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 **FINAL ORDER**

This matter comes before the South Carolina Administrative Law Court (ALC or Court) pursuant to a request for a contested case hearing filed by McEntire Produce, Inc. (McEntire or Petitioner) under S.C. Code Ann. § 12-60-460 (Supp. 2017). Petitioner contests the South Carolina Department of Revenue's (Department or Respondent) Determination that certain purchases of supplies are taxable for the period of October 1, 2012 through September 30, 2015 (Audit Period).

Petitioner, which is taxed and classified as a manufacturer, 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. §12-36-2120(17) too narrowly in light of Petitioner's food produce processing operations. Second, Petitioner contends that the Pollution Control Exemption found in Clause B of § 12-36-2120(17) applies to purchases of coveralls, eyewear, gloves, aprons, and hairnets (hereinafter collectively referred to as "protective clothing")[1] designed to ensure that Petitioner's operations do not spread pollutants onto the finished product and into the facility outflow. Finally, with respect to the purchases of protective clothing during the Audit Period, Petitioner contends the Department failed to recognize the "Clean Room Exemption" available under § 12-36-2120(54) for the Class 100 clean room environment which Petitioner maintains at its manufacturing facility.

[1]Generally, in addition to these, other items such as overshoes, boot covers, sleeve covers, sanitized smocks, bump caps, and beard covers fall into the category of "protective clothing" in the food processing industry. However, in this case, only five items of protective clothing were specifically listed as being at issue: coveralls, eyewear, gloves, aprons, and hairnets. The Court recognizes that other items fall into the broader category of protective clothing and may be used at Petitioner's facility but, for purposes of this case, "protective clothing" shall only encompass the five items specifically enumerated in Exhibit A of the parties' Stipulations of Fact. *See infra,* p. 4.

A hearing was held before the Court on November 14 and 15, 2018. The parties submitted Stipulations of Fact, including a list of thirty-five (35) items that Petitioner alleges should have been classified as exempt from sales and use tax pursuant to the aforementioned provisions of § 12-36-2120. The parties also stipulated that Petitioner's witness, Dr. David Gombas, is an expert in the area of protective clothing for food safety purposes. Pursuant to Rule 32(a)(3)(B) of the South Carolina Rules of Civil Procedure, Dr. Gombas' deposition transcript was read into the hearing and admitted as Petitioner's Exhibit 25.

At the conclusion of Petitioner's case-in-chief, the Department conceded that McEntire's purchases of two (2) of the items at issue – the refrigerator in the quality assurance lab and lamps that were also used for quality assurance purposes – should be exempt from sales and use tax based on testimony presented. Thus, the Court is charged with determining whether Petitioner's purchases of the remaining thirty-three (33) items are exempt from sales and use tax.

In addition, Petitioner also contends that part of the Department's Proposed Assessment falls outside of the prescribed thirty-six (36) month statute of limitations. As such, the Court must also determine if the Department correctly assessed taxes for the eight (8) month period that Petitioner argues should be barred from consideration in the audit as falling outside of the statute of limitations.

STIPULATIONS OF FACT

At the hearing, the parties entered the following written Stipulations of Fact, which contained Exhibit A entitled "Supplies at Issue," into the Record pursuant to Rule 25(C) of the Rules of Procedure for the Administrative Law Court:

1. Petitioner operates a produce processing facility in Columbia, South Carolina. Petitioner processes lettuce, onions, cabbage, tomatoes, and other vegetables (hereinafter "produce") for sale. Petitioner's produce processing includes, but is not limited to, washing, cutting, mixing, and packaging the finished produce at Petitioner's facility.
2. On September 22, 2015, the Department initiated a sales and use tax audit of Petitioner for tax periods October 1, 2012 through September 30, 2015 (the "Audit Period").

3. During the audit, the Department reviewed Petitioner's purchase invoices and, after discussing questionable items with Petitioner, determined that Petitioner failed to report use tax on its purchases of numerous supplies and protective clothing. Accordingly, on July 19, 2016, the Department mailed to Petitioner a Proposed Assessment showing a total tax due in the amount of $126,912.60. [2]

4. The supplies that remain at issue are attached to these Stipulations as Exhibit A.

5. On August 1, 2016, Petitioner timely protested the Proposed Assessment due to the parties' disagreement as to whether 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 in $82,305.83 (plus interest).[3]

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

8. Petitioner timely requested a contested case hearing.

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

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

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[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 and later submitted to the Court in the Stipulation of Facts. Additionally, Petitioner has paid a portion of the tax due on the items it agrees are taxable. While information regarding the actual amount of tax owed has not been provided to the Court, Petitioner does agree that within thirty (30) days of receiving the Court's Final Order, it will remit payment in the amount due plus interest for items the Court finds taxable. The Department agrees to provide Petitioner with the updated balance along with the amount of interest due when Petitioner informs the Department that it is prepared to submit payment. The parties also agree that if Petitioner prevails on the statute of limitations argument, the amount of tax due, if any, will be reduced based on any period the Court determines falls outside of the statute.

[3] *See above*, n. 2.

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 to the Department to calculate the tax and interest due on the items deemed taxable by the Court.

The following Exhibit was attached to the Stipulations of Fact (*supra*, p. 3, stipulation 4) and submitted to the Court as follows:

[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 productions offices
34. Drug test kits
35. Storage water tank

* At the conclusion of Petitioner's case-in-chief, the Department conceded that McEntire's purchases of items (9) and (11) should be exempt from sales and use tax, leaving the Court to consider the remaining 33 items. (*See supra,* p. 2).

FINDINGS OF FACT

Having observed the witnesses and exhibits presented at the hearing, and closely passed upon their credibility, and taking into consideration the burden of persuasion upon the parties, the Court makes the following additional Findings of Fact by a preponderance of the evidence:[4]

A. McEntire's Operations

Petitioner operates in the specialized and highly-regulated arena of fresh food processing for its customers. Those customers, primarily large restaurant chains, 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. Initially, McEntire contracts with a grower to harvest the product at a temperature of around 80-85 degrees. Within hours of harvesting, the temperature of the produce must be reduced below 40 degrees in order to slow the natural ripening process in each particular

[4] To the extent that any Findings of Fact set forth herein shall be considered not to be Findings of Fact but Conclusions of Law, they may be deemed as such.

fruit or vegetable. McEntire is required by State and federal regulation, and also through contractual terms with individual customers, to track the produce as soon as it is loaded into the climate-controlled trucks after harvest. At all times, McEntire must be able to demonstrate that the temperature on these trucks remains between 33 and 40 degrees until the produce is unloaded for processing at Petitioner's plant.

Several witnesses for Petitioner described the physical layout of the produce processing plant as well as the operations that take place inside the plant to produce the finished product. During the periods at issue, McEntire's produce production primarily consisted of lettuce, onions, cabbage, tomatoes, and other vegetables. Because the ultimate consumer who eats the fresh produce does not take any preventative steps such as microwaving or cooking the vegetable to eliminate any harmful contaminants, McEntire must, and does, operate in a manner designed to reduce or eliminate those harmful contaminants. Furthermore, as a fresh produce processer, McEntire 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).

