IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
March 8, 2023 Session

ALSCO, INC. v. TENNESSEE DEPARTMENT OF REVENUE

Appeal from the Chancery Court for Davidson County
No. 21-1055-III Ellen Hobbs Lyle, Chancellor

No. M2022-01019-COA-R3-CV

A taxpayer who rented hygienically-clean textiles to its customers challenged the revocation of three industrial machinery tax exemption certificates that it had previously been issued. An administrative judge determined that the taxpayer was not entitled to the exemption because the taxpayer's operations did not constitute "manufacturing" as they were not necessary for processing tangible personal property. The taxpayer appealed to the Chancery Court for Davidson County. The chancery court reversed after concluding that the administrative decision was not supported by substantial and material evidence. Discerning no error, we affirm the chancery court's decision.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court Affirmed

ANDY D. BENNETT, J., delivered the opinion of the Court, in which JEFFREY USMAN, J., joined. CARMA DENNIS MCGEE, J., filed a separate dissenting opinion.

Jonathan Skrmetti, Attorney General and Reporter, Andrée Blumstein, Solicitor General, and Mary Ellen Knack, Senior Assistant Attorney General, for the appellant, Tennessee Department of Revenue.

Carolyn S. Wenzel and Christina Rae Burgart Lopez, Nashville, Tennessee, for the appellee, Alsco, Inc.

OPINION

FACTUAL AND PROCEDURAL BACKGROUND

This case involves the revocation of industrial machinery exemption certificates. Alsco, Inc. ("Alsco") is a Nevada corporation that operates industrial facilities in Memphis, Nashville, and Knoxville. Alsco is in the business of leasing hygienically-clean textiles to customers for a single use in a variety of industries, including food and beverage,

healthcare, and hospitality and lodging. Depending on the industry being served, the leased textiles may include sheets, towels, napkins, tablecloths, and uniforms. Some of these textiles are new and some are used. When Alsco purchases new textiles, it must sanitize them before leasing them to customers. After textiles are used, Alsco retrieves them from the customers. The used textiles are often heavily soiled and must be sanitized before customers can again rent them.

In 2019, Alsco engaged in discussions with the Tennessee Department of Revenue ("the Department") about Alsco's Tennessee facilities receiving an exemption from Tennessee's sales and use tax. The exemption Alsco sought was the industrial machinery exemption found in Tenn. Code Ann. § 67-6-206(a), which provides that no sales and use tax is due in regard to industrial machinery. "Industrial machinery" means "[m]achinery, apparatus and equipment with all associated parts . . . that is necessary to, and primarily for, *the fabrication or processing of tangible personal property* for resale and consumption off the premises . . . by one who engages in such fabrication or processing as one's principal business." Tenn. Code Ann. § 67-6-102(46)(A)(i) (emphasis added). According to Alsco, its Tennessee facilities qualified for the exemption because the machinery and processes it uses for sanitizing its textiles constitute "processing of tangible personal property." *Id.*

On April 22, 2019, the Department granted Alsco Sales and Use Tax Certificates of Exemption for all three of its Tennessee facilities. A month later, however, the Department revoked all three certificates of exemption after concluding that Alsco did not qualify for the industrial machinery exemption. Alsco requested a hearing on the revocations, and an administrative judge was appointed to hear the matter. After conducting a contested hearing, the administrative judge issued an order on August 6, 2021, concluding that Alsco was not entitled to the industrial machinery exemption because Alsco's activities "do not constitute manufacturing under Tennessee law as they were not necessary for processing tangible personal property." The administrative judge explained, in pertinent part, as follows:

> Under Tennessee law, "processing" involves a transformation of materials into a different state or form than their original existence, which results in a marketable product. In this case, there is no doubt that [Alsco's] sterilization processes add value to the linens and transform them into marketable products. . . . [T]he state or form of the linens in no way [has] been altered—they are the same uniforms, bar towels, etc. both before and after cleaning. Merely creating a marketable product is not enough; [Alsco] must show that its activity fundamentally changes or transforms the property from the state or form in which it originally existed. While [Alsco's] activities do create a marketable product in that the linens cannot be leased to customers in a soiled and unsterile condition, [Alsco's] activities do not create a new and different substantive product.

