

CAPITAL CITY FRUIT COMPANY, INC. (TRU) (2016)

Topic Code: M011 Machinery & Equipment Document Reference: 16300081

October 5, 2016

Rusty Murl, Controller
Capital City Fruit Company Inc.
1505 North Avenue
Norwalk, IA 50211-1581

RE: Capital City Fruit Company Inc. Sales and Use Tax Protests
Docket No. 2014-320-1-0009 and 2014-300-2-0700
Department Number 2014038700042 and 2014094700072

Dear Mr. Murl:

The Department has considered your letter dated June 30, 2016 in which you restate your position that Capital City Fruit Company qualifies as a manufacturer and, therefore, their purchases of machinery, equipment and replacement parts should qualify for exemption under Iowa Code §423.3(47). However, the Department has not changed its position and reiterates its stance that the protests must be denied.

In your letter, you seem to indicate that because Capital City Fruit sorts, grades, and washes fruits and vegetables, the expanded definition of “processing” for manufacturers of food products automatically renders your company a manufacturer.

The Department does not agree with this interpretation. Manufacturing and processing are two separate and distinct activities. As presented in my June 2, 2016 position letter, Iowa Code §428.20 defines “manufacturer” as the following:

A person who purchases, receives, or holds personal property of any description for the purpose of adding to its value by a process of manufacturing, refining, purifying, combining of different materials, or by the packing of meats, with a view to selling the property for gain or profit...
(Emphasis added)

Rule IAC 701—17.3(1) allows an exemption for services used in processing and states the following:

Electricity, steam, or any other taxable service is used in processing only if the taxable service is used in any operation which subjects raw material to some special treatment which changes, by artificial or natural means, the form, context, or condition of the raw material and results in a change of the raw material into marketable tangible personal property intended to be sold ultimately at retail. (Emphasis added)

The expanded definition of “processing” for manufacturers of food products, as presented in rule IAC 701—17.3(2), includes the following, in relevant part:

- (1) Treatment of material that changes its form, context, or condition in order to produce a marketable food product for human consumption. “Special” treatment of the material to change its form, context, or condition is not necessary. Examples of “treatment” which would not be “special” are the following: washing, sorting and grading of fruits or vegetables; the washing, sorting, and grading of eggs; and the mixing or agitation of liquids. By way of contrast, sterilization would be “special treatment.”
- (2) Maintenance of quality or integrity of the food product and the maintenance or the changing of temperature levels necessary to avoid spoilage or to hold the food in marketable condition. Any carbon dioxide in liquid, solid, or gaseous form, electricity, steam, or other taxable service used in freezers, heaters, coolers, refrigerators, or evaporators used in cooling or heating which holds the food product at a temperature necessary to maintain quality or integrity or avoid spoilage of the food or to hold the food product in marketable condition is exempt from tax. It is not necessary that the taxable service be used to raise or lower the temperature of the food. Also, processing of food products for human consumption does not cease when the food product is in marketable form. Any carbon dioxide in liquid, solid, or gaseous form, electricity, steam, or other taxable service used to maintain or to change a temperature necessary to keep the product marketable is exempt from tax.

The expanded definition of processing is not a factor in determining whether a company qualifies as a manufacturer; it only increases the number of enumerated services that qualify for the processing exemption for manufacturers of food products for human consumption.

The discussion concerning the expanded definition of processing was included in the Department’s initial position letter to show how the terms storing, sorting, grading, washing, and packaging (used in your protests to support your position) relate to manufacturing activities.

However, the refund claims that are the subject of your protests do not include enumerated services; the transactions included in the refund claims are for machinery and equipment (including replacement parts) said to be used in processing by a manufacturer.

The exemption for machinery and equipment is discussed in Iowa Code §423.3(47)“a” and exempts the following, in relevant part, from sales tax:

The sales price from the sale or rental of computers, machinery, and equipment, including replacement parts, and materials used to construct or self-construct computers, machinery, and equipment if such items are any of the following:

- (1) Directly and primarily used in processing by a manufacturer.
- (2) Directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer, including test equipment used to control quality and specifications of the product. (Emphasis added)

For the purposes of the machinery and equipment exemption discussed in Iowa Code §423.3(47), the term “processing” means the following:

