THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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

CASE NO. 17-ALJ-17-0060-CC
APPELLATE CASE NO. 2019-001933

McEntire Produce, Inc., ...Respondent,

v.

South Carolina Department of Revenue, ...Appellant.

FINAL BRIEF OF APPELLANT

Elisabeth W. Shields, Esquire (Bar No. 100784)
Counsel for Litigation
Jason P. Luther, Esquire (Bar No. 78021)
General Counsel for Litigation
P.O. Box 12265
Columbia, SC 29211
803-898-5576 (Tel.)
803-896-0171 (Fax)
Elisabeth.Shields@dor.sc.gov
CourtOrders@dor.sc.gov

Attorneys for Appellant
South Carolina Department of Revenue

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STATEMENT OF THE CASE

This matter came before the Administrative Law Court (ALC) in accordance with the Administrative Procedures Act, S.C. Code Ann. §§ 1-23-310 et seq. (2005 & Supp. 2015), for a contested case hearing. McEntire Produce, Inc., ("Respondent") filed a request for a contested case hearing with the ALC on March 7, 2017, in case number 17-ALJ-17-0060-CC to challenge a Department Determination issued by the South Carolina Department of Revenue ("Department" or "Appellant") on February 7, 2017. (R. pp. 736-745, 1177; Req. for Contested Case Hr'g; Dep't Determination pp. 1-10). In the Department Determination, the Department concluded that the Respondent's purchases of certain supplies and protective clothing were subject to use tax for tax periods October 1, 2012 through September 30, 2015 (the "Audit Period") and were not exempt from use tax under S.C. Code Ann. § 12-36-2120(17) (Supp. 2018). (R. pp. 736-745; Dep't Determination pp. 1-10).

On November 14 and 15, 2018, the ALC held a contested case hearing. Thereafter, the ALC issued its Final Order on September 6, 2019, and determined that the majority of the items, including those items identified as protective clothing, for which the Respondent sought exemptions were exempt from use tax under § 12-36-2120(17), hereinafter referred to as the "Machine Exemption." (R. p. 42; Order p. 42) (The ALC's Final Order will be referred to, hereinafter, as the "Order"). The ALC further found that the items designated as protective clothing were also exempt from use tax under a separate provision in § 12-36-2120(17) commonly referred to as the "Pollution Control Machine Exemption." (R. p. 42; Order p. 42). Because the ALC held certain items taxable, the ALC remanded the matter to the Department, instructing the Department to calculate the tax and interest due on the items the ALC deemed taxable. (R. p. 42; Order p. 42).

On September 19, 2019, the Department filed a Motion for Reconsideration, and/or to Alter or Amend. (R. pp. 47-71; Mot. to Recons. pp. 1-25). The Respondent did not file a response to the Department's Motion. (R. p. 44-45; Order Denying Mot. to Recons.). The ALC issued an order on October 16, 2019, denying the Department's Motion for Reconsideration. (R. pp. 44-45; Order Denying Mot. to Recons.). The Department appealed the Order and the Order Denying Respondent's Motion to Reconsider, Alter or Amend on November 20, 2019.[1] (See Appellant's Notice of Appeal).

STATEMENT OF FACTS

A. The Respondent's Operations.

The Respondent operates a fresh produce processing facility in Columbia, South Carolina, for processing lettuce, onions, cabbage, tomatoes, and other vegetables (hereinafter "produce") for sale. (R. pp. 2, 6; Order pp. 2, 6). As a fresh produce processor, the Respondent is regulated by the Food and Drug Administration ("FDA"), the South Carolina Department of Agriculture ("SCDA"), and the South Carolina Department of Health and Environmental Control ("DHEC"). (R. p. 6; Order p. 6). The Respondent's produce processing includes washing, cutting, mixing, and packaging the fresh produce at the facility. (R. p. 2; Order p. 2).

The Respondent purchases raw produce from third-party growers. (R. p. 5; Order p. 5). Once the produce is harvested from the growers' locations, the Respondent transports the produce to its facility via climate-controlled trucks, maintaining the temperature inside the trucks between 33 and 40 degrees. (R. p. 6; Order p. 6). Once the produce arrives at the Respondent's facility,

[1]While the ALC filed its Order Denying Respondent's Motion to Reconsider, Alter or Amend on October 16, 2019, the Department did not receive it until October 22, 2019. Therefore, pursuant to Rule 203(b)(6), SCACR, the Department timely filed its Notice of Appeal.

the produce is unloaded into one of six raw coolers, which the Respondent also maintains at a temperature between 33 and 40 degrees. (R. p. 6; Order p. 6).

The majority of the plant is divided into two areas: the "low-care" areas and the "high-care" areas. (R. p. 6, 500-502; Order p. 6; Respondent's Exhibit 8). The low-care areas involve the ripening, sorting, defect removal, repackaging, and storage of produce. (R. p. 6; Order p. 6). The low-care areas are generally reserved for either whole produce or produce that the Respondent has cut and packaged and is awaiting shipment out of the facility. (R. p. 6; Order p. 6). Areas of the Respondent's plant designated as low-care areas include the receiving area, the raw coolers, the tomato coolers, the raw feed area, the tomato repack room, the pack-out room, the palletizing room, the finished goods storage rooms, and the shipping area. (R. p. 6; Order p. 6). The Respondent does not cut any produce within the low-care areas. (R. p. 6; Order p. 6).

The Respondent only cuts produce into smaller pieces and packages the cut produce in the high-care area. (R. p. 6; Order p. 6). When the Respondent is ready to cut raw produce, it moves the produce to the raw feed area and then into the cutting room, which is within the high-care area. (R. p. 6; Order p. 6). There, employees sort, inspect, and trim the produce before it moves along the conveyor belt down to an industrial cutter where the produce is cut and chopped according to each customer's specifications. (R. pp. 6-7; Order pp. 6-7). The cutter then discharges the produce into a washing flume, which is a stainless-steel bath where the produce is rinsed and sanitized. (R. p. 7; Order p. 7). Once the produce is washed, it moves to the de-watering mechanism, which is essentially an industrial-sized salad spinner. (R. p. 7; Order p. 7).

After the produce is cut, washed, and dried in the high-care area, it is then metered onto a conveyor system where it is weighed and bagged. (R. p. 8; Order p. 8). Each bag is sealed and

run through a metal detector before it is moved into low-care areas to be boxed, labeled, palletized, and stored until shipped to customers. (R. p. 8; Order p. 8).

At all times, not just during processing, the produce must remain at a temperature between 33 and 40 degrees in accordance with contracts between the Respondent and its customers as well as in accordance with regulations by the FDA, SCDA, and DHEC. (R. p. 8; Order p. 8). Any violations of these contracts or regulations by the Respondent could result in the Respondent's customers refusing the products, as well as potential reprimands, fines, or facility closure by the regulatory agencies. (R. p. 8; Order p. 8).

B. <u>The Supplies at Issue</u>.

The parties stipulated to the supplies at issue in this case. (R. pp. 4-5; Order pp. 4-5). Of those items, the ALC determined that several of these items are exempt from use tax under the Machine Exemption "by virtue of being machines substantially used in the facility on an ongoing and continuous basis while serving as an essential and indispensable component part of the manufacturing process." (R. p. 23; Order p. 23). Those items include: cut wheel and disc maintenance tools; general maintenance tools; conveyances, such as forklift rentals and their various batteries and parts, as well as hand trucks, pallet jacks, and oils and lubricants used therein; and rented ethylene generators. (R. pp. 23-24; Order pp. 23-24).

The ALC further determined that several other items in dispute are exempt from use tax under the Machine Exemption "because they are integral and necessary to the manufacturing process by virtue of maintaining the integrity and safety of the finished food product by preventing its contamination." (R. p. 24; Order p. 24). Those items include: items for storage and temperature control, such as stacking containers, warehouse racks, pallet flow brakes, and blower fans; recordkeeping items, such as bar code scanners, black ink aerosol cans, and mobile computer

stands; protective clothing, such as coveralls, eyewear, gloves, aprons, and hairnets; storage water tanks; cleaning machines (foamers) and floor treatment chemicals; and floor drain covers. (R. pp. 24-28; Order pp. 24-28).[2]

C. <u>The Department's Sales and Use Tax Audit and Assessment</u>.

On September 22, 2015, the Department initiated an audit of the Respondent's sales and use tax returns for the tax periods within the Audit Period. (R. p. 2; Order p. 2). On July 19, 2016, after reviewing the Respondent's purchase invoices and discussing questionable items with the Respondent, the Department issued a Proposed Assessment, finding that the supplies at issue were subject to use taxes, which the Respondent had not paid. (R. pp. 737-738; Dep't Determination pp. 2-3).

The Respondent timely protested the Proposed Assessment on August 1, 2016. (R. p. 738; Dep't Determination p. 3). In its protest letter, the Respondent argued that its purchases of protective clothing were exempt from use tax based on Federal safety standards. (R. p. 738; Dep't Determination p. 3). The Respondent further argued that, because the manufacturing process begins when the Respondent receives the raw produce and ends when the Respondent loads the finished product on trucks for shipment, all of the supplies at issue are used in the manufacturing

[2]Other items in dispute included towels, plastic shelves for the maintenance parts room, drug test kits, and a utility cart for maintenance tools. (R. pp. 4-5; Order pp. 4-5). However, the ALC noted that the Respondent did not offer any testimony regarding the purpose of these items in its facility. (R. p. 19; Order p. 19). As such, the ALC determined that the Respondent failed to meet its burden of proof relating to these items and upheld the Department's Determination that these items are taxable. (R. p. 19; Order p. 19).

Also among the items in dispute at the hearing were brooms, squeegees, white boards in production offices, and warning signs and stickers. (R. pp. 4-5; Order pp. 4-5). For reasons more detailed in the ALC's Order, the ALC correctly determined that these items are not integral and necessary to the manufacturing of fresh produce and, thus, did not qualify for the Machine Exemption. (R. pp. 28-29; Order pp. 28-29).

process and, thus, are exempt. (R. p. 738; Dep't Determination p. 3).

