Cite as Det No. 12-0029, 32 WTD 179 (2013)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 12-0029
. . .	)	
	)	Registration No. . . .
	)	Document No. . . ./Audit No. . . .
	)	
	)	Docket No. . .

[1] RCW 82.60.020: RURAL COUNTY SALES AND USE TAX DEFERRAL – SEED CONDITIONING – QUALIFIED BUILDINGS. The "conditioning of vegetable seeds" is limited to the cleaning, drying, scarifying, and coating of seeds for purposes of the rural county sales and use tax deferral available for certain manufacturing activities. A seed vault and storage building were not essential or integral parts of a factory or plant used for seed conditioning.

[2] RULE 24001A; RCW 82.60.020: RURAL COUNTY SALES AND USE TAX DEFERRAL – RESEARCH & DEVELOPMENT – QUALIFIED BUILDINGS. Development of foundation seed and stock seed constitute "research and development." A seed vault and storage building were not essential or integral parts of a laboratory used for research and development.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Sohng, A.L.J. – Seed manufacturer protests the denial of the sales and use tax deferral for investments in rural counties with respect to a seed vault and a storage building that houses equipment used to plant and harvest seed. We deny the petition.[1]

ISSUES

1. Are a seed vault and an equipment storage building essential or integral parts of a factory or plant used for "seed conditioning," for purposes of the tax deferral under RCW 82.60?

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

2. Are a seed vault and an equipment storage building essential or integral parts of a laboratory used for "research and development," for purposes of the tax deferral under RCW 82.60?

FINDINGS OF FACT

[Taxpayer] is a Washington corporation . . . . Taxpayer is a real estate holding company engaged in the business of leasing buildings . . . . [The seed company] is a Washington corporation . . . engaged in the business of producing, conditioning, and selling vegetable seeds.

Deferral Project

On February 26, 2009, Taxpayer applied to the Department for the rural county sales and use tax deferral provided by RCW 82.60 for two buildings constructed for certain manufacturing and research and development activities. Taxpayer leases the buildings to [the seed company].

On March 2, 2009, the Department approved Taxpayer's deferral application and issued Rural County Sales and Use Tax Deferral Certificate . . . which was valid for deferral of sales and use tax incurred from March 2, 2009, through June 30, 2009 (the "Deferral Period"). The Department's approval letter notified Taxpayer that the Audit Division would verify that Taxpayer was "performing qualified activities at this facility and that 100% of the structure . . . [was] eligible for the deferral."

The Audit Division examined Taxpayer's books, records, and facilities relating to the project authorized under the Deferral Certificate for the period August 1, 2006, through May 31, 2010 (the "Audit Period"). On February 3, 2011, the Audit Division disallowed the deferral and issued Assessment No. . . . in the amount of $. . .; including $. . .in use tax/deferred sales tax, $. . .in interest, and $. . . in penalties. Taxpayer appeals this assessment.

Foundation Seed

[The seed company's] seed production activities begin at its [research] facility located in [Town A], Washington. [The seed company's] research team cross-breeds various vegetable species in order to identify and isolate desirable traits, such as disease resistance, leaf pucker, and shelf life. It generally takes five to seven years to isolate a desirable trait and to develop a few grams of seed that carry the desirable traits (known as "foundation seed"). Once a sufficient quantity of genetically stable foundation seed has been produced at the research facility, [the seed company] transfers it to the Seed Vault (described below).

Stock Seed

The initial few grams of foundation seed are repeatedly planted, harvested, and processed by cleaning and drying machinery until approximately 50 pounds of seed are produced (known as "stock seed"). Stock seed is the raw material that [the seed company] starts with to eventually create a commercially viable seed. [The seed company] does not sell its stock seed . . . . Stock

seed serves only as a repository of useful genetic material that is combined with the useful genetic material in other strains of stock seed to produce a commercially viable seed.

[The seed company] propagates the stock seed by planting them in small, isolated fields of approximately two to five acres, each containing only one strain of stock seed. [The seed company] continually tests and evaluates the stock seed at its research facility in [Town A, Washington] to determine if it has remained viable and has retained the desired, isolated trait. When sufficient volumes of a desired stock seed strain have been created, [the seed company] cross breeds it with other stock seed strains to determine if a commercially useful product will result.

Commercial Seed

Once [the seed company's] research department discovers a successful formula for cross breeding stock seed, it combines the appropriate strains of stock seed in a commercial production field . . .