As soon as the fresh produce is unloaded from refrigerated trucks at Petitioner'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 low-care areas, which involve the ripening, sorting, defect removal, repackaging, and temporary storing of the products, are generally reserved for either whole produce that is never cut down by Petitioner, produce that is waiting to be transferred to the high-care area for cutting, or produce that has already been cut and packaged and is awaiting shipment out of the facility. Areas of the 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. In these areas, no physical cutting of the produce takes place.

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 physical cutting of the vegetables releases pollutants that are present on the produce at the farm harvesting level, allowing those pollutants to grow, multiply, and spread. Pollutants (chiefly E. coli) can also be brought into the facility by way of pathogens present on the shoes and clothing of employees. To avoid both the introduction and the spread of contaminants, employees in the high-care area are required by State and federal law to wear more protective clothing than that required in the low-care area. High-care area employees must also undergo a specialized sanitation procedure before they enter the area and a specific "dress-down" routine upon leaving the area. These procedures are both designed to prevent the spread of pollution – one to limit the introduction of contamination into the area by way of harmful microbes that may be on an employee and the other to prevent the spread of contamination that may have been present on the produce and dispersed into the air and water and onto exposed surfaces, including the employee's protective clothing, during the cutting process. The overall purpose of the climate control and other environmental controls like protective clothing, employee sanitation, and air filtration procedures is to protect the produce from pollutants transferable through human contact, microbial growth, and surface contact and to prevent the spread of harmful contaminants unearthed during the cutting process into the air and water.

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. While some items of protective clothing are required in the low-care area, before entering the high-care area employees must go through an additional sequence of steps in the high-care hygiene room to

ensure that sanitation standards are maintained. Here, employees are required to put on overshoes, wash their hands, and put on smocks, gloves, and any other protective gear that is required by law.[5]

Once the produce is cut, washed, and dried in the high-care area, it is then metered onto a conveyance system where it is weighed and bagged. 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 for a short period of time until employees load the product onto Petitioner's refrigerated trucks for delivery to customers.

At all times, the produce must remain at temperatures between 33-40 degrees. McEntire's customers, the FDA, SCDA, and DHEC can audit any item that comes out of the facility to ensure it has not spent any significant time outside of the temperature "safe zone." Any violations could result in rejection of the product by McEntire's customers and in reprimands, fines, or even plant closure by the regulatory agencies. Temperature, environmental controls, protective clothing, and other safe practices utilized to produce an uncontaminated product and to prevent pollution, as well as devices and mechanisms used to track the produce through the production process, are vital elements necessary to McEntire's operations.

B. Foodborne Illnesses

In the food processing industry, there are three primary foodborne illnesses that cause sickness and could cause death to consumers: (1) Listeria; (2) E. coli; and, (3) Salmonella. Many of the items disputed in the audit relate to Petitioner's efforts to combat these three serious foodborne illnesses caused by microbes that are described as follows:

(1) Listeria monocytogenes is a germ that can cause a serious infection called Listeria, 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 those with weakened immune systems. Approximately 80% of those with Listeriosis are hospitalized and as many as 18% of those infected die.

[5] Carter McEntire testified that other items of protective gear required by law include bump caps, hairnets, head bands, smocks, plastic arm sleeves, nitrile gloves, and rubber overboots. (Trial Tr., p. 59:9-17). Although he testified that all of these items were deemed taxable by the Department, the only items listed in Exhibit A, to which the parties stipulated, are coveralls, eyewear, gloves, aprons, and hairnets. (*See also supra* at pp. 1, fn. 1).

(2) E. coli are bacteria that can cause diarrhea, urinary tract infections, respiratory illnesses and pneumonia, and other illness. E. coli are pathogenic, meaning they can cause 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 persons or animals.

(3) Salmonella is a bacteria that can cause diarrhea, fever, and abdominal cramps between 12 and 72 hours after infection. The illness usually lasts from four to seven days and in some cases patients must be hospitalized. Salmonella infection may spread from the intestines to the blood stream and on to other sites in the body and, in these cases, Salmonella can cause death unless the person is promptly treated with antibiotics. The elderly, infants, and those with impaired immune systems are more likely to suffer the severe cases of Salmonella.

All three of these microbes grow naturally in South Carolina and are present in farms across the country and in Mexico where Petitioner's produce is harvested. In conducive environments, germs and bacteria can breed in the produce. Petitioner deals with these pollutants in two scenarios: (1) during the manufacturing process, to prevent the spread of contaminants which are present in the produce when it is delivered to the McEntire facility; and, (2) to prevent employees from introducing pollutants into the facility from their own clothing and shoes.

C. Pollution and Federal and State Regulation

As a manufacturer of fresh produce, McEntire is subject to both federal and state regulation with regards to food safety. Dr. David Gombas, McEntire's expert witness in the area of food safety and protective clothing, has counseled over one hundred fresh produce manufacturers on the role of protective clothing and the spread of contaminants as part of his over thirty-year career as a food safety professional, microbiologist, and advisor to the FDA in creating good manufacturing practices codified in federal and state regulations. The contaminants or pollutants specific to this case are in the forms of microorganisms and allergens that can come into the plant either on the fresh produce itself or on the employees and can be spread by contact with other surfaces and by water used in the facility. From there, by way of cross-contamination, Dr. Gombas testified that it is possible for any surface or piece of equipment to serve as a "harborage point" for the pathogenic

bacteria that can then spread throughout the facility, into the water, and on to the public if not properly controlled. (Trial Tr., p. 242:6-15).

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). "The way protective clothing is used in the food industry is, by definition, clothing that is used to protect the food from contamination. (Trial Tr., p. 232:25-233:2) 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.

Specifically, Dr. Gombas identified the following functions related to pollution control or abatement that protective clothing serves: (1) to substitute for the employee's street clothing so that the employee is not bringing the pollution into the facility or contacting the produce with that pollution; (2) within the facility, as contamination may occur from the produce itself, the water, or the equipment and exposed surfaces, to minimize the opportunity to spread the contamination on to a broader range of food. (*See* Trial Tr., p. 243:20-244:6).

D. The Supplies at Issue

The Court heard testimony from several witnesses describing the items at issue and how they are used at Petitioner's facility. However, of the thirty-three (33) items the Court must consider, no testimony was given regarding the following items listed in Exhibit A: Towels; Plastic Shelves for the Maintenance Parts Room; Utility Cart(s) for Maintenance Tools; and Drug Test Kits. For purposes of efficiency and clarity, the remaining supplies at issue are grouped, titled, and described as follows and will be referred to under these headings and the corresponding item numbers in this Order:

(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 prayer to spray a "use-through code" and a "lot code" onto the finished packaging. The lot codes assist in the FDA trace-back process.

(3) Mobile Computer Stands

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

(4) White Boards in Production Offices

Petitioner uses white boards to track production efficiency and yield. For example, employees receive a bonus depending on how fast they produce sliced tomatoes. The white boards are used to track the employees' progress.