Alsco filed a petition for judicial review in the Davidson County Chancery Court pursuant to Tenn. Code Ann. § 4-5-322(b), arguing that the Department's decision violated Tennessee law, was arbitrary and capricious, and was not supported by substantial and material evidence. After reviewing the administrative record and hearing oral arguments on the matter, the chancery court entered an order reversing the Department's decision. In making its decision, the court made the following pertinent findings of fact and conclusions of law:

> [Alsco] is certified and regulated by the National Sanitary Foundation ("NSF"), an international accrediting organization. To maintain the NSF certification[, Alsco] must follow specific protocols, and the NSF audits [Alsco's] operation. In addition to NSF, [Alsco's] chemical supplier audits [Alsco's] operation. Further, [Alsco's] equipment contains "watchdog" monitors for quality control of the sanitization that [Alsco] performs. All of these checks are needed because the soils on the textiles [Alsco] obtains are oils, medical waste, blood, waxes and other chemicals. . . . These textiles are unusable and possibly contaminated or infectious. . . . Because of their soiled condition and the nature of the soils, the textiles are neither safe nor absorbent. . . .
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> The testimony of [Alsco's] Knoxville plant manager Mr. Iasiello; Mr. Patel a corporate engineer with degrees in mechanical engineering; and an expert witness chemist and biologist, Mr. David Tibbitts, established that the transformation/conversion that occurs is that [Alsco] changes the state or form of its textiles during the sanitization process. As Mr. Tibbitts's testimony confirms, the very composition of Alsco's textiles is altered when contaminants affix/bind to them. Interfacial energies are created between the fabric and the soil that must then be physically broken down with a "chemical attack." [Alsco's] highly specific chemical processes are applied to the fabric and contaminant—which at that point have been physically bound together—to "chemically change those soils for removal." This is true of both new textiles, which must be processed before they can be used because they contain oils, waxes, and other chemicals from the manufacturing process, and of used textiles, which have been heavily soiled with particulate soils, animal oils, and vegetable oils. Both are transformed from unmarketable textiles into hygienically clean and marketable textiles by the physical and chemical changes that [Alsco's] processes impose. Thus, [Alsco] causes both its new and used textiles to . . . "transform[] or conver[t]" . . . "into a different state or form from that in which they originally existed." . . .
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> An example provided in the testimony is that [Alsco] purchases new bar towels that are not capable of absorption due to being treated with oils, waxes, and other chemicals during the manufacturing process. During the washing stage, [Alsco] must apply a specific chemical formula to break down

> the interfacial tensions between the bar towel fibers and these contaminants. If this controlled, multi-step chemical treatment were not used, the bar towels would not be absorbent or fit for customer use.
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> . . .
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> Further, [Alsco's] operations are industrial in nature. Each Tennessee Facility is 65- to 70,000 square feet. [Alsco] employs multiple engineers at the corporate and facility levels to continually review the safety and efficiency of the process flow for each Tennessee facility and maintain the equipment. [Alsco's] engineer, Mr. Patel, testified about the multiple pieces of complex industrial machinery used in the operations. Examples he gave in the Tennessee facilities were high pressure boilers to generate steam for various pieces of equipment. The Tennessee facilities also contain multiple large and expensive washers, dryers, irons, and steam tunnels with complex monitoring systems and safety features. [Alsco] is required to comply with many of the same policies and procedures applicable to industrial manufacturing plants, and [Alsco's] overall process flow is analogous to that of an industrial facility.
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> All of the foregoing evidence in the record, the Court concludes, is both substantial and material, and it detracts and undercuts the decision reached by the [administrative judge] that [Alsco's] operation does not fit the industrial machinery exemption. . . . The evidence of record is that the textiles are undisputedly not in the same physical state before and after processing, because molecules of various contaminants (also known as soils) physically, electrically, and chemically adhere to the fabric. The soils do not merely reside on the surface of a textile; they are interwoven in the fabric and chemically bonded to the threads. Breaking those chemical bonds, as [Alsco] does by using highly customized processing formulas that regulate water temperatures, chemicals, dilution, and duration of each step, alters the state of the textiles.

The Department appealed and presents the following issue for our review: whether the Department's decision was supported by substantial and material evidence, consistent with statutory provisions, and not arbitrary or capricious.

STANDARD OF REVIEW

The Uniform Administrative Procedures Act ("UAPA"), Tenn. Code Ann. §§ 4-5-101 to -325, governs judicial review of an administrative agency's decision. *See MobileComm of Tenn., Inc. v. Tenn. Pub. Serv. Comm'n*, 876 S.W.2d 101, 104 (Tenn. Ct. App. 1993); *see also City of Memphis v. Civ. Serv. Comm'n of City of Memphis*, 238 S.W.3d 238, 242 (Tenn. Ct. App. 2007). Under the UAPA, "[t]he reviewing court's standard of review is narrow and deferential." *StarLink Logistics Inc. v. ACC, LLC*, 494

S.W.3d 659, 668 (Tenn. 2016). The UAPA limits reversal or modification of an agency's decision to situations where the decision is:

> (1) In violation of constitutional or statutory provisions;
> (2) In excess of the statutory authority of the agency;
> (3) Made upon unlawful procedure;
> (4) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
> (5)(A)(i) . . . [U]nsupported by evidence that is both substantial and material in the light of the entire record;
>
> > (ii) In determining the substantiality of evidence, the court shall take into account whatever in the record fairly detracts from its weight, but the court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact.

