(R. p. 10; Order p. 10)

When determining "pollution," it is important to consider not only the harmful microbes at issue (i.e., Listeria, E. coli, salmonella), but also the host/carrier of those microbes. These microbes are typically transmitted through human and animal feces. This means the

[4] The Law Dictionary, Featuring Black's Law Dictionary Free Online Legal Dictionary 2d Edition, https://thelawdictionary.org/pollution (emphasis added).

microbes are being transported when fecal matter lands on or around the produce, and then travels on the produce to the processing facility. Fecal matter can also be transported into the facility on the shoes and feet of employees, particularly those with pets or who live in rural areas with deer and other wild animals. All of Respondent's control efforts are focused on the prevention or abatement of fecal pollution into the water or air. The Environmental Protection Agency recognizes the significant threat of fecal pollution:

> *Fecal pollution of water from a health point of view is the contamination of water with disease-causing organisms (pathogens) that may inhabit the gastrointestinal tract of mammals, but with particular attention to human fecal sources as the most relevant source of human illnesses globally.* Ingestion of water contaminated with feces is responsible for a variety of diseases important to humans via what is known as the fecal-oral route of transmission. Food, air, soil, and all types of surfaces can also be important in the transmission of fecal pathogens, and thereby implicated in disease outbreaks...In 1998, it was estimated that 2.2 million deaths were associated with diarrhea each year, a good percentage of them due to fecal pollution of water, with the vast majority of victims being children in poor countries (WHO, 2000). This should not be a surprise as it has been estimated that more than 1 billion people worldwide lack access to safe drinking water, and more than 2 billion lack sanitation. Sadly, very little progress has been made in the last 20 years to ameliorate these problems, particularly due to the rapidly increasing global population. *On the contrary, problems associated with fecal pollution of water are likely to worsen in coming decades*, as more people are moving to coastal areas, most people now live in urban centers, many of which have out of control growth rates, and demands for animal meat products are increasing due to current trends in dietary regimes. *Considering that per capita water availability and quantity are diminishing worldwide, it is reasonable to assume that fecal pollution of water is one of the most important and difficult challenges for future generations.* (emphasis added).[5]

Moreover, there is a large amount of case law throughout the United States which

[5] Santo-Domingo, J.W. and N. Ashbolt, *Fecal Pollution of Water*, Cutler J. Cleveland (ed.) Encyclopedia of Earth, National Council for Science and the Environment (2008), *extract available at* https://cfpub.epa.gov/si/si_public_record_Report.cfm?Lab=NERL&dirEntryId=196784.

categorizes contamination of food as a pollutant with respect to a commercial insurance policy where the term "pollutant" is specifically defined in the *exclusion section* of such policies. The Court of Appeals of Wisconsin held that the term " 'contaminants' as used in [the] pollution exclusion of [a] commercial property insurance policy, included bacteria, and thus the insurance policy excluded coverage *for any losses resulting from bacterial outbreak at insured's food processing facility.*" *Landshire Fast Foods of Milwaukee, Inc. v. Employers Mut. Cas. Co.*, 269 Wis.2d 775, 783, 676 N.W.2d 528, 532 (Ct. App. 2004) (emphasis added). In this case, Landshire, a food preparer, delivered sandwiches containing listeria to its client, Great Lakes Naval Training Station commissary. *Id.* at 778, 676 N.W.2d at 529. Once the contamination was discovered, Great Lakes returned all of the contaminated food to Landshire. *Id.* Landshire determined that the food contamination occurred on a meat slicer at their facility. *Id.* at 779, 676 N.W.2d at 529. After this contaminated food incident, Landshire "submitted claims for loss of income, loss of product, sanitizing expenses, and costs related to investigating the source of the bacteria" to their insurance company. *Id.* at 779, 676 N.W.2d at 530. Landshire's insurance policy contained what is commonly referred to as a pollution exclusion. *Id.* at 782, 676 N.W.2d at 531. Landshire's insurance policy specifically stated, "[w]e will *not pay for loss or damage* caused directly or indirectly by any of the following . . . Discharge, dispersal, seepage, migration, release or escape of '**pollutants**' unless the discharge, dispersal, seepage, migration, release or escape is itself caused by . . . .". *Id* (emphasis added). Furthermore, the policy defined pollutants as " any solid, liquid, gaseous or thermal irritant or **contaminant**, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." *Id* (emphasis added). The parties in this case disputed the actual scope of the term "contaminant," and specifically whether listeria was a "contaminant." *Id.* at 782-

83, 676 N.W.2d at 531. To answer this question, the court looked to *Richland Valley Products, Inc. v. St. Paul Fire & Cas. Co.*, which held that:

> [C]ontamination 'connotes a condition of impurity resulting from mixture or contact with a foreign substance,' that that it means 'to make inferior or impure by mixture; and impairment of impurity; loss of purity resulting from mixture or contact,' a definition the court found consistent with common understand and WEBSTERS NEW INTERNATIONAL DICTIONARY. . .

201 Wis.2d 161,169-70, 548 N.W.2d 127, 169 (Ct. App. 1996 (quoting *American Casualty Co. of Reading, P.A. v. Myrick*, 304 F.2d 179, 183 (5th Cir. 1962)) (emphasis in original). The court ultimately held that the term "contaminant" in an insurance contract such as the one in dispute in the case is not susceptible to multiple interpretations. *Landshire,* 269 Wis.2d at 785, 676 N.W.2d at 533. Therefore, the food contamination caused by listeria was a *pollutant* and was thus excludable from an insurance claim by Landshire. *Id.*

South Carolina case law is nearly identical to the states discussed above. For example, in *Helena Chemical Co. v. Allianz Underwriters Ins. Co.*, the Supreme Court of South Carolina held that the pollution exclusion in the plaintiff's policy barred its claims. 357 S.C. 631, 641, 594 S.E.2d 455, 460 (2004). In *Helena*, the Court noted that almost all insurance policies contain an identical pollution exclusion policy. *Id.* The Court went on to state that "pollution arising from ordinary business operations is not covered. *But* if the damage were caused by a 'sudden and accidental' discharge, release, or escape of pollutants, *then the insurers must provide coverage.*" *Id.* (emphasis added). Because the Court held that "the *contamination* at the various sites was caused by Helena's routine business operations and was, therefore, not unexpected and accidental," plaintiff fell under the pollution exclusion. *Id.* at 642, 594 S.E.2d at 460.

Here, with Respondent's case, even though S.C. Code Ann. § 12-36-2120 *does not*

contain a definition of "pollutant," insurance policies throughout the entire country repeatedly and continuously consider contaminants such as bacteria on foods to be a "pollutant" due to its "contaminating" nature. *See also Nova Cas. Co. v. Waserstein*, 424 F.Supp 1325, 1334 (S. D. Fla. 2006) (holding that "living organisms," "microbial populations," "airborne and microbial contaminants," and "indoor allergens" are contaminants and are excluded from coverage under the insurance policies pollution exclusion). Based upon the foregoing, the ALC concluded that E. coli, Listeria, and Salmonella constitute "pollution." In addition, the use of Respondent's safety attire protects against pollution through the contamination of food.

b. Respondent Established the Protective Clothing Prevents or Abates Pollution.

In Respondent's industry, the contaminants described above are most commonly transmitted via the transfer of feces.[6] Contamination could potentially come into the facility in one of two ways: (1) inside the produce and/or (2) from employees. Employees can bring E. coli, Listeria and Salmonella principally from fecal matter and dirt on their shoes and on their hands. Contamination gets on hands/feet from pathogens from employees who walk on/in the dirt, fecal matter from wild animals (deer, raccoons, etc.), and fecal matter and dirt from household pets. (R. p. 382, 383; Tr. p. 241, lines 10-12, p. 242, lines 5-13) In addition to required hand washing and cleanliness, protective clothing severely minimizes the transfer of such a pollutant from employees to Respondent's produce.

Respondent's witnesses went into great detail to describe the manufacturing process. In short, when the fresh produce is picked and enters the trucks for transport, it may have one of the contaminants described above either inside or on the surface of the produce. When the

[6] *See also* Bacteria and Viruses, available at https://www.foodsafety.gov/poisoning/causes/bacteriaviruses/ecoli/index.html.

produce is cut during the manufacturing process, either by hand or with its mechanized choppers, those contaminants can be released into the air or water, and can essentially transfer to an exposed surface, where it can subsequently contaminate other produce as well as reproduce. (This is described by the FDA as cross-contamination). Additionally, when those pollutants are exposed during the cutting process, Respondent's water sprayers and flume systems can cause the pollutants to aerosolize – that is, be transferred into tiny droplets of water that are dispersed into the air. (R. p. 382; Tr. p. 241, line 21–p. 242, line 12) The spread of the pollutants also occurs when the produce is dried – both the blowers and the produce dryers (think large salad-spinners) cause potentially polluted water to aerosolize. Use of the uniforms, cleaning chemicals, and other precautions during the manufacturing process helps to ensure that the pollution, which is exacerbated and disturbed from its state while on the produce, does not spread, generally referred to as cross-contamination or cross-contact.

Of interest is S.C. Private Letter Ruling (PLR) # 95-8. The taxpayer was an environmental consulting firm that contracted with manufacturing companies to remediate contaminated soil and water beneath and surrounding the manufacturer's facilities. The contaminated areas were a direct result of chemical releases from machines used in manufacturing tangible personal property for sale. The taxpayer designed and installed dual vacuum extraction systems to contain and recover contaminants from soil and ground water. The systems were constructed from pumps, tanks, piping, and vacuum extraction devices to remove water and vapor from the ground. By removing the water and vapor, contaminants were removed from the ground so they could be disposed of properly. In addition, the now-clean water could, if needed, be used as a coolant in the manufacturing plant. The taxpayer made all purchases of the component parts that were used to construct these systems.

