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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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

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

McEntire Produce, Inc., ...Respondent,

v.

South Carolina Department of Revenue, ...Appellant.

FINAL REPLY BRIEF OF APPELLANT

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Pursuant to Rule 208(a)(3), SCACR, the Appellant South Carolina Department of Revenue ("Department") files its Reply to the Initial Brief of Respondent McEntire Produce, Inc. ("Respondent").

ARGUMENTS

I. THE RESPONDENT USES THE INCORRECT STANDARD OF REVIEW.

The Respondent argues that the issues before the Court in this case involve questions of fact and, therefore, the Court should affirm the Administrative Law Court's ("ALC") decision so long as there is substantial evidence in the record to support the ALC's ruling. (Respondent's Initial Brief, pp. 7-8). However, the Department's appeal is based on the ALC's erroneous legal conclusions, which stem from disregarding applicable regulations. While the Department disagrees with some of the ALC's factual conclusions, those conclusions are based on an erroneous legal analysis. Had the ALC properly applied the plain meaning of the relevant statutes and regulations, the ALC could not have made the conclusions that it did in this case. Thus the ALC's error is an error of law. See Bursey v. S.C. Dep't of Health & Envtl. Control, 369 S.C. 176, 184-185, 631 S.E.2d 899, 904 (2006), overruled on other grounds by Allison v. W.L. Gore & Assocs., 394 S.C. 185, 188, 714 S.E.2d 547, 549 (2011) (recognizing the meaning of a statutory term is a question of law).

Furthermore, the Respondent implies that the Department bore the burden of proving that the items in dispute were *not* exempt from use tax. Throughout its brief, the Respondent asserts that, "[n]either DOR witness testified these items were not exempt" with regard to certain disputed items. (Respondent's Initial Brief, pp. 24 (regarding conveyances), 27 (regarding storage/temperature control items), 28 (regarding storage water tanks), 30 (regarding floor

treatment chemicals and cleaning machines), 31 (regarding maintenance tools), 32 (regarding generator rentals)).

It is well-settled in South Carolina that the taxpayer bears the burden of proving it is entitled to an exemption. (See TNS Mills, Inc. v. S.C. Dep't of Revenue, 331 S.C. 611, 618, 503 S.E.2d 471, 475 (1998) ("The burden is on claimants to prove their right to an exemption by bringing themselves clearly within the conditions imposed by the statute") (referencing York County Fair Assoc. v. S.C. Tax Comm'n, 249 S.C. 337, 341, 154 S.E.2d 361, 363 (1967)). The fact that neither of the Department's witnesses testified that the items in dispute were not exempt is irrelevant—the Respondent bore the burden of proving its right to the exemptions that it sought.[1] Furthermore, in its brief, the Respondent quotes Clark v. S.C. Tax Comm'n, 259 S.C. 161, 169, 191 S.E.2d 23, 26 (1972), wherein the Court states, "[r]evenue laws are generally construed in favor of the taxpayer and against the taxing authority." Id. The Clark case dealt with estate taxes, not an exemption from taxes. The law is clear regarding the construction of exemption statutes in that exemption statutes are to be strictly construed against the claimed exemption. See CareAlliance Health Services v. S.C. Dep't of Revenue, 416 S.C. 484, 488, 787 S.E.2d 475, 477 (2016).

II. THE RESPONDENT'S PURCHASES OF PROTECTIVE CLOTHING CANNOT BE EXEMPT FROM USE TAX UNDER THE POLLUTION CONTROL MACHINE EXEMPTION EVEN IF THE COURT DETERMINES FOOD CONTAMINATION IS "POLLUTION."

The Respondent's argument that purchases of protective clothing are not subject to use tax is based on the contention that food contamination[2] constitutes "pollution" for purposes of the

[1]It is questionable whether the Department's witnesses would have even been allowed to offer this testimony, in that the ultimate issue in this case is whether the exemption applies to a variety of Respondent's purchases.

[2]In this situation, the pathogens at issue, which potentially lead to food contamination, are Listeria, E.Coli, and Salmonella.