On February 7, 2017, the Department issued its Determination finding that the Respondent's purchases during the Audit Period of the supplies at issue, including protective clothing, were subject to use tax. (R. pp. 736-745; Dep't Determination pp. 1-10). The Respondent timely requested a contested case hearing with the ALC. (R. p. 1; Order p. 1). Prior to the hearing in this matter, the parties resolved the issues related to the Respondent's purchases of electricity and all other supplies except the supplies listed under "Exhibit A" of the parties' Stipulations of Facts, which the ALC incorporated in its Order. (R. pp. 4-5; Order pp. 4-5).

STANDARD OF REVIEW

In an appeal from the decision odministrative agency, the Administrative Procedures Act provides the appropriate standard of review. Olson v. S.C. Dep't of Health & Envtl. Control, 379 S.C. 57, 63, 663 S.E.2d 497, 500-501 (Ct. App. 2008); Turner v. S.C. Dep't of Health & Envtl. Control, 377 S.C. 540, 544, 661 S.E.2d 118, 120 (Ct. App. 2008); Clark v. Aiken County Gov't, 366 S.C. 102, 107, 620 S.E.2d 99, 101 (Ct. App. 2005). S.C. Code Ann. § 1-23-610(D) (Supp. 2017) provides the applicable standard:

> (D) The review of the administrative law judge's order must be confined to the record. The court may not substitute its judgment for the judgment of the administrative law judge as to the weight of the evidence on questions of fact. The court of appeals may affirm the decision or remand the case for further proceedings; or, it may reverse or modify the decision if the substantive rights of the petitioner have been prejudiced because the finding, conclusion, or decision is:
>
> (a) in violation of constitutional or statutory provisions;
> (b) in excess of the statutory authority of the agency;
> (c) made upon unlawful procedure;
> (d) affected by other error of law;
> (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
> (f) arbitrary or capricious or characterized by abuse of

discretion or clearly unwarranted exercise of discretion.

The decision by the ALC in this case is "affected by [an] error of law" and is in violation of statutory and regulatory provisions. Resolution of the issues in this case depends upon the rules of statutory construction and when construing a statute, the cardinal rule is to ascertain the intent of the legislature. Georgia-Carolina Bail Bonds, Inc. v. County of Aiken, 354 S.C. 18, 22, 579 S.E.2d 334, 336 (Ct. App. 2003). "All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute." Id. at 23, 579 S.E.2d at 336. The words of the statute "must be given their plain and ordinary meaning without resort[ing] to subtle or forced construction to limit or expand [the statute's] operation." Hitachi Data Sys. Corp. v. Leatherman, 309 S.C. 174, 178, 420 S.E.2d 843, 846 (1992) (internal citations omitted).

Furthermore, "[t]he language of a tax exemption statute must be given its plain, ordinary meaning and must be strictly construed *against* the claimed exemption." CareAlliance Health Services v. S.C. Dep't of Revenue, 416 S.C. 484, 488, 787 S.E.2d 475, 477 (2016) (citing TNS Mills, Inc. v. S.C. Dep't of Revenue, 331 S.C. 611, 620, 503 S.E.2d 471, 476 (1998)) (emphasis added). "In construing statutory language, the statute must be read as a whole, and sections which are part of the same general statutory law must be construed together and each one given effect." TNS Mills at 620, 503 S.E.2d at 476. Further, "[t]he Court must presume the legislature did not intend a futile act, but rather intended its statutes to accomplish something." Id.

Finally, "[t]he construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons." Brown v. S.C. Dep't of Health & Envtl. Control, 348 S.C. 507, 515, 560 S.E.2d 410,

414 (2002) (quoting Dunton v. S.C. Bd. of Examin'rs in Optometry, 291 S.C. 221, 223, 353 S.E.2d 132, 133 (1987)); See also Nucor Steel v. S.C. Pub. Serv. Comm'n, 310 S.C. 539, 543, 426 S.E.2d 319, 321 (1992) (recognizing that where an agency is charged with the execution of a statute, the agency's interpretation should not be overruled without cogent reason).

ARGUMENT

I. THE ADMINISTRATIVE LAW COURT ERRED BY GRANTING "THE MACHINE EXEMPTION" AND "THE POLLUTION CONTROL MACHINE EXEMTPION," BOTH FOUND IN S.C. CODE ANN. § 12-36-2120(17) (SUPP. 2018), TO THE RESPONDENT'S PURCHASES OF ITEMS THAT ARE NOT "MACHINES."

South Carolina imposes a use tax on "the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State . . . ." S.C. Code Ann. § 12-36-1310(A) (2014). However, exempt from the use tax are "the gross proceeds of sales, or sales price of . . . *machines* used in manufacturing, processing . . . recycling, compounding, mining, or quarrying tangible personal property for sale." § 12-36-2120(17) (emphasis added).[3] In order to qualify for the Machine Exemption, the item for which the exemption is sought must be a "machine." By improperly broadening the meaning of the term "machine," the ALC incorrectly granted the Machine Exemption to items that are not, by law, "machines."

A. The ALC incorrectly broadened the meaning of the term "machine" as used in the Machine Exemption.

The ALC erred by broadening the term "machine" beyond its plain meaning in the Machine

[3]As noted by the ALC, the legislature added to the list of exempt uses found in the Machine Exemption the term "agricultural packaging" in July 1, 2016, which was after the Audit Period. (R. p. 19, footnote 8; Order p. 19, footnote 8). The above quote of § 12-36-2120(17) is a reflection of the Machine Exemption as it was written during the Audit Period. As will be more fully discussed herein, the ALC improperly relied on the addition of this term "agricultural packaging" when broadening the Machine Exemption.

Exemption. In so doing, the ALC incorrectly determined that items such as protective clothing, aerosol cans, mobile computer stands, and floor drain covers were "machines" for purposes of the exemption. A "machine" is "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ." S.C. Code Ann. Regs. 117-302.5(B)(1) (2012). Items such as protective clothing, aerosol cans, mobile computer stands, and floor drain covers are neither mechanical devices nor are they a combination of mechanical powers, parts, attachments, or devices. Therefore, these items cannot qualify as "machines."

In determining that the term "machine" is broad for purposes of the Machine Exemption, the ALC cited Hercules Contractors and Engineers v. S.C. Tax Comm'n, 280 S.C. 426, 313 S.E.2d 300 (1984), where the Court of Appeals held that the vats, basins, railings, walkways, and ladders of a waste treatment facility were exempt under the Machine Exemption. (R. p. 20; Order p. 20). However, these items treated by the Court of Appeals as exempt can easily be distinguished from the non-mechanical items the ALC found exempt. In Hercules, the Court found that the entire waste treatment facility was a machine. Id. at 431, 313 S.E.2d at 304. Therefore, the vats, basins, tanks, pumps, etc., which had no use apart from the waste treatment facility, were exempt *as parts of that machine*. Id. (emphasis added).

That is not the case here because, unlike the waste treatment facility, the Respondent's whole plant is not a machine. The question is not whether the protective clothing, for example, is integral to the operation of the Respondent's plant as a whole, but whether the protective clothing is an integral part of an exempt machine. None of the items to which the ALC applied the machine exemption are integrated into the Respondent's plant. They are each distinct items, and the analysis of whether they are "machines" must be independent of their connection to the plant.

Furthermore, the Hercules Court found that the vats and basins of the waste treatment facility, unlike other buildings, "have utterly no use apart from the machine of which they are an integral part." Id. On the other hand, in this case, each of the Respondent's witnesses testified as to how the purpose of the Respondent's protective clothing was not integral to the operation of any of the machines in the Respondent's plant, but was to prevent the contamination of the Respondent's final product. (R. p. 249, lines 17-22, p. 299, lines 16-18, p. 302, lines 18-23, p. 314, lines 3-13, p. 356, lines 13-16, p. 373, line 19-p. 374, line 4; Hr'g Tr. pp. 108:17-22, 158:16-18, 161:18-23, 173:3-13, 215:13-16, 232:19-233:4). Thus, by admission of the Respondent's own witnesses, the purpose of the Respondent's non-mechanical items the ALC found exempt have nothing to do with any exempt machines within the Respondent's facility. For example, the ALC found aerosol cans to be exempt. (R. p. 26; Order p. 26). The Respondent's CEO and President, Carter McEntire, testified that the black ink aerosol cans label finished cases of produce for tracking purposes. (R. p. 220, lines 2-16; Hr'g Tr. p. 79:2-16). Again, the purpose of this non-mechanical item has nothing to do with an exempt machine, as opposed to the vats and basins in the Hercules case, where the Court found that such items had no other purpose but to be parts of an exempt machine. Hercules at 431, 313 S.E.2d at 304.

As an additional justification for its broad interpretation of "machine," the ALC referenced S.C. Code Ann. Regs. 117-302.5 (2012) (hereinafter referred to as the "Machine Exemption Regulation"), stating that "[t]he regulations defining 'machine' expand the definition beyond traditional notions of the term" in that "[the Regulation] provides that patterns for machinery parts and chemicals used in *the manufacturing process* qualify for the Machine Exemption." (R. p. 20; Order p. 20) (emphasis added). However, these specific provisions within the Machine Exemption Regulation are limiting the term to only those items that are integral and necessary to the

functioning of an *exempt machine*, and solely for this reasoning are such items integral and necessary to the manufacturing process. See Regulation 117-302.5(5)(a) ("Chemicals, including greases, oils, lubricants, and coolants, *used in an exempt manufacturing machine* that are essential to the functioning of the exempt machine during the manufacturing process are integral, necessary, and indispensable to the manufacturing process and are exempt as part of the machine") (emphasis added). Accordingly, as stated earlier, the determination as to whether items constitute a "machine" for purposes of the Machine Exemption is not made based on whether the item is an integral part of the manufacturing process, but rather whether it is integral to the function of an already exempt machine.[4]

B. Record keeping items used for tracking produce are not "machines" and, as such, cannot qualify for the Machine Exemption.

The ALC found that bar code scanners, black ink aerosol cans, and mobile computer stands, all of which the Respondent uses to track the produce as required by law, were exempt from use tax. (R. p. 26; Order p. 26).