Tenn. Code Ann. § 4-5-322(h).

This standard of review is narrower than what is generally applied in other appeals because it "reflects the general principle that courts should defer to decisions of administrative agencies when they are acting within their area of specialized knowledge, experience, and expertise." *StarLink Logistics Inc.*, 494 S.W.3d at 669. As a result, a reviewing court does not review an agency's factual findings de novo or "second-guess the agency as to the weight of the evidence" even when "the evidence could support a different result." *Id.* Rather, we review an agency's factual findings to determine whether they are supported by substantial and material evidence in the record. Tenn. Code Ann. § 4-5-322(h)(5); *see also Macon v. Shelby Cnty. Gov't Civil Serv. Merit Bd.*, 309 S.W.3d 504, 508 (Tenn. Ct. App. 2009).

Tennessee Code Annotated section 4-5-322(h) does not define "substantial and material evidence," but Tennessee courts have described it as "less than a preponderance of the evidence and more than a 'scintilla or glimmer' of evidence." *StarLink Logistics Inc.*, 494 S.W.3d at 669 (quoting *Wayne Cnty. v. Tenn. Solid Waste Disposal Control Bd.*, 756 S.W.2d 274, 280 (Tenn. Ct. App. 1988)). It is "'such relevant evidence as a reasonable mind might accept to support a rational conclusion and such as to furnish a reasonably sound basis for the action under consideration.'" *Macon*, 309 S.W.3d at 508 (quoting *Pruitt v. City of Memphis*, No. W2004-01771-COA-R3-CV, 2005 WL 2043542, at *7 (Tenn. Ct. App. Aug. 24, 2005)). Thus, under this standard of review, we may not reverse an agency's decision merely "'because the evidence could also support another result.'" *Ramos v. Elec. Emps.' Civ. Serv. & Pension Bd. of Metro. Gov't of Nashville & Davidson Cnty.*, No. M2020-00324-COA-R3-CV, 2020 WL 7861470, at *2 (Tenn. Ct. App. Dec. 23, 2020) (quoting *City of Memphis*, 238 S.W.3d at 243). We may reverse an agency's decision "'only if a reasonable person would necessarily arrive at a different conclusion based on the evidence.'" *Id.* (quoting *City of Memphis*, 238 S.W.3d at 243).

Tennessee Code Annotated section 4-5-322(h)(4) also authorizes a reviewing court to modify or reverse an administrative agency's decision if it is "[a]rbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion." As we have explained:

> A decision unsupported by substantial and material evidence is arbitrary and capricious. Yet, a clear error of judgment can also render a decision arbitrary and capricious notwithstanding adequate evidentiary support. A decision is arbitrary or capricious if it "is not based on any course of reasoning or exercise of judgment, or . . . disregards the facts or circumstances of the case without some basis that would lead a reasonable person to reach the same conclusion."

City of Memphis, 238 S.W.3d at 243 (quoting *City of Memphis v. Civ. Serv. Comm'n of City of Memphis*, 216 S.W.3d 311, 315 (Tenn. 2007)) (further citations omitted).

The issue raised by the Department requires us to construe statutes relating to the industrial machinery exemption. When construing statutes, our primary objective "is to ascertain and give effect to the intention or purpose of the legislature as expressed in the statute," *In re Adoption of A.M.H.*, 215 S.W.3d 793, 808 (Tenn. 2007), "'without unduly restricting or expanding'" the coverage of the statute beyond its intended scope. *Sallee v. Barrett*, 171 S.W.3d 822, 828 (Tenn. 2005) (quoting *Houghton v. Aramark Educ. Res., Inc.*, 90 S.W.3d 676, 678 (Tenn. 2002)). To achieve this objective, we look to the plain and ordinary meaning of the language in the statute. *Id.* We must construe the words used "in the context in which they appear in the statute and in light of the statute's general purpose." *Lee Med., Inc. v. Beecher*, 312 S.W.3d 515, 526 (Tenn. 2010). If a statute's language is clear and unambiguous, we "need not look beyond the statute itself to ascertain its meaning." *Id.* at 527. When the language is ambiguous, we must review the statutory scheme in its entirety and consider additional extrinsic sources to determine legislative intent. *Id.* at 527; *Sallee*, 171 S.W.3d at 828. An ambiguity exists "when a statute is capable of conveying more than one meaning." *Najo Equip. Leasing, LLC v. Comm'r of Revenue*, 477 S.W.3d 763, 768 (Tenn. Ct. App. 2015). Statutory construction presents a question of law that we review de novo without a presumption of correctness. *State v. Welch*, 595 S.W.3d 615, 621 (Tenn. 2020).