Pollution Control Machine Exemption in S.C. Code Ann. § 12-36-2120(17) (Supp. 2018), on which the ALC agreed. However, even if this Court agrees with the ALC that food contamination is "pollution," the Respondent's purchases of protective clothing are still subject to use tax for two reasons. First, the law in this State clearly provides that protective clothing *does not qualify* as a machine, which is a requirement when seeking to exempt an item under either the Machine Exemption or the Pollution Control Machine Exemption. Second, and more specific to the Pollution Control Machine Exemption, the Respondent admits that the sources of pollution do not come from any machines within the Respondent's facility.

A. The Pollution Control Machine Exemption requires that the item for which the exemption is sought be a "machine," and S.C. Code Ann. Regs. 117-302.5(B)(10) (2012) specifically states that protective clothing *is not* a machine.

"It is axiomatic that statutory interpretation begins (and often ends) with the text of the statute in question." Smith v. Tiffany, 419 S.C. 548, 555, 799 S.E.2d 479, 483 (2017) "'[T]here is no occasion for employing rules of statutory interpretation and the court has no right to look for or impose another meaning' unless a statutory provision is ambiguous." Id. (citing Paschal v. State Election Comm'n, 317 S.C. 434, 436, 454 S.E.2d 890, 892 (1995)). "'Regulations authorized by the Legislature have the force of law.'" Home Medical Systems, Inc. v. S.C. Dep't of Revenue, 382 S.C. 556, 564, 677 S.E.2d 582, 587 (2009) (citing Southeastern-Kusan, Inc. v. S.C. Tax Comm'n, 276 S.C. 487, 489, 280 S.E.2d 57, 58 (1981)).

The Respondent argues that the term "machine" in § 12-36-2120(17) is broad enough to encompass protective clothing, but admits that its argument stretches the definitional bounds of "machine:" "[a]t first blush, protective clothing does not seem to fit in the definition of machinery and equipment." (Respondent's Initial Brief p. 33). Not only does protective clothing "not seem

to fit in the definition of machinery and equipment," but South Carolina law specifically states that protective clothing *is not a machine*, a law that the ALC failed to acknowledge.

The Pollution Control Machine Exemption found in § 12-36-2120(17) provides an exemption from sales and use tax for *machines* that "are necessary to comply with the order of an agency of the United States or of this State for the prevention or abatement of pollution of air, water, or noise that is caused or threatened by any machine used as provided in this section." Section 12-36-2120(17). Thus, even before determining whether there is "pollution of air, water, or noise," the item for which the Pollution Control Machine Exemption is sought must be a "machine." If the item for which the exemption is sought is not a "machine," it is irrelevant if there is "pollution of air, water, or noise."

As the Department argued in its initial brief, the Legislature added a provision within S.C. Code Ann. Regs. 117-302.5 (2012) (the "Machine Exemption Regulation") that specifically states "protective clothing worn by an employee working in the area in which the manufacturing process occurs *does not qualify as a machine and is not exempt* from the [use] tax as a machine . . . ." 117-302.5(B)(10). This provision of the Machine Exemption Regulation is clear and unambiguous—protective clothing *is not a machine*. Neither the Respondent nor the Court should look for or impose another meaning behind the regulation. Thus, the ALC erred in this case because the protective clothing worn by the Respondent's employees are not "machines" and, as such, do not qualify for the Machine Exemption or the Pollution Control Machine Exemption.