The PLR held that such purchases fell under the pollution control exemption, stating:

> The [pollution control exemption] regulation does not restrict the exemption to machines that prevent pollution or that reduce the amount of pollution released into the environment. *The clear language of the regulation also allows the exemption for machines used to reduce the amount of pollution already in the environment.* In other words, machines used to "clean up" pollution "caused . . . by the operation of other machines that are used in the mining, quarrying, compounding, processing, or manufacturing of tangible personal property" for sale qualify for the exemption under Code Section 12-36-2120(17). (Emp. added).

The protective clothing at issue is vital to Respondent's control and containment of the pollutants described above. Most importantly, the protective clothing serves as a barrier between the high care area – where those pollutants are exposed and dispersed in the air and water – and the outside. Witnesses for Respondent testified as to the rigorous processes for entering and exiting the high care area. All are designed to ensure that none of the dangerous microbes leave that area. Without the control, Respondent could spread those microbes outside the facility. By requiring full dress-down when exiting the clean room, Respondent is able to contain the pollutants that may have been released from the produce during the manufacturing process.

The protective clothing serves the additional purpose of ensuring those pollutants are not introduced into the clean room environment by Respondent's employees. Respondent's manufacturing process results in significant spray-back, as cutters chop the produce, sprayers and wash flumes wash down the produce, and blowers and spinners dry the produce. Through this process, a significant amount of water becomes airborne. (R. p. 288, 291, 306; Tr. p. 147, line 21–p. 148, line 20, p. 150, lines 1-21, p. 165, lines 3-21) Pollutants brought into the room from an unsanitary employee could be released into the air or introduced to water used in Respondent's manufacturing process. For this reason, the protective clothing is changed and

washed daily.

c. The Respondent Established that the Machines within its Facility Cause or Threaten to Cause Pollution of Air, Water, or Noise.

Since Respondent has demonstrated that the protective clothing protects against "pollution," it must also establish that the pollution for which it protects against consists of air, water, or noise. According to the World Health Organization:

> Foodborne illnesses are usually infectious or toxic in nature and caused by bacteria, viruses, parasites or chemical substances entering the body through *contaminated food or water*.
>
> *Foodborne pathogens* can cause severe diarrhea or debilitating infections including meningitis.
>
> Chemical contamination can lead to acute poisoning or long-term diseases, such as cancer. Foodborne diseases may lead to long-lasting disability and death. Examples of unsafe food include uncooked foods of animal origin, *fruits and vegetables* contaminated with feces, and raw shellfish containing marine bio toxins.[7]

Such contaminated food, if not disposed of properly, can contaminate the water supply. Respondent is the manufacturer in a very large and diverse supply chain. Once product leaves Respondent's facility, within a short period of time, due to the spoilage nature of produce, it is disseminated to thousands of businesses throughout the Southeast. If Respondent did not prevent the pollution as described above, the ultimate and immediate affects to the water supply of communities throughout the Southeastern United States could be substantial if such pathogen contaminated food is not disposed of properly.

Furthermore, Respondent uses three-hundred thousand (300,000) gallons of water per day at its facility, and discharges at least 150,000 gallons into the municipal sewer system

[7] Food Safety-Key Facts, World Health Organization, *available at* http://www.who.int/news-room/ fact-sheets/detail/food-safety (emphasis added).

daily. (R. p. 325; Tr. p. 184, lines 16-19) Water is the means by which the Respondent is able to deliver its sanitizing agents to the produce and the facility. Approximately half of that water is recycled, and the other half of the water makes its way through the local sewage system. Respondent's use of safety materials directly prevents pollution which could contaminate the water supply at Respondent's facility and subsequently enter the counties water supply and/or rivers. After a recent Listeria outbreak in Arizona, the Food and Drug Administration determined that that the root cause was water found in a nearby stream.[8] After an extensive investigation, the Food and Drug Administration concluded that:

> [t]hree samples of irrigation canal water collected by the team were found to contain Ecoli O157:H7 with the same rare molecular fingerprint (using whole genome sequencing (WGS)) as the strain that produced human illnesses (the outbreak strain). These samples were collected from an approximate 3.5-mile stretch of an irrigation canal in the Wellton area of Yuma County that delivers water to several of the farms identified in the traceback investigation as shipping romaine lettuce that was potentially contaminated with the outbreak strain. *This recent news story demonstrates the threat of* ***pollution*** *to area waterways is a significant issue that affects the entire community.*[9]

In response to Respondent's argument, the Order (R. pp. 30-31; Order pp. 30-31) found: "When the produce is cut during the manufacturing process, either by hand or with the cutting machine, those contaminants spread directly onto the cutting equipment and can

---

[8] See Cynthia Hubert, *Heading to the American River this Week? Here's where E. Coli Levels are High*, Sacramento Bee, *available at* https://www.sacbee.com/news/article214295669.html; Sandee LaMotte, *Deadly E. Coli Outbreak in Lettuce Traced to Contaminated Water*, *available at* https://www.cnn.com/2018/06/29/health/e-coli-romaine-lettuce-outbreak-cause/index.html; AP, *Source of Romaine Lettuce E. Coli Outbreak Identified, available at* https://www.cbsnews.com/news/source-of-romaine-lettuce-e-coli-outbreak-identified/; Maggie Fox, *Dirty Canal Water May Have Tainted Romaine Lettuce with E. Coli*, *available at* https://www.nbcnews.com/health/health-news/dirty-canal-water-may-have-tainted-romaine-lettuce-e-coli-n887606; Julia Jacobs, *Officials Identify a Source in the Romaine Lettuce E. Coli Outbreak*, *available at* https://www.nytimes.com/2018/07/01/us/romaine-lettuce-e-coli-nyt.html

[9] See October 24, 2018 Memorandum to the File on the Environmental Assessment; Yuma 2018 E. coli O157:H7 Outbreak Associated with Romaine Lettuce, *available at* https://www.fda.gov/ucm/ groups/fdagov-public/@fdagov-afda-orgs/documents/document/ucm624633.pdf.

transfer onto other items of produce. The contaminants may also be transferred onto any other exposed surface where they can subsequently contaminate other produce, as well as reproduce. Additionally, when those same harmful pathogens are exposed during the cutting process, [Respondent]'s water sprayers and flume systems can cause the pollutants to aerosolize – that is, be transferred into tiny droplets of water that are dispersed into the air. Furthermore, the spread of pollutants also occurs when the produce is dried – both the blowers and the produce dryers, which operate like large salad-spinners, cause potentially polluted water to be sprayed around the high-care area in such a manner that the back-spray settles on the protective gear worn by employees and onto other exposed surfaces. These various forms of transfer are described by the FDA and the Respondent's expert witness in this case as "cross-contamination."

The ALC determined that food contamination constitutes pollution of air and water because the bacteria that contaminates the food "could contaminate the air inside the facility and the water supply both at the plant and in the municipal water system and/or rivers." (R. p. 35; Order p. 35) These conclusions were supported by the substantial evidence presented at the hearing.

d. The Protective Clothing is Required to Comply with Federal and State Regulations.

In this case, the purchases at issue are required by the both federal and state regulation and statutes. Prior ALC case law has established that federal agency regulations satisfy this requirement. *See Duke Energy Corp. v. Dep't of Revenue,* Docket No. 12-ALJ-17-0031-CC (filed April 28, 2017) (exemption applied to canister system used to comply with regulations of the U.S. Nuclear Regulatory Commission, an "independent United States agency").

The FDA has established extensive regulations to combat "environmental pathogens,"

which are those pathogens:

> capable of surviving and persisting within the manufacturing, processing, packing, or holding environment such that food may be contaminated and may result in foodborne illness if that food is consumed without treatment to significantly minimize the environmental pathogen.
>
> Examples of environmental pathogens for the purposes of this part include *Listeria monocytogenes and Salmonella spp.* but do not include the spores of pathogenic sporeforming bacteria.

21 CFR § 117.3 (emphasis added). The following summarizes the state and federal agency requirements requiring the use of the gear at issue, all of which apply to Respondent.

e. FDA GMP Regulations

Specifically, 21 C.F.R. § 110.10 requires plant management to take all reasonable measures and precautions regarding the maintenance of a clean facility, including the following:

> (b) *Cleanliness.* All persons working in direct contact with food, food-contact surfaces, and food-packaging materials **shall** conform to hygienic practices while on duty to the extent necessary to protect against contamination of food. The methods for maintaining cleanliness include, but are not limited to:
>
> > (1) Wearing outer garments suitable to the operation in a manner that protects against the contamination of food, food-contact surfaces.
> > ...
> > (3) Washing hands thoroughly (and sanitizing if necessary to protect against contamination with undesirable microorganisms) in an adequate hand-washing facility before starting work, after each absence from the work station, and at any other time when the hands may have become soiled or contaminated.
> > ...
> > (5) Maintaining gloves, if they are used in food handling, in an intact, clean, and sanitary condition. The gloves should be of an impermeable material.
> > (6) Wearing, where appropriate, in an effective manner, hair nets, headbands, caps, beard covers, or other effective hair restraints.

Furthermore, 21 C.F.R. § 117.10(b), describes the measures and precautions that firms such as Respondent must exercise in order to:

> conform to hygienic practices while on duty to the *extent necessary* to protect *against* allergen cross-contact and against *contamination of food.* The methods for maintaining cleanliness include: (1) *[w]earing outer garments* suitable to the operation in a manner that protects against allergen cross contact and against the *contamination* of food, food contact surfaces, or food-packaged materials. . . (5) [m]aintaining *gloves*, if they are used in *food handling*, in an intact, clean and sanitary condition, (6) [w]earing, where appropriate, in an effective manner, *hair nets, headbands, caps, beard covers,* or other effective hair restraints. . . (9) [t]aking any other necessary precautions to protect against allergen cross-contact and against contamination of food, food contact surfaces, or food-packaging materials with microorganisms or foreign substances. . . ."(emphasis added).