...a series of operations in which materials are manufactured, refined, purified, created, combined, or transformed by a manufacturer, ultimately into tangible personal property. Processing encompasses all activities commencing with the receipt or producing of raw materials by the manufacturer and ending at the point products are delivered for shipment or transferred from the manufacturer. Processing includes but is not limited to refinement or purification of materials; treatment of materials to change their form, context, or condition; maintenance of the quality or integrity of materials, components, or products; maintenance of environmental conditions necessary for materials, components, or products; quality control activities; and construction of packaging and shipping devices, placement into shipping containers or any type of shipping devices or medium, and the movement of materials, components, or products until shipment from the processor. (Emphasis added)

In order for Capital City Fruit to qualify for the machinery and equipment exemption discussed in Iowa Code §423.3(47)“a”, they must first meet the qualifications of being a manufacturer. Therefore, Capital City Fruit *must* purchase, receive, or hold personal property of any description for the purpose of adding to its value by a process of manufacturing, refining, purifying, combining of different materials, or by the packing of meats, with a view to selling the property for gain or profit. The protests state that Capital City Fruit performs activities “not unlike what is being done by a company that packages meat” and should, therefore, qualify as a manufacturer. The Department addressed this issue in its previous letter and maintains your company does not meet the qualifications for being a manufacturer.

The fact that Capital City Fruit has a Food Processing Plant License from the Department of Inspections and Appeals (DIA) does not mean that they qualify as a manufacturer for sales tax purposes. The purpose of such a license from DIA is to recognize that the food processing plant has been inspected and has met minimum standards to protect consumers from foodborne illness. Iowa Code §137F.1(8) defines “food processing plant” as “a commercial operation that manufactures, packages, labels, or stores food for human consumption and does not provide food directly to a consumer...” (Emphasis added)

To qualify as a food processing plant under DIA rules, an entity must meet only one of the conditions presented in §137F.1(8). The Department acknowledges that Capital City Fruit packages, labels, and stores food for human consumption and is, therefore, properly categorized as a “food processing plant” for DIA purposes. However, this categorization has no impact on the question of whether Capital City Fruit qualifies as a manufacturer for sales tax purposes.

To summarize, the Department’s position remains that Capital City Fruit does not meet the qualifications for being a manufacturer under Iowa Code §428.20 and, therefore, does not qualify for the machinery and equipment exemption presented in Iowa Code §423.3(47)

Please respond in writing by November 7, 2016 whether you agree with the Department’s position. If you agree, or choose not to pursue the protest, your letter will serve as authority for the Department to request the Director to close the protest.

If you disagree with the Department’s position in this matter, the Department requests that you identify those areas of disagreement and provide documentation to support your position. Upon receipt of your

letter, the Department may file an Answer, which will initiate the process for an administrative hearing on your protest. A departmental attorney will be assigned to your protest at that time.

If no response is received by November 7, 2016, the Department will construe this inaction as failure to pursue the protest and will request dismissal of the protest pursuant to departmental rule 701 IAC 7.11(2).

If you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

Steve Campbell, Technical Tax Specialist
Policy and Communications Division
Audit Services Section
Telephone: 515-242-6049
Fax: 515-242-6040
Email: Steve.Campbell@iowa.gov

June 2, 2016

Nate Johnson
Capital City Fruit Company Inc.
1505 North Avenue
Norwalk, IA 50211-1581

RE: Capital City Fruit Company Inc. Sales and Use Tax Protests
Docket Nos. 2014-320-1-0009 and 2014-300-2-0070
Department Nos. 2014038700042 and 2014094700072

Dear Mr. Johnson:

The Review Unit of the Iowa Department of Revenue has considered your protests. After reviewing the facts and evidence presented and the laws which apply to the protests, the Review Unit denies your protests for the following reasons.

Your protests were filed due to the denial of refund claims for tax paid on purchases of machinery, equipment, and replacement parts claimed to be exempt as machinery and equipment used by a manufacturer. In support of your claims, you cite the Department of Revenue's website which provides

a definition of the term “manufacturer” and explains the exemption for machinery, equipment, and computers used by a manufacturer.

The wording of the definitions and explanations cited from the Department’s website are slightly different than the controlling statutes from the Iowa Code. Iowa Code §428.20 defines the term “manufacturer” as the following:

A person who purchases, receives, or holds personal property of any description for the purpose of adding to its value by a process of manufacturing, refining, purifying, combining of different materials, or by the packing of meats, with a view to selling the property for gain or profit...

