



SC REVENUE RULING #91-8

- SUBJECT:** Water Treatment Plants
(Sales and Use Tax)
- TAX ANALYST:** Deana West
- EFFECTIVE DATE:** With respect to traveling water screens, the effective date is July 1, 1991. With respect to all other issues, this ruling applies to all periods open under statute.
- SUPERCEDES:** All previous documents and any oral directives in conflict herewith.
- REFERENCE:** S.C. Code Ann. Section 12-36-2120(17) (Supp. 1990)
- AUTHORITY:** S.C. Code Ann. Section 12-3-170 (Supp. 1989)
SC Revenue Procedure #87-3
- SCOPE:** A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Questions:

1. Are the raw water pump, traveling water screen, valve vault, iron pipe, chemical basin mixer, flocculators, sludge collection machinery, chemical machinery, various chemical tanks, various pumps which convey finished water, and the related concrete, piping, electrical and mechanical instrumentation used in expanding a municipal water treatment plant, as described in the facts, exempt from sales and use tax pursuant to Code Section 12-36-2120(17)?
2. Are the granular media filters, fiberglass troughs, electrical and mechanical instrumentation, steel pipes and related piping, steel and concrete used in constructing a filter building addition at a municipal water treatment plant, as described in the facts, exempt from sales and use tax pursuant to Code Section 12-36-2120(17)?

Facts:

A contract has been awarded for the construction and installation of the surface water treatment plant expansion and water treatment facilities for a South Carolina municipality. The facility produces water for use by residents and businesses in the area.

The water treatment plant expansion includes the construction and/or installation of the following items which are numbered to correspond to the water process described below:

1. Raw water pump and traveling water screen
2. Concrete valve vault and mechanical instrumentation
3. Ductile iron pipe
4. Chemical basin mixer, flocculators, rectangular sludge collection machinery
5. Granular media filters, fiberglass troughs, electrical and mechanical instrumentation, stainless steel pipe
6. Chemical machinery and various chemical tanks
7. Various pumps which convey finished water
8. Pipe, electrical and instrumentation work, miscellaneous steel items and concrete used in constructing or installing items 1 - 7 above.

The addition to the water treatment process can be described as follows:

1. Raw water enters an intake structure containing a traveling water screen and a raw water vertical pump from the Intra- coastal Waterway and is piped immediately to the plant for processing. The traveling water screen removes large debris from the raw water so the pumps will not be damaged.
2. A concrete enclosed, underground valve vault containing valves, motors, and mechanical instrumentation is used to divert the flow of water. The instrumentation is very sensitive to weather and is enclosed within a concrete structure for protection.
3. The water is then piped through an existing meter vault. A new pipe from the valve vault is being installed to meter the flow of influent water.
4. Moving through an existing preozone contact chamber and rapid mix tank, the water is to be dispersed into a flocculation and settling basin once constructed. The settling basin, a rectangular concrete structure, is equipped with flocculation and sludge collection machinery whereby solid particles settle out of the water and the waste is piped to a sludge pond (See Exhibit A).
5. The final filtration process occurs in the filter building which has granular media filters, troughs, pipe and electrical and mechanical instrumentation. The filter building is composed of concrete, brick, glass, and other materials and is covered to protect water from contamination before use by customers (See Exhibit B).
6. Chemicals are injected at various points in the filtration process, both before and after the water passes through the filter building. The chemicals are conveyed through small diameter pipelines and are pumped from a number of chemical pumps which are fed from

various chemical tanks. A caustic storage tank, a hydrofluosilicic tank, a polyphosphate tank and a polyphosphate day tank are being built.

7. Once the process is complete in the filter building, the water treatment plant will use various pumps to provide the final means of water conveyance. The pumps under construction will pump finished water from the filters to the existing clearwells for storage, pump water back from the clearwells to the municipality for distribution to the public and pump water from the finished water line back to the ozone building for use in the manufacture of ozone.