The Respondent's bar code scanners are hand-held devices that the Respondent uses to trace the produce backwards one-step to the grower-shipper and forward one-step to the customer's distribution center.[5] (R. p. 205, line 22-p. 206, line 2; Hr'g Tr. pp. 64:22-65:2). This trace-back

[4]In an effort to justify its expansion of "machine," the ALC cited to the Department's S.C. Rev. Rul. # 13-3, noting that "the Department found that the component parts used to construct a manufacturing machine qualified as a "machine" for purposes of the exemption." (R. p. 20; Order p. 20). The Machine Exemption is not the issue in S.C. Rev. Rul. # 13-3. Rather, # 13-3 deals with S.C. Code Ann. § 12-36-2120(51) (2014), which is for material handling systems and material handling equipment. The ALC's reliance on #13-3 was improper because this is a completely different exemption.

[5]Mr. McEntire testified that the need for a trace-back arises when a food-borne illness results in sickness or death and the FDA needs to determine the source of the illness. (R. p. 206, lines 12-17; Hr'g Tr. p. 65:12-17).

system is required by federal law. (R. p. 205, line 24; Hr'g Tr. p. 64:24). The Respondent scans raw produce when it enters the facility, when the raw produce goes into processing, when it then goes into the finished goods area, and lastly when the produce goes from the finished goods section onto the refrigerated delivery trucks. (R. p. 206, lines 2-9; Hr'g Tr. p. 65:2-9).

The Respondent also uses black ink aerosol cans as part of this tracking process. (R. p. 220, line 25-p. 221, line 4; Hr'g Tr. pp. 79:25-80:4). Specifically, the ink goes across a jet ink sprayer to spray a "use-through code" and a "lot code" onto a finished case of produce in the pack-out and repack areas of the Respondent's facility. (R. p. 220, lines 10-16; Hr'g Tr. p. 79:10-16). In basic terms, the black ink aerosol cans label finished cases. (R. p. 220, lines 2-7; Hr'g Tr. p. 79:2-7).

The Respondent uses a computer program to track its produce through the processing stages. (R. p. 236, line 24-p. 237, line 1; Hr'g Tr. pp. 95:24-96:1). The Respondent places computers on mobile computer stands in various parts of the facility so the employees can more easily track the process as the produce moves through the facility. (R. p. 237, lines 1-9; Hr'g Tr. p. 96:1-9).

Regulation 117-302.5(B)(9) specifically provides that administrative items such as *items used for recordkeeping* are not "machines used in processing tangible personal property for sale." (Emphasis added). An item used merely to track the produce throughout the stages of processing is used for recordkeeping. While recordkeeping may be legally required (much like all taxpayers are legally required to keep certain records for tax purposes), that does not transform the items used for recordkeeping into exempt machines. Moreover, none of these recordkeeping items are integral to the functioning of an exempt machine. Accordingly, the ALC erred in finding such items to be exempt.

C. Floor drain covers are not "machines" and, as such, cannot qualify for the Machine Exemption.

The ALC determined that the floor drain covers the Respondent purchases and uses within its plant are exempt from use tax under the Machine Exemption. (R. p. 28; Order p. 28). The Respondent installs stainless steel floor drain covers inside the high-care area of its facility to keep debris and product from entering the floor drain system. (R. p. 239, lines 11-15; Hr'g Tr. p. 98:11-15). The Respondent uses the floor drain system to recapture spilled water so it may reuse the water to wash the produce. (R. p. 239, lines 15-24; Hr'g Tr. 98:15-24).

The description provided by the Respondent of the floor drain covers does not fall within the meaning of a "machine," as the floor drain covers are neither mechanical devices nor are they a combination of mechanical powers, parts, attachments, or devices. To meet the Machine Exemption, the item for which the exemption is sought must be a "machine"—a "mechanical device or combination of mechanical powers, parts, attachments and devices . . . ." See Regulation 117-302.5(1). A floor drain cover that keeps debris and produce from entering into the Respondent's floor drain system is not a mechanical device or a part of a mechanical device and, as such, is not a "machine" for purposes of the Machine Exemption.[6]

[6]The ALC found that the floor drain covers the Respondent purchases and uses within its plant are integral and necessary to processing produce because they prevent pollution of the waste water and, as such, are exempt. (R. p. 28; Order p. 28). However, this determination is not supported by the facts in this case. The evidence suggests the floor drain covers, which prevent waste material from entering the plant's floor drain system, are integral and necessary to *the Respondent's plant*. The floor drain system allows the Respondent to recapture and recycle the water it uses *in* the plant in order to reduce its sewer outflow. (R. p. 239, lines 8-18; Hr'g Tr. 98:8 – 18). Mr. McEntire testified that "we consider that a part of our process because we're recapturing that water . . . [a]nd it's important to recapture that water so we can reuse it to wash produce later . . . ." (R. p. 239, lines 18-22; Hr'g Tr. 98:18-22). Mr. McEntire's testimony does not support a finding that the Respondent uses these floor drain covers during processing or to prevent pollution. Rather, his testimony supports a finding that the Respondent uses these floor drain covers so it can filter and reuse water for its own benefit.

D. Protective clothing worn by employees is not a "machine;" thus, protective clothing cannot qualify for the Machine Exemption.

The ALC disregarded numerous South Carolina Regulations that limit what can and cannot be exempt from use tax under § 12-36-2120(17). One of the more troubling findings reached by the ALC is its determination that protective clothing worn by the Respondent's employees are "machines" for purposes of the exemptions found in § 12-36-2120(17). As discussed in more detail below, this determination is in direct contradiction to South Carolina law. But for the ALC's incorrect conclusion that the Respondent's protective clothing are "machines," the ALC would have been unable to conclude that the same were exempt under both the Machine Exemption and the Pollution Control Machine Exemption.

i. The Respondent requires its employees to wear certain protective clothing within its facility for food safety purposes.

The Respondent requires its employees to wear gloves, aprons, hairnets, coveralls, and eyewear (collectively referred to as "protective clothing") in its facility.[7] (R. p. 15; Order p. 15). Pursuant to Federal and State law, the Respondent requires its employees to wear more protective clothing in the high-care area than in the low-care area, because that is where the produce is cut.

As will be discussed herein, the Machine Exemption Regulation states that tanks that store water are taxable. See Regulation 117-302.5(B)(7)(b). If tanks that store water prior to processing and pipes that move necessary water into a plant to be used in processing are taxable (see Regulation 117-302.5(B)(4)(b)), it follows that items used to filter the water *after* processing are also taxable.

[7]Mr. McEntire testified that the Respondent's employees also wear bump caps, headbands, smocks, plastic arm sleeves, and overshoes as additional items of protective clothing. (R. p. 15, footnote 6, p. 200, lines 10-14; Hr'g Tr. p. 59:10-14; Order p. 15, footnote 6). However, the only items characterized as "protective clothing" that were in dispute at the hearing were gloves, aprons, hairnets, coveralls, and eyewear. (R. p. 4, p. 15, footnote 6; Order pp. 4, 15, footnote 6). Mr. McEntire confirmed during the hearing that this list of items were the only items of protective clothing in dispute. (R. p. 247, line 17-p. 248, line 3; Hr'g Tr. pp. 106:17-107:3).

(R. p. 7; Order p. 7). Most of the Respondent's protective clothing items are single use items, but other items, such as smocks and overshoes, are washed and reused daily. (R. p. 198, line 12-p. 199, line 3; Hr'g Tr. pp. 57:12-58:3).

Wayne Bailey, the Respondent's food safety director, testified that the Respondent is particularly concerned about three specific food-borne illnesses in the processing of fresh produce: Listeria monocytogenes ("Listeria"), Salmonella, and E. coli (hereinafter collectively referred to as "pathogens"). (R. p. 277, lines 12-19; Hr'g Tr. p. 136:12-19). As these pathogens may be present at the farms from which the Respondent receives its fresh produce, these pathogens may enter the Respondent's facility through the produce. (R. pp. 280-282; Hr'g Tr. pp. 139-141). The Respondent's employees could also bring these pathogens into the Respondent's facility if, for example, these pathogens are present on the employees' shoes or hands and then the employee does not take the appropriate steps before entering the Respondent's high-care areas. (R. p. 284, lines 8-20; Hr'g Tr. p. 143:8-20).[8]

Based on the above, Mr. Bailey testified that the Respondent's "good manufacturing practices" and the FDA require the wearing of appropriate apparel so that a person in street clothes and street shoes does not come into contact with food-contact surfaces or the produce within the Respondent's facility. (R. p. 276, lines 11-12, p. 297, lines 3-17, p. 299, lines 14-15, 18-19; Hr'g Tr. pp. 135:11-12, 156:3-17; 158:14-15, 18-19). In so doing, the Respondent is attempting to protect *the produce* from outside contamination, such as the above-listed pathogens, either by cross contamination from aerosolized pathogens exiting contaminated produce once it is cut or by an

[8]The Respondent's food safety expert, Dr. David Gombas, also testified that the sources of contaminants, or pathogens, are the employees and the raw produce itself, as well as the water used in the facility. (R. p. 367, lines 15-18, p. 379, line 21-p. 380, line 3; Hr'g Tr. pp. 226:15-18, 238:21-239:3).

employee's personal clothing on which such pathogens are potentially present. (R. p. 297, lines 17-19, p. 302, lines 9-15, p. 304, lines 5-11, p. 306, lines 3-17, p. 324, lines 16-20; Hr'g Tr. p. 156:17-19, 161:9-15, 163:5-11, 165:3-17, 183:16-20). Ultimately, the purpose of the protective clothing is to protect the Respondent's final product—a food item—from contamination. (R. p. 249, lines 17-22, p. 299, lines 16-18, p. 302, lines 18-23, p. 314, lines 3-13, p. 356, lines 13-16, p. 373, line 19-p. 374, line 4; Hr'g Tr. pp. 108:17-22, 158:16-18, 161:18-23, 173:3-13, 215:13-16, 232:19-233:4). But, while protective clothing may prevent harmful pathogens from contaminating the Respondent's produce if such pathogens are present on the Respondent's employees, it cannot prevent the harmful pathogens from entering the facility through contaminated produce. (R. p. 324, line 21-p. 325, line 3; Hr'g Tr. pp. 183:21-184:3).

ii. The Machine Exemption Regulation explicitly states that protective clothing is not a "machine;" thus, protective clothing cannot qualify for the Machine Exemption.