In its brief, the Respondent maintains that "[t]he Department itself acknowledges . . . that protective clothing fits within the machinery and equipment ambit." (Respondent's Initial Brief, p. 33). The Respondent further argues that the Department's published guidance, which quotes Regulation 117.302.5(B)(10), "is intended to apply to protect the worker's own clothing from dirt,

paint, oils, etc. which are given off in the manufacturing process." (Respondent's Initial Brief, p. 33). However, the Respondent does not cite to any "Department published guidance" or to any other relevant or binding authority. In fact, there is no South Carolina statute or regulation which, for purposes of the Machine Exemption, distinguishes between protective clothing worn to protect an employee versus protective clothing worn by an employee to protect other persons or tangible personal property. Regulation 117-302.5(B)(10)[3] clearly instructs that *any and all* "[p]rotective clothing worn by an employee working in the area in which the manufacturing process occurs does not qualify as a machine . . . ." There is simply no authority[4] supporting the Respondent's differentiation between protective clothing that "protects the produce from the worker (for the purpose of protecting the ultimate consumer)" and any other protective clothing for purposes of the Machine Exemption or the Pollution Control Machine Exemption. (Respondent's Initial Brief p. 33).

B. <u>The Pollution Control Machine Exemption requires that "pollution" come from a machine, which the Respondent admits any alleged "pollution" does not come from any machine</u>.

Along with requiring the item for which the exemption is sought be a "machine," the Pollution Control Machine Exemption provides further requirements for a machine to qualify for

[3]While the Department may not have raised Regulation 117-302.5(B)(10) in its Proposed Assessment or Department Determination, the Department is not prohibited from presenting the law as it is today and as it was during the audit period. Furthermore, at trial the Respondent unsuccessfully objected to the Department's witness's testimony about Regulation 117-302.5(B)(10). The basis for the unsuccessful objection was that the Department did not present the regulation in its Proposed Assessment or Department Determination. (Hr'g Tr., pp. 311-314). Respondent did not appeal the ALC's decision to allow that testimony.

[4]The Respondent only cites to authority from other jurisdictions as support of the distinction between clothing that protects the worker and clothing that protects others. (Respondent's Initial Brief, p. 34). However, the Legislature of *our* state has enacted a regulation specifically relating to the taxability of protective clothing *within this State*. The Respondent's reliance on any contrary outside authority is misplaced.

its exemption.[5] This includes the requirement that the machine for which the exemption is sought is operated and/or installed for the purpose of preventing or abating "pollution of air, water, or noise *that is caused or threatened by any machine* used as provided in this section." § 12-36-2120(17) (emphasis added). S.C. Code Ann. Regs. 117-302.6 (2012) further explains the Pollution Control Machine Exemption:

> Code Section 12-36-2120(17) exempts from the sales or use tax the gross proceeds of the sale of machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property . . . . Frequently, *these machines* cannot be operated when *the same* pollute beyond regulated levels and[,] in compliance with orders of agencies of the United States or of this state to abate or prevent pollution caused or threatened *by the operation of such machines*[,] it is necessary to install other machines that are designed and operated exclusively for the purpose of abating or preventing this pollution.

Regulation 117-302.6.

The Respondent consistently acknowledges that the alleged "pollutants"—Listeria, E.Coli, and Salmonella—do not originate from any machine within its facility. Rather, the Respondent concedes that the only two potential sources of these "pollutants" entering its facility are from the produce itself and from employees. (Respondent's Initial Brief, pp. 4, 5, 7, 37, 41). The Respondent specifically states that these "pollutants" "could potentially come into the facility in one of two ways: (1) inside the produce and/or (2) from the employees." (Respondent's Initial

[5]The Respondent states that in order to qualify for the Pollution Control Machine Exemption, "four elements must be met: (1) a machine that (2) prevents or abates pollution (3) caused by machines used in the manufacturing process and is (4) necessary to comply with the order of an agency." (Respondent's Initial Brief, p. 33). The Pollution Control Machine Exemption and its corresponding Regulation 117-302.6 do not require that the machine is necessary to comply with *any* order from a Federal or State agency, but an order "for the prevention or abatement of pollution." See § 12-36-2120(17) and S.C. Code Ann. Regs. 117-302.6 (2012).

Brief, p. 41). Thus, the Respondent admits that these alleged "pollutants" do not originate from any machine within their facility.