Seed Processing

[The seed company] processes harvested seed in the following manner:

1. *Receiving*. Seeds generally arrive at the plant in a roughly cleaned state and undergo a mechanical scalping process, which quickly removes sticks, stems, and other plant material, as well as small seeds that do not meet size requirements. If the seeds have a high moisture content, they are dried in a lot stabilization process. The scalping process significantly reduces the amount of material to be dried, thus shortening the time that it takes to lower the moisture level down to a stable level. During the receiving stage, a representative sample is collected and sent to [the seed company's] laboratories for analysis.

2. *Initial Cleaning*. The cleaning process may take different paths through the mill that require the use of several specialized pieces of cleaning equipment, depending on what materials need to be removed. Such materials include weed seeds or plant parts that may be of similar size, color, or weight to the seeds being cleaned; sticks that are physically attached to the seeds; small particles of soil that are of similar size to the seeds being cleaned; and in certain cases, the corky outer shell of the seed.

3. *Post Cleaning Operations*. There are many seed lots that cannot be cleaned sufficiently in the initial cleaning process to meet quality standards and therefore require additional seed enhancement procedures that target a unique problem. . . . Once the seeds are of proper quality, new samples are collected for germination and physical and genetic purity analysis. Seeds that cannot be cleaned to a proper state or fail to meet genetic purity standards are discarded. After the seed lot has been processed and meets all quality standards, it can be treated, packed, and used as needed.

Building #1 – Seed Vault

The first building Taxpayer constructed under the deferral project was a seed vault located across the street from its primary facility in [Town B], Washington (the "Seed Vault"). The Seed Vault is a . . . storage facility . . . . [The seed company] maintains . . . strains of both foundation seed and stock seed in the Seed Vault. No commercial seed is stored in the Seed Vault.

Building #2 – Storage Building

The second building that Taxpayer constructed under the deferral project was primarily a storage facility (the "Storage Building") that [the seed company] uses to store and maintain machinery and equipment . . . (the "Equipment"). The Storage Building is [in Town B]. In addition to the storage and maintenance of the Equipment, portions of the Storage Building were used during the Audit Period as office space . . . .

> *Stock and Foundation Seed.* [The seed company] uses some of the Equipment to perform all of its agricultural operations relating to stock seed and foundation seed, from original ground preparation prior to sowing through post-harvest final ground preparation, including planting seeds, cultivating fields, and harvesting the seeds. Foundation seed is planted at the research facility in [Town A], Washington while the stock seed is planted in various locales across [Washington] counties . . . .
>
> *Commercial Seed.* With respect to commercial production, [the seed company] uses some of the Equipment only for planting seeds and transplanting existing plants, as well as occasional cultivation, fertilizer side-dressing, and roto-tilling. . . .

ANALYSIS

[1] The rural county sales and use tax deferral program is provided under RCW 82.60 *et seq.* This deferral is available to certain businesses engaged in manufacturing, research and development, or computer-related activities in eligible areas of Washington. Under this deferral, taxpayers may defer paying sales and use taxes otherwise due on investments in qualified buildings, machinery, and equipment to be used therein as an integral and necessary part of the manufacturing, research and development, or computer operations of an eligible investment project. *See generally* RCW 82.60.020.

The tax deferral is available only for "eligible investment projects." "Eligible investment projects" means an "investment project that is located . . . in an eligible area." RCW 82.60.020(4)(a). An "eligible area" is a rural county as defined in RCW 82.14.370. RCW 82.60.020(3)(a). There is no dispute as to whether Taxpayer's Deferral Project was conducted in an eligible area and therefore, this element of the tax deferral is not at issue.

An "investment project" is an investment in qualified buildings or qualified machinery and equipment, including labor and services rendered in the planning, installation, and construction of the project. RCW 82.60.020(6). "Qualified buildings" means:

> [T]he "construction of new structures . . . used for manufacturing or research and development activities, including plant offices and warehouses or other facilities for the storage of raw material or finished goods if such facilities are an essential or an integral part of a factory, mill, plant, or laboratory used for manufacturing or research and development. If a building is used partly for manufacturing or research and development and partly for other purposes, the applicable tax deferral must be determined by apportionment of the costs of construction under rules adopted by the department.

RCW 82.60.020(9) (emphasis added).

1. Seed Conditioning

RCW 82.60.020(7)(b) provides that the term "manufacturing" expressly includes "the conditioning of vegetable seeds." The Audit Division disallowed the deferral on the grounds that neither the Seed Vault nor the Storage Building was an integral or necessary part of seed conditioning. The Audit Division narrowly construed the term "seed conditioning" to include only the cleaning, drying, and coating of seeds. On that basis, the Audit Division concluded that "the buildings used to store stock seed prior to planting and to shelter farming machinery and equipment used in the farming operation do not qualify for deferral."