The Respondent sought to have its purchases of protective clothing exempt from use tax under the Machine Exemption. As discussed above, in order to be exempt under the Machine Exemption, the item sought to be exempt must be a machine. See § 12-36-2120(17). However, Regulation 117-302.5(B)(10) specifically states that "**[p]rotective clothing** worn by an employee working in the area in which the manufacturing process occurs **does not qualify as a machine and is not exempt from the tax as a machine used in manufacturing tangible personal property for sale under Section 12-36-2120(17)**." (Emphasis added).[9]

[9]The Regulation goes on to say, "[h]owever, 'clothing and other attire required for working in a Class 100 or better as defined in Federal Standard 209E clean room environment' is exempt under the provisions of [S.C. Code Ann. §] 12-36-2120(54) [(2014)]." Regulation 117-302.5(B)(10). In this case, the Respondent did seek to have its purchases of protective clothing exempt from use tax under the exemption referenced in this provision, also known as the "Clean Room Exemption," found in § 12-36-2120(54). (R. p. 40; Order p. 40). However, the ALC correctly determined that the Respondent did not meet its burden of proof regarding this issue and,

The plain reading of this Regulation is clear—protective clothing can never be considered a machine for purposes of the Machine Exemption. Because protective clothing can never be considered a "machine" for purposes of the Machine Exemption, protective clothing can never be exempt from use tax as a machine used in processing or manufacturing. As the ALC pointed out, "[w]hat a legislature says in the text . . . is considered the best evidence of the legislative intent or will." (R. p. 20; Order p. 20) (quoting Bayle v. S.C. Dep't of Transp., 344 S.C. 115, 122, 542 S.E.2d 23, 26 (1972)). By approving the language set forth in Regulation 117-302.5(B)(10), the General Assembly clearly never intended for protective clothing to be considered "machines" for purposes of the exemption in § 12-36-2120(17). Thus, to conclude that protective clothing is a "machine" for purposes of the Machine Exemption in light of Regulation 117-302.5(B)(10) is an error of law.

The ALC attempted to distinguish the protective clothing in this case from the regulation by finding that the clothing is "not used to protect the employee from hazards incurred during the manufacturing process." (R. p. 27; Order p. 27). However, the regulation is not limited to protective clothing used to protect the employees. Rather, the regulation provides that protective clothing *in general* is taxable unless it falls under the exemption set forth in S.C. Code Ann. § 12-36-2120(54) (2014). "The language of a tax statute must be given its plain ordinary meaning in the absence of an ambiguity therein." Beach v. Livingston, 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1966). To get to the result reached by the ALC goes beyond the plain ordinary meaning of the words in the regulation and requires the addition of language so that the regulation would read "clothing worn to *protect* an employee working in the area in which the manufacturing process

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as such, could not conclude that the Respondent's purchases of protective clothing qualify for the Clean Room Exemption. (R. p. 41; Order p. 41).

occurs." This reading violates the plain meaning rule and, thus, is improper.

iii. Because the Machine Exemption Regulation explicitly states that protective clothing is not a "machine," protective clothing also cannot qualify for the Pollution Control Machine Exemption.

The Respondent also sought to have its purchases of protective clothing exempt under the Pollution Control Machine Exemption, which is also found in § 12-36-2120(17). (R. p. 1; Order p. 1). Specifically, the Pollution Control Machine Exemption provides an exemption from sales and use tax for *machines, machine parts, and attachments* that "are necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section." Section 12-36-2120(17). S.C. Code Ann. Regs. 117-302.6 (2012) explains that a machine constitutes an exempt pollution control machine if such machine is "installed and operated for compliance with an order of an agency of the United States or of this state to prevent or abate pollution caused or threatened by the operation of other machines used in the . . . manufacturing of tangible personal property."

Accordingly, the Respondent had the burden to prove that (1) the operation of at least one of its machines used in its processing of fresh produce causes or threatens to cause pollution of air, water, or noise; (2) a State or Federal agency requires the prevention or abatement of such pollution; and (3) the machine for which this exemption is sought is installed and/or operated to prevent or abate the pollution caused or threatened to be caused by one of its machines used in processing. For the following reasons, the Respondent failed to meet its burden on these elements, and the ALC erred in finding that the Respondent met its burden.

a. <u>The Respondent failed to show that any of the machines within its facility cause or threaten to cause pollution of air, water, or noise</u>.

The ALC determined that food contamination constitutes pollution of air and water because

the bacteria that contaminates the food "could contaminate the air inside the facility and the water supply both at the plant and in the municipal water system and/or rivers." (R. p. 35; Order p. 35). Assuming food contamination constitutes pollution of the air and/or water, that means the Respondent only satisfied part of the first element.[10] The Respondent still needed to prove that a machine within its facility caused or threatened to cause such food contamination.

The ALC found that machines in Respondent's facility cause "pollution" through "direct contact with harmful microbes and through cross-contamination." (R. p. 31; Order p. 31). The ALC seemed to rely on the fact that, since cutting produce *may* release contaminant already present in the produce, the cutting machine caused or threatened to cause pollution of the air or water. If this were true, then any processing machine that could cut an employee causing him to bleed, and thus possibly release a pre-existing contaminant, would arguably cause or threaten pollution of the air or water. Clearly, the legislature did not intend for the phrase "cause or threaten to cause" to be construed so broadly, especially since exemption statutes are to be strictly construed against the exemption. Rather, the plain reading of the Pollution Control Machine Exemption is that a processing machine must *create or result* in pollution or threaten to do so, and not merely have the

[10]The Department does not agree that food contamination constitutes pollution. While bacteria could become a pollutant, food poisoning, for example, is not pollution. Moreover, the ALC's reliance on the definition of pollution as used in commercial insurance policies is misplaced. It is well-settled under South Carolina law that courts construe insurance contracts "against the party who prepares them and liberally in favor of the insured [i.e., in favor of the person seeking coverage]." S.C. State Budget & Control Bd. v. Prince, 304 S.C. 241, 245–246, 403 S.E.2d 643, 646 (1991). Exemption statutes, as previously stated, are to be construed strictly against the exemption, i.e., strictly construed against the person or entity seeking the exemption. See CareAlliance Health Services., 416 S.C. 484, 787 S.E.2d 475. Thus, the term "pollution" when used in an insurance contract must be liberally construed in favor if the insured while the same term when used in a tax exemption must be strictly construed against the one seeking the exemption. Clearly these two rules of statutory construction conflict. Because a court will construe the term pollution more broadly in insurance cases, reliance on such cases when construing the term pollution in a tax exemption statute is misplaced.

potential to release a pre-existing contaminant.

Here, neither the cutting machine (nor any other processing machine) creates or results in bacteria contaminating the Respondent's produce, or even the water or air. If the cutting machine releases contaminants, that means the produce was already contaminated. Thus, the produce itself causes or threatens to cause contamination, not the machine. The machine is, in fact, one-step removed from the source of the "pollution," i.e., the bacteria in the contaminated food. Further, the only other source of contamination, namely the Respondent's employees, is not caused by the cutting machine, nor does the cutting machine threaten to cause such contamination—the employees cause or threaten to cause the contamination. Accordingly, the Respondent failed to prove that a machine used in processing produce causes or threatens to cause pollution of the air or water.

b. <u>The Respondent failed to show that any of the Federal or State regulations it relied on requires the use of protective clothing to prevent or abate pollution</u>.

Even if the ALC properly concluded that a processing machine caused or threatened to cause pollution of the air or water, which the Department disputes, the Respondent still failed to prove that a State or Federal agency requires that such pollution be prevented or abated. In its Order, the ALC found that State and Federal regulations require the Respondent to use protective clothing to prevent or abate pollution. (R. pp. 36-39; Order pp. 36-39).

While the Respondent may be required to use protective clothing for *food safety purposes*, the State and Federal regulations relied on by the Respondent do not require the Respondent to use protective clothing in order to *prevent or abate pollution of the air or water*. In fact, the regulations relied on by the Respondent and cited in the Order are wholly unrelated to the prevention or abatement of air or water pollution. None of the regulations cited even mention air or water pollution. Rather, the regulations pertain to the prevention of food contamination for food safety

purposes. As such, assuming one or more of Respondent's processing machines cause or threaten to cause air or water pollution, the Respondent failed to prove that it is required by a State or Federal agency to use protective clothing in order to prevent or abate said air or water pollution.[11]

c. The Respondent failed to show that it installed or operated any machine to prevent or abate pollution.

Lastly, even though it is a subpart within § 12-36-2120(17), the Pollution Control Machine Exemption still requires that the item for which the exemption be sought is a *machine*—a machine which is installed or operated for the purpose of preventing or abating pollution caused by another machine fitting within the Machine Exemption. As previously addressed, protective clothing, per the Machine Exemption Regulation, cannot be considered "machines," either for purposes of the Machine Exemption or the Pollution Control Machine Exemption. Accordingly, because the Machine Exemption Regulation clearly states that protective clothing cannot be considered machines for purposes of exemptions sought under § 12-36-2120(17), by law, protective clothing cannot be "machines installed or operated" to prevent or abate pollution. Thus, the ALC's

[11]The ALC's Order creates a new rule that anything legally required for a manufacturing facility to operate is integral and necessary to manufacturing tangible personal property for sale and, therefore, is exempt pursuant to the Machine Exemption. (R. pp. 25-27; Order pp. 25-27). However, if the general Machine Exemption already exempted anything legally required for a plant to operate, the Pollution Control Machine Exemption would be unnecessary.

Using the ALC's reading of the Machine Exemption, the items that the ALC designated as "pollution control machines," i.e., protective clothing, are integral and necessary to the functioning of the plant as a whole because they are legally required and, therefore, would be exempt without the Pollution Control Machine Exemption. Thus, if the Machine Exemption was supposed to be applied so broadly, the Pollution Control Machine Exemption would be rendered superfluous and unnecessary. Statutes are not to be construed in a manner that renders any portion superfluous. See Duvall v. S.C. Budget & Control Bd., 377 S.C. 36, 42, 659 S.E.2d 125, 128 (2008) ("The Court must presume the Legislature intended its statutes to accomplish something and did not intend a futile act."); State v. Sweat, 386 S.C. 339, 351, 688 S.E.2d 569, 575 (2010) ("A statute should be so construed that no word, clause, sentence, provision or part shall be rendered surplusage, or superfluous." (quoting In re Decker, 322 S.C. 215, 219, 471 S.E.2d 462, 463 (1995))).

determination that the protective clothing worn by the Respondent's employees was used to prevent or abate pollution of air and water was an error of law, as the item which is installed or operated to prevent or abate pollution of air or water *must* be a *machine*.

