2907a

TAX APPEAL BOARD

OF THE STATE OF DELAWARE

MILFORD FERTILIZER CO., INC.
Petitioner,

v.

DIRECTOR OF REVENUE,
Respondent.

Docker No. 642

Before: Joseph S. Yucht, Esquire, Chairman, Cyric W. Cain, Jr., Nettie C. Reilly, and Harry B. Roberts, Jr., members. (James C. Eberly, Esquire, Vice-Chairman did not participate in this decision.)

Randy J. Holland, Esquire of Dunlap, Holland & Eberly for Petitioner.

John P. Fedele, Esquire for Respondent.

DECISION AND ORDER

Respondent has moved for reconsideration and or rehearing of the Decision and Order dated July 20, 1979. In that opinion, we held that, based on the evidence, Petitioner is not subject to the provisions of Chapter 27, of Title 30 of the Delaware Code, as a manufacturer, but is and was subject to the provisions of 30 Del. C. §2907(a).

Respondent contends, inter alia, that:

1. We erred in that we based our decision on a matter which was not in issue; and

2. We erred as a matter of law.

We have reviewed the evidence presented, arguments submitted by the parties and our prior decision and we re-affirm our decision and conclusion of law.

This case is one of first impression and required the Board to interpret the law as it applied to the evidence presented.

When we analyzed the nature of Petitioner's operations we concluded that the provisions of 30 Del. C. §2907(a) properly apply. We are still of the same opinion. Accordingly, we deny Respondent's motion for reconsideration and rehearing.

Respondent also moved, pursuant to 30 Del. C. §§331 and 366 to extend the time for appeal to the Superior Court, should his motion for reconsideration and rehearing be denied. The Board hereby, pursuant to 30 Del. C. §331, grants Respondent's motion and extends the time to appeal to the Superior Court. Said appeal must be filed within 30 days after the date of this Order.

IT IS SO ORDERED.

Dated: February 8, 1980

BEFORE THE TAX APPEAL BOARD OF THE STATE OF DELAWARE

MILFORD FERTILIZER CO., INC.	)	
Petitioner,	)	
v.	)	Docket No. 642
DIRECTOR OF REVENUE,	)	
Respondent.	)	

Before: Joseph S. Yucht, Esquire, Chairman; Cyric W. Cain, Jr., Nettie C. Reilly, and Harry B. Roberts, Jr., Member

Randy Holland, Esquire for Petitioner.

John P. Fedele, Esquire, Deputy Attorney General for Respondent.

DECISION AND ORDER

Harry B. Roberts, Jr., Member: This case involves a deficiency determined by the Division of Revenue in taxpayer's payment of the Manufacturer's Gross Receipts Tax of Delaware, 30 Del.C., Chapter 27. The deficiency arose as a result of its not paying tax on out-of-state sales for the taxable periods involved, July 1, 1973 through the period ending December 31, 1976; the total amounts originally $23,081.84 plus interest, has been adjusted to $14,936.63 plus interest of $4,275.18.

Taxpayer, Milford Fertilizer Co., Inc., appealed the Division's determination to the Tax Appeal Board. During the pendency of the appeal, the original deficiency was revised to the latter amount stated above, because it had included sales of non-manufactured items among the taxpayer's gross receipts.

There is no dispute of the facts developed at the hearing of this case and as contained in exhibits attached to the taxpayer's brief.

Briefly, taxpayer, whose plant is located in Milford, Sussex County, Delaware, has for many years been in the business of "manufacturing" fertilizer and

selling it to farmers in the State of Delaware, and elsewhere. Approximately 98 percent of its customers are farmers. Its product is used to fertilize the farmers' fields. It has been stated by the Director of Revenue in his brief, and not denied, that taxpayer is one of the larger independent producers of fertilizer in the country. During the license periods involved here, its annual gross receipts amounted to from $3.5 million to $5.5 million, aggregating some $19 million for the three and one-half year period. Taxpayer has applied for and has paid a license fee and has been issued a license for each of the license years as a "manufacturer." Its president, however, testified that until it sent for and examined a copy of the law when this deficiency was first assessed, the company was under the mistaken impression that it was a manufacturer and subject to the law under Chapter 27, but little attention had been paid to this matter because the rate of taxation was so small until it was raised in 1969. He further stated that when the law was amended in 1969, he became concerned about the amount of the tax but only with reference to excluding the amount of the company's gross receipts pertaining to out-of-state sales, from the rate base. An affidavit, which is a part of the record by Mr. Davis, former State Tax Commissioner of Delaware, states that during June of 1969 the Legislature increased the rate of taxation on the Manufacturer's Gross Receipts Tax; that during that month, he spoke to former Governor Elbert N. Carvel about the increase and method of computing the Manufacturer's Gross Receipts Tax in

reference to its applicability to the operations of the Valiant Fertilizer Company in Laurel and those of the Milford Fertilizer Company in Milford; and that he advised former Governor Carvel in response to his inquiry that the increase in the rate of the Manufacturer's Gross Receipts Tax would have absolutely no effect on the out-of-state sales of those companies, inasmuch as the Manufacturer's Gross Receipts Tax did not apply to out-of-state sales.