Taxpayer, on the other hand, argues that the Audit Division's interpretation is too narrow:

> Seed conditioning is properly defined as the selection and manipulation of plant seeds to isolate useful traits for combination with other useful traits resulting in a seed that is in a proper state for use for production of food. Drying and cleaning seeds are an inherent part of the process, but so are the storage facilities, equipment and machinery necessary to convert seed from foundation seed to stock seed and finally to the end product of commercial production seed.[2]

. . . In interpreting exemption provisions, the burden is squarely upon the taxpayer to show that the exemption applies and any ambiguity is "construed strictly, though fairly and in keeping with the ordinary meaning of their language, against the taxpayer." Det. No. 04-0147, 23 WTD 369, 375 (2004) (quoting *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 150, 3 P.3d 741 (2000)).

The term "conditioning of vegetable seeds" or "seed conditioning" is not defined in RCW 82.60.020 or the administrative regulations promulgated by the Department. When statutory terms are not defined in the statute, we generally turn to their ordinary dictionary meaning. *Western Telepage, Inc. v. City of Tacoma*, 140 Wn. 2d 599, 609, 998 P.2d 884 (2000); *see also*

[2] Taxpayer's Supplemental Petition, dated March 24, 2011, at 3-4.

Palmer v. Department of Rev., 82 Wn. App. 367, 372, 917 P.2d 1120 (1996). But when an otherwise common word or phrase is given a distinct meaning in a technical dictionary or other technical reference and has a well-accepted meaning within the industry, and when the word is used in a rule promulgated by an expert agency familiar with the technical meaning, courts turn to a technical rather than a general purpose dictionary to resolve ambiguities in its definition. *City of Spokane v. Dep't of Revenue*, 145 Wn.2d 445, 454, 38 P.3d 1010 (2002); *see also Blue Mountain Mem'l Gardens v. Dept. of Licensing*, 94 Wn. App. 38, 43, 971 P.2d 75 (1999).

In determining what is included in the term "the conditioning of vegetable seeds," the Department refers to RCW 15.49, formerly known as the Washington State Seed Act. RCW 15.49.011(6) defines "conditioning" as follows:

> "Conditioning" means drying, cleaning, scarifying, and other operations that could change the purity or germination of the seed and require the seed lot to be retested to determine the label information.

In addition, references to commercial terms should be given the meaning commonly used in the regulated industry, absent clear legislative intent to the contrary. *Restaurant Development, Inc. v. Cananwill, Inc*. 150 Wn. 2d 674, 685, 80 P.3d 598 (2003). The term "seed conditioning" has a well-accepted meaning in the seed industry as the removal of undesirable material, including debris and stray seeds, from raw harvested seed in order to create planting seed that delivers high-yielding crops. *See* BILL GREGG & GARY BILLUPS, SEED CONDITIONING, VOLUME 1 at Foreward (2009) ("Seed conditioning processes raw harvested seed into pure crop seed which is free of undesirable materials, protected from pests and diseases, and can be planted properly to give the farmer a good stand of healthy plants of the desired crop.").

Gregg and Billups further characterize seed conditioning thusly:

> Seed conditioning involves drying the seed to safe moisture contents, cleaning the seed to remove undesirable materials, sometimes treating the seed with a protective chemical, and packaging the seed in the package sizes needed by the using farmers.

Id. at 13.

Because the statutory definition found in RCW 15.49.011 is consistent with the industry meaning of the term, we adopt the definition of "seed conditioning" set forth in RCW 15.49.011 for purposes of the deferral provided under RCW 82.60. Thus, "seed conditioning" is limited to the cleaning, drying, scarifying, and in some cases, coating of seeds.

Because the storage of stock and foundation seed in the Seed Vault occurs well in advance of drying, cleaning, or scarifying of seeds, it is not an essential or integral part of a plant used for "seed conditioning." Thus, the Seed Vault is not a "qualified building" under RCW 82.60.020(9) and does not qualify for the deferral under RCW 82.60. With respect to the Storage Building, the Equipment housed therein is used to plant and harvest seed, which also occurs well in advance of the seed conditioning process, and as such, is not an essential or integral part of a

plant used for "seed conditioning." The Storage Building is not a "qualified building" and does not qualify for the deferral under RCW 82.60. Taxpayer's petition is denied with respect to the seed conditioning issue.

