Cite as Det. No. 92-110, 12 WTD 355 (1992).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition	)	D E T E R M I N A T I O N
for Correction of Assessment	)	
of	)	No. 92-110
	)	
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .
	)	

[1] RULE 19301: B&O TAX -- MATC -- ALASKA OIL PRODUCTION TAX -- GROSS RECEIPTS TAX. MATC granted for amounts paid to the state of Alaska for oil production taxes to the extent the amounts due were computed and paid through the percentage-of-value method.

[2] RULE 252: HAZARDOUS SUBSTANCE TAX -- FIRST POSSESSION -- EXPORT EXEMPTION -- REIMPORTED. Hazardous substance tax (HST) was not due on fuel products originally refined by the taxpayer in Washington and transferred to Oregon for further processing even though the fuel products were subsequently sold to Washington customers.

[3] RULE 252: HAZARDOUS SUBSTANCE TAX -- EXCHANGE SALES -- EXPORT EXEMPTION CERTIFICATE -- ASSUMPTION OF LIABILITY. The acceptance of validly executed export certificates on sales of fuel products to exchange partners relieves the seller from liability for hazardous substance tax. However, if the taxpayer issues export certificates to its exchange partners on its purchases of fuel products, the taxpayer/issuer has assumed HST liability for those products purchased. See: Det. No. 88-329, 6 WTD 321, (1988).

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: . . .

NATURE OF ACTION:

The taxpayer protests the disallowance of Multiple Activities Tax Credits taken on amounts paid to the state of Alaska for Oil Production taxes and also additional hazardous substance taxes assessed on exchange sales.

FACTS:

Okimoto, A.L.J. -- [Taxpayer] operated an Oil refinery in . . . , Washington. The taxpayer's books and records were examined by a Department of Revenue (Department) auditor for the period January 1, 1985 through December 31, 1988. As a result Doc. No. . . . was issued [in December 1989]. After several post-assessment conferences between the taxpayer and the Audit Division several of the issues raised in the original petition were resolved and withdrawn by the taxpayer. A subsequent adjusted tax assessment resulted and Doc. No. . . . was issued [in March 1990] in the amount of $ . . . . The taxpayer has protested the remaining issues in the assessment and it remains due.

TAXPAYER'S EXCEPTIONS:

Schedule II: Disallowed MATC Taken During Audit Period.

In this schedule, the auditor disallowed Multiple Activities Tax Credits (MATC) taken by the taxpayer for amounts paid to the state of Alaska for oil production taxes. The auditor apparently conceded that the Alaska oil production tax was imposed on an extracting activity, but disallowed the credit because it was not a "gross receipts tax" within the meaning of RCW 82.04.440.

The taxpayer disputes this conclusion and argues in its petition:

> WAC 458-20-19301(5) indicates that Gross Receipts taxes generally include (b) Severance taxes measured by the selling price of the ingredients or products severed rather than measured by costs of production... the volume or number of units produced or some other formulary tax base. ... Alaska Severance tax is levied upon the producer of oil and gas based upon a gross value at the well of all oil and gas removed or sold from each lease or property in the State. Gross value at the well would be the total sales price less costs of movement to the point of sale.

Schedule XVII: Hazardous Substance Tax Due on Imports.

In this schedule, the auditor assessed hazardous substance tax (HST) on fuel products which were originally refined by the

taxpayer at its [Washington] plant and then transferred to its [out-of-state] facility. At the time the fuel was transferred to an out-of-state location, the taxpayer deducted its value from the measure of the HST. While at its [out-of-state] facility other additives were mixed into the fuel and subsequently sold and delivered directly to independently owned dealers located inside the state of Washington. Because the taxpayer was the first possessor of the oil products in Washington (at the [Washington] refinery) the auditor assessed the HST on the value of the fuel sold.
The taxpayer agrees that it was the first possessor of the oil product within the state of Washington, but argues that this possession was an exempt possession under WAC 458-20-252 (4)(c)(iii) because the fuel was later exported for use or sale [out-of-state]. The taxpayer also argues that at the time of its possession, the fuel was not a finished product because several ingredients had to be added [out-of-state]. Therefore, the taxpayer's possession was not a taxable possession within the meaning of Rule 252. The taxpayer contends that the first taxable possession of the finished fuel within the state of Washington fell upon the independent dealers to whom the taxpayer sold and delivered the finished fuel product.

In the alternative, the taxpayer states that it specifically instructed these independent dealers to pay the HST on these sales and believes that they did so. Although the taxpayer has submitted no documentation to substantiate this assertion, it believes that if the dealers have paid the HST on these purchases of fuel, then it should be relieved of any further liability.

Schedule XVIII: <u>Disallowed Exchange Delivery Deductions</u>.

