Cite as Det. No. 02-0199R, 24 WTD 151 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 02-0199R[1]
	)	
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .
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RULE 112; RCW 82.04.230, RCW 82.04.240: B&O TAX -- VALUE OF PRODUCTS. All costs, including certain period costs, must be included in the calculation of "value or products."

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.

Lewis, A.L.J. – Taxpayer appeals Det. No. 02-0199, which affirmed that all costs must be included when computing the value of product based on the cost of production. Rule 112 does not allow a taxpayer to pick and choose what costs it wishes to include when valuing a product by means of the cost of production. While some costs may be more directly linked to the production of a good, all costs incurred that are necessary to produce the product must be included in the computation. In this case, because we find that costs of start-up, exploration, plant and equipment, and reclamation are necessary to produce the [metal], they must be included as a component when valuing the [metal] based on a cost of production. Accordingly, Taxpayer's petition is denied. [2]

ISSUE:

Did Det. No. 02-0199 err in affirming the Audit Division method of calculating the value of Taxpayer's [alloy], by including all costs of production?

[1] The original determination, Det. No. 02-0199, is published at 24 WTD 147 (2005).
[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FINDING OF FACTS:

. . . . Taxpayer produces [an alloy]. The process of producing [alloy] requires the mining and transportation of ore to the mill where the [metal is] . . . recovered . . . . The [alloy] is then transported to a third party refinery [outside Washington] where it is further processed into [the finished product]. The [finished product] is then sold by Taxpayer . . . . All of Taxpayer's sales occur outside Washington.

The Audit Division of the Department of Revenue ("Department") audited Taxpayer's books and records for the period January 1, 1995 through December 31, 2000. During the audit period, Taxpayer reported its business and occupation ("B&O") tax obligation under the extracting B&O tax classification.[3] Taxpayer computed the value subject to B&O tax by using the gross proceeds of sales method, whereby the number of [metal] ounces contained in the [alloy] were multiplied by the average monthly . . . price of [metal] to arrive at the value of the product subject to Washington's B&O tax. As part of the audit, Taxpayer requested that the Audit Division recalculate the value of [metal] produced using a cost basis, rather than gross proceeds. The Audit Division used a cost basis that included all Taxpayer's business costs.

Taxpayer disagreed with the Audit Division's method of computing the value of the [metal] produced using all business costs. On December 18, 2001, Taxpayer filed a petition for refund requesting that the Audit Division compute the value of the product using a [standard] format.

. . . . The [standard] was subsequently adopted by the accounting industry and is now a generally accepted accounting practice in the [metal] producing industry.[4]

The [standard] is a uniform standard for use by [metal] producing companies to report production costs on a per-ounce basis. The [standard] allows . . . investors a tool to make meaningful comparison of operating costs of [metal] mining companies. The [standard] method that Taxpayer advocates computes the cash operating cost per ounce of [metal] by excluding certain non-cash period costs such as: royalties, amortization of the mine and milling start-up costs, depreciation of machinery and equipment, and provision for reclamation of the land costs.[5]

On November 27, 2002, the Department issued Det. No. 02-0199 affirming the Audit Division's inclusion of all costs in computing the value of the [alloy]. Det. No. 02-0199 rejected Taxpayer's general argument that the financial statement conventions adopted by the [standard]

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[3] At its Washington location, Taxpayer both mined and processed ore into [alloy]. Therefore, Taxpayer performed both extracting and manufacturing activities. However, rather than reporting under both the extracting and manufacturing classifications and utilizing the Multiple Activities Tax Credit ("MATC"), Taxpayer reported solely under the extracting classification and did not utilize the MATC.

[4] . . . .

[5] "Period costs are those cost expirations that are more closely related to a period of time than to a product, such as administrative salaries. Period costs are charged to expense on the basis of the period of benefit." *Accounting Theory, - Text and Readings* 74 (4th ed. 1991).

should govern the computation of value of product for computing Washington's B&O tax by stating:

> Financial reports and tax reports have different purposes and are prepared using different mixes of revenue and cost figures. Thus, the income shown on a company's financial statements is not necessarily the same for either federal or state tax reporting purposes. While the [standard] may be the standard for financial statement reporting, those same standards are not the standard for reporting Washington's B&O tax. Washington's legislature and Department of Revenue have adopted their own standards for computing costs of production.