ANALYSIS

The Department contends that the record contains substantial and material evidence supporting the administrative judge's determination that Alsco failed to establish it was entitled to the industrial machinery exemption. "[A]lthough laws imposing a tax are strictly construed against the taxing authority, tax emption statutes are strictly construed against the taxpayer." *AFG Indus., Inc. v. Cardwell*, 835 S.W.2d 583, 584 (Tenn. 1992). "[A]n exception from sales tax must positively appear because it will not be implied," and

"[a]ny well-founded doubt is sufficient to defeat a claimed exemption from taxation." *Nashville Clubhouse Inn v. Johnson*, 27 S.W.3d 542, 544 (Tenn. Ct. App. 2000). The taxpayer bears the burden of proving that it is entitled to the exemption. *AFG Indus., Inc.*, 835 S.W.2d at 584-85.

The question then is what did Alsco need to prove to establish it was entitled to the exemption. To qualify for the industrial machinery exemption, a taxpayer's manufacturing operations must contain three elements: (1) the machinery or equipment used "is necessary to, and primarily for, the fabrication or processing of tangible personal property," (2) the tangible personal property is sold for "consumption off the premises," and (3) the operation or activity is the manufacturer's "principal business." Tenn. Code Ann. § 67-6-102(46)(A)(i). There is no dispute that Alsco proved that its operations contain the second and third elements. The parties' dispute focuses solely on whether Alsco's operations contain the first element. According to the Department, Alsco's sanitization operations do not contain the first element because the operations do not constitute "processing" under the statute.

Tennessee's sales and use tax statutes do not define the term "processing." In *Beare Co. v. Tennessee Department of Revenue*, 858 S.W.2d 906, 908-09 (Tenn. 1993), the Tennessee Supreme Court undertook the challenge of defining "processing" in the context of sales tax exemptions. The *Beare* taxpayer's operations involved two methods for preserving food products. *Beare*, 858 S.W.2d at 907. The first method was a blast-freezing process applied to fresh or raw food products, and the second method was preservation storage of already frozen food products to keep them in a frozen state. *Id.* The blast-freezing method "drastically lower[ed] the temperature of the products to zero degrees Fahrenheit or below within a period of 72 hours." *Id.* This process caused the food products to "undergo certain chemical and/or Als changes." *Id.* The preservation storage method, on the other hand, caused no changes in the already frozen products; it merely prevented change and maintained the product in the same form. *Id.*

To determine whether the taxpayer qualified for a reduced sales and use tax rate, the *Beare* Court looked to other jurisdictions for guidance on defining the term "processing." *Id.* at 908-09. Ultimately, the Court adopted the following definition from *Gressel Produce Co. v. Kosydar, Inc.*, 297 N.E.2d 532, 535 (Ohio 1973), a case where the Ohio Supreme Court considered whether a taxpayer that packaged eggs for sale to retailers qualified for an exemption from Ohio's sales and use tax:

> "['Processing' is] 'essentially a transformation or conversion of materials or things into a different state or form from that in which they originally existed—the actual operation incident to changing them into marketable products.'"

Beare, 858 S.W.2d at 908 (quoting *Gressel*, 297 N.E.2d at 535). As explained by the *Beare* Court, the *Gressel* Court applied the foregoing definition and concluded that "cleaning, cooling, sorting, and application of oil to eggs did not constitute 'processing' because there was no change in the state or form of the eggs." *Id.* (citing *Gressel*, 297 N.E.2d at 535). The *Beare* Court then relied on another Ohio case to emphasize that "mere enhancement of the value of a product, absent a *change* in 'state or form' from that in which it originally existed, does not constitute 'processing.'" *Id.* (quoting *Sauder Woodworking Co. v. Limbach*, 527 N.E.2d 296, 297 (Ohio 1988)).