Despite consistently acknowledging that the alleged "pollutants" come from sources other than any machine within its facility, the Respondent still argues that the "contamination comes from the machines essential to the production of the fresh produce, namely the cutting machines." (Respondent's Initial Brief, p. 35). As support, the Respondent describes the fresh-produce processing process and how the cutting of already contaminated produce may cause pathogens to be "released into the air or water" and may "subsequently contaminate other produce as well as reproduce." (Respondent's Initial Brief, p. 41). The Respondent refers to this as "cross-contamination" and alleges that this, along with employees potentially bringing these pathogens into the facility on their street clothes, is prevented by the use of protective clothing.

While all of that may be true, a plain reading of Regulation 117-302.6 demonstrates that the Legislature did not intend for the Pollution Control Machine Exemption to apply in situations where the source of pollution is anything other than a machine used in the manufacturing process. As emphasized above, the Legislature acknowledges that the use of certain *machines* that qualify for the immediately preceding Machine Exemption cannot be operated when "*the same pollute* . . . ." Clearly, when the Legislature enacted the Pollution Control Machine Exemption, it intended for the exemption to apply when the source of pollution to be prevented or abated is an actual *machine.* The Legislature did not intend for the Pollution Control Machine Exemption to apply to preventative or abatement machines when the alleged "polluting machine" merely exacerbates pollution that originated from some other source. Thus, even if the Respondent's purchases of protective clothing are "machines," which the law clearly states they are not, they do not qualify under the Pollution Control Machine Exemption because the alleged "pollution" for which the

protective clothing is used to prevent or abate does not originate from the operation of any machine used in the manufacturing process.

The Private Letter Ruling discussed by the Respondent supports the Department's argument. In S.C. Private Letter Ruling #95-8 ("PLR 95-8"), the Department determined that certain purchases were exempt under the Pollution Control Machine Exemption because those items were purchased in an effort to remediate contaminated soil and ground water surrounding manufacturing facilities. S.C. Private Letter Ruling #95-8. The facts described in PLR 95-8 indicate that the contamination in that case was a ***direct result*** of chemicals released *by machines* within a manufacturing facility. Id. The Department also concluded that the Pollution Control Machine Exemption applies to machines that are used to "reduce the amount of pollution already in the environment." Id. The Respondent argues that PLR 95-8 means the exemption can apply to machines used to remediate or abate pollution which comes *from* the environment, like those on Respondent's produce, but that is not what PLR 95-8 means. The finding in PLR 95-8 merely means that the Pollution Control Machine Exemption applies to machines used to remediate or abate pollution which entered the environment as a result of the operation of a manufacturing machine, prior to the installation of the remediation machine. Thus, the pollution still must be caused by the operation of another manufacturing machine.

In the case at bar, Respondent has conceded that the "pollution" which is purportedly remediated by the protective clothing came from either its produce or its employees and was not generated by another machine. Accordingly, the Department's interpretation of the Pollution Control Machine Exemption is supported by its interpretation in PLR 95-8.

For the foregoing reasons, even if this Court agreed with the ALC and the Respondent that Listeria, E.Coli, and Salmonella constituted "pollution," the Respondent's purchases of protective clothing still do not qualify for the Pollution Control Machine Exemption.[6]

III. THE REGULATIONS AND DEPARTMENT PUBLISHED GUIDANCE CITED BY THE RESPONDENT SUPPORTS, NOT CONTRADICTS, THE DEPARTMENT'S INTERPRETATION OF WHAT CONSTITUTES A "MACHINE."

The Respondent argues that the Department has taken a position in this matter that is contradictory to the position promulgated in its regulations and previously published guidance. (Respondent's Initial Brief, pp. 16-17). Respondent misunderstands the Department's position on what constitutes a "machine."