In this schedule the auditor disallowed deductions taken by the taxpayer from the hazardous substance tax on exchange sales made to Washington exchange partners even though the partners gave Mobil an export certificate on those sales. The auditor made two arguments. First, that exchange sales are inherently local and not entitled to the export exemption. Second, that the taxpayer has both accepted export certificates from its partners on exchange sales made to those partners and also issued export certificates on exchange purchases made from those same partners. The auditor contends that the total effect of these cross-issued export certificates is that no oil company has paid the HST on any of these exchange sales.

As we understand the facts, exchange sales normally occur in the following manner.

1) Exchange Partner's (Partner) customer orders fuel from Partner. Because Partner doesn't have this fuel readily

available, it contacts [the taxpayer] to deliver the fuel directly to Partner's customer with the understanding that Partner will pay back [the taxpayer] in like kind by delivering fuel to a future [customer of the taxpayer]. Mobil delivers the fuel to Partner's customer shipside or to a local gas station but in either case delivery takes place within the state of Washington. [Taxpayer] then accrues a receivable in its exchange account and Partner accrues a liability. Partner issues a blanket export certificate, which [taxpayer] accepts in good faith. Partner invoices Partner's customer for the delivered fuel.

(2) Two weeks later [taxpayer's] customer orders fuel from [the taxpayer]. [The taxpayer] notifies Partner. As repayment for the prior transaction, Partner delivers comparable fuel to [taxpayer's] customer at a location within the state. [The taxpayer] issues a blanket export certificate which Partner accepts in good faith. [The taxpayer] credits Partner's outstanding exchange receivable for the value of the fuel delivered. [The taxpayer] invoices its customer for the fuel.

The taxpayer argues in its supplemental petition:

> Rule 252 (4)(C)(iv) provides that the exemption for possession of petroleum products for export may be taken by "any person within the chain of distribution of such products within this state." The <u>only</u> requirement for the deduction is that the transferee give Mobil an export certificate in which the transferee assumes the liability for the HST for any product not actually exported.

(Emphasis theirs.) The taxpayer relies on Det.No. 88-329, 6 WTD 321, (1988) in support of this position.

Schedule XIX: <u>Unreported Value of Out-of-state Transfers</u>.

Taxpayer states in its petition:

> Auditor disallowed a transportation charge deduction totaling $ . . . for transfers out of state from locations in Washington other than the . . . refinery. WAC 458-20-112 clearly states that actual transportation costs from the point at which the shipment originates in Washington to the point of delivery outside the state may be deducted.

In response to this argument the auditor stated that he did not disallow a deduction for transportation costs but merely adjusted the value for other reasons. The taxpayer and the audit supervisor involved have agreed to further discuss and clarify this issue. Accordingly, this matter will be remanded to the Audit Division for further investigation.

ISSUES:

1) Does the MATC apply to amounts paid to the state of Alaska for oil production taxes imposed by AS Section 43.55.011?
2) Is hazardous substance tax due on fuel products originally refined by the taxpayer in Washington and transferred [out-of-state] for further processing if the fuel products are subsequently sold to Washington customers?
3) Under what circumstances does the acceptance of export certificates on sales of fuel products made to exchange partners relieve the seller from liability for hazardous substance tax?

DISCUSSION:

Schedule II: Disallowed MATC Taken During Audit Period.

[1] RCW 82.04.440(4) allows persons taxable under the Manufacturing tax classification a credit against those taxes for any "gross receipts taxes paid to another state with respect to the sales of the products so extracted or manufactured in this state." RCW 82.04.440(5)(a) further defines "Gross receipts tax" to mean a tax:

> (i) Which is imposed on or measured by the gross volume of the business, in terms of gross receipts or in other terms, and in the determination of which the deductions allowed would not constitute the tax an income tax or value added tax: and
>
> (ii) Which is also not, pursuant to law or custom, separately stated from the sales price.

WAC 458-20-19301 (Rule 19301) is the lawfully promulgated regulation concerning the MATC. It states in part:

> (5) Other states' qualifying taxes. The law defines "gross receipts tax" paid to other states to exclude income taxes, value added taxes, retail sales taxes, use taxes, or other taxes which are generally stated separately from the selling price of products sold. Only those taxes imposed by other states which include gross receipts of a business activity within their measure or base are qualified for these credit(s). The burden rests with the person claiming any MATC for other states' taxes paid to show that the

> other states' tax was a tax on gross receipts as defined herein. Gross receipts taxes generally include:
>
> (a) Business and occupation privileges taxes upon extracting, manufacturing, and selling activities which are similar to those imposed in Washington state in that the tax measure or base is not reduced by any allocation, apportionment, or other formulary method resulting in a downward adjustment of the tax base. If costs of doing business may be generally or routinely deducted from the tax base, the tax is not one which is similar to Washington state's gross receipts tax.
>
> (b) Severance taxes measured by the selling price of the ingredients or products severed (oil, logs, minerals, natural products, etc.) rather than measured by costs of production, stumpage values, the volume or number of units produced, or some other formulary tax base.
>
> (c) Business franchise or licensing taxes measured by the gross volume of business in terms of gross receipts or other financial terms rather than units of production or the volume of units sold.
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> Other states' tax payments claimed for MATC must be identifiable with the same ingredients or products which incurred tax liability in Washington state, i.e., they must be product specific.