(5) Warning Signs and Stickers

Warning signs and stickers are found throughout the plant to warn of certain hazards and to remind employees of certain procedures. Approximately 80% of these signs and stickers are used in the plant or processing area of the facility while the other 20% are used in the administrative/office area.

(6) Stacking Containers

Stacking containers are used in the "work in progress" section of the facility to separate processed produce until it is combined. For example, the combination of cabbage and carrots makes coleslaw. Once the carrots are cut to specified form, they are held in the stacking containers until the cabbage is processed. 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.

(7) Warehouse Racks

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

(8) Pallet Flow Brakes

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

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

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

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

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 conveyer belt at the beginning of the cutting area.

(11) Blower Fan

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

(12) Maintenance Tools

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

(13) Cut Wheel and Disc Maintenance Tools

The cut wheel and disc maintenance tools are used specifically on the cut wheels and discs on the produce cutting machines in the high-care area.

(14) Brooms

Petitioner uses brooms throughout the facility, including the administrative/office area, but only seeks to claim an exemption for the brooms used in the plant areas of the facility. In those areas, brooms are used to sweep debris from the floor and off of storage racks in order to sanitize those areas.

(15) Squeegees

Squeegees are used primarily in the high-care area to move debris and water off of the floor and into the drain system. Because the debris in this area is a harbor point for bacteria and pathogens, the squeegees help to sanitize the area. The squeegees used in the high-care area are kept there. Other squeegees are used interchangeably to clean the floors of the facility and to clean the windows of the administrative/office area.

(16) Floor Drain Covers

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

(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% used outside of the high-care area.

(18) Storage Water Tanks

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

(19) Cleaning Machines

Every night, a specific sanitation shift utilizes cleaning machines, called "foamers," to sanitize the machines and surfaces used in the high-care area. Petitioner's witness testified that these machines are required by the FDA and that 80% of their use occurs in the high-care area.

(20) Generator Rental

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

(21) Coveralls, Eyewear, Gloves, Aprons, and Hairnets

Collectively referred to as "protective clothing"[6] in this case, these items are used in both the low-care and high-care areas of the plant for health and safety measures integral in the manufacture of fresh produce. Most of the protective clothing items are for single use but items that can be reused must be washed at high temperatures for long periods of time after each use in order to maintain sanitation standards. Petitioner spends roughly $100,000 to $150,000 per year on protective clothing, the exemption for which the Department disallowed.

E. The Audit Period and the Statute of Limitations

Generally, pursuant to S.C. Code Ann. § 12-54-85(A), the Department has thirty-six (36) months from the date a return is filed or due to be filed, whichever is later, to determine and assess taxes. Logan Mitchell, the auditor for the Department, testified that it is routine and customary for the Department to ask the taxpayer to sign consent-to-extend forms when there is a possibility the audit may take longer than the prescribed thirty-six (36) months to avoid any statute of limitations issue. Based on that routine practice, the auditor that was previously assigned to this matter before Mitchell took over entered into three consent-to-extend agreements with Petitioner. (*See* Pet. Ex. 19). The first extension agreement was entered into on November 5, 2015, and the third and last agreement was signed on March 23, 2016, and expired on May 31, 2016. *Id.* In these agreements, Petitioner's CPA and the Department agreed to extend the time for mailing the notice of assessment for any sales and use tax due for the expressly stated period of October 1, 2012 through September 30, 2015. *Id.*

As an exception to the general thirty-six (36) month time period to assess taxes, § 12-54-85(C)(3) provides that taxes may be assessed and determined at any time within seventy-two (72) months from the date a return is filed or due to be filed, whichever is later, when there is a twenty (20) percent understatement of all taxes required to be shown on the return or document. In this case, Petitioner filed three returns for all periods during the Audit Period. For periods ending September 30, 2013, November 30, 2013, and April 30, 2015, Petitioner paid $2.00, $2.00, and $642.00, respectively, in sales and use taxes. Mitchell testified that based on her calculations, the lowest

[6] Petitioner's witness, Carter McEntire, testified that the items McEntire uses as "protective clothing" inside the facility include bump caps, hairnets, head bands, smocks, plastic arm sleeves, gloves, and overboots. (Trial Tr. p. 59:10-14). However, as previously discussed, because the Stipulations of Fact include a list entitled "Supplies at Issue" as Exhibit A, the Court will only consider the items enumerated in that list for purposes of this case.

percentage of understatement for any given period during the Audit Period was 327%, which is significantly greater than 20%. Accordingly, Mitchell concluded she 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 so, upon taking over the case, she did not ask Petitioner to sign another consent-to-extend agreement.[7]

Mitchell issued the Proposed Assessment, which covered the agreed to Audit Period of October 1, 2012 through September 30, 2015, on July 19, 2016. The section of the Proposed Assessment entitled "EXCEPTION TO TIME LIMITATION FOR ASSESSMENT OF TAXES" provided that "[p]er S.C. Code Section 12-54-85, the time limitation did not apply to this audit since the taxpayer had a 20% understatement of the total 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 the audit." (Pet. Ex. 21, p. 3). Upon email receipt of the Proposed Assessment on July 19, 2016, Petitioner's CPA responded to Mitchell stating that he believed the last agreement to extend the limitation had expired, making a portion of the audit time-barred under the statute of limitations. (*See* Pet. Ex. 17). In an email chain that continued on the same day, Mitchell responded that the agreed upon extension had expired but that the thirty-six (36) month time limitation did not apply because there was more than a 20% understatement which allowed for a seventy-two (72) month assessment period pursuant to § 12-54-85. *Id.* Petitioner's CPA replied and asked her to review the matter and to make adjustments to the Proposed Assessment resulting from her review before they proceeded with the necessary steps to appeal the assessment. *Id.* According to testimony, the Department received no further correspondence from Petitioner regarding the statute of limitations issue. McEntire timely protested the Proposed Assessment on August 1, 2016, but did not raise the statute of limitations issue. On September 23, 2016, Petitioner supplemented that protest letter and again did not raise the statute of limitations issue.

Petitioner contends that the Proposed Assessment includes taxes that are outside the statute of limitations. Specifically, Petitioner alleges that the tax periods from October 1, 2012 through May 31, 2013, should be time-barred because the Department opened that eight-month period for audit

[7] The first return at issue was due on November 20, 2012, and the last return at issue was due on October 20, 2015. Under the seventy-two (72) month statute of limitations, the Department had until November 20, 2018, at the latest, to timely issue the Proposed Assessment for the entire Audit Period. The Department initiated the audit in September 2015 and issued the Proposed Assessment on July 19, 2016, well within seventy-two (72) months from the date the returns at issue were due.

solely pursuant § 12-54-85(C)(3). According to Petitioner, when the Proposed Assessment was appealed and the Department issued its Determination on March 15, 2017, the Determination did not provide a legal justification for utilizing the longer assessment period. Petitioner contends that under § 12-36-30(10), as "the final determination from which a person may request a contested case hearing before the Administrative Law Court," the Department Determination must, by statute, "explain the basis for the department's determination." S.C. Code Ann. §12-60-450(D)(2). Thus, by failing to reference the basis for extending the assessment period in the Department Determination, Petitioner asserts the Department effectively abandoned any argument or leeway it had to utilize the statutory mechanism to extend the assessment period.