Taxpayer also argued that the Department erred in its reading of WAC 458-20-112 ("Rule 112"). Rule 112 allows for determining the value of a good based on cost when there are no comparable sales. Specifically, Rule 112 provides:

> In the absence of sales of similar products as a guide to value, such value may be determined upon a cost basis. In such cases, there shall be included every item of cost attributable to the particular article or article extracted or manufactured, including direct and indirect overhead costs.

Taxpayer argued that certain costs were excludable in computing value for two reasons. First, the phrase "attributable to a particular article" modified cost thus signaling that the only relevant costs were those attributable to a certain article. And, second, had the rule meant to include all costs attributable to a particular article it would not have been necessary to include the phrase "including direct and indirect overhead costs."

Det. No. 02-0199 rejected Taxpayer's argument reasoning that:

> In direct contrast to Taxpayer's conclusion, the phrase "including direct and indirect overhead costs" emphasizes that not just direct costs of the product should be considered, but that all costs of the product including both direct and indirect overhead costs be considered.

Taxpayer disagreed with Det. No. 02-0199. On December 27, 2002, Taxpayer filed a petition for executive level reconsideration. The Department, while granting Taxpayer's petition for reconsideration, rejected Taxpayer's request for executive level review.

Taxpayer's petition for reconsideration requests that four period costs: depreciation of equipment and buildings, amortization of start-up costs, reclamation of land expense, and exploration expense be excluded when computing the value of the product produced. Taxpayer maintains that the exclusion of period costs is required by Rule 112.

ANALYSIS:

Taxpayer is required to pay B&O tax on the "value of product" [alloy] it produces. RCW 82.04.230 and RCW 82.04.240. In general, the "value of product" it produces is determined by the selling price. However, in cases where no wholesale or retail sale is made, a taxpayer must use comparable sales in the state to determine its tax base. RCW 82.04.240(2).

. . . . Because of Taxpayer's unique situation there are no comparable sales for [alloy] in Washington. WAC 458-20-112 ("Rule 112") provides that when no comparable sales exist the taxpayer may use a cost basis to determine the value of its products:

> In the absence of sales of similar products as a guide to value, such value may be determined upon a cost basis. In such cases, there shall be included every item of cost attributable to the particular article extracted or manufactured, including direct and indirect overhead costs.

Taxpayer's reading of Rule 112 would allow for the exclusion of certain period costs in computing the value of the [metal] it produces. Specifically, Taxpayer maintains that depreciation cost of plant and equipment, amoritization of start-up costs, land reclamation costs, and exploration costs are not cost[s] attributable to the particular article extracted and thus excludable when computing the value of the [metal] produced.

In Det. No. 02-0199, we rejected Taxpayer's reading of Rule 112 that allows for excluding some of the costs of producing the product when computing the value of the product. We now reject that same argument on reconsideration.

The preferred method of determining the value of a product is by the "gross proceeds of sale," i.e., the selling price. Rule 112 explains that the "gross proceeds of sale" means the "value proceeding or accruing from the sale . . . without any deduction on account of the cost of the property sold, the cost of the materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses." (RCW 82.04.070). Thus, when valuing a product by means of the gross proceeds of the sale no deductions are allowed whether it be material, labor, taxes, "and other expenses." Consistent with Rule 112's valuation of a product on the basis of "gross proceeds of sales" without deduction on account of cost we conclude that no deduction on account of cost is allowable when valuing a product based on the cost of production.

While certain period costs, such as those raised by Taxpayer may not be directly linked with the production of the [metal], the costs are nevertheless integral to the production of the product. Certainly plant and equipment are necessary to mine and process the ore. The mine would not have come into being without incurring start-up costs or costs of exploration. Similarly, federal and state law requires the reclamation of land after a mining operation. In each case, the costs while not as directly tied to production as the miner's salaries or taxes, are nevertheless a cost attributable to the production of the [metal]. Accordingly, we reaffirm Det. No. 02-0199 ruling that Rule 112 requires all costs of production be included when determining the value of a product based on cost.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 31st day of July, 2003.