Additionally, 21 C.F.R. § 117.80(a)(1) states that Respondent's operations must comply with the following sanitation principles:

> (2) [a]ppropriate quality control operations must be employed to ensure that food is *suitable* for human consumption and that food-packaging materials are safe and suitable...(c)(2) [a]ll food manufacturing, processing, packing, and holding must be conducted under such conditions and controls as are necessary to *minimize* the potential for the growth of *microorganisms, allergen cross-contact, contamination of food,* and deterioration of food...(5) [w]ork-in-process and rework *must be handled* in a manner that protects against allergen cross-contact, *contamination, and growth of undesirable microorganisms*...(10) [s]teps such as washing, peeling, trimming, cutting, sorting, inspecting, mashing, dewatering, cooling, shredding, extruding, drying, whipping, defatting, and forming must be performed *so as to protect* against allergen *cross-contact* and *against contamination.* Food must be protected from contaminants that may drip, drain, or be drawn into the food.

Finally, according to § 117.37, "adequate sanitary facilities and accommodations include:

> (a) Water supply. The water supply must be adequate for the operations intended and must be derived from an adequate

> source. Any water that contacts food, food-contact surfaces, or food-packaging materials must be safe and of adequate sanitary quality. Running water at a suitable temperature, and under pressure as needed, must be provided in all areas where required for the processing of food, for the cleaning of equipment, utensils, and food-packaging materials, or for employee sanitary facilities.(emphasis added).

McEntire is subject to all these regulatory requirements. (e.g., R. p. 317; Tr. p. 176, lines 24-25) Based on the foregoing, federal law explicitly requires all clothing at issue in this case, and there was no testimony from the DOR to the contrary.

f. DHEC Statutes and Regulations

According to S.C. Code Ann. § 39-25-180(H):

> Good manufacturing practice regulations and their amendments now or hereafter adopted pursuant to the authority of the federal Food, Drug, and Cosmetic Act are the good manufacturing regulations of this State. However, the commissioner may adopt a regulation that prescribes conditions under which good manufacturing processes may be used in this State whether or not in accordance with regulations promulgated pursuant to the federal act.

DHEC has accordingly adopted the Part 110 and Part 117 guidelines stated above which require protective clothing. Moreover, DHEC also has promulgated Regulation 61-25, which also provides rules and regulations for entities engaged in food production. Produce manufacturers like Respondent comply with such regulations.

These regulations require the use of protective clothing to reduce or eliminate opportunities for cross-contamination, and place responsibility for use on food protection managers. *See* S.C. Regs. §§ 61-25, 2-103.11 (person in charge "shall ensure that ... (L) employees are preventing cross-contamination of ready-to-eat food with bare hands by properly using suitable utensils such as deli tissue, spatulas, tongs, single-use gloves, or dispensing equipment"). Section 3-301.11(B) prohibits food employees from contacting

exposed, ready-to-eat food with bare hands, and requires use of gloves. Under S.C. Regs. § 2-402.11(B), food employees must wear hair restraints, including hats, hair covering and nets, beard restraints, and clothing that covers body hair. Those restraints must be both designed and worn to effectively keep hair from contacting exposed food, clean equipment, utensils, and linens. *Id.* Accordingly, state law requires all the clothing at issue in this matter. (R. pp. 167, 347, 385; Tr. p. 26, lines 3-13, p. 206, lines 6-8, p. 244, lines 12-16)

VI. CONCLUSION

Based on the foregoing, Respondent respectfully requests this Court affirm the ALC's Order, which properly applied the Machine Exemption and Pollution Control Exemption to the purchases at issue, finding its application of the law and conclusions supported by substantial evidence.

Respectfully Submitted,

June 2, 2020

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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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.

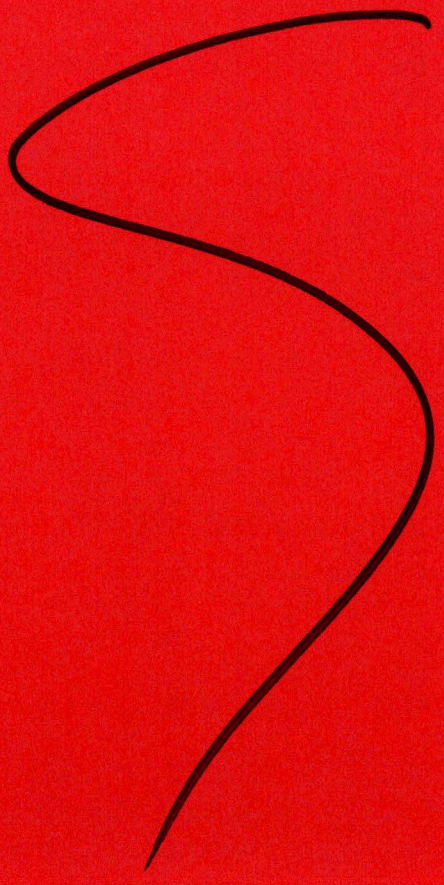
CERTIFICATE OF COUNSEL

The undersigned certified that this Final Brief of Respondent complies with Rule 211(b), SCACR.

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In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

THE HONORABLE H.W. FUNDERBURK, JR., ADMINISTRATE 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.

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Pursuant to Rule 208(a)(3), SCACR, the Appellant South Carolina Department of Revenue ("Department") files its Reply to the Initial Brief of Respondent McEntire Produce, Inc. ("Respondent").

ARGUMENTS

I. THE RESPONDENT USES THE INCORRECT STANDARD OF REVIEW.

The Respondent argues that the issues before the Court in this case involve questions of fact and, therefore, the Court should affirm the Administrative Law Court's ("ALC") decision so long as there is substantial evidence in the record to support the ALC's ruling. (Respondent's Initial Brief, pp. 7-8). However, the Department's appeal is based on the ALC's erroneous legal conclusions, which stem from disregarding applicable regulations. While the Department disagrees with some of the ALC's factual conclusions, those conclusions are based on an erroneous legal analysis. Had the ALC properly applied the plain meaning of the relevant statutes and regulations, the ALC could not have made the conclusions that it did in this case. Thus the ALC's error is an error of law. See Bursey v. S.C. Dep't of Health & Envtl. Control, 369 S.C. 176, 184-185, 631 S.E.2d 899, 904 (2006), overruled on other grounds by Allison v. W.L. Gore & Assocs., 394 S.C. 185, 188, 714 S.E.2d 547, 549 (2011) (recognizing the meaning of a statutory term is a question of law).

Furthermore, the Respondent implies that the Department bore the burden of proving that the items in dispute were *not* exempt from use tax. Throughout its brief, the Respondent asserts that, "[n]either DOR witness testified these items were not exempt" with regard to certain disputed items. (Respondent's Initial Brief, pp. 24 (regarding conveyances), 27 (regarding storage/temperature control items), 28 (regarding storage water tanks), 30 (regarding floor

treatment chemicals and cleaning machines), 31 (regarding maintenance tools), 32 (regarding generator rentals)).

It is well-settled in South Carolina that the taxpayer bears the burden of proving it is entitled to an exemption. (See TNS Mills, Inc. v. S.C. Dep't of Revenue, 331 S.C. 611, 618, 503 S.E.2d 471, 475 (1998) ("The burden is on claimants to prove their right to an exemption by bringing themselves clearly within the conditions imposed by the statute") (referencing York County Fair Assoc. v. S.C. Tax Comm'n, 249 S.C. 337, 341, 154 S.E.2d 361, 363 (1967)). The fact that neither of the Department's witnesses testified that the items in dispute were not exempt is irrelevant—the Respondent bore the burden of proving its right to the exemptions that it sought.[1] Furthermore, in its brief, the Respondent quotes Clark v. S.C. Tax Comm'n, 259 S.C. 161, 169, 191 S.E.2d 23, 26 (1972), wherein the Court states, "[r]evenue laws are generally construed in favor of the taxpayer and against the taxing authority." Id. The Clark case dealt with estate taxes, not an exemption from taxes. The law is clear regarding the construction of exemption statutes in that exemption statutes are to be strictly construed against the claimed exemption. See CareAlliance Health Services v. S.C. Dep't of Revenue, 416 S.C. 484, 488, 787 S.E.2d 475, 477 (2016).

II. THE RESPONDENT'S PURCHASES OF PROTECTIVE CLOTHING CANNOT BE EXEMPT FROM USE TAX UNDER THE POLLUTION CONTROL MACHINE EXEMPTION EVEN IF THE COURT DETERMINES FOOD CONTAMINATION IS "POLLUTION."

The Respondent's argument that purchases of protective clothing are not subject to use tax is based on the contention that food contamination[2] constitutes "pollution" for purposes of the

[1]It is questionable whether the Department's witnesses would have even been allowed to offer this testimony, in that the ultimate issue in this case is whether the exemption applies to a variety of Respondent's purchases.

[2]In this situation, the pathogens at issue, which potentially lead to food contamination, are Listeria, E.Coli, and Salmonella.

Pollution Control Machine Exemption in S.C. Code Ann. § 12-36-2120(17) (Supp. 2018), on which the ALC agreed. However, even if this Court agrees with the ALC that food contamination is "pollution," the Respondent's purchases of protective clothing are still subject to use tax for two reasons. First, the law in this State clearly provides that protective clothing *does not qualify* as a machine, which is a requirement when seeking to exempt an item under either the Machine Exemption or the Pollution Control Machine Exemption. Second, and more specific to the Pollution Control Machine Exemption, the Respondent admits that the sources of pollution do not come from any machines within the Respondent's facility.

A. The Pollution Control Machine Exemption requires that the item for which the exemption is sought be a "machine," and S.C. Code Ann. Regs. 117-302.5(B)(10) (2012) specifically states that protective clothing *is not* a machine.