Discussion:

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...

Regulation 117-174.145 provides that "sales of machines to municipalities for use in processing water are not subject to the [sales and use] tax."

Furthermore, Regulation 117-174.120 provides an interpretation of the term "machines" and reads, in part:

The terms "...parts of such machines" are restricted to the following: (a) they must be used or manufactured for use, on or in the operation of such machines; (b) necessary to the operation of such machines and (c) customarily so used. These restrictions are interpreted to mean that the part or attachment must be purchased in the form in which it will be used by the manufacturer without any fabrication or alteration by him, except the usual and customary minor adjustment (except as stated at 117-174.123) and that it is a standard part or attachment customarily used and, further, that the machine or machinery on which it is used would not do the work for which it was designed if it were not used.

This, of course, exempts all parts and attachments without which the machine would do no work, and, in addition, it exempts parts and attachments designed to increase the efficiency of the machine.

The law, therefore, provides that machines, their parts and attachments, subject to certain restrictions, that are used by a municipality in processing water for sale qualify for the exemption found in Code Section 12-36-2120(17). However, as a general rule, tax exemption statutes are strictly construed against the taxpayer. Owen Industrial Products, Inc. v. Sharpe, 274 SC 193, 262 SE 2d 33 (1980), Hollingsworth on Wheels, Inc. v. Greenville County Treasurer et al, 276 SC 314, 278 SE 2d 340 (1981). This rule of strict construction simply means that constitutional and statutory language will not be strained or liberally construed in the taxpayer's favor. York County Fair Association v. SC Tax Commission, 249 SC 337, 154 SE 2d 361 (1967).

In order to determine whether machines and attachments are used in processing water for sale, it is essential to ascertain the points at which processing at the municipal water treatment plant begins and ends. American Law Reports Annotated 2d suggests the following in making this determination and reads:

While the determination of whether the use is a taxable one or not appears to depend largely upon the peculiarities of the taxpayer's operations, so as to be essentially a question of fact in each case, it seems that the tax will be imposed where the transportation or storage is clearly of raw materials prior to the start of manufacturing or processing, or of the completed product after such operations have clearly terminated, but that the handling and storage intermediate to the various manufacturing or processing operations may be regarded as a part of those operations, and so free from the tax. Annot., 30 A. L. R. 2d 1449 (1953).

Also, in Bird & Son, Inc. v. Limbach, 45 Ohio St. 3d 76, 543 N.E.2d 1161 (1989), the Ohio Supreme Court concluded that "tangible personal property which is employed in operations preliminary or preparatory to the production of the marketable product,..., or employed subsequent to the completion of the manufacturing process,..., is not exempt" (emphasis added).

Based upon this reasoning and the above facts, the processing of water begins at the existing rapid mix tank and ends with the final filtration in the filter tanks located in the filter building. Machines and their parts and attachments, including the chemical machinery, contained within the water process are exempt from sales and use tax.

It must now be determined whether the chemical tanks are "machines" allowed the exemption from sales and use tax provided in Code Section 12-36-2120(17). The following regulations provide guidance in making this determination and read as follows:

Regulation 117-174.140 - Tanks which are part of the chain of processing operations are exempted by the machine exemption.

Regulation 117-174.141 - Storage tanks are not exempted from the tax by the machine exemption.

Regulation 117-174.139 - Piping leading to and from storage tanks...does not come within the machine exemption.

Based upon the above regulations, the chemical tanks described in the facts are not "machines" for tax purposes since there is no processing taking place in the chemical tanks. Instead, the chemical tanks are storage tanks.

Finally, it must be determined whether the flocculators and the filter building are machines. In other words, can a structure affixed to the land be a machine. The Court of Appeals in South Carolina reviewed this issue in Hercules Contractors and Engineers, Inc. v. South Carolina Tax Commission, 280 SC 426, 313 SE2d 300 (1984). The court concluded the Klopman facility, which treated waste in connection with the manufacture of textile products for sale, was a machine used in the manufacture of tangible personal property and was exempt from sales taxes.