Iowa Code §423.3(47)“a” provides the exemptions upon which you base the refund claims. That code section exempts the following from tax, in relevant part:

The sales price from the sale or rental of computers, machinery, and equipment, including replacement parts, and materials used to construct or self-construct computers, machinery, and equipment if such items are any of the following:

(2) Directly and primarily used to maintain the integrity of the product or to maintain unique environmental conditions required for either the product or the computers, machinery, and equipment used in processing by a manufacturer, including test equipment used to control quality and specifications of the product. (Emphasis added)

You state that Capital City purchases produce in bulk and, through a process of storing, sorting, grading, washing, and packaging of fruits and vegetables, adds value to the produce. You assert that the “re-packing of produce is not unlike what is being done by a company that packages meat” which qualifies Capital City as a manufacturer. As a manufacturer, you believe that Capital City’s purchases of machinery and equipment used for maintaining an environment necessary to preserve the integrity of the produce throughout the manufacturing/repacking process as well as machinery and equipment used to transport the produce throughout the warehouse are exempt from tax.

The Department does not agree with your assertion. You state that Capital City adds value to the produce by performing the activities mentioned above. Rule IAC 701—17.3(1) discusses an exemption for services used in processing. It states the following:

Electricity, steam, or any other taxable service is used in processing only if the taxable service is used in any operation which subjects raw material to some special treatment which changes, by artificial or natural means, the form, context, or condition of the raw material and results in a change of the raw material into marketable tangible personal property intended to be sold ultimately at retail.

Rule IAC 701—17.3(2) discusses an expanded definition of “processing” for manufacturers of food products. Paragraph “a” of that subrule presents activities which constitute processing “when performed by a manufacturer to create food products for human consumption”. Included in the list of qualifying activities, as presented in subparagraph (1) are the following:

Treatment of material that changes its form, context, or condition in order to produce a marketable food product for human consumption. “Special” treatment of the material to change its form, context, or condition is not necessary. Examples of “treatment” which would not be “special” are the following: washing, sorting and grading of fruits or vegetables; the washing, sorting, and grading of eggs; and the mixing or agitation of liquids. By way of contrast, sterilization would be “special treatment.”

The activities of sorting, grading and washing of fruits and vegetables performed by Capital City would qualify as processing activities only if Capital City is considered to be a manufacturer of food products for human consumption. If Capital City is not considered to be a manufacturer of food products for human consumption, those activities would not qualify as processing because of the “special” treatment requirement for non-food manufacturers. Non-food manufacturers must subject raw materials to “special” treatment in order to qualify as processing, and, as stated above, washing, sorting, and grading of fruits or vegetables do not qualify as “special” treatment.

The protests also state that Capital City’s activities are “not unlike” the activities of meat-packing companies which qualify as “manufacturers” as defined in Iowa Code §428.20. The Department’s position is that adding value alone does not qualify a company as a manufacturer; it must add value “by a process of manufacturing, refining, purifying, combining of different materials, or by the packing of meats...” While Capital City claims its processes are “not unlike” the packing of meats, it must be determined whether the legislature intended to include the packing of fruits and vegetables when enacting Iowa Code §428.20.

The Department points to *Hearst v. Iowa Department of Revenue & Finance*, 461 N.W.2d 295 (Iowa 1990), which states that “to ascertain the legislative intent we must look to what the legislature said, rather than what it should or might have said.” The legislature specifically included “the packing of meats” when crafting their definition of “manufacturer” presented in §428.20. That definition does not include the packing of fruits, vegetables or other types of food products. The legislature could have included the packing of other food products in the definition of manufacturer but it chose to limit that part of the definition to the packing of “meats”. Therefore, the Department does not believe that the packing of fruits and vegetables constitute manufacturing activities.

As stated previously, one of the requirements in order for purchases of machinery and equipment (including replacement parts) to qualify for exemption under Iowa Code §423.3(47)“a”(2) is that the machinery and equipment must be “used in processing by a manufacturer”. Other than performing activities similar to the packing of meats, Capital City makes no argument that its activities meet any other aspect of the definition of “manufacturer”. Therefore, it is the Department’s position that Capital City does not qualify as a manufacturer and their activities do not constitute processing.

In summary, your protests are denied. Please respond in writing by July 5, 2016 whether you agree with the Department’s position. If you agree, or choose not to pursue the protest, your letter will serve as authority for the Review Unit to request the Director to close the protest.

If you disagree with the Department’s position in this matter, the Review Unit requests that you identify those areas of disagreement and provide documentation to support your position. Upon receipt of your

letter, the Review Unit may file an Answer, which will initiate the process for an administrative hearing on your protest. A departmental attorney will be assigned to your protest at that time.

If no response is received by July 5, 2016, then the Review Unit will construe this inaction as failure to pursue the protest and will request dismissal of the protest pursuant to departmental rule 701 IAC 7.11(2).

If you have any questions regarding this matter, please do not hesitate to contact me.

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