"It is axiomatic that statutory interpretation begins (and often ends) with the text of the statute in question." Smith v. Tiffany, 419 S.C. 548, 555, 799 S.E.2d 479, 483 (2017) "'[T]here is no occasion for employing rules of statutory interpretation and the court has no right to look for or impose another meaning' unless a statutory provision is ambiguous." Id. (citing Paschal v. State Election Comm'n, 317 S.C. 434, 436, 454 S.E.2d 890, 892 (1995)). "'Regulations authorized by the Legislature have the force of law.'" Home Medical Systems, Inc. v. S.C. Dep't of Revenue, 382 S.C. 556, 564, 677 S.E.2d 582, 587 (2009) (citing Southeastern-Kusan, Inc. v. S.C. Tax Comm'n, 276 S.C. 487, 489, 280 S.E.2d 57, 58 (1981)).

The Respondent argues that the term "machine" in § 12-36-2120(17) is broad enough to encompass protective clothing, but admits that its argument stretches the definitional bounds of "machine:" "[a]t first blush, protective clothing does not seem to fit in the definition of machinery and equipment." (Respondent's Initial Brief p. 33). Not only does protective clothing "not seem

to fit in the definition of machinery and equipment," but South Carolina law specifically states that protective clothing *is not a machine*, a law that the ALC failed to acknowledge.

The Pollution Control Machine Exemption found in § 12-36-2120(17) provides an exemption from sales and use tax for *machines* that "are necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section." Section 12-36-2120(17). Thus, even before determining whether there is "pollution of air, water, or noise," the item for which the Pollution Control Machine Exemption is sought must be a "machine." If the item for which the exemption is sought is not a "machine," it is irrelevant if there is "pollution of air, water, or noise."

As the Department argued in its initial brief, the Legislature added a provision within S.C. Code Ann. Regs. 117-302.5 (2012) (the "Machine Exemption Regulation") that specifically states "protective clothing worn by an employee working in the area in which the manufacturing process occurs *does not qualify as a machine and is not exempt* from the [use] tax as a machine . . . ." 117-302.5(B)(10). This provision of the Machine Exemption Regulation is clear and unambiguous—protective clothing *is not a machine.* Neither the Respondent nor the Court should look for or impose another meaning behind the regulation. Thus, the ALC erred in this case because the protective clothing worn by the Respondent's employees are not "machines" and, as such, do not qualify for the Machine Exemption or the Pollution Control Machine Exemption.

In its brief, the Respondent maintains that "[t]he Department itself acknowledges . . . that protective clothing fits within the machinery and equipment ambit." (Respondent's Initial Brief, p. 33). The Respondent further argues that the Department's published guidance, which quotes Regulation 117.302.5(B)(10), "is intended to apply to protect the worker's own clothing from dirt,

paint, oils, etc. which are given off in the manufacturing process." (Respondent's Initial Brief, p. 33). However, the Respondent does not cite to any "Department published guidance" or to any other relevant or binding authority. In fact, there is no South Carolina statute or regulation which, for purposes of the Machine Exemption, distinguishes between protective clothing worn to protect an employee versus protective clothing worn by an employee to protect other persons or tangible personal property. Regulation 117-302.5(B)(10)[3] clearly instructs that *any and all* "[p]rotective clothing worn by an employee working in the area in which the manufacturing process occurs does not qualify as a machine . . . ." There is simply no authority[4] supporting the Respondent's differentiation between protective clothing that "protects the produce from the worker (for the purpose of protecting the ultimate consumer)" and any other protective clothing for purposes of the Machine Exemption or the Pollution Control Machine Exemption. (Respondent's Initial Brief p. 33).

B. <u>The Pollution Control Machine Exemption requires that "pollution" come from a machine, which the Respondent admits any alleged "pollution" does not come from any machine</u>.

Along with requiring the item for which the exemption is sought be a "machine," the Pollution Control Machine Exemption provides further requirements for a machine to qualify for

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[3]While the Department may not have raised Regulation 117-302.5(B)(10) in its Proposed Assessment or Department Determination, the Department is not prohibited from presenting the law as it is today and as it was during the audit period. Furthermore, at trial the Respondent unsuccessfully objected to the Department's witness's testimony about Regulation 117-302.5(B)(10). The basis for the unsuccessful objection was that the Department did not present the regulation in its Proposed Assessment or Department Determination. (Hr'g Tr., pp. 311-314). Respondent did not appeal the ALC's decision to allow that testimony.

[4]The Respondent only cites to authority from other jurisdictions as support of the distinction between clothing that protects the worker and clothing that protects others. (Respondent's Initial Brief, p. 34). However, the Legislature of *our* state has enacted a regulation specifically relating to the taxability of protective clothing *within this State*. The Respondent's reliance on any contrary outside authority is misplaced.

its exemption.[5] This includes the requirement that the machine for which the exemption is sought is operated and/or installed for the purpose of preventing or abating "pollution of air, water, or noise *that is caused or threatened by any machine* used as provided in this section." § 12-36-2120(17) (emphasis added). S.C. Code Ann. Regs. 117-302.6 (2012) further explains the Pollution Control Machine Exemption:

> Code Section 12-36-2120(17) exempts from the sales or use tax the gross proceeds of the sale of machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property . . . . Frequently, *these machines* cannot be operated when *the same* pollute beyond regulated levels and[,] in compliance with orders of agencies of the United States or of this state to abate or prevent pollution caused or threatened *by the operation of such machines*[,] it is necessary to install other machines that are designed and operated exclusively for the purpose of abating or preventing this pollution.

Regulation 117-302.6.

The Respondent consistently acknowledges that the alleged "pollutants"—Listeria, E.Coli, and Salmonella—do not originate from any machine within its facility. Rather, the Respondent concedes that the only two potential sources of these "pollutants" entering its facility are from the produce itself and from employees. (Respondent's Initial Brief, pp. 4, 5, 7, 37, 41). The Respondent specifically states that these "pollutants" "could potentially come into the facility in one of two ways: (1) inside the produce and/or (2) from the employees." (Respondent's Initial

[5]The Respondent states that in order to qualify for the Pollution Control Machine Exemption, "four elements must be met: (1) a machine that (2) prevents or abates pollution (3) caused by machines used in the manufacturing process and is (4) necessary to comply with the order of an agency." (Respondent's Initial Brief, p. 33). The Pollution Control Machine Exemption and its corresponding Regulation 117-302.6 do not require that the machine is necessary to comply with *any* order from a Federal or State agency, but an order "for the prevention or abatement of pollution." See § 12-36-2120(17) and S.C. Code Ann. Regs. 117-302.6 (2012).

Brief, p. 41). Thus, the Respondent admits that these alleged "pollutants" do not originate from any machine within their facility.

Despite consistently acknowledging that the alleged "pollutants" come from sources other than any machine within its facility, the Respondent still argues that the "contamination comes from the machines essential to the production of the fresh produce, namely the cutting machines." (Respondent's Initial Brief, p. 35). As support, the Respondent describes the fresh-produce processing process and how the cutting of already contaminated produce may cause pathogens to be "released into the air or water" and may "subsequently contaminate other produce as well as reproduce." (Respondent's Initial Brief, p. 41). The Respondent refers to this as "cross-contamination" and alleges that this, along with employees potentially bringing these pathogens into the facility on their street clothes, is prevented by the use of protective clothing.

While all of that may be true, a plain reading of Regulation 117-302.6 demonstrates that the Legislature did not intend for the Pollution Control Machine Exemption to apply in situations where the source of pollution is anything other than a machine used in the manufacturing process. As emphasized above, the Legislature acknowledges that the use of certain *machines* that qualify for the immediately preceding Machine Exemption cannot be operated when "*the same pollute . . .*" Clearly, when the Legislature enacted the Pollution Control Machine Exemption, it intended for the exemption to apply when the source of pollution to be prevented or abated is an actual *machine.* The Legislature did not intend for the Pollution Control Machine Exemption to apply to preventative or abatement machines when the alleged "polluting machine" merely exacerbates pollution that originated from some other source. Thus, even if the Respondent's purchases of protective clothing are "machines," which the law clearly states they are not, they do not qualify under the Pollution Control Machine Exemption because the alleged "pollution" for which the

protective clothing is used to prevent or abate does not originate from the operation of any machine used in the manufacturing process.

The Private Letter Ruling discussed by the Respondent supports the Department's argument. In S.C. Private Letter Ruling #95-8 ("PLR 95-8"), the Department determined that certain purchases were exempt under the Pollution Control Machine Exemption because those items were purchased in an effort to remediate contaminated soil and ground water surrounding manufacturing facilities. S.C. Private Letter Ruling #95-8. The facts described in PLR 95-8 indicate that the contamination in that case was a ***direct result*** of chemicals released *by machines* within a manufacturing facility. Id. The Department also concluded that the Pollution Control Machine Exemption applies to machines that are used to "reduce the amount of pollution already in the environment." Id. The Respondent argues that PLR 95-8 means the exemption can apply to machines used to remediate or abate pollution which comes *from* the environment, like those on Respondent's produce, but that is not what PLR 95-8 means. The finding in PLR 95-8 merely means that the Pollution Control Machine Exemption applies to machines used to remediate or abate pollution which entered the environment as a result of the operation of a manufacturing machine, prior to the installation of the remediation machine. Thus, the pollution still must be caused by the operation of another manufacturing machine.

In the case at bar, Respondent has conceded that the "pollution" which is purportedly remediated by the protective clothing came from either its produce or its employees and was not generated by another machine. Accordingly, the Department's interpretation of the Pollution Control Machine Exemption is supported by its interpretation in PLR 95-8.