The ALC's erroneous determination that the protective clothing worn by its employees are "machines" is critical because, as discussed, the protective clothing can *only* qualify for the exemptions at issue if the clothing is first determined to be a "machine." By ignoring the Machine Exemption Regulation, which states that protective clothing *cannot* be "machines," the ALC created a new, expansive, nearly limitless application of the two exemptions. If the ALC's interpretation is correct, then any clothing or protective items worn by any person who is merely *operating* an exempt machine would now be considered an exempt component of that machine for sales and use tax purposes. Clearly, by approving the Machine Exemption Regulation, the Legislature did not intend for the Machine Exemption and the Pollution Control Machine Exemption to be interpreted so broadly.

II. THE ADMINISTRATIVE LAW COURT ERRED BY GRANTING "THE MACHINE EXEMPTION" TO THE RESPONDENT'S PURCHASES OF MACHINES THAT ARE NOT "USED IN PROCESSING TANGIBLE PERSONAL PROPERTY FOR SALE."

Even if an item is a "machine," the machine must be "used in processing tangible personal property for sale" to qualify for the Machine Exemption. § 12-36-2120(17). The Department determined that certain items for which the Respondent sought exemptions from use tax under the Machine Exemption fell outside the Respondent's manufacturing process and, as such, were not machines used in processing tangible personal property for sale. (R. p. 736-745; Dep't Determination).

The ALC incorrectly concluded that the Department's interpretation of the manufacturing process was too restrictive under the Machine Exemption. (R. p. 21; Order p. 21). A statute must

be construed in light of "the purpose of the whole statute" and "the policy of the law." Enos v. Doe, 380 S.C. 295, 305, 669 S.E.2d 619, 623 (Ct. App. 2008). Thus, to properly construe the Machine Exemption and apply the law to the facts in this case, the Machine Exemption and the Machine Exemption Regulation must be read in conjunction. Further, as stated above, the relevant statute and regulation must be strictly construed *against* the claimed exemption. CareAlliance at 488, 787 S.E.2d at 477. By failing to acknowledge the limitations to the Machine Exemption set forth in the Machine Exemption Regulation, the ALC improperly expanded the meaning of "used in processing" for purposes of the Machine Exemption.

A. South Carolina utilizes a *limited* integrated plant theory when determining what constitutes machines "used in processing."

The ALC correctly noted that South Carolina abandoned the strict production line theory and adopted an integrated plant theory as it relates to the Machine Exemption.[12] (R. p. 21; Order p. 21). South Carolina courts have recognized that South Carolina uses an integrated plant theory for the purpose of applying the Machine Exemption. See Anonymous Corp. v. S.C. Dep't of Revenue, 1999 WL 1094323 (S.C. Admin. Law. Judge Div., November 9, 1999), aff'd S.C. Dept. of Revenue v. Springs Indus., Inc., 2003-UP-029 (Ct. App. 2003) (hereinafter referred to as "Spring Industries"); and Anonymous Taxpayer v. S.C Dep't of Revenue, Docket No. 02-ALJ-17-0350-CC (S.C. Admin. Law. Judge. Div. July 8, 2003). In response to these decisions, the Department issued S.C. Rev. Rul. # 04-7 and proposed amendments to the Machine Exemption

[12]The ALC commented that "[g]enerally, states follow one of two distinct lines of authority when determining what qualifies as machinery used in manufacturing: (1) the Integrated Plant Concept or (2) the 'Ohio Rule.'" (R. p. 21; Order p. 21) (referencing Hellerstein, State Taxation, at ¶14.05). The Ohio Rule is typically narrower than the Integrated Plant Concept (R. p. 21; Order p. 21) (referencing The Youngstown Building Material & Fuel Co. v. Bowers, Tax Commr., 167 Ohio St. 363, 149 N.E.2d 1 (1958)), but the General Assembly narrowed South Carolina's application of the Integrated Plant Concept by regulation.

Regulation, which the legislature ultimately adopted. See Regulation 117-302.5. Thus, the Machine Exemption Regulation in use during the Audit Period in this case established a *limited* integrated plant theory.

However, instead of relying on South Carolina's limited integrated plant theory reflected in the Machine Exemption Regulation, the ALC applied the integrated plant theory used in New York. Niagara Mohawk Power Corp. v. Wannamaker, 144 N.Y.S.2d 458 (N.Y. App. Div. 1955). New York's integrated plant theory is not a reflection of South Carolina's integrated plant theory. Rather, New York's integrated plant theory is much broader. Therefore, the ALC found certain items exempt from use tax contrary to specific provisions of the Machine Exemption Regulation. Accordingly, the reliance by the ALC on any other integrated plant theory rather than the limited theory set forth in our Machine Exemption Regulation was an error.

B. The ALC incorrectly expanded what it means to be "used in processing."

By failing to apply the limitations to South Carolina's integrated plant theory set forth in the Machine Exemption Regulation, the ALC improperly broadened what it means to be "used in processing." As it relates to this case, the ALC determined that "processing" includes everything that happens inside the facility, excluding the administrative area, relating to the Respondent's overall operations. (R. pp. 22-23; Order pp. 22-23). In doing so, the ALC disagreed with the Department's longstanding interpretation of "processing," asserting that the Department's interpretation was more restrictive (like the production line theory) than an integrated plant theory adopted by South Carolina courts. (R. pp. 21-23; Order pp. 21-23). The ALC incorrectly labeled the Department's interpretation of "processing" in this case as too restrictive; rather, the Department's interpretation comes from applying the Respondent's operations to South Carolina's more limited version of the integrated plant theory, which is established by the Machine Exemption

Regulation.

i. The Department's interpretation of "used in processing" and its application to this case.

During the Audit Period, the Machine Exemption stated that the gross proceeds of sales, or sales prices of machines used in manufacturing, processing, recycling, compounding, mining, or quarrying tangible personal property for sale are exempt from sales and use tax. Section 12-36-2120(17). The Machine Exemption Regulation defines what machines qualify for the Machine Exemption: "[a] machine qualifies for the [Machine Exemption] if the machine is integral and necessary to the manufacturing process . . . ." Regulation 117-302.5. Thus, to be an exempt machine, the item in dispute must: (1) be a machine, which includes every mechanical device or combination of mechanical powers, parts, attachments and devices that perform some function and produce a certain effect or result; (2) which is integral and necessary; (3) to processing tangible personal property for sale.

Thus, the processing of tangible personal property, i.e., fresh produce, in the Respondent's plant must begin when the Respondent performs some act on the produce that is intended to result in packaged cut produce or packaged sorted tomatoes and end when the produce is packaged for sale. The activities necessary to turn raw produce into cut produce are sorting, cutting, washing, and packaging said produce. Similarly, the activities necessary to sort and repackage whole tomatoes are sorting and packaging. Accordingly, the Machine Exemption exempts those machines that are integral and necessary to the sorting, cutting, washing, and packaging of produce.

ii. The Machine Exemption Regulation supports the Department's interpretation of "used in processing" and its application to this case.

The Machine Exemption Regulation supports the Department's interpretation of "used in

processing" and its application to the Respondent's operations. The Machine Exemption Regulation specifically states: "[a] machine is not a part of the manufacturing process merely because it is integral and necessary to the manufacturer. For example, *machines used for warehouse, distribution, or administrative purposes are integral and necessary to the manufacturer, but not part of the manufacturing process*." Regulation 117-302.5(B)(1)(b) (emphasis added). Additionally, the regulation explains that generally, conveyances/material handling machines,[13] chemicals, maintenance machines, storage machines, administrative machines, and protective clothing are not integral and necessary to processing tangible personal property for sale. See Regulation 117-302.5(B). Thus, according to the Machine Exemption Regulation, "processing" does not include: moving raw or finished product; cleaning the processing area; maintenance; storage[14]; or administrative activities.

While one might assume that every "machine" used until the point a product becomes marketable is integral and necessary, the Machine Exemption Regulation makes it clear this is not the case. The Machine Exemption Regulation draws clear boundaries around what is "processing" for purposes of the Machine Exemption.

[13]An exemption specific to material handling machines used in the operation of a manufacturing facility, as opposed to in processing tangible personal property for sale, can be found in § 12-36-2120(51). The existence of and the language used in subsection (51) demonstrates there is a difference between a machine being *used in the operation of a manufacturing facility* to support the overall manufacturing process and a machine being *used in manufacturing tangible personal property for sale*.

[14]The Machine Exemption Regulation narrows the meaning of processing even further when it explains that "[r]acks and tanks used to store a finished product while it cures" are not integral and necessary to processing. Regulation 117-302.5(B)(7)(c). The logical inference to be drawn from this example is that while an item is sitting on a storage rack waiting to become marketable, that item is not being processed and, thus, the storage rack is not being used in processing. Accordingly, the Machine Exemption Regulation demonstrates that in this case, "processing" occurs only while the produce is being sorted, cut, washed, and packaged, not while it is being stored or transported throughout the storage areas of the plant.

iii. The usual and customary meanings of terms within the Machine Exemption Regulation support the Department's interpretation of "used in processing" and its application to this case.

"When faced with an undefined statutory term, the court must interpret the term in accord with its usual and customary meaning." Strother v. Lexington County Recreation, 332 S.C. 54, 62, 504 S.E.2d 117 (1998); See also Hughes v. Western Carolina Sewer Auth., 689 S.E.2d 638, 386 S.C. 641 (S.C. App., 2009). In doing so, our Supreme Court has looked to the dictionary definition of an undefined term. See Murphy v. S.C. Dep't of Health & Envt'l Control, 396 S.C. 633, 641, 723 S.E.2d 191, 195 (2012).

As previously stated, a machine qualifies for the Machine Exemption if it is "integral and necessary" to, in this case, the processing of fresh produce. See Regulation 117-302.5. The Machine Exemption Regulation further states that, to be considered "integral and necessary," a machine must be "used in, and serve as an *essential and indispensable* component part of the manufacturing process . . . ." Regulation 117-302.5(B)(1)(b).