Contrary to the Respondent's argument, the Department does not limit a "machine" to a "mechanical device" or a "combination of mechanical powers, parts, attachments or devices." (Respondent's Initial Brief, pp. 16-17). In its brief, the Department defined "machine" as "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ." (Department's Initial Brief, p. 10). But, the Department acknowledges the Court of Appeals' holding in Hercules Contractors and Engineers v. S.C. Tax Comm'n, 280 S.C. 426, 313 S.E.2d 300 (1984). There, the Court of Appeals determined certain non-mechanical items were "machines" for purposes of § 12-36-2120(17) because they were incorporated into an exempt machine, which, in that case, was an

[6]The Respondent states that the Department's two witnesses agreed to the definitions of the term "pollution" presented by the Respondent's counsel during cross-examination. (Respondent's Initial Brief, pp. 36-37). Specifically, the Respondent states that the Department's witnesses agreed with definitions of "pollution" from Black's Law Dictionary, The Law Dictionary, Wikipedia, and Dictionary.com. Id. However, simply agreeing that a definition of the term "pollution" exists does not mean that the Department's witnesses agreed that Listeria, E.Coli, and Salmonella fit within these definitions when applied to the facts and law at issue in this case.

entire wastewater treatment facility. Thus, the Department correctly interprets a "machine" to be "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ," to include all parts, attachments, or items necessary for the creation and operation of an exempt machine.

A. Regulation 117-302.5 demonstrates the Department's consistent and correct interpretation of "machine."

The various regulations on which the Respondent relies actually support the Department's arguments. First, the Respondent lists what it deems to be "non-mechanical items" from Regulation 117-302.5(B)(2) and (5) as examples of how the Department is contradicting itself. Regulation 117-302.5(B)(2) and (5) addresses parts or attachments to machines and chemicals used on machines. Per these regulations, these chemicals and parts or attachments of machines are exempt when used on an exempt manufacturing machine and when such use is integral and necessary to the functioning of the exempt machine during the manufacturing process. See Regulation 117-302.5(B)(2) and (5). This falls directly in line with how the Department is interpreting the term "machine" for purposes of the exemptions in § 12-26-2120(17), as these chemicals and parts are considered "machines" because they become a part of and are integral and necessary to the operation of an exempt machine. [7]

The Respondent also cherry-picked terms from section (C) of 117-302.5, terms which may appear, at first glance, to be non-mechanical devices. These terms include "traveling water

[7]The first four (4) regulations the Respondent lists, which cite to Regulation 117-302.1, do not apply to the exemptions in § 12-36-2120(17). Rather, Regulation 117-302.1 states, "[p]urchases of tangible personal property are not subject to the tax under [S.C. Code Ann. §] 12-36-120 [(2014)] if . . ." and then the remainder of the regulation sets forth the conditions on which tangible personal property is not subject to sales tax as a wholesale item. See also S.C. Code Ann. § 12-36-120 (2014). Accordingly, any argument that the items listed in Regulation 117-302.1 are examples of non-mechanical devices that the Department determined are "machines" is incorrect.

screens," "tanks," "patterns," "boiler tubes," and "insulation for pipe coverings, tank coverings, and boiler insulation." (Respondent's Initial Brief, p. 17). See Regulation 117-302.5(C)(2), (8), (9), (15), and (30). The Respondent isolates these terms and takes them out of context in an ill-conceived effort to show that the Department is contradicting itself. However, the title of this particular regulation is "Other Examples Of *Exempt Machines and Machine Parts.*" Regulation 117-302.5(C). Thus, section (C) provides a list of exempt machines and parts of *exempt machines*. Accordingly, section (C) provides a list of items that fit squarely within what the Department considers to be a "machine," that is "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ," to include all parts, attachments, or items necessary for the creation and operation of an exempt machine.

B. The Department's published policy documents on which the Respondent relies demonstrates the Department's interpretation of what constitutes a "machine" as a long-standing administrative practice.

The same can be said for the Department published policy guidance—it is consistently supportive of the Department's interpretation of "machine." For example, the settling basin at issue in Revenue Ruling #89-7 is very much like the basins within the wastewater treatment facilities in the Hercules case. Consistent with the Hercules decision, the Department determined that the settling basins in the situation addressed in 89-7 were part of a single entity—an exempt machine. Thus, the materials used to construct the "machine" were exempt. The very same can be said for the gamma irradiator in Private Letter Ruling #90-3, wherein the Department determined that the gamma irradiator itself constituted a "machine," so the materials used to create the "machine," i.e. concrete, reinforced steel bars, and a metallic pool liner, were all exempt as part of an exempt machine.