Taxpayer now takes the position: 1. that it is exempt altogether from the Manufacturer's Gross Receipts Tax under 30 Del.C. §2703, providing that Chapter 27 shall not apply to the production of the "usual farm products," and, 2. taxpayer maintains that because of the opinion of the then State Tax Commissioner in 1969 and its reliance on the opinion, the State may not now assess taxes attributable to its out-of-state sales. All of the tax deficiency here involved represents the appropriate taxes, during the pertinent years, on only out-of-state sales.

It is unnecessary to decide the question of estoppel by reason of the former State Commissioner's advice, because we are of the opinion that the activities engaged in by the taxpayer are such that it is not subject to the tax under Chapter 27, as a manufacturer, because they do not meet the law's definition of "manufacturing."

I - Manufacturer's tax. Part III of Title 30 of the Delaware Code has to do with occupational and business licenses and taxes. Generally, it imposes an

annual license requirement, usually accompanied by an annual fee (now $50 for taxpayer's class), and additional taxes at various rates upon the gross purchases, as to retailers, and gross receipts, as to wholesalers and manufacturers. Chapter 21 of this Part contains general provisions applicable to all classes of occupations, and is not material here. Chapter 23 sets forth occupations which require licensing, definitions, and the annual fees, and exemptions, concerning some 88 miscellaneous occupations and trades which are not specifically taxed under Chapters 25 (contractors), Chapter 27 (manufacturers), and Chapter 29 (retail and wholesale merchants). It is possible that the activities of this taxpayer could, conceivably, fall under the provisions pertaining to retailers, or wholesalers, or manufacturers. However, our analysis of its operation, based upon the facts in the record, lead us to the conclusion that taxpayer should be taxed under the provisions of Chapter 29, Section 2907, headed "Farm Machinery Retailer License Requirements; License Fees; ..." Our reasons follow.

At the beginning, however, let us state that we we do not agree with the taxpayer's assertion that it is exempt as a manufacturer under the provisions of Section 2703 (Chapter 27, Title 30). That section reads as follows:

> "This Chapter shall not apply to the production or manufacture of steam, gas or electricity for heat, light or power, or to the production of the usual farm products for home consumption or market purposes."

This exemption is clear enough on its face, to us. First, there is a distinction in the two operative phrases applying on the one hand to steam, gas or electricity, and to farm products on the other. With reference to steam, gas, etc., the law reads "production or manufacture of" (steam, gas, etc.); but then it continues, "or to the production of the usual farm products for home consumption or market purposes." This seems to imply a difference between producing or manufacturing steam, gas and electricity, and merely producing farm products. The key phrase, however, in our opinion, is "usual farm products for home consumption or market purposes." Clearly the taxpayer is not engaged in the production of any products for home consumption, and we do not think the phrase is intended to be so broken down or separated as to have it read only "production of usual farm products for market purposes." Obviously, this law was meant to exempt the farmer who produces such usual farm products as, for example, soy beans, corn, tomatoes and similar items of farm produce, either for his own home consumption or for farmers' marketing purposes. We do not think the taxpayer has shown that it produces "usual farm products" for these purposes in the sense intended by this statute.

We turn, now to the question of whether or not the activities of the taxpayer constitutes manufacturing, as it is defined in the statutes, at all.

For the purposes of Chapter 27, dealing with the manufacturer's license and tax, manufacturing is specifically defined in Paragraph (2), Section 2701, as follows:

"'Manufacturing,' except as provided in the definition of 'wholesaler' in §2901 of this Title, includes any processing, working, development, change, conditioning or reconditioning of raw materials or products into products of a different character, finished or unfinished, or effecting any combination or composition of materials the inherent nature of which is changed."

Thus, it is clear that to constitute manufacturing within this definition the raw materials must be changed into products of a different character, or result in a combination or composition of materials the inherent nature of which is changed from that of the raw materials.