For the foregoing reasons, even if this Court agreed with the ALC and the Respondent that Listeria, E.Coli, and Salmonella constituted "pollution," the Respondent's purchases of protective clothing still do not qualify for the Pollution Control Machine Exemption.[6]

III. THE REGULATIONS AND DEPARTMENT PUBLISHED GUIDANCE CITED BY THE RESPONDENT SUPPORTS, NOT CONTRADICTS, THE DEPARTMENT'S INTERPRETATION OF WHAT CONSTITUTES A "MACHINE."

The Respondent argues that the Department has taken a position in this matter that is contradictory to the position promulgated in its regulations and previously published guidance. (Respondent's Initial Brief, pp. 16-17). Respondent misunderstands the Department's position on what constitutes a "machine."

Contrary to the Respondent's argument, the Department does not limit a "machine" to a "mechanical device" or a "combination of mechanical powers, parts, attachments or devices." (Respondent's Initial Brief, pp. 16-17). In its brief, the Department defined "machine" as "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ." (Department's Initial Brief, p. 10). But, the Department acknowledges the Court of Appeals' holding in Hercules Contractors and Engineers v. S.C. Tax Comm'n, 280 S.C. 426, 313 S.E.2d 300 (1984). There, the Court of Appeals determined certain non-mechanical items were "machines" for purposes of § 12-36-2120(17) because they were incorporated into an exempt machine, which, in that case, was an

[6]The Respondent states that the Department's two witnesses agreed to the definitions of the term "pollution" presented by the Respondent's counsel during cross-examination. (Respondent's Initial Brief, pp. 36-37). Specifically, the Respondent states that the Department's witnesses agreed with definitions of "pollution" from Black's Law Dictionary, The Law Dictionary, Wikipedia, and Dictionary.com. Id. However, simply agreeing that a definition of the term "pollution" exists does not mean that the Department's witnesses agreed that Listeria, E.Coli, and Salmonella fit within these definitions when applied to the facts and law at issue in this case.

entire wastewater treatment facility. Thus, the Department correctly interprets a "machine" to be "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ," to include all parts, attachments, or items necessary for the creation and operation of an exempt machine.

A. Regulation 117-302.5 demonstrates the Department's consistent and correct interpretation of "machine."

The various regulations on which the Respondent relies actually support the Department's arguments. First, the Respondent lists what it deems to be "non-mechanical items" from Regulation 117-302.5(B)(2) and (5) as examples of how the Department is contradicting itself. Regulation 117-302.5(B)(2) and (5) addresses parts or attachments to machines and chemicals used on machines. Per these regulations, these chemicals and parts or attachments of machines are exempt when used on an exempt manufacturing machine and when such use is integral and necessary to the functioning of the exempt machine during the manufacturing process. See Regulation 117-302.5(B)(2) and (5). This falls directly in line with how the Department is interpreting the term "machine" for purposes of the exemptions in § 12-26-2120(17), as these chemicals and parts are considered "machines" because they become a part of and are integral and necessary to the operation of an exempt machine.[7]

The Respondent also cherry-picked terms from section (C) of 117-302.5, terms which may appear, at first glance, to be non-mechanical devices. These terms include "traveling water

[7]The first four (4) regulations the Respondent lists, which cite to Regulation 117-302.1, do not apply to the exemptions in § 12-36-2120(17). Rather, Regulation 117-302.1 states, "[p]urchases of tangible personal property are not subject to the tax under [S.C. Code Ann. §] 12-36-120 [(2014)] if . . ." and then the remainder of the regulation sets forth the conditions on which tangible personal property is not subject to sales tax as a wholesale item. See also S.C. Code Ann. § 12-36-120 (2014). Accordingly, any argument that the items listed in Regulation 117-302.1 are examples of non-mechanical devices that the Department determined are "machines" is incorrect.

screens," "tanks," "patterns," "boiler tubes," and "insulation for pipe coverings, tank coverings, and boiler insulation." (Respondent's Initial Brief, p. 17). See Regulation 117-302.5(C)(2), (8), (9), (15), and (30). The Respondent isolates these terms and takes them out of context in an ill-conceived effort to show that the Department is contradicting itself. However, the title of this particular regulation is "Other Examples Of *Exempt Machines and Machine Parts.*" Regulation 117-302.5(C). Thus, section (C) provides a list of exempt machines and parts of *exempt machines*. Accordingly, section (C) provides a list of items that fit squarely within what the Department considers to be a "machine," that is "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ," to include all parts, attachments, or items necessary for the creation and operation of an exempt machine.

B. The Department's published policy documents on which the Respondent relies demonstrates the Department's interpretation of what constitutes a "machine" as a long-standing administrative practice.

The same can be said for the Department published policy guidance—it is consistently supportive of the Department's interpretation of "machine." For example, the settling basin at issue in Revenue Ruling #89-7 is very much like the basins within the wastewater treatment facilities in the Hercules case. Consistent with the Hercules decision, the Department determined that the settling basins in the situation addressed in 89-7 were part of a single entity—an exempt machine. Thus, the materials used to construct the "machine" were exempt. The very same can be said for the gamma irradiator in Private Letter Ruling #90-3, wherein the Department determined that the gamma irradiator itself constituted a "machine," so the materials used to create the "machine," i.e. concrete, reinforced steel bars, and a metallic pool liner, were all exempt as part of an exempt machine.

Lastly, in Tax Commission Decision #89-82, the Department determined that the liners used by the taxpayer to process waste were "machines." Thus, the materials used to construct these liners, which included materials called liners, filters, resins, and other items of personal property, were exempt as part of an *exempt machine*. Not only does this Commission Decision fall directly in line with the logic previously discussed regarding items which become a part of or are integral and necessary to the operation of an exempt machine, but it defines "machine" the same as argued by the Department in this case. Specifically, as quoted by the Respondent, the Department in Commission Decision #89-82 defined "machine" as "every mechanical device or combination of mechanical power and devices to perform some function and produce a certain effect or result." As such, the Department is not contradicting itself, but is consistent in its interpretations and definitions established years ago.[8]

[8]The Respondent also references S.C. Rev. Rul. #13-3, stating "the Department found that the component parts used to construct a manufacturing machine qualified as a 'machine' for purposes of the exemption." (Respondent's Initial Brief, p. 19). However, that Revenue Ruling does not discuss the exemptions within § 12-36-2120(17), but instead discusses the material handling exemption found in § 12-36-2120(51). Therefore, the Court should not consider any analysis therein, as it analyzes facts with an exemption not before the Court.

Furthermore, the Respondent references S.C. Tax Commission Decision #92-19 and provides that "the former Tax Commission held that stack liners and ash pond pipes and pumps were exempt as they operated exclusively in the abatement of pollution caused by the production of electricity." (Respondent's Initial Brief, p. 18). There is nothing within the policy document that proves that "stack liners" and "ash pond pipes and pumps" are not "mechanical device[s] or [a] combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ." Furthermore, the decision states, "[b]ased on the foregoing, we conclude the subject items are machines *or attachments* within the meaning of § 12–36–2120(17)." Therefore, even if there were evidence to show that these "stack liners" and "ash pond pipes and pumps" were not "mechanical devices" or "machines," they were attachments to exempt machines.

C. **The Respondent's protective clothing, record keeping items, and floor drain covers do not fit within the correct interpretation of what constitutes a "machine," and thus do not qualify for an exemption from use tax under § 12-36-2120(17).**

While a "machine" is "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ," including all parts, attachments, or items necessary for the creation and operation of an exempt machine, if an item is not a part of, and integral and necessary to, the operation of an exempt machine, the item for which the exemption is sought stands on its own. Thus, that item must be a stand-alone "machine."

The Supreme Court's decision in Hercules demonstrates the Respondent's faulty position. The Respondent argues that the Hercules Court held, "railways, walkways and ladders were exempt under the machine exemption as they were required by state and federal law and thus were necessary, to the overall function of the system." (Respondent's Initial Brief, p. 34). See Hercules at 430, 313 S.E.2d at 303. Respondent argues that this supports its claim to the tax exemption for any items necessary to its *operations* because such items are required by Federal or State regulations, but this ignores other critical findings by the Supreme Court. The Hercules Court determined the *entire* wastewater treatment facility in that case to be a "machine," therefore the "railways, walkways and ladders" were exempt as part of an *exempt machine*—not simply because they were necessary to Hercules' *operations* or required by Federal or State law. Id.

In this instance, because the Respondent's entire facility is not a "machine," the analysis of whether the disputed items are subject to the exemptions in § 12-36-2120(17) is narrower than in Hercules. It is not whether the items in dispute are integral and necessary to the Respondent's manufacturing *operations*, rather it is whether the items are integral and necessary to the operation of an *exempt machine*. There is no evidence in the record that the protective clothing worn by the

Respondent's employees are integral and necessary to the operation of any exempt machine within the facility. Likewise, there is no evidence that the Respondent's record keeping items (bar code scanners, black ink aerosol cans, and mobile computer stands) or floor drain covers are integral and necessary to the operation of an exempt machine. For purposes of the Machine Exemption and the Pollution Control Machine Exemption, it is not enough that these items may be integral and necessary to the Respondent's operations – even if they are required for Respondent to satisfy Federal and State regulations. See Regulation 117-302.5(B)(1)(b).

IV. THE ALC IMPROPERLY BROADENED THE TERM "PROCESSING" AND APPLIED THE MACHINE EXEMPTION TO ITEMS WHICH ARE NOT "MACHINES USED IN PROCESSING."

As discussed in the Department's Initial Brief, the ALC improperly expanded "processing" for purposes of the Machine Exemption and, therefore, erred by applying the Machine Exemption to machines that are not "used in processing tangible personal property for sale." Respondent argues that the ALC's expansion was proper, but improperly relies upon an irrelevant statutory amendment (the addition of "agricultural packaging" to the list of exempt activities). (Respondent's Initial Brief, pp. 9-13).