Lastly, in Tax Commission Decision #89-82, the Department determined that the liners used by the taxpayer to process waste were "machines." Thus, the materials used to construct these liners, which included materials called liners, filters, resins, and other items of personal property, were exempt as part of an *exempt machine*. Not only does this Commission Decision fall directly in line with the logic previously discussed regarding items which become a part of or are integral and necessary to the operation of an exempt machine, but it defines "machine" the same as argued by the Department in this case. Specifically, as quoted by the Respondent, the Department in Commission Decision #89-82 defined "machine" as "every mechanical device or combination of mechanical power and devices to perform some function and produce a certain effect or result." As such, the Department is not contradicting itself, but is consistent in its interpretations and definitions established years ago.[8]

[8]The Respondent also references S.C. Rev. Rul. #13-3, stating "the Department found that the component parts used to construct a manufacturing machine qualified as a 'machine' for purposes of the exemption." (Respondent's Initial Brief, p. 19). However, that Revenue Ruling does not discuss the exemptions within § 12-36-2120(17), but instead discusses the material handling exemption found in § 12-36-2120(51). Therefore, the Court should not consider any analysis therein, as it analyzes facts with an exemption not before the Court.

Furthermore, the Respondent references S.C. Tax Commission Decision #92-19 and provides that "the former Tax Commission held that stack liners and ash pond pipes and pumps were exempt as they operated exclusively in the abatement of pollution caused by the production of electricity." (Respondent's Initial Brief, p. 18). There is nothing within the policy document that proves that "stack liners" and "ash pond pipes and pumps" are not "mechanical device[s] or [a] combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ." Furthermore, the decision states, "[b]ased on the foregoing, we conclude the subject items are machines *or attachments* within the meaning of § 12–36–2120(17)." Therefore, even if there were evidence to show that these "stack liners" and "ash pond pipes and pumps" were not "mechanical devices" or "machines," they were attachments to exempt machines.

C. The Respondent's protective clothing, record keeping items, and floor drain covers do not fit within the correct interpretation of what constitutes a "machine," and thus do not qualify for an exemption from use tax under § 12-36-2120(17).

While a "machine" is "every mechanical device or combination of mechanical powers, parts, attachments and devices to perform some function and produce a certain effect or result . . . ," including all parts, attachments, or items necessary for the creation and operation of an exempt machine, if an item is not a part of, and integral and necessary to, the operation of an exempt machine, the item for which the exemption is sought stands on its own. Thus, that item must be a stand-alone "machine."

The Supreme Court's decision in Hercules demonstrates the Respondent's faulty position. The Respondent argues that the Hercules Court held, "railways, walkways and ladders were exempt under the machine exemption as they were required by state and federal law and thus were necessary, to the overall function of the system." (Respondent's Initial Brief, p. 34). See Hercules at 430, 313 S.E.2d at 303. Respondent argues that this supports its claim to the tax exemption for any items necessary to its *operations* because such items are required by Federal or State regulations, but this ignores other critical findings by the Supreme Court. The Hercules Court determined the *entire* wastewater treatment facility in that case to be a "machine," therefore the "railways, walkways and ladders" were exempt as part of an *exempt machine*— not simply because they were necessary to Hercules' *operations* or required by Federal or State law. Id.

In this instance, because the Respondent's entire facility is not a "machine," the analysis of whether the disputed items are subject to the exemptions in § 12-36-2120(17) is narrower than in Hercules. It is not whether the items in dispute are integral and necessary to the Respondent's manufacturing *operations*, rather it is whether the items are integral and necessary to the operation of an *exempt machine*. There is no evidence in the record that the protective clothing worn by the

Respondent's employees are integral and necessary to the operation of any exempt machine within the facility. Likewise, there is no evidence that the Respondent's record keeping items (bar code scanners, black ink aerosol cans, and mobile computer stands) or floor drain covers are integral and necessary to the operation of an exempt machine. For purposes of the Machine Exemption and the Pollution Control Machine Exemption, it is not enough that these items may be integral and necessary to the Respondent's operations – even if they are required for Respondent to satisfy Federal and State regulations. See Regulation 117-302.5(B)(1)(b).