Applying these principles to the facts in the record before it, the *Beare* Court concluded that the taxpayer's blast-freezing activities changed the state or form of the food products and, therefore, constituted "processing" within the meaning of the statute. *Id.* at 909. The preservation storage activities did not constitute "processing," however, because those activities merely preserved the prefrozen condition of those foods. *Id.* In other words, the preservation storage activities caused no change to the state or form of the foods undergoing that process.

Here, Alsco contends that its sanitization operations constitute "processing" under the definition adopted in *Beare* because the administrative record contains evidence showing that Alsco's sanitization operations alter the textiles' state or form. Alsco points to evidence showing that, in the sanitization process, soiled, unabsorbent textiles undergo a physical change because highly customized processing formulas are applied to break the chemical bonds between the soils interwoven with the fabric, transforming the textiles into sanitized and absorbent textiles. The Department agrees that Alsco subjects its textiles to a rigorous and highly specialized cleaning process that makes them marketable, but the Department argues that this process does not constitute "processing" because bar towels and uniforms are the same bar towels and uniforms before and after going through Alsco's sanitization process. Essentially, the Department's argument is that Alsco's operations do not constitute "processing" because the resulting product is neither a new nor substantively different product—the sanitization process "merely return[s] the items to the hygienic condition in which they were originally rented to its customers." In other words, sanitized bar towels once again become sanitized bar towels after undergoing Alsco's operations.

After extensively researching this issue, we are unaware of any Tennessee case considering whether a sanitization operation like the one in this case constitutes "processing" under the definition adopted in *Beare*. However, we are not without guidance. Beginning with the definition adopted in *Beare*, we note that it contains the phrase "a different state or form from that in which they originally existed." *Beare*, 858 S.W.2d at 908. The "originally existed" language taken by itself gives some credence to the Department's argument, but the *Beare* Court's definition did not stop there. Immediately after that phrase is the following language: "the actual operation incident to changing [the articles or materials] into marketable products." *Id.* This phrase means that the change the material undergoes must be the result of the taxpayer's operations and that

the change must result in a marketable product. When the two phrases are considered in conjunction with one another, we interpret the "originally existed" language as simply requiring that the taxpayer's operations cause the articles or materials to change state or form from the state or form they were in prior to being submitted to the taxpayer's operations and that the changed articles or materials be marketable products. We find nothing in the *Beare* decision indicating that the change in state or form cannot be to a state or form the textile has been in at some point in the past. All that is required is that each time the articles or materials are submitted to a taxpayer's operations, they must be in a state or form different than the state or form they were in prior to undergoing the process.

We find support for this interpretation in another case from the Ohio Supreme Court, *Van Dyne Crotty Co. v. Limbach*, 558 N.E.2d 44 (Ohio 1990). In that case, the taxpayers were laundry companies that leased "clean shop towels, walk-off mats, continuous roll towels, dust mops and cloths, and work uniforms" to their industrial customers. *Van Dyne Crotty Co.*, 558 N.E.2d at 45. Similar to the present case, the taxpayers' operations involved delivering "specified clean articles, pick[ing] up soiled articles, launder[ing] or dry-clean[ing] the soiled articles, and start[ing] the cycle over again with a delivery of clean articles and a pick-up of soiled ones." *Id.* The taxpayers cleaned the articles they leased to customers by using "soap, bleach, chemicals, washing machines, extractors, dryers, and other equipment." *Id.* The taxpayers claimed they were entitled to a manufacturing or processing exemption similar to Tennessee's industrial machinery exemption.[1] *Id.* at 48.

The Ohio Supreme Court applied the definition of "processing" stated in *Gressel*—the same definition adopted by the Tennessee Supreme Court in *Beare*—and concluded that the taxpayers qualified for the exemption because the taxpayers' operations resulted in their linens undergoing a change in state or form from that in which they originally existed. *Id.* at 48-49. As the Court explained,

> [T]he laundry companies change the state of the articles laundered. They physically remove dirt, grime, oil, and other contaminants from the fibers, changing the state of the article to a clean product. In some cases, the companies, by removing flammable oil and grease, change non-fire retardant garments into fire retardant ones. They also change non-absorbent towels into absorbent ones by cleaning them. Moreover, the laundry companies would have had few sales, if any, of soiled articles since their customers contracted to receive only clean articles.

Id. at 48.

[1] The manufacturing or processing exemption "except[ed] items used or consumed directly in the production of tangible personal property for sale by manufacturing or processing." *Van Dyne Crotty Co.* 558 N.E.2d at 48.

