

REDACTED VERSION

November 16, 2012

[redacted]

Re: Formal Ruling 12-10

Dear [redacted]:

This is a formal ruling for [Taxpayer], regarding the applicability of the sales tax exemption for fuels used in manufacturing. This ruling is based upon representations in your letters of [dates], and the Taxpayer Web site which you noted.

RULING

Based upon the facts presented, Taxpayer's use of diesel fuel in its [redacted] paper shredding units is not exempt from sales and use tax as fuel used in manufacturing.

FACTS

Taxpayer is a [state] business providing document and media destruction services. On its [redacted] Web site, it describes the services it offers as follows:

[redacted] paper shredding, document imaging, off-site records storage, electronic media storage and electronics recycling. [redacted]

Taxpayer operates [redacted] paper shredding units. [Redacted]. The units are powered by diesel fuel. The byproduct of Taxpayer's shredding service is shredded paper. Taxpayer sells this shredded paper to paper mills. The paper mills use the shredded paper to produce facial tissues, toilet paper and recycled paper.

DISCUSSION

You have asked for a ruling that Taxpayer's use of diesel fuel in its [redacted] paper shredding units will be exempt from the sales and use tax as fuel used in manufacturing. You

request that the Department find that shredding paper qualifies as manufacturing; or in the alternative, that shredding paper is part of a larger series of manufacturing steps which include the production of facial tissues, recycled paper, etc., because Taxpayer sells the shredded paper to other businesses which then produce the facial tissues, recycled paper, etc.

Vermont's sales and use tax laws provide an exemption for "Sales of electricity, oil, gas, and other fuels used directly or indirectly in manufacturing tangible personal property for sale." 32 V.S.A. § 9741(34).

Taxpayer provides a document destruction service to its customers, in which it shreds paper documents provided to it by the customer. The resulting by-product of this service is shredded paper. Taxpayer asserts that its production of the shredded paper qualifies as "manufacturing" and the use of diesel fuel to power the shredding apparatus is therefore exempt fuel used in manufacturing.

Tax exemptions are strictly construed against the taxpayer by confining their meaning to the express letter or necessary scope of their language. Hopkinton Scout Leaders Ass'n v. Town of Guilford, 176 Vt. 577, 578 (2004); Richard and Amy Tarrant v. Department of Taxes, 169 Vt. 189, 206 (1999); Wettersau, Inc. v. Department of Taxes, 141 Vt. 324, 329-330 (1982).

The Supreme Court has found that "'manufacture' is generally regarded as the process of 'transforming raw materials into an altered form for use.'" Wettersau, Inc. v. Department of Taxes, 141 Vt. at 328-9. In that case, the Court held that cutting meat, poultry and fish into smaller pieces was not a sufficient change to qualify as a "transformation into an altered form," and was therefore not "manufacturing." When Taxpayer provides its shredding service to a customer, the byproduct is smaller pieces of the original larger pieces of paper. Under the

holding of the *Wettereau* Court, this is not a sufficient change to qualify as a “transformation into an altered form” and would not constitute “manufacturing.”

You suggest that Taxpayer’s paper shredding differs from meat cutting, because the “end-use remains the same” for the meat, but not for the paper. You state that the smaller pieces of paper may no longer be used to record information. But by the same token, smaller pieces of chicken could just as easily be said to have a different end use, since ground chicken does not have the same end use as a whole chicken, except in the most general sense, as food. In any case, the *Wettereau* Court did not look at whether the end use could in any sense be called “the same;” it looked at the fact that making smaller pieces was not a sufficient transformation to be called manufacturing.

You also propose that *Wettereau* does not apply, because it dealt with the cutting of “raw material” into pieces, and you assert that paper is not a “raw material.” You propose that paper is not a “raw material” because it is not a material found in nature, such as the “wood, metal, rubber and minerals” listed in the Department’s regulation as “tangible personal property.”¹ That regulation establishes that items such as wood, metal, rubber and minerals, which are unprocessed materials, will still be subject to sales tax when sold, because they are tangible personal property. On the other hand, the *Wettereau* Court used “raw material” in a similar but somewhat broader sense, to refer to the unprocessed starting material which is then “transformed” in the manufacturing process. Clearly, the starting material may be something other than that found in nature - such as sheet metal for manufacture of cars, or polystyrene for manufacture of toys. In any case, the point of *Wettereau* is not whether the starting material is

¹ Tax Department Reg. § 1.9701(7)-1(A)(1) defines “tangible personal property” (tpp) for purposes of the sales tax. It provides that tpp includes “but is not limited to . . . raw materials, such as wood, metal, rubber and minerals.” This definition lists those four items as examples of raw materials, and the prefatory words “such as” and “not limited to” explain that the list is not an exclusive list of all raw materials. While the four items listed are all “items found in nature,” they might also be described as “unprocessed items.”

found in nature. The point of *Wettereau* is that the starting material needs to be processed in a more significant manner than merely cutting it into smaller pieces.