IV. THE ALC IMPROPERLY BROADENED THE TERM "PROCESSING" AND APPLIED THE MACHINE EXEMPTION TO ITEMS WHICH ARE NOT "MACHINES USED IN PROCESSING."

As discussed in the Department's Initial Brief, the ALC improperly expanded "processing" for purposes of the Machine Exemption and, therefore, erred by applying the Machine Exemption to machines that are not "used in processing tangible personal property for sale." Respondent argues that the ALC's expansion was proper, but improperly relies upon an irrelevant statutory amendment (the addition of "agricultural packaging" to the list of exempt activities). (Respondent's Initial Brief, pp. 9-13).

The Department is not advocating for a "strict production line" theory as in prior litigation. See Hercules, *infra*, and S.C. Dep't of Revenue v. Springs Industries, Inc., 2003-UP-029 (Ct. App. 2003). Rather, the Court should apply South Carolina's integrated plant theory consistent with the Machine Exemption Regulation. Contrary to Respondent's contention, the Department does not contend here that "machines used in processing" only includes "items which are part of a production line." (Respondent's Initial Brief, p. 13). Rather, the Court should apply the clear and unambiguous Machine Exemption Regulation and find that the items for which Respondent seeks the exemption are not "machines *used in processing* tangible personal property for sale."

Like the ALC, the Respondent incorrectly relies on the Legislature's addition of the term "agricultural packaging" to its list of exempt activities within § 12-36-2120(17). First, Respondent fails to acknowledge that the General Assembly did not add "agricultural packaging" until after the applicable audit period. Nevertheless, Respondent relies on the definition of "agricultural packaging" found in S.C. Code Ann. § 12-6-3360(M)(16) (Supp. 2018) and claims that "the statute clearly envisions a more expansive concept of 'agricultural packaging,' to include the transportation and warehousing both before and after the literal packaging." (Respondent's Initial Brief, p. 10). The addition of a completely new category to the Machine Exemption could not have been meant to clarify any already existing exemption to agricultural packagers, but instead to provide a new exemption for an activity not previously recognized. Thus, the Respondent's reliance on the addition of "agricultural packaging" to the Machine Exemption as well as the definition of same found in § 12-6-3360(M)(16) in support of its argument that activities both before and after the actual processing of fresh produce within its facility is "processing" is misplaced.[9]

CONCLUSION

South Carolina law specifically states that protective clothing is not a machine for purposes of the exemptions in § 12-36-2120(17). Furthermore, the alleged "pollution" is not created by any machine within the Respondent's facility, but instead originates from other sources, namely the produce itself or it is brought inside on the employees' clothing. Accordingly, the Court should

[9]The Respondent further relies on authority from other states to argue that the items in dispute in this case are "machines used in processing." (See Respondent's Initial Brief, pp. 25, 31, 34). However, as previously addressed, the Legislature of *our* state has enacted regulations specifically relating to the taxability of the items in dispute *within this State*. Therefore, Respondent's reliance on any contrary outside authority is misplaced.

find that the Respondent's purchases of protective clothing are subject to use tax, even if the Court considers food contamination to be "pollution."

Furthermore, the many regulations and policy documents cited by the Respondent support, rather than contradict, what the Department considers a "machine" and, as such, supports the Department's arguments in its Initial Brief. The Respondent improperly relies on the addition of "agricultural packaging" to the list of exempt uses to the Machine Exemption to support the ALC's expansion of "processing" and, thus, the expansion of "machines used in processing."

For the reasons set forth herein and in the Department's Initial Brief, the ALC committed an error of law and the Court should reverse the ALC's findings and hold that the items for which the Respondent sought exemptions are taxable.

Respectfully Submitted,

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CERTIFICATE OF COUNSEL

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

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