As we understand the testimony and exhibits, the taxpayer purchases raw materials, most of which have been mined, and blends them together according to the requirements of the soil involved and the type of crop that is to be grown on the soil. The three major ingredients used in fertilizers are nitrogen, phosphorus, and potash. These come in various forms. At the hearing, the taxpayer's president Mr. Fischer displayed jars of the raw materials, some of which contained two sources of nitrogen (that is, ammonium sulphate and ammonium nitrate), and two sources of phosphorus (diamonium phosphae and triple super phosphate). He also had one form of potash (muriatic potash) and a filler used when formulating a ton of fertilizer, called grandol, which is a granular dolomite mined in Pennsylvania. The taxpayer's process is the selection of the various particular types of the three basic elements to be used in the particular setting of soil and for particular crops, and blending them in the right proportions.

Taxpayer does, however, treat these raw materials to the extent of purification and concentration, but the basic plant nutrients are not materially changed. In response to the questioning of the Chairman of the Tax Appeal Board, Mr. Fischer testified that the company purchased the raw materials which appeared in the plastic bags which he placed in evidence and the company then mixes them into a formula based upon whatever the soil requirements may be, and that "we do not change them." He stated further in answer to the Chairman's questioning:

> "In actuality, we blend these raw materials and sell them for distribution."

In this fashion, Petitioner makes about 30 different formulas, called "standard grades." However, Petitioner does quite often formulate special mixes, for specific problems. It appears that all of the formulas contain various forms of nitrogen, phosphorus and potash, in various percentages. These are not changed into anything else, but are merely combined and blended in various proportions, with the dolomite added as a filler. These three basic fertilizer ingredients are received by taxpayer in various forms, as mentioned above. (Record, pages 10, 11, 12, 14, 15 and 16)

Mr. Fischer, in response to questioning by taxpayer's counsel, also made a conclusionary type of statement to the effect that what the company does is described by the provisions of §2103, Title 3, Delaware Code. That part of the Code regulates the sale and labeling of fertilizer and §2103 defines fertilizer material as being derived from plant or animal residue

or by-product of a natural mineral deposit; and that it is processed in such a way that its content of primary plant nutrients has not been materially changed, except by purification and concentration (Record, page 12) His testimony was buttressed by his Affidavit, attached to the taxpayer's brief in which he states that the overwhelming majority of taxpayer's product is best described by subparagraph (1)(c) of §2103, Paragraph (A). This defines "fertilizer material" as a commercial fertilizer which:

> "(c) Is derived from a plant or animal residue or by-product or a natural material deposit which has been processed in such a way that its content of primary plant nutrients has not been materially changed except by purification and concentration."

Although the record may not be as detailed as it perhaps should be, it seems clear that the processes used by taxpayer in composing its fertilizers for sale do not involve any material change in the basic nature of the raw nutrients, and therefore does not come within the statutory definition of what a manufacturer does. Section 2701, Paragraph (2), above.

This conclusion is fortified by taxpayer's reference to a 1976 decision by the Kent County Planning and Zoning Office to the effect that the mixing or blending of fertilizer is not considered fertilizer manufacturing or processing in the application of the Kent County Zoning Ordinance. The decision was rendered July 15, 1976 and stated that it was a unanimous ruling of those members of the Board present and voting that

"the blending of fertilizer, when it does not involve changing the chemical or physical properties of the substances to be blended, is not considered manufacturing or processing. Therefore, fertilizer blending under these circumstances would be permitted in the limited industrial district as a special exception under approval of the Board of Adjustment. (See Kent County Planning and Zoning Office Exhibits in taxpayer's brief).

Upon the face of it, the Zoning Office decision indicated that there was a public hearing. We assume that taxpayer presented evidence at that hearing, or at least there was an investigation into its operations by the appropriate County authority, so the Zoning decision was an informed one. It is entitled to some weight.

Further, a decision in a zoning matter by the Supreme Court of Pennsylvania also supports our conclusion. In Gaspari v. Board of Adjustment (Muhlenberg), 392 Pa. 7, 139 A.2d 544 (Supr. Ct. Pa. 1958), the production of synthetic compost for growing mushrooms was held not to be manufacturing. The reported facts in that case were like this one in several respects. The modern compost process had its origins in the use of manure, as did commercial fertilizers such as taxpayer's. Its purose is to "feed" the mushroom spawn, so that it will grow into saleable mushrooms. The ingredients of compost--

> "...are simply hay and crushed corn cobs which are mixed and aerated, and treated with cyanamid, potash and gypsum. The completed operation usually takes 15 days, during which time the accumulations are moved approximately every three days..." (at p. 546)

Following its previous decisions that roasting of coffee beans was not manufacturing for purposes of the mercantile tax, and that pasteurization of milk, even though extensive use is made of machinery in the process was not manufacturing, the Pennsylvania Court reversed the lower courts and Board, holding that the Gasparis were not violating the Township Zoning ordinance by engaging in manufacture, but instead came within the permissive use for "marketing or processing of farm products... (incidental to raising such products)...".