The Court then compared the laundry companies' activities with the egg packaging activities at issue in *Gressel* and found that, unlike the packaging of already marketable eggs, the laundry companies' operations "do not simply enhance the marketability of their product; they actually change, in these operations, the articles into marketable products. They make them 'fit for consumption.'" *Id.* (quoting *Gressel*, 297 N.E.2d at 536) (further citations omitted). Thus, even though the laundry companies' operations consisted of a continuous cycle of returning soiled linens to clean linens, these operations satisfied the definition of "processing" because each time the soiled linens underwent the cleaning process they changed state or form from contaminated, flammable, non-absorbent linens to clean, fire retardant and absorbent linens, which made them marketable products again.

Although the facts in *Van Dyne Crotty Co.* bear a striking similarity to those in the present case, the Department urges us to reject the reasoning followed in that case because it "is just . . . a decision of an Ohio court." The Department is correct that *Van Dyne Crotty Co.* is from another jurisdiction and is, therefore, not binding authority on this Court. But, the Court in that case based its decision on one of the same cases setting forth the definition for "processing" adopted by the Tennessee Supreme Court in *Beare*. Thus, we find it very persuasive and applicable to the issue before us. Nonetheless, the Department contends that there is a Tennessee case that controls this issue and requires us to reach a different conclusion than that reached by the *Van Dyne Crotty Co.* Court.

In *Walker's Inc. v. Farr*, 338 S.W.3d 887, 888 (Tenn. Ct. App. 2010), the taxpayer provided dry-cleaning and laundering services to a formalwear business that rented and sold shirts, tuxedos, and accessories to its customers. The taxpayer argued that the services it provided to the formalwear business were entitled to exemption from an assessment of retail sales taxes[2] under the sale for resale exemption. *Walker's*, 338 S.W.3d at 889. Under that exemption, there is no tax on a transaction if "the products or services sold become 'an industrial material or supply in a manufacturing or processing operation.'" *Id.* at 893 (quoting TENN. COMP. R. & REGS. 1320-05-01-.62(1) (2010)).

The *Walker's* court applied the holding in *Beare* to determine whether the taxpayer's dry-cleaning and laundering operations constituted "processing" and concluded that the taxpayer did not qualify for the exemption. *Id.* at 893-94. The court reasoned that "nothing in the appellate record indicat[ed] that the laundering and dry-cleaning services sold by Walker's resulted in a change in state or form." *Id.* at 894 (citing *Beare*, 858 S.W.2d at 908). The court considered the facts in the record before it to be "more akin to those in *Gressel Produce Co.*, relied upon in *Beare Co.*, in which the *Gressel* court found that the 'cleaning,' 'sorting,' and 'application of oil' to eggs did not constitute 'processing'

[2] Absent an exemption, Tennessee imposes a retail sales tax on "[t]he laundering or dry cleaning of any kind of tangible personal property, excluding coin-operated laundry or dry cleaning, where a charge is made for the laundering or dry cleaning[.]" Tenn. Code Ann. § 67-6-205(c)(5); *see also Walker's*, 338 S.W.3d at 892.

within the meaning of that state's sales tax statutes." *Id.* (quoting *Beare*, 858 S.W.2d at 908) (citing *Gressel*, 297 N.E.2d at 535).

First, we note that nothing in the *Walker's* court's decision suggests that laundering or dry-cleaning operations can never constitute "processing" simply because such operations return soiled textiles to clean textiles. Rather, the *Walker's* court determined that the specific laundering and dry-cleaning services at issue in that case did not meet the definition of "processing" because the record before it included no evidence showing that those operations resulted in the textiles changing state or form. *Id.* at 894. Second, contrary to the Department's assertion, the facts of this case can be meaningfully distinguished from those in *Walker's*. As Alsco points out, the administrative record in this case contains copious evidence regarding Alsco's "business model, complex sanitization methods, regulatory framework, chemistry, [and] industrial nature" showing that its operations subject the textiles to a highly specialized, rigorous cleaning, whereas nothing in *Walker's* indicated that the taxpayer's dry-cleaning service involved anything comparable to the extreme nature of the waxes, oils, and chemicals interwoven with the textiles that Alsco's sanitization operation must clean. The record in *Walker's* indicated that the taxpayer performed nothing more than a simple dry-cleaning service. We agree with Alsco's assertion that the two operations are not analogous. Thus, although applicable and binding authority, the *Walker's* decision does not contradict the reasoning followed in *Van Dyne Crotty Co.*, nor does it make that reasoning any less applicable here.[3]