Conversely, the Department argues that by including the tax periods at issue in the Determination, the Department implicitly asserted that the entire Audit Period was at issue. Moreover, the Department argues that it cannot address every potential argument a taxpayer may make, nor does the Revenue Procedures Act (RPA) require such. *See* S.C. Code Ann. § 12-60-10 *et. seq.* Rather, the RPA requires that the department determination use the information provided by the taxpayer in its protest to then explain the basis for the department's determination. *Id.* 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 ..." Accordingly, the Department argues that because Petitioner did not mention that part of the Audit Period should be time-barred in its initial protest letter or in its supplemental protest letter, the Department was not specifically required to address the statute of limitations in its Determination. The Department also asserts that by failing to raise the statute of limitations issue in its protest, Petitioner waived the right to raise that issue during the hearing in this case.

The Court finds neither of these arguments to be persuasive. Based on the evidence and testimony presented at the hearing, the Court finds that the parties agreed that the Audit Period was going to run from October 1, 2012 through September 30, 2015. While the previous auditor may have found it necessary or wise to ask Petitioner to agree to the extensions, nothing in that agreement prevented Mitchell from later determining that a 20% substantial understatement existed such that she could proceed under the seventy-two (72) month time allotment without the agreement of Petitioner. The fact that the Proposed Assessment was issued by a second auditor fifty-nine (59) days later does not change the fact that Petitioner repeatedly agreed to the Audit Period and had previously agreed to just under seven (7) months of extensions. Only upon learning of the amount owed, did

Petitioner seek to utilize a technicality to object to that which had been mutually established. Moreover, premised on Petitioner's substantial understatement, the Department did not need to ask for another extension. Based upon the evidence and testimony presented at the hearing, the Court finds that the Audit Period in this case should remain as established and agreed upon by the parties from the outset, that is from October 1, 2012 through September 30, 2015.

CONCLUSIONS OF LAW

Based upon the Findings of Fact and the applicable law, along with exhibits and testimony presented at the hearing, the Court makes the following Conclusions of Law:

The ALC has jurisdiction over this case pursuant to S.C. Code Ann. §§ 1-23-600(A) (Supp. 2015) and 12-60-460 (2014). In presiding over this contested case, the Court serves as the finder of fact and makes a *de novo* determination regarding the matters at issue. *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). The weight and credibility assigned to evidence presented at a hearing is within the province of the trier of fact. *See S.C. Cable Television Ass'n v. S. Bell Tel. & Tel. Co.*, 308 S.C. 216, 222, 417 S.E.2d 586, 589 (1992). The Court makes its factual findings based on 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)).

In South Carolina, a sales tax is imposed "upon every person engaged or continuing within the State in the business of selling tangible personal property at retail." S.C. Code Ann. § 12-36-910(A) (2014). 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 (2014). Absent an exemption, a taxpayer is responsible for sales and use tax. Moreover, the taxpayer claiming the exemption has the burden to prove the 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).

At the outset, the Court notes that of the thirty-three (33) items listed in Exhibit A as "Supplies at Issue," no testimony was offered regarding the purpose or use of Towels, Plastic Shelves for the Maintenance Parts Room, the Utility Cart for Maintenance Tools, and Drug Test Kits. (*See supra*, p. 4, Exhibit A entitled "Supplies at Issue"). Since the Court cannot assume the characteristics, purpose, or uses for these items in order to determine whether or not they qualify under one or more of the exemptions found in § 12-36-2120, Petitioner has failed to meet the burden of proof as to these items. Accordingly, with respect to these items, the Department's determination that these supplies are taxable must stand.

A. The Machine Exemption (S.C. Code Ann. § 12-36-2120(17))

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).[8] "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 (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.*

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).

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[8] The term "agricultural packaging" was added to S.C. Code Ann. § 12-36-2120(17) on July 1, 2016, after the Audit Period in this case concluded. The Court notes that the definition of "agricultural packaging" and its inclusion in § 12-36-2120(17) in 2016 evidences the legislature's intent that far more than just the sorting, cutting, washing, and packaging of produce be considered as the manufacturing process at issue in a case such as this. Instead, the definition of "agricultural packaging," found in S.C. Code Ann. §12-6-3360(M)(16), which provides a jobs tax credit for manufacturers and agricultural packagers meeting certain requirements, is

> 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).

"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 23, 26 (1972) (internal quotation marks omitted).

The regulations defining "machine" expand the definition beyond traditional notions of the term. 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. This definition also includes attachments to machines. South Carolina Tax Commission, SC Technical Advice Memorandum #94-3 (Tax) (1994). In 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. Additionally, in *Hercules Contractors and Engineers v. S.C. Tax Commission*, the South Carolina Court of Appeals held that vats and basins used in a wastewater treatment facility which performed no processing were exempt. 280 S.C. 426, 313 S.E.2d 300 (1984). "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.* at 430, 313 S.E.2d at 303.

Recognizing that the definition of "machine" is broad, the key becomes whether the machine is "integral and necessary" to the manufacturing process. S.C. Code Ann. Regs. 117-302.5 provides a three-part test to determine machines that are "integral and necessary" to the manufacturing process:

> (1) The machine is used at a manufacturing facility....
>
> (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 require 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.

Reg. 117-302.5(B)(1). Thus, for purposes of the general sales and use tax portion of the exemption (not the Pollution Control Exemption found in Clause B of § 12-36-2120(17)) a machine is *integral and necessary* to the manufacturing process, and not just to the individual

manufacturer, if: (1) the machine is used at a manufacturing facility; (2) the machine is used in and serves as an essential and indispensable component part of the manufacturing process; (3) the machine is used on an ongoing and continuous basis during the manufacturing process; and (4) the machine is substantially used in manufacturing tangible personal property for sale. The Regulation further clarifies that "more than one-third of a machine's use in manufacturing is substantial." *Id.*

To determine the machines integral and necessary to Petitioner's operations, the Department asserts that the manufacturing process at issue in this case is the processing of produce – the sorting, cutting, washing, and packaging of produce. Based on that assertion, the Department determined that only certain machines involved in the operations inside of the tomato repack room, the pack-out room, and the cutting room, also known as the high-care area, fall within the Machine Exemption as "integral and necessary" to the processing of produce as outlined in Reg. 117-302.5(B)(1). Basically, absent some other specific exemption or relation to the tomato repack or pack-out rooms, the Department contends that the Machine Exemption should be limited to those machines found directly in the production line which, in this case, primarily equates to operations inside of the cutting room/high-care area of the plant.