The Department is not advocating for a "strict production line" theory as in prior litigation. See Hercules, *infra*, and S.C. Dep't of Revenue v. Springs Industries, Inc., 2003-UP-029 (Ct. App. 2003). Rather, the Court should apply South Carolina's integrated plant theory consistent with the Machine Exemption Regulation. Contrary to Respondent's contention, the Department does not contend here that "machines used in processing" only includes "items which are part of a production line." (Respondent's Initial Brief, p. 13). Rather, the Court should apply the clear and unambiguous Machine Exemption Regulation and find that the items for which Respondent seeks the exemption are not "machines *used in processing* tangible personal property for sale."

Like the ALC, the Respondent incorrectly relies on the Legislature's addition of the term "agricultural packaging" to its list of exempt activities within § 12-36-2120(17). First, Respondent fails to acknowledge that the General Assembly did not add "agricultural packaging" until after the applicable audit period. Nevertheless, Respondent relies on the definition of "agricultural packaging" found in S.C. Code Ann. § 12-6-3360(M)(16) (Supp. 2018) and claims that "the statute clearly envisions a more expansive concept of 'agricultural packaging,' to include the transportation and warehousing both before and after the literal packaging." (Respondent's Initial Brief, p. 10). The addition of a completely new category to the Machine Exemption could not have been meant to clarify any already existing exemption to agricultural packagers, but instead to provide a new exemption for an activity not previously recognized. Thus, the Respondent's reliance on the addition of "agricultural packaging" to the Machine Exemption as well as the definition of same found in § 12-6-3360(M)(16) in support of its argument that activities both before and after the actual processing of fresh produce within its facility is "processing" is misplaced.[9]

CONCLUSION

South Carolina law specifically states that protective clothing is not a machine for purposes of the exemptions in § 12-36-2120(17). Furthermore, the alleged "pollution" is not created by any machine within the Respondent's facility, but instead originates from other sources, namely the produce itself or it is brought inside on the employees' clothing. Accordingly, the Court should

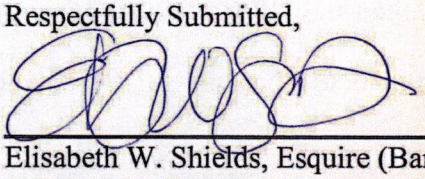
[9]The Respondent further relies on authority from other states to argue that the items in dispute in this case are "machines used in processing." (See Respondent's Initial Brief, pp. 25, 31, 34). However, as previously addressed, the Legislature of *our* state has enacted regulations specifically relating to the taxability of the items in dispute *within this State*. Therefore, Respondent's reliance on any contrary outside authority is misplaced.

find that the Respondent's purchases of protective clothing are subject to use tax, even if the Court considers food contamination to be "pollution."

Furthermore, the many regulations and policy documents cited by the Respondent support, rather than contradict, what the Department considers a "machine" and, as such, supports the Department's arguments in its Initial Brief. The Respondent improperly relies on the addition of "agricultural packaging" to the list of exempt uses to the Machine Exemption to support the ALC's expansion of "processing" and, thus, the expansion of "machines used in processing."

For the reasons set forth herein and in the Department's Initial Brief, the ALC committed an error of law and the Court should reverse the ALC's findings and hold that the items for which the Respondent sought exemptions are taxable.

Respectfully Submitted,



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June 2, 2020

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THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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

CASE NO. 17-ALJ-17-0060-CC
APPELLATE CASE NO. 2019-001933

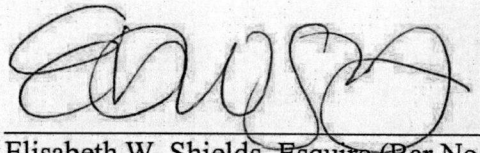
McEntire Produce, Inc., ...Respondent,

v.

South Carolina Department of Revenue, ...Appellant.

CERTIFICATE OF COUNSEL

The undersigned certifies that this Final Reply Brief complies with Rule 211(b), SCACR.



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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

McEntire Produce, Inc., Respondent,

v.

South Carolina Department of Revenue, Appellant.

Appellate Case No. 2019-001933

Appeal From The Administrative Law Court
Harold W. Funderburk, Jr., Administrative Law Judge

Opinion No. 5972
Submitted December 1, 2022 – Filed March 1, 2023

REVERSED

Elisabeth W. Shields and Jason P. Luther, both of the South Carolina Department of Revenue, of Columbia, for Appellant.

Burnet Rhett Maybank, III and James Peter Rourke, both of Nexsen Pruet, LLC, of Columbia, for Respondent.

THOMAS, J.: The South Carolina Department of Revenue (SCDOR) appeals a decision by the Administrative Law Court (ALC) that held purchases by McEntire Produce, Inc. (McEntire) of certain supplies and protective clothing are entitled to the South Carolina partial sales tax exemption under section 12-36-2120(17) of the South Carolina Code (Supp. 2022). SCDOR argues the ALC erred in granting "the machine exemption" and "the pollution control machine exemption," both found in section 12-36-2120(17), to McEntire's purchases of items that are not "machines." We reverse.

FACTS

McEntire operates a produce processing facility in Columbia, South Carolina. The facility processes lettuce, onions, cabbage, tomatoes, and other vegetables for sale. Its produce processing includes, but is not limited to, washing, cutting, mixing, and packaging the finished produce at the facility. As a manufacturer of fresh produce, McEntire is subject to both federal and state regulation, 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), with regards to food safety.

On February 7, 2017, SCDOR determined McEntire's purchases of certain supplies and protective clothing were subject to use tax for the tax periods October 1, 2012 through September 30, 2015 (the "audit period") and were not exempt from the use tax under section 12-36-2120(17). As such, SCDOR assessed McEntire $136,250.51 in unpaid taxes on July 19, 2016; however, between the issuance of SCDOR's determination and the hearing before the ALC, the parties agreed to a reduced amount of $126,912.60. McEntire timely protested the proposed assessment due to the parties' disagreement as to whether McEntire's purchase of supplies and protective clothing was exempt from the use tax. On March 7, 2017, McEntire filed a request for a contested case hearing with the ALC to challenge SCDOR's determination.

The ALC held a contested case hearing on November 14 and 15, 2018, and the court issued its final order on September 6, 2019. The court 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."[1] 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."[2] Because the ALC held some items were taxable, the ALC remanded the matter to SCDOR, instructing it to

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[1] The exempted items included: cut wheel and disc maintenance tools; maintenance tools; forklift rental, forklift batteries, forklift parts, and forklift repair parts; hand trucks, pallet jacks, and oil lubricant used therein; generator rental; stacking containers; warehouse racks; pallet flow brakes; blower fans; bar code scanners; black ink aerosol cans; mobile computer stands; storage water tanks; cleaning machines; floor treatment chemicals; and floor drain covers.

[2] The exempted protective clothing items included coveralls, eyewear, gloves, aprons, and hairnets.

calculate the tax and interest due on the items the ALC deemed taxable. SCDOR filed a motion for reconsideration and/or to alter or amend on September 19, 2019. The ALC issued an order on October 16, 2019, denying SCDOR's motion. This appeal followed.[3]

STANDARD OF REVIEW

"Upon exhaustion of his prehearing remedy, a taxpayer may seek relief from the department's determination by requesting a contested case hearing before the Administrative Law Court." S.C. Code Ann. § 12-60-460 (2014). "In an appeal from the decision of an administrative agency, the Administrative Procedures Act [the Act] provides the appropriate standard of review." *Original Blue Ribbon Taxi Corp. v. S.C. Dep't of Motor Vehicles*, 380 S.C. 600, 604, 670 S.E.2d 674, 676 (Ct. App. 2008). The Act provides the applicable standard:

> (B) 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.

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[3] We find the order on appeal is immediately appealable. *See Torrence v. S.C. Dep't of Corr.*, 433 S.C. 224, 227, 857 S.E.2d 549, 550 (2021) (explaining a remand from the ALC to an agency may be immediately appealed if the remand is "viewed as ministerial").

S.C. Code Ann. § 1-23-610(B) (Supp. 2022).

"The decision of the [ALC] should not be overturned unless it is unsupported by substantial evidence or controlled by some error of law." *Original Blue Ribbon Taxi Corp.*, 380 S.C. at 604, 670 S.E.2d at 676. "The court of appeals may reverse or modify the decision only if the appellant's substantive rights have been prejudiced because the decision is clearly erroneous in light of the reliable and substantial evidence on the whole record, arbitrary or otherwise characterized by an abuse of discretion, or affected by other error of law." *SGM-Moonglo, Inc. v. S.C. Dep't of Revenue*, 378 S.C. 293, 295, 662 S.E.2d 487, 488 (Ct. App. 2008).

LAW/ANALYSIS

SCDOR argues the ALC erred in granting the "machine exemption" and the "pollution control machine exemption," both found in section 12-36-2120(17), to McEntire's purchases of items that are not "machines." We agree.

Section 12-36-2120(17), the "machine exemption," currently provides certain items are exempted from sales taxes, including "machines used in manufacturing, processing, agricultural packaging, recycling, compounding, mining, or quarrying tangible personal property for sale."[4] Subsection 17 further provides:

> "Machines" include the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of the machines and which
> (a) are necessary to the operation of the machines and are customarily so used . . . .