While the Machine Exemption Regulation does not define "essential" or "indispensable," the common dictionary definitions for both terms provide that something is "essential" or "indispensable" if it is "absolutely necessary" or "of the utmost importance." Merriam-Webster Dictionary, http://www.merriam-webster.com/dictionary/indispensable, http://www.merriam-webster.com/dictionary/essential. Further, the Machine Exemption Regulation does not, nor does any other relevant statute or regulation, define "processing." However, other states with similar undefined terms have relied on dictionary definitions and provide guidance here.

For example, in Tetra Tech EC, Inc. v. Wis. Dep't of Revenue, the Supreme Court of Wisconsin analyzed a statute that imposed a tax "for the 'processing' of river sediments into waste sludge, reusable sand, and water." 914 N.W.2d 21, 28 (Wis., 2018). The Wisconsin Supreme

Court explained that "[t]he *noscitur a sociis* canon of construction (literally, 'it is known from its associates') instructs that '[w]hen two or more words or phrases are listed together, the general terms . . . may be defined by the other words and understood in the same general sense.'" Tetra Tech EC, Inc., 914 N.W.2d at 60. The other words listed with "processing" in the Tetra Tech case were fabricating, printing, and producing. In relying on the aforesaid maxim and the definition of "processing" from the Oxford Dictionary, the Wisconsin Court determined the proper meaning of the term "processing" encompasses "the performance of a mechanical or chemical operation on tangible personal property, a task that can be completed without transforming the property into a new product, or adding anything to it that was not already there." Id. at 61.

When applying these definitions, South Carolina's Machine Exemption exempts the Respondent's purchases of (1) machines (as defined above), (2) which are used in, serve as an essential, indispensable, and are an absolutely necessary or important component part of, (3) the performance of some mechanical or chemical operation on fresh produce to be sold. See Regulation 117-302.5(B)(1). Thus, once all "machines" are identified, the issue becomes which of those machines are integral and necessary to the performance of some mechanical or chemical operation on tangible personal property to be sold, because only those machines are subject to the exemption. See Regulation 117-302.5(B)(1)(b).

The mechanical or chemical operation on tangible personal property conducted at the Respondent's facility is the sorting, cutting, washing, and packaging of produce. Accordingly, not every activity that occurs within the Respondent's facility is "processing." It follows then that not every machine in the facility serves as an essential and indispensable component part of processing fresh produce to be sold. While the ALC was correct that a machine does not have to be used directly in the production line to be exempt, the machine must be integral and necessary to

processing produce as defined above, not to the operation of the Respondent's entire plant.

Thus, in the context of the Respondent's operations, a machine at the Respondent's plant qualifies for the Machine Exemption only when it is *absolutely necessary* to the actual process of sorting, cutting, washing, and packaging of fresh produce. Based on this, it is of no consequence that the Respondent's operations are heavily regulated by Federal and State laws; that fact merely demonstrates that the activities prior to and after the sorting, cutting, washing, and packaging of fresh produce are absolutely necessary and important *for the Respondent* to continue operating.[15]

When applying the appropriate standard and strictly construing the exemption statute against the Respondent, it is clear that the activities that occur prior to and after the actual sorting, cutting, washing, and packaging of produce (i.e., air quality control, storage, material handling) are not absolutely necessary because the sorting, cutting, washing, and packaging of fresh produce can be done without such activities. Thus, these activities are not considered a part of the "processing" of fresh produce and the associated machines or items do not qualify for the Machine Exemption to the use tax.

iv. The ALC incorrectly relied on the addition of "agricultural packaging" to the Machine Exemption as evidence of legislative intent as the Machine Exemption was written during the Audit Period.

In 2016, after the Audit Period, the General Assembly added the term "agricultural packaging" to the list of exempt uses under the Machine Exemption. The ALC incorrectly interpreted this addition to mean that "the legislature intended this manufacturing process to be much broader than the production line definition espoused by the Department." (R. p. 22, footnote

[15]The ALC incorrectly relied on the Federal and State regulations the Respondent must follow regarding food safety in determining that "the machinery and equipment used both before and after the actual production line processing of fresh produce are integral and necessary not only to the overall manufacturing process, but also to the health and safety functions imbedded within the manufacturing of fresh produce." (R. p. 22; Order p. 22).

9; Order p. 22, footnote 9). Again, the Department did not utilize a production line theory but rather a limited integrated plant theory as required by the Machine Exemption Regulation.

Moreover, the fact the legislature added "agricultural packaging" as an exempt use is not an indication that the General Assembly had intended such a use to be included in the previous version of the Machine Exemption. On the contrary, the addition indicates that those activities *were not* exempt prior to the 2016 statutory change. Generally, "[w]hen a statute is amended, there is a presumption that the legislature intended to change the existing law." Duvall v. S.C. Budget & Control Bd., 377 S.C. 67, 80-81, 716 S.E.2d 877, 884 (2011).

Here, when the General Assembly amended the Machine Exemption to include "agricultural packaging" as an exempt use, it stated in the enacting legislation that this was "[a]n act . . . to amend [the Machine Exemption], as amended, relating to exemptions from the state sales tax, *so as to exempt machines used in agricultural packaging*." 2016 S.C. Acts No. 256 § 427 (effective June 8, 2016) (emphasis added). Thus, according to the Act, the purpose of the amendment was to make agricultural packaging an exempt use, not to clarify any legislative intent on the exempt uses previously codified. Therefore, the ALC incorrectly used the statutory amendment as a basis for its flawed decision.

Finally, contrary to the ALC's assertion, the addition of the term agricultural packaging does not mean that the terms "manufacturing" or "processing" should be construed broadly. The addition simply means that, after the effective date of the amendment, exempt machines include those machines that are integral and necessary to agricultural packaging. Further, the addition of the term "agricultural packaging" does not change the meaning of "manufacturing" and "processing" (or any of the other terms in the statute), nor does the fact that the General Assembly chose to define "agricultural packaging" for purposes of a tax credit change the definition of the

terms manufacturing or processing as used in the Machine Exemption.

C. <u>The conveyances at issue are not machines used in processing tangible personal property for sale</u>.

The Respondent uses forklifts (along with their respective parts and batteries), pallet jacks, and hand trucks to move produce from place to place and to certain lines of production within the facility. (R. p. 209, lines 1-2, p. 218, lines 13-25, p. 254, lines 9-12; Hr'g Tr. p. 68:1-2, 77:13-25; 113:9-12). The Respondent uses these supplies mostly in the palletizing, shipping, finished storage, raw storage, tomato repack, and receiving dock areas (i.e., the low-care areas) of the facility to move produce. (R. p. 209, lines 6-9, p. 219, lines 3-6; Hr'g Tr. pp. 68:6-9, 78:3-6).

Aside from transporting produce from place to place within the facility, the Respondent also uses the forklifts to dump produce onto the conveyor system, which moves the raw produce into the high-care area for processing. (R. p. 210, lines 3-5, p. 252, line 19-p. 253, line 15; Hr'g Tr. pp. 69:3-5, 111:19-112:15). Mr. McEntire testified that roughly twenty-five (25) percent of the Respondent's forklifts are used to put raw produce onto the conveyor system. (R. p. 256, lines 13-18; Hr'g Tr. p. 115:13-18). However, the Respondent does not have a method of tracking the use of its forklifts, except for the fact of knowing that the Respondent does not use any of its forklifts in the high-care area. (R. p. 209, lines 5-6, p. 255, lines 18-20, p. 256, lines 19-21; Hr'g Tr. 68:5-6, 114:18-20, 115:19-21).

The Respondent's pallet jacks are electric hand trucks that can lift pallets and move them from place to place. (R. p. 218, lines 13-16; Hr'g Tr. p. 77:13-16). While similar, the pallet jacks cannot perform all the same functions as a forklift. (R. p. 254, lines 7-22; Hr'g Tr. p. 113:7-22). Thus, the Respondent does not use its pallet jacks to transfer produce onto a conveying mechanism like the forklifts. (R. p. 254, line 23-p. 255, line 2; Hr'g Tr. pp. 113:23-114:2).

The Respondent uses a food-grade oil and a food-grade grease to lubricate its hand trucks

and pallet jacks in order to maintain the hand trucks and pallet jacks and keep them in good, working order. (R. p. 219, line 22-p. 220, line 1; Hr'g Tr. pp. 78:22-79:1).

i. The Respondent's conveyances do not fit within the conveyances that are deemed exempt under the Machine Exemption Regulation.

The ALC found that these various conveyances and their respective batteries, parts, and oils and lubricants are exempt from use tax under the Machine Exemption. (R. p. 24; Order p. 24). The Machine Exemption Regulation provides that the following conveyances serve as an essential and indispensable component part of processing: (1) conveyance machines feeding the first processing machine; (2) conveyance machines moving in-process materials; and (3) conveyance machines discharging the finished product from the last processing machine. See Regulation 117-302.5(B)(4)(a).

The limitations set by this regulation demonstrate that not all conveyances used in manufacturing or processing are considered essential and indispensable component parts of manufacturing or processing tangible personal property for sale. Only those specifically identified within the Machine Exemption Regulation are considered essential and indispensable. Logically, this is because processing machines could not perform their intended function without machines that feed materials into the processing machines, move in-process materials from one processing machine to another, and discharge the finished product. The processing machines could, however, perform their intended functions without machines that move materials around a storage area.

Further, the conveyances must still satisfy the general Machine Exemption test, meaning they must be substantially used in processing (as opposed to storage, for example) and must be used on an ongoing and continuous basis (not "as needed"). See Regulation 117-302.5(B)(1). This means that, even if a conveyance is found to be the machine feeding the first processing machine, it still will not qualify for the exemption if it is not used on an ongoing and continuous basis.

Based on the Department's interpretation of "processing," the first processing machine in the Respondent's plant is in the high-care area where the produce is sorted, inspected, trimmed, and placed onto a conveyor belt leading to the cutter. (R. pp. 6-7; Order pp. 6-7). Mr. McEntire explained this process as follows: "Once we take the lettuce out of the raw product area, we dump it through a bin dumping conveyance system, and it enters the high-care area. **In that first step**, we sort it, trim it, and remove any defects. And then it continues conveying up to a cutting area." (R. p. 189, lines 12-17; Hr'g Tr. p. 48:12-17) (emphasis added). Thus, the bin dumping conveyance system is the conveyance that feeds the first processing machine. The forklifts feed the bin dumping conveyance system and, therefore, do not feed the first processing machine. (R. p. 210, lines 3-5, p. 252, line 19-253, line 15; Hr'g Tr. pp. 69:3-5, 111:19-112:15). As such, the forklifts are not exempt.