However, the Court declines to adopt such a restrictive view of the manufacturing process. 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 narrow "Ohio Rule" only allows an exemption for those machines that physically transform raw materials during the manufacturing process. Much like the Department's interpretation, this rule establishes the "used directly" in the manufacturing process requirement. *See The Youngstown Building Material & Fuel Co. v. Bowers, Tax Commr.*, 167 Ohio St. 363, 149 N.E. 2d 1 (1958).

The Integrated Plant Concept, which has been implemented by the ALC in South Carolina in previous cases, is less restrictive. *See Anonymous Corp. v. S.C. Dep't of Rev.*, 99-ALJ-17-0153-CC (1999) (acknowledging South Carolina as an Integrated Plant Concept state); *aff'd, S.C. Dep't of Rev. v. Springs Indus., Inc.*, 2003-UP-029 (Ct. App. 2003) (unpublished opinion affirming that acknowledgment), *cert. denied* (10/8/03). As the name implies, if machinery performs an essential or indispensable function in the taxpayer's manufacturing operations, regardless of whether it actually causes a physical change, it should be eligible for the exemption. The test is derived from

Niagara Mohawk Power Corp. v. Wanamaker, 286 A.D. 446 (N.Y. 1955). The *Niagara* court found that material handling equipment, including equipment used for both coal handling and ash dumping, was an integral part of a steam electric generating plant and determined that this equipment was as essential to the plant's production as the actual generator itself. The material handling equipment was necessary to the functioning of the plant as a whole. Without it, a serious breakdown in operation would quickly stop or impair the taxpayer's manufacturing process, such that one part could not operate without the other. The *Niagara* court held that directness of the activity is not the test. Instead, the test is whether all parts of the plant contribute, continuously and vitally, to production and whether they are all integrated and harmonized.

In adhering to the restrictive production line theory, the Department's audit of McEntire held that the machinery and equipment used before the cutting process and the equipment used to move the fresh produce into the manufacturing process inside the cutting room were not exempt. There is no dispute that most of the machinery used directly in the cutting and processing that occurs inside of the cutting room/high-care area were exempt.

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, Petitioner 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.[9] In essence, without many of these processes,

[9] While the actual term "agricultural packaging" may not have been included in the Machine Exemption during the Audit Period, the plain language of the statutory definition of the term is evidence that the legislature intended this manufacturing process to be much broader than the production line definition espoused by the Department. The statutory definition of "agricultural packaging" includes the transportation and warehousing of the product before and after packaging. The "coordinated system" of preparation, as termed by the legislature, includes the receipt of the raw produce, its storage in the temperature-controlled climate of the plant, the sorting, preparing, washing, inspection and cutting of the produce, and the packaging, labeling, and storage of the finished product before ultimate delivery to McEntire's customers. Moreover, machines involved in the "enclosing or protecting or preserving" of agricultural products also fall within the definition of agricultural processing as defined by the legislature. S.C. Code Ann. § 12-6-3360(M)(16) (emphasis added). Thus, many of the items at issue in this case clearly fall within the Machine Exemption as it stands today with the inclusion of agricultural packaging.

Petitioner would be unable to produce any type of marketable product and would likely be shut down by State and federal agencies in charge of regulating the fresh produce industry.

Having concluded that McEntire's manufacturing operations consist of more than the simple production line manufacturing occurring in the cutting room as determined by the Department, the Court must determine whether the supplies at issue fall within the definition of "machine" so as to qualify as exempt under § 12-36-2120(17). Some of the items at issue fall within the general sales and use tax portion of the Machine Exemption as integral and necessary to the manufacturing process by virtue of being machines substantially used in the facility on an ongoing and continuous basis while serving as an essential and indispensable component part of the manufacturing process.

The Cut Wheel and Disc Maintenance Tools (13) are used on the cutter, an exempt machine, to maintain the integrity of the machine on an ongoing basis and to repair it when needed. Because these items are used on an ongoing and continuous basis to maintain an exempt machine, they qualify as exempt under the Machine Exemption and as exempt maintenance machines under Reg. 117-302.5(B)(6).

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

Reg. 117-302.5(B)(4) provides that material handling machinery and their parts are subject to the tax up until the point where the materials go into process and that the machine feeding the first processing machine is exempt. Material handling machinery used for transporting in-process material from one process stage to another also falls within the exemption. *Id.* Testimony revealed that 90% of Petitioner's forklifts are used in the climate-controlled areas of the plant to move 800-2,000 lb. pallets of produce into and out of the rack system and onto the conveyer belt that feeds into 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 a processer of fresh produce, Petitioner 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.

Petitioner also rents ethylene generators to facilitate the tomato ripening process. Because tomato crops are variable, 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.

Additionally, the Court finds that other items fall within the Machine Exemption because they are integral and necessary to the manufacturing process by virtue of maintaining the integrity and safety of the finished food product by preventing its contamination. Outside of the considerations of the Pollution Control Exemption of Clause B involving air, noise, or water pollution (to be

discussed *infra)*, State and federal agencies heavily regulate the fresh produce industry and dictate that certain requirements be met so that a product can safely enter the consumer marketplace. As such, while many of the supplies at issue may not be used directly in the production line, they are integral and necessary to the processing of fresh produce under the Integrated Plant Concept and are integrated and harmonized as continuous and vital elements of production within the McEntire plant.

Ever present in Petitioner's manufacturing process is the aspect of safety in producing a noncontaminated product, which is the subject of federal guidelines. 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 less than or equal to 41 degrees. The Food Safety Modernization Act of 2011, Section 117.93, further mandates 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." (emphasis added). Additionally, 21 C.F.R. § 110.80(b), under the heading "Manufacturing Operations," provides:

> (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...* (emphasis added).

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 plant 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).

Specifically, testimony from Petitioner's witnesses showed that **Stacking Containers (6), Warehouse Racks (7), Pallet Flow Brakes (8),** and the **Blower Fan (11)** all work to maintain the proper temperature within the plant and also to hold and transport the produce before and after it is cut so that it cannot become adulterated or spoiled during processing, as outlined above in the FDA's Guide to Minimize Microbial Food Safety Hazards of Fresh-cut Fruits and Vegetables and in 21 C.F.R. § 110.80(b). Absent the climate and environmental controls provided by these machines, temperature inside of the plant and the temperature and integrity of the produce itself could not be maintained, resulting in an increased likelihood of contamination and/or adulteration. Without these machines, contamination occurs and McEntire would effectively have no product, thus making them integral and necessary to the manufacturing process under the general sales and use tax provision of the Machine Exemption. Additionally, in order to comply with the regulations governing the processing of fresh produce, these machines are integral and necessary to Petitioner's manufacturing process. As such, the Court finds that these items fall within the Machine Exemption.