South Carolina Code of State Regulations 117-302.5(A) (2012) also explains "[m]achines used in manufacturing, processing, compounding, mining, or quarrying tangible personal property for sale, and the replacement parts and attachments to such machines, are exempt from the sales and use tax under Code Section 12-36-2120(17)." Regulation 117-302.5(B)(1) (2012) states a "machine qualifies for the exemption under Code Section 12-36-2120(17) if the machine is integral and necessary to the manufacturing process and the product being manufactured is being manufactured 'for sale.'" The Regulation adds a machine "includes every mechanical device or combination of mechanical powers, parts,

[4] This section was updated in 2016, after the audit period in this case, to add the term "agricultural packaging."

attachments and devices to perform some function and produce a certain effect or result, is integral and necessary to the manufacturing process . . . ." *Id.* It further enunciates a three-part test to determine whether a machine is "integral and necessary" to the manufacturing process:

> (a) The machine is used at a manufacturing facility. . . .
> (b) The machine is used in, and serves as an essential and indispensable component part of the manufacturing process, and is used on an ongoing and continuous basis during the manufacturing process. A machine is not a part of the manufacturing process merely because it is integral and necessary to the manufacturer. For example, machines used for warehouse, distribution, or administrative purposes are integral and necessary to the manufacturer, but not part of the manufacturing process.
> (c) The machine must be substantially "used in manufacturing . . . tangible personal property for sale." The statute does not require that the machine be used exclusively in manufacturing; however, incidental manufacturing use will not qualify for the exemption. For purposes of the exemption, more than one-third of a machine's use in manufacturing is substantial.

Id.

"The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature." *Hawkins v. Bruno Yacht Sales, Inc.*, 353 S.C. 31, 39, 577 S.E.2d 202, 207 (2003). "The legislature's intent should be ascertained primarily from the plain language of the statute." *State v. Landis*, 362 S.C. 97, 102, 606 S.E.2d 503, 505 (Ct. App. 2004). "The language of a tax exemption statute must be given its plain, ordinary meaning and must be strictly construed against the claimed exemption." *TNS Mills, Inc. v. S.C. Dep't of Revenue*, 331 S.C. 611, 620, 503 S.E.2d 471, 476 (1998) (quoting *John D. Hollingsworth on Wheels, Inc. v. Greenville Cnty. Treasurer*, 276 S.C. 314, 317, 278 S.E.2d 340, 342 (1981)). However, "[i]f a statute is ambiguous, the courts must construe its terms." *Ferguson Fire & Fabrication, Inc. v. Preferred Fire Prot., L.L.C.*, 409 S.C. 331, 343, 762 S.E.2d 561, 567 (2014). "Where a word is not defined in a statute, our appellate courts have looked to the usual dictionary meaning to supply its meaning." *Lee v. Thermal Eng'g Corp.*, 352 S.C. 81, 91-92, 572 S.E.2d 298, 303 (Ct. App. 2002). The interpretation of a statute or construction of a regulation is a

question of law for the court. *Hopper v. Terry Hunt Constr.*, 383 S.C. 310, 314, 680 S.E.2d 1, 3 (2009); *S.C. Dep't of Revenue v. Blue Moon of Newberry, Inc.*, 397 S.C. 256, 260, 725 S.E.2d 480, 483 (2012) (quoting 2 Am. Jur. 2d *Administrative Law* § 245). This court will correct the decision of the ALC if it is affected by an error of law or if substantial evidence does not support the findings of fact. *Blue Moon of Newberry*, 397 S.C. at 260, 725 S.E.2d at 483; *Be Mi, Inc. v. S.C. Dep't of Revenue*, 408 S.C. 290, 297, 758 S.E.2d 737, 741 (Ct. App. 2014).

A. Machine Exemption

SCDOR determined the manufacturing process at issue in this case is the processing of produce and only certain machines involved in the operations fall within the machine exemption as "integral and necessary" to the processing of produce as outlined in Regulation 117- 302.5(B)(l). Thus, SCDOR found the following items were not tax exempt "machines": cut wheel and disc maintenance tools; maintenance tools; forklift rental, forklift batteries, forklift parts, and forklift repair parts; hand trucks, pallet jacks, and oil lubricant used therein; generator rental; stacking containers; warehouse racks; pallet flow brakes; blower fans; bar code scanners; black ink aerosol cans; mobile computer stands; storage water tanks; cleaning machines; floor treatment chemicals; and floor drain covers.

In making its decision that these items were tax-exempt machines, the ALC applied the "Integrated Plant Concept," which it stated finds machinery that performs an essential or indispensable function in the taxpayer's manufacturing operations, regardless of whether it actually causes a physical change, is eligible for the exemption. The ALC cited *Niagara Mohawk Power Corporation v. Wanamaker*, 144 N.Y.S.2d 458, 461-62 (N.Y. App. Div. 1955) for the test. The *Niagara* court concluded the purchase or use of coal and ash handling equipment was not taxable because the equipment was as essential to production as the generator itself. *Id.* The court further determined the buildings at a steam station were not taxable because they housed and steadied the machinery that was essential to production. *Id.* The court stated "[t]he important thing is that all parts of the plant contribute, continuously and vitally, to production, and they are all integrated and harmonized." *Id.*

SCDOR agrees our courts have recognized that South Carolina uses an integrated plant theory for the purpose of applying the machine exemption. However, SCDOR asserts our integrated plant theory is a limited one and the court erred in relying on the *Niagara* case because New York's integrated plant theory is much broader. Thus, SCDOR maintains the ALC incorrectly expanded what it means to

be "used in processing." SCDOR states Regulation 117-302.5 provides that to be an exempt machine, the item must: (1) be "[a] machine, which includes every mechanical device or combination of mechanical powers, parts, attachments and devices that perform some function and produce a certain effect or result"; (2) which "is integral and necessary"; (3) to processing "tangible personal property for sale." In this case, it argued the machine exemption exempts only those machines that are integral and necessary to the sorting, cutting, washing, and packaging of produce.

The ALC disagreed with SCDOR and 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." Further, "[w]ithout the processes that occur in the climate-controlled [] areas of the plant, [McEntire] would be unable to safely and efficiently produce a finished product for sale and distribution." Thus, "[t]hese processes contribute continuously and vitally to the plant's overall production and are also integrated and harmonized into the activities that occur directly in the production line, as conceived in the Integrated Plant Concept." Having concluded McEntire's manufacturing operations consisted of more than the simple production line manufacturing occurring in the cutting room, the ALC then had to determine whether the supplies at issue fell within the definition of "machine" so as to qualify as tax exempt under section 12-36-2120(17).

In *Hercules Contractors & Engineers, Inc. v. South Carolina Tax Commission*, 280 S.C. 426, 429-30, 313 S.E.2d 300, 302-03 (Ct. App. 1984), this court found the evidence clearly supported the holding of the trial court that a facility that treated waste of a plant produced in connection with its manufacture of textile products for sale operated as one single entity and that entity was a "machine." The court also found various "vats or basins," as well as certain railings, walkways and ladders, and tanks, troughs and pipes, were all "integral and necessary to the operation of the system as a whole." *Id.* at 430, 313 S.E.2d at 303. Further, it noted railings, walkways, and ladders were required by state and federal law and were necessary to the overall function of the system. *Id.* Thus, all materials used in the facility's construction were tax exempt. *Id.* at 429, 313 S.E.2d at 302.

SCDOR asserts *Hercules* is distinguishable, because in that case, this court determined the entire treatment facility was a machine, whereas here, McEntire's whole facility is not a machine. It asserts none of the items the ALC found were

exempt under the machine exemption are integrated into McEntire's facility or have anything to do with exempt machines within McEntire's facility. SCDOR also argues the ALC erred by broadening the term "machine" beyond its plain meaning in the machine exemption. SCDOR asserts a machine is defined by Regulation 117-302.5(B)(1) as "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ." SCDOR states Regulation 117-302.5 limits the term machine to "only those items that are integral and necessary to the functioning of an exempt machine, and solely for this reasoning are such items integral and necessary to the manufacturing process."

The machine exemption regulation does not define the terms "integral" and "necessary." Those are commonly defined as "essential to completeness" and "an indispensable item." *Merriam-Webster Collegiate Dictionary* 607 & 776 (10th ed. 1993). The regulation also does not define "essential" or "indispensable," but the common dictionary definitions for both terms provide that something is essential or indispensable if it is "of the utmost importance" or "absolutely necessary." *Merriam-Webster Collegiate Dictionary* 396 & 593 (10th ed. 1993). Further, "processing" is not defined in the regulation. The word "process" is defined as "to subject to a special process or treatment (as in the course of manufacture)." *Merriam-Webster Collegiate Dictionary* 929 (10th ed. 1993).

SCDOR argues 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. Thus, a machine at McEntire's plant qualifies for the machine exemption only when it is absolutely necessary to the actual processing of fresh produce. As a result, SCDOR maintains activities that occur prior to and after the sorting, cutting, washing, and packaging of produce (i.e., air quality control, storage, material handling) are not absolutely necessary and are not considered a part of the processing of fresh produce and the associated machines or items do not qualify for the machine exemption to the use tax.

Further, SCDOR argues the fact the legislature added "agricultural packaging" as an exempt use in 2016,[5] after the audit period in this case, is not an indication that it had intended such a use to be included in the previous version of the machine exemption. It states that the addition indicates those activities were not exempt prior to the 2016 statutory change and the purpose of the amendment was to make agricultural packaging an exempt use, not to clarify any legislative intent on the

[5] 2016 S.C. Acts No. 256 § 427 (effective July 1, 2016).

exempt uses previously codified. Accordingly, it states the ALC erred in considering the amendment in its decision.

We consider each of the specific items at issue:

1. Fork lifts, pallet jacks, and lubricants:

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. Thus, these items are not tax exempt.

McEntire also asserted the forklifts were used directly in the food processing to dump produce onto the conveyor system, which moves the raw produce into the processing area. However, 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." (Emphasis added). Thus, because the forklifts feed the bin dumping conveyance system and not the first processing machine, they are not tax-exempt conveyance machines.

2. Bar code scanners, black ink aerosol cans, and mobile computer stands:

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 used in the process of manufacturing tangible personal property for sale and are not exempt from the tax." Thus, these items are not tax exempt.

3. Floor drain covers:

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.

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 mulitple areas. Thus, blower fans are not tax exempt.

5. Water storage tanks:

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.

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.

7. General maintenance tools:

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.