The evidence further demonstrates that the remaining conveyance machines are used in the "palletizing, shipping, finished storage, raw storage, tomato repack area, and receiving dock." (R. p. 219, lines 4-6; Hr'g. Tr. 78:4-6). Thus, no conveyance machines are used to feed the first processing machine or to move in-process material. Some conveyance machines appear to be used to discharge the finished product in the palletizing area or move in-process material within the tomato repack area, but the Respondent did not keep a record of how often it used these items for these exempt purposes. (R. p. 209, lines 5-6, p. 255, lines 18-20, p. 256, lines 19-21; Hr'g Tr. 68:5-6, 114:18-20, 115:19-21). Accordingly, the Respondent presented no evidence to demonstrate that more than one third of the conveyance machines were used for those exempt purposes.[16] Therefore, the ALC erred in finding that such machines were exempt.

[16]Regulation 117-302.5 provides that a "machine must be substantially 'used in manufacturing . . . tangible personal property for sale.'" Further, "more than one-third of a machine's use in manufacturing is substantial." Id. Therefore, in order to receive the exemption

D. <u>The items used for storage/temperature control are not machines used in processing tangible personal property for sale</u>.

The Respondent uses two primary types of warehouse racks: a flow-through rack and a pushback rack system. (R. p. 210, lines 15-21; Hr'g Tr. p. 69:15-21). It uses flow-through racks in the storage coolers where palletized raw produce flows through from one side of the cooler to the other. (R. p. 210, lines 16-18; Hr'g Tr. p. 69:16-18). It uses the pushback rack system where the Respondent places raw produce or finished produce onto a carriage that is pushed back several spaces or up and out. (R. p. 210, lines 18-24; Hr'g Tr. p. 69:18-24). These racks help with efficiency, keeping the produce separated, and maintaining the temperature of the produce during storage. (R. p. 210, line 24-p. 211, line 2; Hr'g Tr. pp. 69:24-70:2).

The Respondent uses pallet flow brakes on the racks in the raw cooler areas. (R. p. 12, p. 213, lines 18-22; Order p. 12; Hr'g Tr. p. 72:18-22). Specifically, the pallet flow brakes slow down the speed of the pallets as they travel down the flow-through pallet system. (R. p. 213, lines 12-13; Hr'g Tr. p. 72:12-13).

The Respondent also uses stacking containers for storage in the "work in progress" section of the facility to store processed produce until the Respondent can combine it with other processed produce. (R. p. 12; Order p. 12). For example, the Respondent combines cabbage and carrots to make coleslaw. (R. p. 12, p. 233, line 24-p. 234, line 2; Hr'g Tr. pp. 92:24-93:2; Order p. 12). The Respondent uses the stacking containers to store cut carrots until the cabbage is processed and ready to be combined to be made into coleslaw. (R. p. 12; Order p. 12).

The Respondent uses blower fans in both the high and low-care areas to move refrigerated

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for the above-listed conveyances, the Respondent had to demonstrate that more than one-third of the conveyances' uses were dedicated to the processing portions of the facility; however, the Respondent failed to provide such evidence.

air in order to maintain the mandated temperature level and to also filter any airborne contaminates. (R. p. 250, lines 9-23; Hr'g Tr. p. 109:9-23).[17]

i. The storage and temperature control items are not used in processing fresh produce for sale.

The ALC found that stacking containers, warehouse racks, pallet flow brakes, and the blower fans used by the Respondent "all work to maintain the proper temperature within the plant and also to hold and transport the produce **before and after it is cut** so that it cannot become adulterated or spoiled . . . ." (R. p. 26; Order p. 26) (Emphasis added). Regarding the stacking containers, warehouse racks, and pallet flow brakes, the testimony presented demonstrates that these items are used only to store produce. (R. p. 12, p. 210, line15-p. 211, line 2, p. 213, lines 12-13 and 18-22; Order p. 12; Hr'g Tr. pp. 69:15-70:2, 72:12-13, 18-22). The Machine Exemption Regulation specifically states that machines used for storage, including racks used to store raw materials or finished goods, are not exempt from sales tax as machines used in manufacturing tangible personal property for sale. Regulation 117-302.5(B)(7).

Thus, while the Respondent might have purchased these specific items for reasons besides just storing produce, i.e., maintaining the temperature of the produce during storage, that is a need found necessary to the Respondent for food safety purposes and not necessary to the processing of produce. As emphasized above, the ALC noted that these items are used "before and after" the cutting of fresh produce. Thus, based on the Department's interpretation of "processing" discussed above, these items fall outside of the processing of fresh produce.

Further, regarding the blower fans, Regulation 117-302.5(C)(24) provides that "[m]achines

[17]The ALC states in its Order that the Respondent could not maintain the required temperature within its facility without these blower fans. (R. p. 13; Order p. 13). However, the record is void of any evidence to support this finding of fact.

used to condition air (including humidification systems) for quality control **during the manufacturing process of tangible personal property** made from natural fibers and synthetic materials" are exempt. (Emphasis added). Thus, any machines used to control the temperature where the produce is being processed would be exempt, but machines used outside of the manufacturing process would be taxable. The logic here is the same as for the items discussed above—the *processing* machines cannot perform their intended function without the temperature control machines because the product would be compromised during the processing. Importantly, if the temperature control item is being used during storage as opposed to during processing, the temperature control item cannot be an integral part of the *processing* of fresh produce.

The Respondent's witnesses testified repeatedly about the importance of keeping the temperature within the facility between 33 and 40 degrees. (R. p. 176, lines 13-20, p. 185, lines 18-20, p. 192, line 2-p. 193, line 12, p. 211, line 24-p. 212, line 4, p. 214, lines 2-6, p. 232, lines 11-21; Hr'g Tr. pp. 35:13-20, 44:18-20, 51:2-52:12, 70:24-71:4, 73:2-6, 91:11-21). The Respondent's witnesses also testified that the blower fans contribute to keeping the plant temperature between 33 and 40 degrees. (R. p. 250, lines 9-23; Hr'g Tr. p. 109:9-23). The Machine Exemption Regulation clearly states that any quality control item used to condition air is exempt only *if used during the processing of tangible personal property*. Accordingly, for the blower fans to be exempt, the Respondent had to show that it used the blower fans substantially in the processing areas of the facility, which includes the areas of the facility where produce is sorted, cut, washed, and packaged. However, the Respondent did not provide any evidence as to where the blower fans are used except to say that they are used in both the high-care and low-care areas (R. p. 250, lines 9-23; Hr'g Tr. p. 109:9-23). In order to prove that the blower fans are substantially used in processing, the Respondent had the burden to show that "more than one-third of the

machine's use" was in processing fresh produce. See Regulation 117-302.5(B)(1)(c). The Respondent failed to provide any evidence that would indicate that more than one-third of the blower fans' uses were within the processing areas. As such, the Respondent failed to prove that it substantially used the blower fans during the manufacturing process.

Because the storage items are explicitly taxable according to the Machine Exemption Regulation, the ALC erred in finding such items to be exempt from use tax.

E. The water storage tanks are not machines used in processing tangible personal property for sale.

The Respondent has large water storage tanks both inside and outside the facility. (R. p. 258, lines 13-14; Hr'g Tr. p. 117:13-14). The outside tank stores chilled water and mixes sanitation chemicals before the water is delivered to the high-care area to wash the produce. (R. p. 258, line 21-p. 259, line 7; Hr'g Tr. pp. 117:21-118:7). The inside tanks are in the high-care area; they recirculate some of the runoff water so that it can be used again in the processing of produce. (R. p. 14, p. 258, lines 8-9, p. 259, lines 21-24; Hr'g Tr. p. 117:8-9, 118:21-24; Order p. 14).

The ALC found these storage water tanks exempt from use tax. (R. p. 27; Order p. 27). However, Regulation 117-302.5(7), as discussed above, provides that machines used for storage are taxable, including "(b) [s]torage tanks used to store raw materials, gasses, *or water*." (Emphasis added). The storage water tanks at the Respondent's facility merely store water that is later used in processing. The Respondent failed to present any evidence that these tanks are used during processing. The *water* from the tanks may be used during processing, but the tanks themselves merely serve as storage tanks and, thus, are taxable.

Further, Regulation 117-302.5(B)(4)(b) provides that "(iii) Piping leading to and from storage tanks [and] (iv) Piping, pumps, and well connections installed for use by a manufacturer **to supply the manufacturing plant with water necessary for the manufacture of tangible**

personal property" are taxable. (Emphasis added). Mr. McEntire conceded that the Respondent does "mix sanitation chemicals [in the storage tank] **before** it's delivered to the processing area." (R. p. 258, line 25-p. 259, line 2; Hr'g Tr. 117:25 – 118:2) (emphasis added). Certainly, if the pipes that take the water from the tank to the processing area are taxable because they are outside of the manufacturing process, then the tanks, which are another step removed from the manufacturing process, must be taxable. In sum, while the storage water tanks maybe be integral and necessary to the Respondent's operations, they are not integral and necessary to processing produce for sale. As such, the ALC erred in finding such items to be exempt.

F. The floor treatment chemicals and cleaning machines (foamers) are not machines used in processing tangible personal property for sale.

The Respondent utilizes cleaning machines, called foamers, to foam and sanitize the "processing equipment" in the high-care area. (R. p. 229, lines 14-22; Hr'g Tr. p. 88:14-22). The Respondent did not provide any evidence regarding the specific "processing equipment" it cleans with these foamers, whether cleaning is necessary to ensure the functioning of the equipment, or whether cleaning ensures the quality of the product. The only evidence the Respondent provided regarding its use of the foamers is that federal law requires the cleaning done by the foamers.[18] (R. p. 229, line 23-p. 230, line 1; Hr'g Tr. pp. 88:23-89:1).