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

Coveralls, Eyewear, Gloves, Aprons, and Hairnets (21), collectively referred to as "protective clothing" in this case, are integral and necessary to the manufacturing of fresh produce in two substantial ways. First, protective clothing substitutes for the employee's street clothing so that the employee does not bring pollution into the facility in the form of harmful microbes that can carry foodborne illnesses like Salmonella, E. coli, and Listeria. Second, when pollution occurs from the contaminated produce brought into the facility and spreads through cross-contamination into the water and onto the equipment and other surfaces that come into contact with harmful microbes,

protective clothing minimizes the spread of contamination onto a broader range of food. Additionally, protective clothing is mandated by the FDA and SCDA and, without it, operations at Petitioner's plant would cease. Thus, protective clothing is integral to the manufacture of fresh produce and necessary, by order of regulatory agencies, to produce a safe and unadulterated product and to, ultimately, remain in business. In that context, the Court finds that protective clothing, to include coveralls, eyewear, gloves, aprons, and hairnets, falls within the Machine Exemption under the Integrated Plant Concept within the scope of Petitioner's manufacture of fresh produce. Additionally, the Court notes that the protective clothing in this case is used for health and safety reasons to protect the product, the consumer, and the general public from foodborne illness. The clothing and gear at issue in this case is not used to protect the employee from hazards incurred during the manufacturing process.

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. The other tank recirculates some of this captured cleaning water and purifies it to be used again in a later stage 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. As such, Petitioner'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 within the Machine Exemption.

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

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

In addition, **Squeegees (15)** used in the cutting room/high-care area to move debris and water off of the floor and into the drainage system also help to sanitize the area and remove the debris that can become a harborage point for bacteria and pathogens. Carter McEntire testified that the squeegees used in the high-care area are kept separate from the other squeegees that are used interchangeably in the administrative/office area and other areas of the plant for cleaning purposes. However, from the testimony provided, the Court cannot determine the purposes of the squeegees found outside of the cutting room/high-care area so as to assess their role in the overall manufacturing process. Therefore, the Court concludes that only the squeegees used and kept inside the cutting room/high-care area should fall within the Machine Exemption as integral and necessary to the manufacturing process to maintain sanitation. However, because no evidence was presented as to the percentage of squeegees used in the high-care area so as to ascertain whether the 1/3 substantial use threshold is me,t and because the burden to prove entitlement to the exemption lies with Petitioner, the Court must conclude that squeegees do not qualify as exempt items for purposes of this Audit Period.

Also, from the testimony provided, the Court cannot determine that **Brooms (14)** used throughout the low-care areas of the plant and in the administrative/office areas are so integral and necessary to the manufacturing process so as to fall within the Machine Exemption. Petitioner testified generally that the brooms used in the actual plant, the only ones for which Petitioner seeks an

exemption, are used for sanitation purposes to sweep the floors of the plant or to knock debris off of the storage racks in order to clean the low-care areas of the plant. However, no evidence was provided as to what percentage of the brooms are used in the plant and what percentage are used in the administrative/office areas of the McEntire facility. Moreover, no testimony was given that the brooms are used on an ongoing and continuous basis within the plant areas of the facility. Accordingly, the Court cannot conclude that Petitioner adequately demonstrated that brooms should fall within the parameters of the Machine Exemption for purposes of the Audit Period.

While there was testimony that **White Boards in Production Offices (4)** are used to track production, unlike the machines necessary to track the produce for health and safety regulations, the purpose of this tracking is to monitor and reward the progress of individual employees. Though this item may be integral to McEntire in the context of its operations, the Court finds that this item is not integral and necessary to the manufacturing of fresh produce in general and, therefore, does not fall within the Machine Exemption.

Finally, **Warning Signs and Stickers (5)** found throughout the plant serve to instruct and remind employees of certain safety procedures. While these signs and stickers may be helpful to McEntire and its employees and may help to produce a safer product, they are not integral and necessary to the manufacturing of fresh produce. Without them, Petitioner may suffer an inconvenience and more human error may occur, but production would continue. Therefore, the Court finds that the white boards in production offices and the warning signs and stickers found in both the plant and administrative areas of McEntire do not fall within the Machine Exemption.

B. The Pollution Control Exemption (S.C. Code Ann. § 12-36-2120(17))

Petitioner also asserts that the Department erred in disallowing protective clothing (**Coveralls, Eyewear, Gloves, Aprons, and Hairnets (21)**) under the second clause of the Machine Exemption. The second clause of the Machine Exemption, referred to as the "Pollution Control Exemption" or "Clause B," 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:

> 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.

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, as a manufacturer of fresh produce, Petitioner is exempt from taxes on machines which are necessary to comply with the order of a State or federal agency to prevent or abate pollution that is precipitated by other machines used in the manufacturing of fresh produce. To prove that protective clothing should fall within the Pollution Control Exemption of § 12-36-2120(17), Petitioner 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 State or federal agency requires that the pollution be prevented or abated; and, (3) that the protective clothing is used to prevent or abate the pollution.

1. The operation of at least one machine used in the manufacturing process causes or threatens to cause pollution of air or water.

Petitioner's witnesses went into great detail to describe the manufacturing process. As previously discussed, when the fresh produce is picked and enters the trucks for transport, it may have a contaminant that causes foodborne illness (chiefly E. coli, Listeria, or Salmonella) either inside or on the surface of the produce. 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 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, 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. 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 by Petitioner's expert witness in this case as "cross-contamination."

With respect to the machines used in the manufacturing process, Dr. Gombas testified that is it possible for equipment to serve as a harbor for pathogenic bacteria, which can then spread through the facility if not controlled. Other witnesses for McEntire also testified as to the specific "dress-down" routine required of employees when exiting the high-care area to ensure that the pathogens that may have been transferred onto the employees through cross-contamination are not able to leave that area and spread into other parts of the plant and to the outside. By requiring full dress-down when exiting the high-care area, Petitioner is able to contain the pollutants that may have been released by various machines operating throughout the manufacturing process. As such, the Court finds that Petitioner has established that the protective clothing at issue is used to prevent or abate "pollution" caused by machines through both direct contact with harmful microbes and through cross-contamination.

Since Petitioner has demonstrated that machines used in the manufacturing process cause "pollution," it must also establish that the pollution prevented is that of air, water, or noise. The major crux of the Department's exclusion of protective clothing as an exempt item under the Pollution Control Exemption is that food contamination is, first, not "pollution" and, second, not pollution of air, water, or noise so as to qualify under the exemption.

Although S.C. Code Ann. § 12-36-2120 does not contain a definition of "pollution," there is caselaw throughout the United States which categorizes contamination of food as pollution with respect to commercial insurance policies where the term "pollutant" is specifically defined in the

pollution exclusion sections that are common to such policies. *See 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, therefore, excluded from coverage under the pollution exclusion of an insurance policy).