8. Generator rentals:

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").

While we note the decision of the ALC should not be overturned unless it is unsupported by substantial evidence or controlled by some error of law, this court generally gives deference to an agency's interpretation of its own statutes and regulations. *See Original Blue Ribbon Taxi Corp.*, 380 S.C. at 604, 670 S.E.2d at 676 ("The decision of the Administrative Law Court should not be overturned unless it is unsupported by substantial evidence or controlled by some error of law."); *Blue Moon of Newberry*, 397 S.C. at 260-61, 725 S.E.2d at 483 ("Although our review of these questions is de novo, we will generally give deference to an agency's interpretation of its own regulation."); *Brown v. Bi-Lo, Inc.*, 354 S.C. 436, 440, 581 S.E.2d 836, 838 (2003) (recognizing this court generally gives deference to an administrative agency's interpretation of an applicable statute or its own regulation). "[T]he construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons." *Be Mi, Inc.*, 408 S.C. at 298, 758 S.E.2d at 741 (alteration by court) (quoting *Brown v. S.C. Dep't of Health & Envtl. Control*, 348 S.C. 507, 515, 560 S.E.2d 410, 414 (2002)); *Kiawah Dev. Partners, II v. S.C. Dep't of Health & Env't Control*, 411 S.C. 16, 34, 766 S.E.2d 707, 718 (2014) ("[T]he deference doctrine[,] properly stated[,] provides that where an agency charged with administering a statute or regulation has interpreted the statute or regulation, courts, including the ALC, will defer to the agency's interpretation absent compelling reasons."); *Marchant v. Hamilton*, 279 S.C. 497, 500, 309 S.E.2d 781, 783 (Ct. App. 1983) ("Administrative interpretations of statutes, consistently followed by the agencies charged with their administration and not expressly changed by Congress, are entitled to great weight."). A tax exemption statute is strictly construed against the taxpayer claiming the exemption. *TNS Mills, Inc.*, 331 S.C. at 620, 503 S.E.2d at 476. "This rule of strict construction simply means that constitutional and statutory language will not be strained or liberally construed in the taxpayer's favor." *CFRE, LLC v. Greenville Cnty. Assessor*, 395 S.C. 67, 74, 716 S.E.2d 877, 881 (2011) (quoting *Se. Kusan, Inc. v. S.C. Tax Comm'n*, 276 S.C. 487, 489, 280 S.E.2d 57, 58 (1981)).

We find SCDOR's interpretation that each of the items at issue are not tax exempt under the machine exception to be supported by the statue and regulations it is charged with administering. Thus, the ALC erred in broadening the machine exemption beyond the statute's plain meaning. *See Be Mi, Inc.*, 408 S.C. at 298, 758 S.E.2d at 741 ("Words in a statute must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the

statute's application." (quoting *Epstein v. Coastal Timber Co.*, 393 S.C. 276, 285, 711 S.E.2d 912, 917 (2011))).

B. Machine Exemption and Pollution Control Machine Exemption

SCDOR also found items designated as "protective clothing" (coveralls, eyewear, gloves, aprons, and hairnets) were not exempt from the use tax under the machine exemption or a provision in section 12-36-2120(17), commonly referred to as the "pollution control machine exemption."

Section 12-36-2120(17)(b) provides:

> "Machines" include the parts of machines, attachments, and replacements used, or manufactured for use, on or in the operation of the machines and which . . . (b) are necessary to comply with the order of an agency of the United States or of this [s]tate for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section.

Regulation 117-302.5(B)(10) (2012) provides:

> Protective clothing worn by an employee working in the area in which the manufacturing process occurs does not qualify as a machine and is not exempt from the tax as a machine used in manufacturing tangible personal property for sale under Section 12-36-2120(17). However, "clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment" is exempt under the provisions of Section 12-36-2120(54).

The pollution control regulation, Regulation 117-302.6 (2012), states in relevant part:

> Code Section 12-36-2120(17) exempts from the sales or use tax the gross proceeds of the sale of machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property and the term

> "machine" includes parts of such machines, attachments and replacements therefor which are used or manufactured for use on or in the operation of such machines and which are necessary to the operation of such machines and which are customarily so used[.]
> . . .
>
> The term "machine" as defined in Section 12-36-2120(17) shall include machines, their parts and attachments, when the same are necessary to comply with the order of an agency of the United States or of this state for the prevention or abatement of pollution that is caused or threatened by any machines used in the mining, quarrying, compounding, processing and manufacturing of tangible personal property.

The ALC concluded protective clothing falls within the parameters of clause A of the machine exemption as a "machine" because it is "necessary and integral" to McEntire's manufacturing process. To prove that protective clothing falls within clause B, the pollution control exemption of section 12-36-2120(17), the ALC held McEntire must show: "(1) the operation of at least one machine used in the manufacturing process causes or threatens to cause pollution of air, water, or noise; (2) a [s]tate or federal agency requires that the pollution be prevented or abated; and (3) [] the protective clothing is used to prevent or abate the pollution."

The ALC noted the word "pollution" is not defined in section 12-36-2120(17) but "'contamination' fits within the ordinary and dictionary definitions of pollution in the context of food." The court found "pollution" is "defined by Black's Law Dictionary as, '[t]he presence of harmful substances (either physical or gaseous), noise or energy (radiation) within a certain area, that causes harm to the surroundings, altering the natural environment around which it has been excreted.'" The court also noted "Wikipedia defines 'pollution' as 'the introduction of contaminants into the natural environment that cause adverse change.'" Also, "Dictionary.com defines 'pollution' as '1. the act of polluting or the state of being polluted, 2. The introduction of harmful substances or products into the environment.'"

The court found Dr. David Gombas, McEntire's expert witness, defined "pollution" as "any contaminant that may be injurious to the intended consumer." In the context of food safety, Dr. Gombas testified "the terms 'pollution' and 'contaminant'

are synonymous and used interchangeably throughout the food manufacturing industry." Dr. Gombas also testified "protective clothing is a necessary protection against contamination or pollution . . . in any fresh cut or fresh produce handling facility; likewise, any ready-to-eat food processing facility." The court found "when asked whether the major foodborne illnesses associated with fresh produce (E. coli, Listeria, and Salmonella) constitute 'pollution' as defined by Black's Law Dictionary, Wikipedia, and dictionary.com, Dr. Gombas answered in the affirmative and confirmed that all three of the harmful substances meet the various definitions of pollution." Further, the court noted a publication by the World Health Organization states "foodborne illnesses are caused by bacteria, viruses, parasites, or chemical substances that enter the human body through contaminated food (i.e. fruits and vegetables contaminated with feces) or water."

The court also noted McEntire was "regulated under the FDA's 21 C.F.R. §§ 110 and 117, which establish the requirements of a food safety plan and the performance of hazard analyses and lay out the preventive controls that must be instituted in order to mitigate hazards in food processing." Dr. Gombas testified "if a manufacturer does not abide by these regulations, for example if McEntire could not afford or did not provide protective clothing to prevent contamination, then the manufacturer would be operating in violation of the law." The ALC then found protective clothing, including coveralls, eyewear, gloves, aprons, and hairnets, fell within the pollution control machine exemption under the Integrated Plant Concept as within the scope of McEntire's manufacture of fresh produce because it is mandated by the FDA and the SCDA and "is used for health and safety reasons to protect the product, the consumer, and the general public from foodborne illness."

However, Regulation 117-302(B)(10) provides: "Protective clothing worn by an employee working in the area in which the manufacturing process occurs does not qualify as a machine and is not exempt from the tax as a machine used in manufacturing tangible personal property for sale under Section 12-36-2120(17)." Thus, because protective clothing is not considered a machine for purposes of the machine exemption, we find protective clothing is not exempt from use tax as a machine used in processing or manufacturing.

The Regulation does provide there is an exception for "clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment." However, the ALC found it could not conclude, based on the limited amount of testimony provided, that McEntire's purchases of protective clothing during the audit period should be exempt from tax based on the Class 100 or better Clean Room Exemption. The SCDOR auditor testified she

denied McEntire the pollution control exemption under the class 100 because it did not provide her with adequate evidence that it met the standard.

We find SCDOR's interpretation that protective clothing is not tax exempt under the machine exemption or the pollution control machine exemption is supported by the statute and regulations it is charged with administering. Thus, the ALC erred in broadening the exemptions beyond the statute's plain meaning. *See Be Mi, Inc.*, 408 S.C. at 298, 758 S.E.2d at 741 ("Words in a statute must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the statute's application." (quoting *Epstein*, 393 S.C. at 285, 711 S.E.2d at 917)).

CONCLUSION

Accordingly, the order of the ALC is

REVERSED.[6]

WILLIAMS, C.J., and LOCKEMY, A.J., concur.

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[6] We decide this case without oral argument pursuant to Rule 215, SCACR.

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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 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, [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 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 [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 spoliation 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 closing 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 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." 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 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. *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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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The 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 16th 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, Attorney for Appellant.

Melinda White

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

March 16, 2023

RECEIVED
MAR 16 2023
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

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SC Court of Appeals

The Honorable Jenny Abbott Kitchings
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1220 Senate Street
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The South Carolina Court of Appeals

McEntire Produce, Inc., Respondent,

v.

South Carolina Department of Revenue, Appellant.

Appellate Case No. 2019-001933

ORDER

After careful consideration of the petition for rehearing, the Court is unable to discover that any material fact or principle of law has been either overlooked or disregarded, and hence, there is no basis for granting a rehearing. Accordingly, the petition for rehearing is denied.

C.J.

J.

A.J.

Columbia, South Carolina

cc:
Elisabeth W Shields, Esquire
Burnet Rhett Maybank, III, Esquire
James Peter Rourke, Esquire
Jason Phillip Luther, Esquire
The Honorable Harold W. Funderburk, Jr.

FILED
May 18 2023