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State of South Carolina  
Department of Revenue  
301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

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SC PRIVATE LETTER RULING #99-3

TO: ABC, Inc.

SUBJECT: Ethylene Concentrate and Generator Used to Ripen Produce at Warehouse  
(Sales and Use Tax)

DATE: August 30, 1999

REFERENCE: S. C. Code Ann. Section 12-36-120 (Supp. 1998)  
S. C. Code Ann. Section 12-36-2120(17) (Supp. 1998)  
SC Regulation 117-174.30

AUTHORITY: S. C. Code Ann. Section 12-4-320 (Supp. 1997)  
SC Revenue Procedure #97-8

SCOPE: A Private Letter Ruling is an official advisory opinion issued by the  
Department of Revenue to a specific person.

NOTE: A Private Letter Ruling may only be relied upon by the person to whom it is  
issued and only for the transaction or transactions to which it relates. A  
Private Letter Ruling has no precedential value.

Questions:

1. Is the Ripener 1 Concentrate sold by ABC, Inc. to produce warehouses and used in triggering the ripening process of produce excluded from the sales and use tax as a “wholesale sale” under Code Section 12-36-120(3)?
2. Is the ethylene generator purchased by ABC, Inc. and used by produce warehouses in triggering the ripening process of produce exempt from the sales and use tax as a machine used in processing tangible personal property for sale under Code Section 12-36-2120(17)?

Conclusions:

Based on the facts set forth below, it is the department’s opinion that:

1. The Ripener 1 Concentrate sold by ABC, Inc. to produce warehouses is not a “wholesale sale” under Code Section 12-36-120(3) since the concentrate is not used in a processing facility (see note below). As such, the sale of the Ripener 1 Concentrate by ABC, Inc. to produce warehouses is not excluded from the sales and use tax under Code Section 12-36-120 and is, therefore, subject to the sales and use tax.

2. The ethylene generator purchased by ABC, Inc., when used by a produce warehouse, is not used in a processing facility (see note below). Therefore, the purchase of an ethylene generator by ABC, Inc. for use by a produce warehouse is not exempt from the sales and use tax as a machine used in processing tangible personal property for sale under Code Section 12-36-2120(17) and is subject to the sales and use tax.

Note: The above opinions are based on the concentrate and the ethylene generators being used by a warehouse whose purpose is the sale or distribution of produce and, in some cases, other merchandise. If a facility's purpose is the ripening of produce, then the exemption and exclusion may be applicable since such a facility's purpose may be the processing of tangible personal property for sale. Such a determination will depend on the facts. In addition, there are no facts indicating that there are two facilities, a warehouse facility and a processing facility. If such were the case, the exemptions and exclusions from the sales and use tax may be applicable.

#### Facts:

ABC, Inc. ("ABC") is in the business of selling Ripener 1 Concentrate to produce warehouses. ABC also loans ethylene generators to these warehouses. These products are used by the warehouses to ripen their produce so that it is ready to sell to the consumer. Such produce warehouses may be operated by an independent distributor of produce or by a large retailer (grocery store chains) for the purpose of supplying produce to its stores.

For example, when a produce warehouse purchases bananas from its supplier, the bananas are in an unripened state and are stone green in color. In this state, the bananas are not salable. As such, these bananas are placed in atmospherically controlled rooms called ripening rooms. Small produce warehouse may have only one such room while large grocery store distribution centers may have twenty such rooms. An ABC ethylene generator (which is loaned to the warehouse at no charge) is placed in the room and filled with the Ripener 1 Concentrate. The Ripener 1 Concentrate contains 92.46% ethanol. When put through the ABC ethylene generator, ethylene gas is produced. This triggers the ripening process and the bananas produce their own ethylene gas. The rooms are then vented and cooled. At this point the bananas are ready for sale to the consumer since the ripening has been triggered. This process is used with respect to other fruits and vegetables such as tomatoes, kiwi, and avocados.

#### Discussion:

In determining the taxability of the concentrate and the ethylene generator, we must review Code Sections 12-36-120 and 12-36-2120(17) and determine if the produce warehouses using the concentrate and the ethylene generators are processing facilities.

Code Section 12-36-120 defines the term "wholesale sale" and excludes from the tax "tangible personal property used directly in manufacturing, compounding, or processing tangible personal property into products for sale."

Code Section 12-36-2120(17) exempts from sales and use tax:

...the gross proceeds of sales of...machines used in ... processing ... tangible personal property for sale. “Machines” include the parts of machines, attachments, and replacements used...in the operation of the machines and which are necessary to the operation of the machines...

It has been the longstanding position of the department that in order to qualify for the above exemption machines must be used by a processor in processing tangible personal property for sale in a processing facility. Based on this position, the department does not consider a produce warehouse to be a processor. A warehouse is a wholesaling, storage or distribution facility.