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). Landshire, a food preparer, delivered sandwiches containing Listeria to a client who, upon discovery of the contamination, returned the polluted food to the company. *Id.* at 778, 676 N.W.2d at 529. After determining that the food contamination occurred on a meat slicer at its facility, Landshire "submitted claims for loss of income, loss of product, sanitizing expenses, and costs related to investigating the source of the bacteria" to its insurance company. *Id.* at 779, 676 N.W.2d at 530. Citing the policy's pollution exclusion, Landshire's insurer refused to pay for loss or damage caused directly or indirectly by the "release or escape of 'pollutants' unless the discharge, dispersal, seepage, migration, release or escape [was] itself caused by any of the 'specified causes of loss' . ." *Id.* at 782, 676 N.W.2d at 531. 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 the 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 settle that dispute, the *Landshire* court looked to *Richland Valley Products, Inc. v. St. Paul Fire & Cas. Co.*, which determined that "contamination" connotes a condition of impurity resulting from mixture or contact with a foreign substance, a definition the court found to be consistent with the common understanding as well as dictionary definitions of the term. 201 Wis.2d 161, 548 N. W.2d 127 (Ct. App. 1996). Finding that the term "contaminant" in the insurance contract was not susceptible to multiple interpretations, the *Landshire* court ultimately held that the food contamination caused by Listeria was a pollutant and, as such, was excludable from the claim under the terms of the insurance policy and the policy's pollution exclusion. *Id.* 269 Wis.2d at 785, 676 N.W.2d at 533.

Although not in the context of food safety, in also determining that contamination can be quantified as pollution, South Carolina caselaw follows much the same direction as the caselaw of the courts discussed above. 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.* 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.

While the word "pollution" is not defined in §12-36-2120(17), "contamination" fits within the ordinary and dictionary definitions of pollution in the context of food. "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."[10] Other dictionary definitions are similar. For example, Wikipedia defines "pollution" as "the introduction of contaminants into the natural environment that cause adverse change."[11] 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."[12]

The major thrust of the Department Determination was that food contamination and the results of such contamination are not "pollution." Corey Smith, the Department's policy witness, testified that he defines pollution as something that causes a health hazard or has a negative effect on the environment. Although he agreed that foodborne illnesses are caused by contamination and that such contamination does produce harmful effects like illnesses, he does not find pollution and contamination to be synonymous. The Department auditor testified that she did not know what the

[10] Black's Law Dictionary, http://thelawdictionary.org/pollution.
[11] Wikipedia, http://en.wikipedia.org/wiki/Pollution.
[12] Dictionary.com, http://www.dictionary.com/browse/pollution.

definition of "pollution" was under the statute, and did not know enough about E. coli, Listeria, or Salmonella to determine whether they constituted "pollution."[13]

On the other hand, Dr. Gombas, McEntire's expert witness, 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 synonymous and are used interchangeably throughout the food manufacturing industry. Dr. Gombas also testified 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 (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.

In addition to Dr. Gombas' expert opinion, to ascertain "pollution" within the scope of fresh food production, it is helpful to consider not only the harmful microbes that contaminate food and cause pollution, but also the host or carrier of those microbes. The microbes associated with the foodborne illnesses at issue in this case 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, clothing, and bodies of employees. Then, through the manufacturing processes occurring inside the plant, fecal pollution can be spread onto the finished product as well as into the air and water. 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.[14] (emphasis added).

[13] This was the auditor's first audit of a fresh food manufacturing facility.

[14] 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.

Additionally, according to the World Health Organization, 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.[15] Based on the uncontroverted testimony of Dr. Gombas, caselaw that encompasses contamination under the umbrella of pollution, and the various definitions of "pollution" in the context of food safety and foodborne illness, the Court finds that, in this case, contamination of produce equates to pollution and that measures used by Petitioner to prevent contamination are the same as measures used to "prevent or abate pollution."

Furthermore, water is the means by which McEntire is able to deliver sanitizing agents directly onto the produce and throughout the facility to maintain the required sanitation levels. In fact, McEntire uses approximately three-hundred thousand (300,000) gallons of water per day at its facility. As previously discussed, Petitioner's manufacturing process results in significant spray-back from cutters that chop the produce, sprayers and wash flumes that wash the produce, and blowers and spinners that dry the produce. While some of this water is aerosolized and dispersed into the air and onto the surfaces exposed inside of the plant, the remainder of that water flushes into the drainage system designed to capture the runoff. Approximately half of that runoff water is recycled by Petitioner and heavily treated so that it can be reused in other phases of the manufacturing process. The other half of the runoff water makes its way from the floor of the McEntire plant to the local sewage system. If the harmful pathogens on the produce and other surfaces, including the protective clothing worn by employees, are not properly contained, they can contaminate the water supply. Since it is responsible for discharging at least one-hundred fifty thousand (150,000) gallons of water into the municipal sewer system daily, McEntire's use of protective clothing and other safety materials directly abates pollution which could contaminate the air inside of the facility and the water supply at both the plant and in the municipal system and/or rivers. As such, the Court finds that the pollution Petitioner seeks to prevent or abate in this case is that of air and water.

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[15] World Health Organization, Food Safety-Key Facts (2017), http://www.who.int/news-room/fact-sheets/detail/food-safety.

2. The use of protective clothing is necessary in order to comply with orders of federal and State agencies to prevent or abate pollution.

In analyzing the Pollution Control Exemption of § 12-36-2120(17), the ALC (in a decision not challenged by the Department) has previously established that an administrative order, including agency regulations issued by an agency of the United States or an agency of South Carolina charged with the duty of preventing or abating pollution, satisfies the requirements of the statute. *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"); *see also* S.C. Code Ann. Regs. 117-302.6 (2012).

Under the Department of Health and Human Services, the FDA is the federal agency primarily charged with the duty of preventing or abating pollution in the context of food production. *See* 21 C.F.R. § 117.3 (defining pathogens that result in foodborne illness caused by contamination during the manufacturing, processing, packing, or holding of food by manufacturers); *see also* Pet. Ex. 25, p. 8:3-6; 34:23-25; 36:18-21 (Dr. Gombas deposition). By first establishing and thereafter continuing to update the Current Good Manufacturing Practices or "CGMP Regulations," the FDA sets out the requirements that food processing facilities such as Petitioner's must adhere to in order to safely process food for consumption in the Unites States. Manufacturers like McEntire are 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 that 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. (Pet. Ex. 25, p. 36:7-10).

i. FDA CGMP 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.

21 C.F.R. § 117.10(b), also describes the measures and precautions that manufacturers such as McEntire 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, other relevant regulations found in 21 C.F.R. § 117.80 state the following:

> (a)(1) [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. (emphasis added).

Based on the foregoing, the Court finds that under order of the FDA, an agency of the United States, Petitioner is required to implement specific measures, including the use of protective clothing, during the manufacture of fresh produce in order to prevent or abate pollution.

ii. State Statutes and Regulations

According to the South Carolina Food and Cosmetic Act, specifically S.C. Code Ann. § 39-25-180(H), the State has adopted Parts 110 and 117 of the above-cited federal regulations stating:

> 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.

Thus, not only has South Carolina expressly adopted the CGMP by statute, the foregoing also establishes that the Commissioner of the South Carolina Department of Agriculture, a State agency that regulates Petitioner, maintains the authority to promulgate regulations necessary or convenient to carry out the purposes of § 39-25-30 *et. seq.*, entitled "Adulterated Food and

Cosmetics." Accordingly, the Court finds that under the orders of both federal and State agencies, the use of protective clothing is a measure required to prevent or abate pollution in the manufacture of fresh produce.

