



SC PRIVATE LETTER RULING #90-14

TO: ABC Company, Inc.

TAX ANALYST: Sally Major

SUBJECT: Electricity Used at a Wool Combing Plant
(Sales Tax)

REFERENCE: S.C. Code Ann. Section 12-36-910(B)(2) (Enacted June, 1990)
S.C. Code Ann. Section 12-36-2120 (19) (Enacted June, 1990)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)
SC Revenue Procedure #87-3

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies only to the specific facts or circumstances related in the request.

Private Letter Rulings have no precedential value and are not intended for general distribution.

Question:

Is the electricity used by ABC Company, Inc. in creating wool top exempt from sales tax under Code Section 12-36-2120 (19)?

Facts:

ABC converts grease wool into wool top using the following steps:

1. ABC receives a customer's grease wool which it grades, cores and blends according to that customer's specifications. Higher quality Australian grease wool is blended with lower quality United States grease wool according to the customer's specifications. The blending process determines the ultimate quality of the fabric produced by a subsequent manufacturer.
2. The wool is washed with a mild detergent to remove grease and vegetation. The washed wool is then rinsed, steamed dry, and additional processes are performed to continue to remove vegetation.

3. The wool is run through a machine which begins to put fibers in one direction and remove short fibers from the wool. This product is carded in web form.
4. Finally, the web wool is run through a combing machine which parallels the wool fibers and controls the weight of the final wool top. This product is spun or combed into thick thread, resembling a very heavy yarn which is stored on spools. This product is known as wool top. The wool top is shipped to customers on demand.

Discussion:

Code Section 12-36-910(B)(2) imposes a sales tax on the gross proceeds accruing or proceeding from the sale of electricity.

Code Section 12-36-2120 provides, in part:

Exempted from the taxes imposed by this chapter are the gross proceeds of sales, or sales price of:

...(19) electricity used by manufacturers, miners, or quarriers to manufacture, mine, or quarry tangible personal property for sale....

The first question presented is whether the taxpayer is a manufacturer. In a decision dated August 22, 1986, the Commission recognized a distinction between processing and manufacturing. In that decision the Commission held:

Processing for sales tax purposes is best defined as the operation by which raw material is changed in form, context[sic] or condition so as to result in a finished product. Linwood Stone Products Co. v. State Dept. of Revenue, 175 N.W.2d 393, 394. However, manufacturing requires more. There must be the creation of a new and substantially different article having a distinctive name and substantially different character or use. Anheuser-Bush Brewing Association v. United States, 207 U.S. 556, 562 (1908) and Prentice v. City of Richmond, 90 S.E.2d 839, 843 (1956). For example, the processing of poultry is not manufacturing (there is no change or transformation of live poultry into an article or product of substantially different characters. See Commonwealth v. Meyer, 23 S.E.2d 353 (1942); a commodity such as poultry that retains a continuing substantial identity through the processing stage is not manufacturing. See East Texas Motor Freight Lines, Inc. v. Frozen Food Express, 351 U.S. 49, 54 (1956)) The processing of fruit is not manufacturing (the chemical treatment of fruit to preserve and enhance its value is not manufacturing. American Fruit Growers, Inc. v. Brogdex Co., 283 U.S. 1, 11-13 (1931).) Likewise, the processing of cork for use in bottling beer is not manufacturing (a cork put through the claimant's process is still a cork, Anheuser-Busch, supra at 562.)

Additionally, Attorney General's opinion S-OAG-13 provides that a ginning company is in the business of processing and is, therefore, not exempt from the sales tax on fuel which it uses for processing since the exemption only applies to manufacturers. This opinion has been confirmed by Regulation 117-174.84 which provides:

The sale or sales of fuel, not otherwise exempted, to cotton ginner for use in drying cotton is subject to the tax.

We must decide whether the taxpayer is a manufacturer or merely a processor.

The taxpayer is involved in one stage of converting wool directly from a sheep into wool fabric or yarn. This type of conversion is substantially different from the processing cases cited by the Commission. In each of the processing cases, although a product may have been enhanced by the process performed, the product and its use remained virtually unchanged.

Likewise, a cotton gin performs a different operation from a wool combing plant. A cotton gin first takes raw cotton and removes the dirt and trash, such as dried leaves and sticks from the cotton. The gin then separates the long cotton fibers from the seeds and rebales the cleaned and seedless cotton which is sent to the textile mill where cotton threads and cloth are made.

At the textile mill the cotton is blended to produce the right mixture of fibers. These fibers are again cleaned to remove dirt and debris from the cotton. The cotton is then carded in web form. The carded cotton is used to form a loose rope of cotton called sliver. The sliver is stretched and the cotton fibers are straightened, producing a loose cotton rope. Finally, the loose cotton rope is twisted into yarn to be used for weaving.

The ABC Company's operations are like the first stages of the textile mill rather than the cotton gin. ABC first blends wool to customers' specifications to produce the desired quality of wool fabric which the customer will subsequently manufacture. This procedure results in wool top specifically designed for a particular customer. After a cleaning process, the company begins making wool top for the customer by removing short fibers and putting fibers in one direction to strengthen the wool. This wool is run through a combing machine which parallels the wool fibers and controls the weight of the final wool top. Finally, the wool is spun or combed into thick thread, resembling a very heavy yarn which is stored on spools. This product is known as wool top. The wool top is shipped to customers on demand. This procedure is virtually identical to the stages of the textile mill described above.

ABC is not merely cleaning the wool for another manufacturer, but is rather creating a heavy wool yarn much like the loose cotton rope produced at a textile mill. Although the completed product is still wool, it has changed substantially from the original sheep's wool both in appearance and use. Performing this type of change is manufacturing.

Even though we have established that ABC is involved in the manufacturing of tangible personal property, we still must decide whether it is involved in manufacturing personal property for sale. ABC does not purchase its own wool. Rather, it takes a customer's wool and produces wool top from that customer's wool to the customer's specifications.

In the textile industry it is common practice for part of the manufacturing process to be performed by an independent manufacturer. In these situations, it is also common practice for the independent manufacturer to receive the textile product from a customer, perform its manufacturing operations, and return the goods to the original customer.

ABC is performing part of the manufacturing process on a contract basis for the seller of the wool product. It has been the Commission's long-standing policy that "manufacturing tangible personal property for sale" includes manufacturing processes performed by a third party on a contract basis for the seller of the product.

Administrative interpretations of statutes by the agency charged with their administration and not expressly changed by the legislative body are entitled to great weight. Merchant v. Hamilton, 309 S.E. 2d 781 (1983). When as in this case, the construction or administrative interpretation of a statute has been applied for a number of years and has not been changed by the legislature, there is created a strong presumption that such interpretation or construction is correct. Ryder Truck Lines, Inc. v. South Carolina Tax Commission, 248 S.C. 148, 149 S.E. 2d 435 (1966); Etiwan Fertilizer Company v. South Carolina Tax Commission, 217 S.C. 354 60 S.E. 2d 682 (1950).

Conclusion:

The taxpayer is a manufacturer of tangible personal property for sale; therefore, it is entitled to the exemption for electricity provided in Code Section 12-36-2120 (19).

NOTE: The exemption only applies to electricity used in the manufacturing process. Electricity used in the offices, reception area, warehouse, etc. is not entitled to the exemption.

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard Jr.

S. Hunter Howard, Jr., Chairman

s/A. Crawford Clarkson Jr.

A. Crawford Clarkson, Jr., Commissioner

s/T. R. McConnell

T. R. McConnell, Commissioner

Columbia, South Carolina
November 27, 1990