The Respondent uses floor treatment chemicals to sanitize the floor in the high-care area and certain low-care areas in certain situations. (R. p. 14, p. 224, lines 8-13; Hr'g Tr. p. 83:8-13; Order p. 14). The Department's audit relating to chemicals included more than floor treatment

[18]In its Order, the ALC stated that the FDA requires these particular machines. (R. p. 14; Order p. 14). However, Mr. McEntire only testified that the cleaning the foamers perform, and not necessarily the foamers themselves, are required. (R. p. 229, line 23-p. 230, line 1; Hr'g Tr. pp. 88:23-89:1).

chemicals. (R. p. 736, footnote 1, p. 743; Dep't Determination p. 1 (footnote 1), 8). However, the only remaining chemicals in dispute at the time of the hearing were floor treatment chemicals. (R. p. 5; Order p. 5). The floor treatment chemicals serve no purpose other than to sanitize the Respondent's facility. (R. p. 258, lines 4-10; Hr'g Tr. p. 117:4-10).

The ALC found that the floor treatment chemicals purchased by the Respondent are exempt. (R. p. 27; Order p. 27). For a chemical to be exempt, it must be used on an exempt machine on an ongoing and continuous basis and be essential to the functioning of the exempt machine. See Regulation 117-302.5(B)(5). When testifying about the chemicals at issue, Mr. McEntire stated these chemicals are used "to sanitize the floor and keep the floor clean . . . ." (R. p. 224, lines 10-11; Hr'g Tr. p. 83:10-11). He also testified that these chemicals serve no other purpose than to sanitize the facility. (R. p. 258, lines 4-10; Hr'g Tr. 117:4–10). The floor in the Respondent's facility is not an exempt machine and there was no testimony that the Respondent uses these particular chemicals on any exempt machines. Therefore, the ALC erred in concluding that these chemicals are exempt.

Furthermore, the Respondent uses the "foamers" every night to foam and sanitize the "processing equipment" in the high-care area. (R. p. 229, lines 14-22; Hr'g Tr. p. 88:14-22). Thus, the Respondent established that it uses the foamers on an ongoing and continuing basis. However, as discussed below, in order for a maintenance machine to be exempt, it must be used to maintain an *exempt machine* on an ongoing and continuous basis, as this would indicate that the maintenance machine serves as an essential and indispensable component part of processing produce to be sold. The Respondent did not provide any evidence that the machines on which the foamers were used would not function without the cleaning conducted by the foamers. Thus, while the Respondent's use of the foamers may be required by Federal law (R. p. 229, line 23-p. 230, line 1; Hr'g Tr. pp.

88:23-89:1), this fact does not mean that the use of the foamers is essential and indispensable to the processing of produce. Rather, it is an indication that the Respondent's use of the foamers is necessary to the Respondent's operations. As such, the ALC incorrectly determined that the foamers are exempt.

G. The maintenance tools at issue are not used on an ongoing and continuous basis, and thus, do not qualify for the exemption.

The Respondent uses general maintenance tools to maintain, repair, install, and uninstall equipment. (R. p. 13; Order p. 13). The Respondent uses these tools anytime a machine breaks or requires care in any part of the facility. (R. p. ; Hr'g Tr. p. 94:13-21). For example, if one of the Respondent's machines breaks down due to water intrusion, the Respondent has designated maintenance employees who use these tools to fix the machine. (R. p. 235, lines 2-7 and 25-p. 236, line 9; Hr'g Tr. pp. 94:2-7, 25-95:9).[19] Further, the Respondent uses the cut wheel and disc maintenance tools to maintain the cut wheels and discs within the produce cutting machines in the high-care area. (R. p. 19; Order p. 13).

The ALC determined that these tools are exempt from use tax. (R. p. 23; Order p. 23). A machine qualifies for the Machine Exemption, meaning that it is a machine "used in processing tangible personal property for sale," if it is "integral and necessary to the manufacturing process." Regulation 117-302.5(B)(1). There are several factors to consider when determining if a machine is "integral and necessary," one of them being whether the machine is "used on an ongoing and

[19]In its Order, the ALC stated that the Respondent's designated maintenance employees are "constantly" working on repairing machines due to the environment of the Respondent's facility. (R. p. 13, p. 23; Order pp. 13 and 23). However, while Mr. McEntire testified that its machines have a "fair amount" of break downs and "many other issues," the record is void of any indication that the Respondent is "constantly" using these maintenance tools. (R. p. 236, lines 4-6; Hr'g Tr. p. 95:4-6).

continuous basis during the manufacturing process." Regulation 117-302.5(B)(1)(b).

Generally, maintenance machines are not exempt from sales and use tax. The Machine Exemption Regulation provides that "[m]aintenance machines used at a manufacturing facility are not exempt from the tax as a machine used in manufacturing tangible personal property for sale." Regulation 117-302.5(B)(6). Further, "[m]achines that are used to maintain non-exempt machines . . . or are not used on an ongoing, continuous basis to maintain exempt manufacturing machines . . . are maintenance machines and are not exempt from the tax . . . ." Id.

Thus, according to the Machine Exemption Regulation, in order for a maintenance machine to be exempt, it must be used to maintain an exempt machine on an ongoing and continuous basis. In other words, a maintenance machine used on an exempt machine on an ongoing and continuous basis serves as an essential and indispensable component part of processing produce to be sold because without ongoing and continuous maintenance, the exempt machine would not work.

In this case, the evidence demonstrates that the Respondent only uses its maintenance tools on an "as needed" basis. (R. p. 235, lines 13-21; Hr'g Tr. p. 94:13-21). First, there is no evidence in the record that these maintenance tools are "machines" as defined by the Machine Exemption Regulation. Second, even if they are "machines," "as needed" is not "ongoing and continuous." If a machine is only used "as needed," it logically cannot serve as an essential and indispensable component part of processing produce to be sold since the machine being maintained by the maintenance machine obviously works without maintenance for most of its operational existence. As such, the ALC erred in finding that such maintenance tools are exempt.

H. The generator rentals the Respondent uses in its facility are not used on an ongoing and continuous basis, and thus do not qualify for the exemption.

Tomatoes arrive at the Respondent's facility in various color stages, and different customers have different color requirements. (R. p. 216, line 16, lines 21-25, p. 217, lines 1-2;

Hr'g Tr. pp. 75:16, 21-25, 76:1-2). When necessary, the Respondent rents ethylene generators to speed up the ripening process and change the color of the tomatoes to a certain color stage, per a customer's request. (R. p. 216, lines 17-25; Hr'g Tr. p. 75:17-25). The Respondent rents these generators when the repack manager determines that a generator is needed based on color of the available crop of tomatoes. (R. p. 257, lines 13-18; Hr'g Tr. p. 116:13-18). The generators are not needed year-round. (R. p. 257, line 12; Hr'g Tr. p. 116:12).

The Respondent must use the generators on an "ongoing and continuous basis" for the generators to be considered integral and necessary to the processing of fresh produce. See Regulation 117-302.5(B)(1)(b). However, renting and using a generator to ripen tomatoes "when necessary" or "as needed" is not using them on an "ongoing and continuous basis." It is only on the occasions when the Respondent's tomato repack manager says a generator is needed that the Respondent rents these generators. (R. p. 257, lines 13-16; Hr'g Tr. p. 116:13-16). The logical inference, then, is that there are times when crops of tomatoes come into the Respondent's facility that are already at the desired color and the generators are not needed, or that the natural ripening that occurs in the low-care area is sufficient for the ripening of a particular crop. (R. p. 6; Order p. 6). As such, the evidence indicates that these generators are not used on an "ongoing and continuous basis."

The ALC determined that the Respondent's rental of these generators are exempt from use tax. (R. p. 24; Order p. 24). Specifically, the ALC determined that, because tomato crops are variable, and the Respondent rents generators on a seasonal basis, then the rental of generators on an as-needed, seasonal basis to process a variable crop makes the Respondent's use of the generators "ongoing and continuous." (R. p. 24; Order p. 24). As the evidence infers, there are crops of tomatoes that arrive at the Respondent's facility that do not need the ripening assistance

of one of these generators. Thus, even during the seasons that tomatoes are harvested, there are crops that arrive at the Respondent's facility which do not need to be ripened by a generator. It is only when a crop arrives at the facility and the Respondent has a specific order from a customer regarding the color of a crop of tomatoes that the Respondent rents and uses a generator to ripen the tomatoes to the customer's desired color. (R. p. 216, line 21-p. 217, line 15; Hr'g Tr. pp. 75:21-76:15). Therefore, the ALC erred in determining that the Respondent's rental and use of these generators are used on an "ongoing and continuous basis."

CONCLUSION

In this case, the ALC improperly expanded the Machine Exemption and disregarded the limitations set forth in the Machine Exemption Regulation when determining whether the Respondent's purchases of the items in dispute qualified for the exemptions within § 12-36-2120(17). In doing so, the ALC's Order is based on an error of law and goes against the plain language of the Machine Exemption, the Pollution Control Machine Exemption, and the Machine Exemption Regulation. As such, the Court should reverse the ALC's findings and hold that the items for which the Respondent sought exemptions are taxable.

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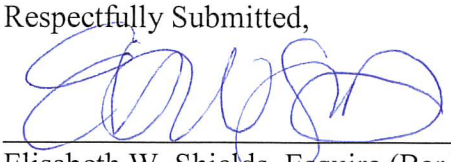
Respectfully Submitted,



Elisabeth W. Shields, Esquire (Bar No. 100784)
Counsel for Litigation
Jason P. Luther, Esquire (Bar No. 78021)
General Counsel for Litigation
P.O. Box 12265
Columbia, SC 29211-9979
803-898-5576 (Tel.)
803-896-0171 (Fax)
Elisabeth.Shields@dor.sc.gov
CourtOrders@dor.sc.gov

Attorneys for Appellant
South Carolina Department of Revenue

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THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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

CASE NO. 17-ALJ-17-0060-CC
APPELLATE CASE NO. 2019-001933

McEntire Produce, Inc., ...Respondent,

v.

South Carolina Department of Revenue, ...Appellant.

CERTIFICATE OF COUNSEL

The undersigned certifies that this Final Brief complies with Rule 211(b), SCACR.

Elisabeth W. Shields, Esquire (Bar No. 100784)
Counsel for Litigation
Jason P. Luther, Esquire (Bar No. 78021)
General Counsel for Litigation
P.O. Box 12265
Columbia, SC 29211
803-898-5576 (Tel.)
803-896-0171 (Fax)
Elisabeth.Shields@dor.sc.gov
CourtOrders@dor.sc.gov

Attorneys for Appellant
South Carolina Department of Revenue