We are aware that some courts in other jurisdictions have concluded that laundering and dry-cleaning operations do not qualify for equipment or machinery exemptions because such operations simply change dirty garments back into clean garments. *See AmeriPride Servs., Inc. v. Comm'r of Revenue*, No. 7971 R., 2008 WL 4472392, at *9 (Minn. Tax Ct. Oct. 3, 2008); *Mechs. Laundry & Supply, Inc. v. Ind. Dep't of State Revenue*, 650 N.E.2d 1223, 1229-30 (Ind. Tax Ct. 1995). The tax statutes in those jurisdictions, however, include definitions for "manufacturing" or "processing" that require the end product of a taxpayer's operations to be new or substantively different. For instance, in *AmeriPride Services, Inc. v. Commissioner of Revenue*, a Minnesota taxpayer sought an exemption "for equipment used to launder clothing products in a manufacturing activity that results in a new article of tangible personal property that was rented or sold at retail." *AmeriPride*, 2008 WL 4472392, at *4. Minnesota's sales tax statutes exempted

[3] During the administrative hearing, Alsco's expert witness acknowledged that Alsco's cleaning operation is similar to operating home laundry machines because both involve using soap, water, and various chemicals to clean garments. The Department's appellate brief focuses on this testimony to argue that, because a similar activity is performed in a home, a laundering service cannot possibly be a manufacturing activity. In making this argument, the Department seems to overlook that, in *Beare*, the taxpayer's operations involved the freezing of raw foods—an activity also often performed in the home. Nonetheless, our Supreme Court held that the taxpayer engaged in manufacturing because its operations satisfied the adopted definition of "processing." *Beare*, 858 S.W.2d at 909. We find the Department's argument on this point unavailing.

capital equipment if it constituted "manufacturing." *Id.* at *5-6. To meet the definition of "manufacturing," the taxpayer needed to demonstrate "that the garments, flats, and other accessories are (1) raw materials, (2) which are changed in form, composition, or condition (3) by machinery and equipment (4) resulting in the production of a new article of tangible personal property." *Id.* at *6. In considering whether the taxpayer qualified for the exemption, the court focused on the "new article" requirement and noted:

> Certainly, the popular conception of manufacturing or processing does not come to mind when a shirt is laundered or a suit is cleaned. Rather, we view the manufacturer as one who produces or fabricates the shirt, or suit of clothes, such as the makers of Arrow shirts, or the Hart, Schaffner and Marx Company. These companies, and other clothing manufacturing concerns, sell a product; the laundry and dry cleaning establishment sells a service.
> . . .
> [i]t seems perfectly plain that a laundry, the business of which is to wash and iron linen and other articles of wearing apparel and domestic use which have become soiled in the service for which they were fabricated, is not a manufacturing establishment within the meaning of the section quoted. *In the common understanding the function of a laundry is to make clothes clean, rather than to make clean clothes.*"

Id. at *8 (quoting *Pellerin Laundry Mach. Sales Co. v. Cheney*, 371 S.W.2d 524, 525-26 (Ark. 1963)) (emphasis added) (footnotes omitted). The taxpayer relied on *Van Dyne Crotty Co.* to contend that its laundering operation met the definition of "manufacturing." *Id.* at *9. The court concluded that this reliance was misplaced:

> The statute in *Van Dyne Crotty Co. v. Limbach*, where laundering equipment and supplies were found to be tax exempt, involved a definition of the term "manufacturing" that did not utilize the term "raw materials" or require that "manufacturing or processing" result in "production of a new article of tangible personal property" as in the instant case. The launderer in *Van Dyne* had to show that the laundry changed state, which is far less than is required of [the taxpayer] in this case.

Id. (footnotes omitted). Thus, the court held that the taxpayer did not qualify for the exemption:

> In short, [the taxpayer's] sophisticated cleaning process does not "manufacture" clothes into clean laundry. Dirty garments, flats, or other accessories are turned into clean items of the exact same type and because of a sophisticated system, [the taxpayer] is able to handle the items in the manner requested by and return the items to the appropriate Customers.

> Unlike a recycling process which makes paper from cotton and linen, the laundering process merely turns dirty laundry into clean laundry.

Id.

Similarly, in *Mechanics Laundry & Supply, Inc. v. Indiana Department of State Revenue*, the taxpayer engaged in the business of renting clean textiles to various commercial customers whose activities often resulted in the textiles becoming heavily soiled, requiring the taxpayer to launder the textiles for re-rental. *Mechs. Laundry*, 650 N.E.2d at 1226. The taxpayer argued that it was entitled to an equipment exemption because its laundering of soiled textiles constituted "processing" under Indiana's sales tax statutes. *Id.* at 1227. The specific exemption at issue provided:

> "Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, *processing*, refining, or finishing of *other tangible personal property*."