II. Taxpayer's Proper Classification.

Clearly, the extensive business of the taxpayer requires it to be subject to the mercantile tax in some form. Since it processes materials and sells directly to consumers for use and not for resale, its activities clearly would fall under the provisions of Chapter 29, as a retailer. The taxpayer would also meet the definition as "wholesaler" contained in §2901 (Definitions)(6);

> "...and also includes the sale of machinery, supplies or materials which are to be directly consumed or used by the purchaser in the conduct of any business or activity, which business or activity is subject to the tax imposed by this Chapter,..."

were it not for the fact that the business or activity of farming is not subject to tax under Chapter 29.

However, we believe the taxpayer's proper classification is included in the identical wording, with the addition of the word "farm," under §2907, "Farm Machinery Retailer," an activity specifically exempt from the provisions of §2905, Retailers. If it falls

under §2907, a similar annual license fee is required and an additional tax is imposed at a percentage rate "of the aggregate gross receipts attributable to all goods sold by the farm machinery retailer for sale within this State..." The percentage rate has been changed several times (and the license fee, at least once). Effective April 1, 1975, it was raised from 1/20 of 1 percent to 1/15 of 1 percent (60 Del. Laws, c. 21, §§17, 18; and c. 23, §§5, 6; and 61 Del. Laws, c. 117, §9).

Section 2907 (a) provides:

> "To the extent that any person is engaged in the business of selling farm machinery, supplies or materials which are to be directly consumed or used by the purchaser in the conduct of any business,...[shall be exempt from §2905 and subject to provisions of this section]."

Again, this statute seems clearly applicable on its face, and there can be no doubt when the over-all pattern of activities described in Chapter 29 is considered. The only question that may arise as to its meaning is that maybe the words "supplies or materials" are restricted to those used only in connection with machinery. This idea is, however, negated by the application of simple grammar. Although the dictionaries say that the word "farm" is a noun and may be used also as a verb, here it is clearly used as a descriptive adjective in a sort of statutory shorthand. We think the word clearly is intended to modify not only "machinery," but "supplies or materials." If the intent was to restrict this class to the business of selling only farm machinery supplies or materials, there certainly would be no need for the comma appearing after "machinery." Reading §2907(a) as a whole and together with §2901(6), it clearly is intended

to apply a reduced rate of mercantile tax to those who sell farm machinery or farm supplies or farm materials which are to be directly consumed or used in the conduct of the farming business, thereby aiding in perhaps a small measure to keep down costs to farmers. This construction was, as a matter of fact, suggested in the Director's brief (see discussion at page 8, and footnote 1 at end). His use of the phrase "farm supply" as material used on the farm, to be distinguished from a "farm product," is natural usage. We think it would be a most strained interpretation of Subsection (a) to conclude that it had reference only to those who sell farm machinery and supplies or materials used only in connection with such machinery. Further, if that were the case, there would seem to be no purpose in limiting the "supplies or materials" to those "which are to be directly consumed or used by the purchaser in the conduct of any business."

We, therefore, hold that this taxpayer is not subject to the provisions of Chapter 27, of Title 30 of the Delaware Code, as a manufacturer, but is and was subject to the provisions of Section 2907(a), of Chapter 29.

It should also be noted that we do not think the fact that the taxpayer has voluntarily applied for and received a manufacturer's license under Chapter 27 for all these years, by what turns out to be a mistake, should prevent the correct classification of taxpayer's activities under the Merchants and Occupations Tax Law. Although it may, perhaps, prevent taxpayer from obtaining affirmative relief (refund), it is the duty of this Board to apply the law correctly to taxpayer's situation.

IT IS SO ORDERED.

/s/ Harry B. Roberts

Cyprian W. Cain

Joseph I. Yunker

Nettie C. Reilly

Dated: July 20, 1979

SYNOPSIS

DOCKET NO. 642

TAX SEGMENT: LICENSE TAX (Manufacturers)

ISSUE: The question is whether Milford Fertilizer Co., Inc. is subject to the manufacturer's license tax or some other license.

Taxpayer blends various products which are sold to farmers as fertilizer.

TAB DECISION: The Tax Appeal Board held taxpayer's business was the sale of farm supplies or materials, subject to tax under 30 Del. C., § 2907 as farm machinery retailer.

DECISION: For Petitioner

DECISION DATE: July 20, 1979