The statute provides an exemption under Code Section 12-36-2120(17) for machines “used in manufacturing ... tangible personal property for sale.” This exemption only applies to a facility whose purpose is that of a manufacturer. Therefore, machines used by a large bakery manufacturer in manufacturing breads, cakes, and pies may be purchased tax free; however, similar machines used by a “Ma & Pa” bakery on Main Street (retail bakery) may not be purchased tax free. In making this determination, the department looks at several factors, including but not limited to: the purpose of the facility and how the operation is perceived by the general public - manufacturer, processor, retailer, wholesalers, distributor; whether sales are mostly at wholesale or at retail; and, how the operation is taxed for property tax purposes.

When confronted with this question in Commission Decision #87-107, the commissioners denied the machine exemption to a business which made and sold ice cream at retail since the taxpayer’s “operation [was] commonly understood to be that of a merchant.” This decision did not elaborate on what was meant by the phrase “commonly understood to be that of a merchant;” however, an examination of case law from other jurisdictions provides insight. These cases, while concerning what is manufacturing, are relevant since South Carolina’s machine exemption applies to “processing” as well as to “manufacturing.”

In HED, Inc. v. Helen A. Powers, Secretary of Revenue, 84 N.C. App. 292, 352 S.E. 2d. 265 (1987), the Court of Appeals of North Carolina did not agree that a Hardee’s restaurant was a “manufacturing industry or plant” within the meaning of N.C. Section 105-164.4(1)(h). Therefore, HED was not entitled to North Carolina’s lower sales tax rate for manufacturing machinery.

In arriving at its decision, the North Carolina court referred to a North Carolina Supreme Court case, Master Hatcheries, Inc. v. Coble, 286 N.C. 518, 212 S.E. 2d. 150 (1950) in stating:

The Court [in Master Hatcheries] recognized as we do here ‘that the term manufacturing as used in tax statutes is not susceptible of an exact and all-embracing definition, for it has many applications and meanings. Where, as here, the statute does not define the term, courts have resorted to the dictionaries to ascertain its generally accepted meaning and have then undertaken to determine its application to the circumstances of the particular case. The court used a comprehensive approach, considering such factors as the general rules regarding statutory interpretation, the commonly accepted meaning of

manufacture as found in Duke Power Co. v. Clayton, 274 N.C. 505, 164 S.E. 2d. 289 (1968), the complexity of the process involved, and cases from other jurisdictions.

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In Duke Power the court stated that the connotative meaning of manufacturing is “the making of a new product from raw or partly wrought materials.” Although HED relies heavily on this definition, we heed the Court’s suggestion in Master Hatcheries that we consider the definition in light of the circumstances of the particular case. A literal application of this definition which HED urges, could result in the inclusion of any business that produces a product. For example, word processing companies take in rough drafts of written materials and produce highly literate well-printed documents but word processing operators are hardly referred to as manufacturers.

HED strenuously argues that such processes as the assemblage of hamburgers and mixing of dough to form biscuits fit the technical perimeters of the above definition. However, manufacturing as that term is commonly understood does not include the mere preparation of food items at a restaurant exclusively for sale on the premises. The essence of Hardee’s operation is the selling or merchandising of its products, not production. Moreover, Hardee’s food preparation is significantly different from the intricate and elaborate industrial operations that have been classified as manufacturing in the past.

In McDonald’s Corporation v. Oklahoma Tax Commission, 563 P.2d 635, the Supreme Court of Oklahoma concluded that “preparation of food for immediate retail sale is not manufacturing or processing ..., in that such preparation or cooking of food is not ‘generally recognized’ as manufacturing or processing.” In arriving at its decision, the Court cited Kansas City v. Manor Baking Company, 377 S.W. 2d 545 (Mo. App. 1964), which addressed whether a business was a manufacturer or a merchant baker.

The Court, in McDonald’s, also cited Roberts v. Bowers, 170 Ohio St. 99, 182 N.E. 2d 858, a property tax case concerning a restaurant. In ruling against the taxpayer, the Ohio Supreme Court reasoned:

The primary purpose of the appellant here is to serve prepared food to the general public. Preparation and mixing of the food from raw materials (as, for example, Salisbury steak and salads) certainly partake of a manufacturing process, but not heretofore during the many years of existence of the statutory definition has one thought of a restaurant proprietor as a manufacturer.

Based on the above, the concentrate and the ethylene generator, when used by a produce warehouse, are not entitled to the sales and use tax exclusions and exemptions for processing tangible personal property for sale. Produce warehouses are not processors, but wholesaling, distributing, or retailing facilities. Therefore, sales of the concentrates to produce warehouses and purchases of ethylene generators by ABC for use by a produce warehouse are subject to the sales and use tax.

Note: The above conclusions are based on the facts set forth above. In the facts presented, the concentrate and the ethylene generators are being used by a warehouse whose purpose is the sale or distribution of produce and, in some cases, other merchandise. If a facility's purpose is the ripening of produce, then the exemption and exclusion may be applicable since such a facility's purpose may be the processing of tangible personal property for sale. Such a determination will depend on the facts. In addition, there are no facts indicating that there are two facilities, a warehouse facility and a processing facility. If such were the case, the exemptions and exclusions from the sales and use tax may be applicable.