It is noted that even if the cutting of paper into smaller pieces may be said to qualify as manufacturing - which under *Wettereau* it may not - Taxpayer would not qualify as a “manufacturer,” because it is not primarily dedicated to the paper cutting activity. The Court in *Wettereau* made clear that a business engaged in manufacturing activity would only qualify as a “manufacturer” if its business were “exclusively, or at least primarily dedicated to manufacturing:”

Finally, we think it evident that the legislature, in providing the exemption for manufacturers contained in § 9741(16), intended it be available only to those taxpayers whose business is exclusively, or at least primarily, dedicated to manufacturing. The exemption should not be broadly construed so as to bring even incidental manufacturing activity within its scope. *In re Middlebury College Sales & Use Tax*, 137 Vt. 28, 31, 400 A.2d 965, 967 (1979) (exemptions from taxation are to be strictly construed).

Id. at 329. Taxpayer is not primarily in the business of cutting paper into smaller pieces. By its own description on its Web site, Taxpayer is in the business of

[H]andling and disposal of your confidential information and electronics. Specializing in paper shredding, document imaging, off-site records storage, electronic media storage and electronics recycling.

Thus, under the reasoning of *Wettereau*, Taxpayer would not qualify as a “manufacturer.”²

Alternatively, you propose that when Taxpayer shreds paper, this step is part of a larger series of manufacturing activities because the shredded paper is ultimately used by other businesses to manufacture facial tissues, recycled paper, etc. This interpretation would not be a strict reading of the exemption, as the law requires. It would be an unacceptably broad reading, to mean that

² This portion of the *Wettereau* case, however, addresses the exemption in Subsection (16), and not the fuel exemption in Subsection (34).

the manufacturing need not be done by the taxpayer who is claiming the exemption. The result of such a broad reading would be that any supplier business that prepared raw material in any way before supplying it to a manufacturer would qualify as part of the ultimate manufacturing process. This broad reading would also contravene the definition of "manufacturing" under Section 9741(34), as follows:

The Subsection (34) exemption for fuels used in manufacturing defines "manufacturing" by reference to the definition of "manufacturing" in Subsection (14).³ Subsection (14), in part, exempts machinery and equipment used in the "manufacturing process." The Subsection (14) "manufacturing process" begins "with the first production process" and does not include "activities prior to the first production stage (such as collecting, weighing, testing, and bulk storage of raw materials)." In other words, machinery and equipment used to collect, weigh, test and store raw materials is not exempt from sales tax, because not used in the "manufacturing process." If, as you propose, Taxpayer's shredding of the paper is merely the first step in the entire process of manufacturing facial tissues, then any activities by the facial tissue company such as collecting, weighing, testing or bulk storage of the raw material (i.e., the shredded paper) would now become a part of the single, larger manufacturing process. The result would be that machinery and equipment used by the tissue company in those pre-production activities could now be viewed as used in the single, larger manufacturing process which began with the shredding; and therefore, the pre-production machinery and equipment would be exempt under Subsection (14). Thus, any manufacturer which obtained its raw materials from a supplier who had processed them in any way would be able to exempt its pre-production machinery and

³ Reg. § 1.9741(34)-2 provides: "Fuel is used directly in manufacturing if used for activities that qualify as direct manufacturing defined under 32 V.S.A. § 9741(14)." Subsection (14) exempts tangible personal property which is used or consumed in the manufacturing of other tangible personal property for sale, and also exempts machinery and equipment used in the manufacturing process.

equipment. This reading of the Subsection (14) and (34) exemptions would clearly not be “confined to the express letter or necessary scope” of their language.

As a result, Taxpayer’s paper shredding service is not a manufacturing process for purposes of the fuel exemption, nor can shredding paper be viewed as part of another entity’s manufacturing process. Accordingly, the diesel used by Taxpayer for paper shredding is not exempt from the sales and use tax.

GENERAL PROVISIONS

This ruling will be made public after deletion of the parties’ names and any information which may identify the parties. A copy of this ruling showing the proposed deletions is attached, and you may request within 30 days that the Commissioner delete any further information that might identify the parties. The final discretion as to deletions rests with the Commissioner.

This ruling is issued solely to the taxpayer and is limited to the facts presented, as affected by current statutes and regulations. Other taxpayers may refer to this ruling, when redacted to protect confidentiality, to determine the department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statutes or regulations.

Emily Bergquist

Date

Approved:

Mary N. Peterson
Commissioner of Taxes

Date