Id. (quoting I.C. 6-2.5-5-3) (emphasis added).

The Tax Court of Indiana determined that, because "the terms used in the equipment exemption statute provide a 'comprehensive description of the various means of *production*,'" the term "processing" had "meaning only to the extent that there is production." *Id.* at 1228 (quoting *Ind. Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 524 (Ind. 1983)) (emphasis added). Therefore, under that statute, a taxpayer did not qualify for the equipment exemption unless it engaged in the production of goods. *Id.* The court further determined that the Indiana Department of Revenue's own regulations further defined "processing" to require the "'end product . . . be substantially different from the component materials used.'" *Id.* at 1229 (quoting 45 I.A.C. 2.2-5-10(k)). Because the taxpayer's laundering operations "merely return[ed] the textiles to the same form and cause[d] them to have the same character or composition that they had when they were acquired," the court concluded that the taxpayer did not produce an end product that was "'substantially different from the component materials used'" and, thus, did not qualify for the exemption. *Id.* (quoting 45 I.A.C. 2.2-5-10(k)).

Unlike the equipment exemptions at issue in *AmeriPride* and *Mechanics Laundry*, Tennessee's industrial machinery exemption does not include a requirement that a taxpayer produce a new or substantially different product to qualify for the exemption. Rather, the General Assembly chose to require only that the taxpayer use the "machinery, apparatus and equipment . . . primarily for[] the fabrication or processing of tangible personal property for resale and consumption off the premises." Tenn. Code Ann. § 67-6-102(46). Furthermore, because the General Assembly elected not to elucidate what a taxpayer must

do to engage in "processing," our Supreme Court had to undertake that task, and the Court adopted the same definition applied in *Van Dyne Crotty Co.*, which does not include a requirement that the end product of a taxpayer's operations be a new or substantially different product. The blast-frozen food products in *Beare* started out as raw food with some water. *Beare*, 858 S.W.2d at 907. After the blast-freezing process, the food products remained raw food with some water. Nothing new or substantially different was created. Nevertheless, the *Beare* Court concluded that the blast-freezing operations met the adopted definition of "processing" because the blast-freezing process caused a change in the physical state of the food products—the water in the food changed from a liquid to a solid. *Id.* 908-09. We conclude that the principles adopted in *Beare* are akin to those followed in *Van Dyne Crotty Co.* We will, therefore, consider the facts of this case in light of *Beare*, the authorities it relies upon, and the reasoning utilized in *Van Dyne Crotty Co.*

The record before us includes evidence indicating that Alsco's sanitization operations result in the textiles undergoing a change in state or form. Regarding the state of the textiles before undergoing the sanitization process, one of Alsco's plant managers testified that, when Alsco retrieves textiles from its customers, the textiles are so soiled with oils, medical waste, blood, and other chemicals, they are neither absorbent nor safe. Thus, Alsco's employees must wear personal protective equipment while sorting the textiles at intake. Alsco's expert witness testified that the various contaminants affixed or bound themselves to the textiles. Alsco's sanitization operations involve application of a chemical process to the textiles that breaks down the bond between the contaminants and the fibers and "chemically change[s] those soils" to remove the contaminants, making the textiles fit for consumption. This is also true of Alsco's newly purchased textiles because they are non-absorbent from being contaminated with oils, waxes, and various chemicals applied during the manufacturing process. During the sanitization process, the various contaminants are removed and the textiles transform into hygienically-clean and absorbent textiles that are fit for consumption. Thus, as the trial court found, "[t]he evidence in the record is that the textiles are undisputedly not in the same physical state before and after processing, because molecules of various contaminants . . . physically, electrically, and chemically adhere to the fabric."

As the parties have noted, their dispute is not over the facts. Given that the question before the Court presents an issue of the statutory construction of Tenn. Code Ann. § 67-6-102(46)(A)(i), most notably, the meaning of the word processing therein, our review on this question of law is de novo. *Eastman Chem. Co. v. Johnson*, 151 S.W.3d 503, 506 (Tenn. 2004). For the reasons discussed above, we agree with the trial court that the administrative judge erred by denying the industrial machinery exemption found in Tenn. Code Ann. § 67-6-206(a).

CONCLUSION

The judgment of the trial court is affirmed. Costs of this appeal are assessed against the appellant, the State of Tennessee, for which execution may issue if necessary.

_/s/ Andy D. Bennett_____
ANDY D. BENNETT, JUDGE