Our court cited Commonwealth v. Philadelphia Electric Company, 472 Pa. 530, 372 A.2d 815 (1977), a property tax decision dealing with the "problem of the connection of a manufacturing machine with the land upon which it sits", which summarized the test for determining what is machinery and equipment, first formulated in [In re Borough of Aliquippa] Jones & Laughlin, 405 Pa. [421] at 431, 175 A.2d [856] at 861. The court held:

[I]mprovements, whether fast or loose, which (1) are used directly in manufacturing the products that the establishment is intended to produce; (2) are necessary and integral parts of the manufacturing process; and (3) are used solely for effectuating that purpose are excluded from real estate assessment and taxation. On the other hand...improvements which benefit the land generally and may serve various users of the land are subject to taxation.

Our court further concluded that a "particular 'structure' may or may not constitute a machine for tax purposes, depending not upon its form but upon its use" and "that the difference between buildings and the vats and basins at issue here is readily apparent. The concrete vats and basins of Klopman, unlike buildings, have utterly no use apart from the machine of which they are an integral part".

The flocculators under construction appear to be improvements to realty; however, the flocculators are machines for tax purposes under the tests established in Hercules v. South Carolina Tax Commission, supra.

In determining whether the "filter building" is a machine or building, Commission Decision S-D-74 provides guidance. This August 13, 1971 decision involved the construction of a large dome-shaped structure housing the nuclear reactor at a nuclear plant in South Carolina. The structure, required to contain radioactive particles, prevented the same from escaping into the atmosphere and possibly injuring persons or property. The Commission Decision concluded "the purpose that the structure serves is not unlike the building that houses or contains a textile manufacturing plant in that humidity and temperatures must be regulated in order to produce a quality product" and was therefore subject to the sales and use tax.

Based upon the court's determination in Hercules v. South Carolina Tax Commission, supra and Commission Decision S-D-74, the filter tank portion of the filter building under construction is a machine. The filter building shell, however, is not a machine for tax purposes.

Conclusion:

1. The iron pipe, chemical basin mixer, flocculators, sludge collection machinery, piping, and the related chemical machinery, concrete, piping and electrical and mechanical instrumentation contained within the water process from the rapid mix tank to the filter building tanks used in expanding a municipal water treatment plant, as described in the facts, are exempt from sales and use tax as provided under Section 12-36-2120(17).

The raw water pump, traveling water screen, valve vault, various chemical tanks (caustic storage tank, hydrofluosilicic tank, polyphosphate tank and polyphosphate day tank), various pumps which convey finished water and the related concrete, piping and

electrical and mechanical instrumentation used in expanding a municipal water treatment plant, as described in the facts, are not exempt from sales and use tax. (See note below to exempt the traveling water screen from sales and use tax.)

2. The granular media filters, fiberglass troughs, electrical and mechanical instrumentation, steel pipes and related piping, steel and concrete used in constructing the filter tank portion of a municipal water treatment plant's filter building, as described in the facts, are exempt from sales and use tax under Code Section 12-36-2120(17).

However, the concrete, brick, glass, and other materials used to construct the shell of the filter building are not exempt from sales and use tax.

NOTE: Effective July 1, 1991, the imposition of sales and use tax upon traveling water screens used in manufacturing and processing will be a question of fact and determined on a case by case basis.

Although the traveling water screen discussed in the facts above is preliminary and preparatory to the processing of water, this traveling water screen would be exempt from sales and use tax if it was purchased under the terms of a pre-July 1991 contract.

Such an exception will be made for similar taxpayers who purchased traveling water screens under the terms of a construction contract executed prior to July 1, 1991 or a written bid submitted prior to July 1, 1991 that culminates in a construction contract.

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
May 22, 1991