3. Protective clothing is used to prevent or abate pollution.

Having already concluded that protective clothing does fall within the parameters of Clause A of the Machine Exemption as a "machine" that is "necessary and integral" to Petitioner's manufacturing process, the Court also concludes that in the context of Clause B, the Pollution Control Exemption, protective clothing is used to prevent or abate pollution.

The protective clothing at issue is vital to Petitioner's ability to control and contain pathogens that cause foodborne illnesses. Dr. Gombas identified the following functions related to pollution control or prevention that protective clothing serves: (1) to substitute for the employee's street clothing so that the employee is not bringing the pollution into the facility or contacting the produce with that pollution; (2) within the facility, as contamination may occur from the produce itself, the water, or the equipment and other exposed surfaces through cross-contamination, to minimize the opportunity to spread the contamination on to a broader range of food. (*See* Trial Tr., p. 231:21-232:1. Moreover, protective clothing serves as a barrier to prevent the spread or release of pollution between the high-care area – where pollutants are exposed and dispersed into the air and water and accumulate on employee's protective clothing – and the outside.

The use of protective clothing, climate control, sanitation procedures, and other precautions during the manufacturing process help to ensure that pollution present in the facility from either the employees or the produce itself does not spread during the manufacturing process through cross-contamination.

Of interest is the Department's PLR # 95-8 which notes:

> 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).

Based on the foregoing, the Court finds that protective clothing is used to prevent or abate pollution inside of Petitioner's facility and in the manufactured product in order to protect the consumer and public from harm and is so used to comply with the requirements of the FDA, a United States agency, along with the SCDA, an agency of the State of South Carolina.

C. Protective Clothing for Class 100 Facility (S.C. Code Ann. § 12-36-2120(54))

Finally, Petitioner asserts that the Department erred in disallowing the purchase of protective clothing to fall within the exemption provided in S.C. Code Ann. § 12-36-2120(54). Section 12-36-2120(54), referred to as the "Clean Room Exemption," 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."[16] "Class 100" describes the number and size of particles permitted per volume of air in "cleanroom" environments. Under the Federal Standard, Class 100 is equivalent to ISO 5 which permits 100 particles of 0.5 microns or greater per cubic foot.

The Department denied the exemption based upon the Department Determination and the testimony at trial for two reasons: (1) the Petitioner did not establish that it met the Class 100 Clean Room requirements; and, (2) that Petitioner did not establish that protective clothing was required to work in the Clean Room.

Carter McEntire testified that, with the help of food safety engineers, the facility was designed so that the high-care area would operate as a Class 100 Clean Room environment or better in accordance with the requirements under State and federal law. (Trial Tr., p. 60:1-13). "The FDA laws require us to maintain a certain level of cleanliness, and those levels of cleanliness meet or exceed Clean 100 standards." (Trial Tr., p. 121:21-25). McEntire also testified that Petitioner is audited by independent organizations, like the British Retail Consortium (BRC), to ensure that the

[16] The parties both acknowledge that Federal Standard 209E was cancelled in 2001 and was replaced by International Standards Organization (ISO) 14644-1. Although the South Carolina General Assembly has not changed the language of the statute, the parties agreed that in order to bring itself clearly within the conditions imposed by the Clean Room Exemption, Petitioner must prove it maintains a Class 100 or better clean room as defined under ISO 14644-1. For purposes of this Order, the Court will use the term "Federal Standard" when referring to ISO 14644-1, formerly Federal Standard 209E.

standard of 0.1 microns, a standard higher than the required 0.5 microns of a Class 100 Clean Room, are met. (Trial Tr., p. 125:12-24).

To prove it met the 0.1 microns standard, Petitioner offered Exhibits 9 and 11 into evidence in addition to the testimony provided by Mr. McEntire. Exhibit 9 consists of several pages purporting to show that air filters in the facility had been properly replaced every few months to ensure that the 0.1 micron standard had been maintained. However, all of the replacement certifications contained in Exhibit 9 are dated in 2018, three years after the conclusion of the Audit Period. Exhibit 11 is the annual BRC audit report of the facility that was concluded on March 12, 2015. While this report does contain statements that Petitioner maintained proper air filtration standards, there are no specific or numeric micron standards mentioned. Based on the time of the Audit Period and the ambiguity contained in these reports, the Court cannot conclude that either of these exhibits provide sufficient evidence that Petitioner can meet the burden of proof to show itself clearly within the Clean Room Exemption for the Audit Period.

Moreover, Petitioner must also establish that protective clothing is required in a Class 100 Clean Room environment. While Petitioner did establish that protective clothing is required by the FDA in a food processing plant, and one may assume that protective clothing would also be required in a Class 100 or better Clean Room environment, the Court cannot make such an assumption based on the limited amount of testimony provided in this case on this matter.

The Court does take note that the auditor for the Department did not know whether protective clothing was required to maintain a Class 100 environment. In addition, she was under the impression that the entire facility had to meet the Class 100 requirement, not just the high-care area where the protective clothing at issue was used. Finally, while it may be incumbent upon the taxpayer to show it maintains a "certified" Class 100 Clean Room in order to claim the exemption, none of the witnesses for the Department were able to articulate or clarify what would constitute this "certification" so that a taxpayer could claim the exemption.

Because of these ambiguities, and because the burden of proof rests with Petitioner, the Court cannot conclude that Petitioner's purchases of protective clothing during the Audit Period should be exempt from tax based on the Class 100 or better Clean Room Exemption.

ORDER

Based on the foregoing, it is the Order of this Court that the following items be exempt from sales and use tax pursuant to the Machine Exemption found in S.C. Code Ann. § 12-36-2120(17): Cut Wheel and Disc Maintenance Tools (13); Maintenance Tools (12); Forklift Rental, Forklift Batteries, Forklift Parts, and Forklift Repair Parts (10); Hand Trucks, Pallet Jacks, and Oil Lubricant Used Therein (9); Generator Rental (20); Stacking Containers (6); Warehouse Racks (7); Pallet Flow Brakes (8); Blower Fan (11); Bar Code Scanners (1); Black Ink Aerosol Cans (2); Mobile Computer Stands (3); Coveralls, Eyewear, Gloves, Aprons, and Hairnets (21); Storage Water Tanks (18); Cleaning Machines (19); Floor Treatment Chemicals (17); and Floor Drain Covers (16). It is also the Order of this Court that Coveralls, Eyewear, Gloves, Aprons, and Hairnets (21), collectively referred to as "protective clothing," be exempt from tax pursuant to the Pollution Control Exemption found in Clause B of S.C. Code Ann. § 12-36-2120(17).

Finally, by agreement of the parties in this matter, because the Court has determined that some of the items at issue are subject to tax while other items are exempt, this matter is hereby remanded to the Department to calculate the tax and interest due on the items deemed taxable by the Court. Any further amounts owed by Petitioner shall be remitted to the Department upon thirty (30) days notice of the balance to Petitioner.

AND IT IS SO ORDERED.

H. W. Funderburk, Jr.
Administrative Law Judge

September 6, 2019
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, Emily B. Howard, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

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