2. Research & Development

[2] The next inquiry is whether the Seed Vault or the Storage Building qualifies for the deferral under RCW 82.60 as an essential or integral part of a research and development laboratory. RCW 82.60.020(14) defines "research and development" as:

> [T]he development, refinement, testing, marketing, and commercialization of a product . . . before commercial sales have begun, but only when such activities are intended to ultimately result in the production of a new, different, or useful substance or article of tangible personal property for sale.

Similarly, Rule 24001(2)(c) defines "research and development" as:

> [T]he development, refinement, testing, marketing, and commercialization of a product, service, or process before commercial sales have begun, but only when such activities are intended to ultimately result in the production of a new, different, or useful substance or article of tangible personal property for sale. For purposes of this section, "commercial sales" excludes sales of prototypes or sales for market testing if the total gross receipts from such sales of the product, service, or process do not exceed one million dollars.

The activities that [the seed company] engages in with respect to creating foundation seed and stock seed constitute "research and development" as defined by RCW 82.60.020(14) and Rule 24001(2)(c). First, such activities develop, refine, and test the seeds until a sufficient quantity of a desirable, viable product results. Second, [the seed company's] activities are intended to result in a new, different, or useful article of tangible personal property for sale, namely, the commercial seed that is ultimately sold to customers. And finally, these activities all occur well before sales of commercial seed have begun. Thus, [The seed company's] development of foundation seed and stock seed constitute "research and development" under RCW 82.60.020(14).

Having established that [the seed company's] foundation seed and stock seed activities constitute "research and development," it must be determined whether the Seed Vault and the Storage Building are essential or integral parts of a research and development laboratory. Rule 24001(3)(c)(i) explains that qualified buildings include "plant offices and warehouses if such facilities are essential to or an integral part of a . . . laboratory used for . . . research and development." Rule 24001(3)(c)(i)(B) provides that "warehouse" means:

> [B]uildings or facilities used for the storage of raw materials or finished goods. A warehouse may be located in a separate building from the building used for manufacturing or research and development activities, but the warehouse must be located

> at the same site as the qualifying building in order to qualify. Warehouse space may be apportioned based upon its qualifying use.

(Emphasis added.) The Seed Vault is used for the storage of raw materials, namely, the stock seed that is used to eventually develop commercially viable seed. Thus, the Seed Vault will be a "qualified building" with respect to research and development if it meets the definition of "warehouse" under Rule 24001(3)(c)(i)(B). The Seed Vault is located in [Town B], Washington and the research facility is located in [Town A], Washington . . . . Because the Seed Vault is not located at the same site as the research and development facility, it is not a "warehouse," and consequently, not a "qualified building" under Rule 24001(3)(c)(i). Thus, the Seed Vault does not qualify for the deferral under RCW 82.60 as an essential or integral part of a research and development laboratory.

Regarding the Storage Building, it will be a "qualified building" with respect to research and development if it is an "essential or integral part" of [the seed company's] research laboratory in [Town A], Washington. We addressed this issue in the context of whether a storage building was an essential or integral part of a factory, mill, or plant under RCW 82.60.020(8)[3] in Determination No. 04-0147, 23 WTD 369 (2004). That determination involved a processor of agricultural products whose cold storage warehouse was located miles away from the actual processing facility. Without the refrigerated warehouse, no processing operation could occur because the agricultural products would rot. The Department held that:

> Physical proximity determines whether a building is part of a factory, mill or plant. Therefore, in order to be 'an essential or an integral part of a factory, mill, or plant,' Taxpayer's warehouses would have to be contiguous to Taxpayer's [agricultural product] processing facility – the actual factory, mill, or plant – in order to qualify for tax deferral.[4]

Id. at 375.

Likewise, in order for the Storage Building to be an "essential or integral part" of a laboratory used in research and development, it must be contiguous to [the seed company's] actual research facility in [Town A], Washington. However, the Storage Building and the research facility are not contiguous and in fact, are . . . miles apart. Under the holding of 23 WTD 369, we conclude that the Storage Building is not an essential or integral part of [the seed company's] research laboratory. Taxpayer's petition is denied with respect to the research and development issue.

[3] RCW 82.60.020(8) (the definition of "qualified buildings") was renumbered to 82.60.020(9). 2010 WASH. LAWS c. 114, § 138.

[4] Det. No. 04-0147, 23 WTD 369 (2004) was published prior to the 2006 amendment to Rule 24001 that required warehouses to be located at the same site as the qualified building.

DECISION AND DISPOSITION

Taxpayer's petition is denied in full.

Dated this 22nd day of February 2012.