The Alaska oil severance and production tax for which the taxpayer claimed a MATC is codified in AS Section 43.55.011. It states in pertinent part:

> Oil production tax. (a) There is levied upon the producer of oil a tax for all oil produced from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation. The tax is equal to either the percentage-of-value amount calculated under (b) of this section or the cents-per-barrel amount calculated under (c) of this section, whichever is greater, multiplied by the economic limit factor determined for the oil production of the lease or property under AS 43.55.013. ....
>
> (b) The percentage-of-value amount equals 12.25 percent of the gross value at the point of production of taxable oil produced on or before June 30, 1981, from the lease or property and 15 percent of the gross value at the point of production of taxable oil produced from the lease or property after June 30, 1981; ...
>
> (c) The cents-per-barrel amount equals $0.60 per barrel of taxable old crude oil produced from the lease

> or property, and $0.80 per barrel for all other taxable oil produced from the lease or property....

AS Section 43.55.011 imposes tax upon the producer of oil measured by the greater of either the percentage-of-value amount or the cent-per-barrel amount. Rule 19301 clearly states that severance taxes which are: "...measured by costs of production, stumpage values, <u>the volume or number of units produced</u>, or some other formulary tax base" are not "gross receipts" taxes. Such taxes are not entitled to the MATC. Accordingly, to the extent that the taxpayer has computed and paid Alaska oil production taxes under AS

Section 43.55.011(c) (the cent-per-barrel method) its petition is denied.

Next, we must determine whether amounts paid under the percentage-of-value amount constitute "gross receipts" taxes. AS Section 43.55.011(b) imposes the oil production tax on the percentage-of-value amount which is equal to "12.25 percent of the gross value at the point of production of taxable oil produced." 15 AAC 55.150(b) further defines "gross value at the point of production" to mean:

> ...the sales price under 15 AAC 55.160 for that oil or gas, less the producer's reasonable costs of transportation under 15 AAC 55.180 and 15 AAC 55.190 for that oil or gas from its point of production to its sales delivery point ...;

Under the above regulation, we believe that it is clear that the measure of the oil production tax is the selling price of the oil less the transportation costs incurred between the point of production and its sales delivery point. However, we do not believe that this deduction from the measure of the tax, in itself, is sufficient to disqualify the Alaska oil production tax as a gross receipts tax within the meaning of RCW 82.04.440.

Unfortunately, the taxable measure of the Alaska oil production tax is further conditionally limited by the economic limit factor under AS 43.55.013. The taxpayer explained at the hearing that this factor is designed to encourage oil companies to keep in production older wells even though they are marginally profitable by reducing the measure of the oil production tax by a specified formulary factor. If the economic limit factor as computed under the formula is .7 or greater, then the economic limit factor is one and it does not effect the measure of the tax. However, if the factor is less than .7 then that factor is multiplied times the percentage-of-value amount or cents-per-barrel amount, which in turn reduces the measure of the tax by that variable factor.

Rule 19301 specifically provides that "gross receipts taxes" generally only include those taxes for which

> "... the tax measure or base is not reduced by any allocation, apportionment, or other formulary method resulting in a downward adjustment of the tax base."

Accordingly, because the economic limit factor is a formulary method which results in a variable downward adjustment of the tax base, we must also deny any MATC for Alaska oil production taxes computed and paid using an economic limit factor of less than "one."

However, we do agree that any Alaska oil production taxes computed and paid using the percentage-of-value amount pursuant to AS 43.55.011(b) and an economic limit factor of "one" are "gross receipts" taxes within the meaning of RCW 82.04.440. Accordingly, the taxpayer's petition is granted on this portion of the issue subject to verification by the Audit Division.

Schedule XVII: Hazardous Substance Tax Due on Imports.

RCW 82.22.010[1] imposed a hazardous substance tax upon "...the first possession of all hazardous substances." RCW 82.22.020 included within the definition of hazardous substances all "petroleum products." It further defined "possession" to mean "... the control of a hazardous substance located within this state and includes both actual and constructive possession."

Under the above statutory guidelines, it is clear that in respect to the oil products that the taxpayer imports from Alaska for refining at its [Washington] refinery, it is the first possessor within the state of Washington. This possession as a manufacturer would normally incur the hazardous substance tax liability. However, RCW 82.22.040 and Rule 252[2] exempt from tax the following possessions:

> (3) Any possession of ... (e) petroleum products that are exported for use or sale outside this state as fuel.

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[1]RCW 82.22 was subsequently repealed by Initiative 97, but was in effect during the audit period of this tax assessment.

[2]Rule 252 was revised after Initiative 97 was passed. We have referred to the Rule as it was written during the audit period of this tax assessment.

Based on the above facts, we agree that the taxpayer's transfer of petroleum fuel products[3] to its [out-of-state] facility for use by further processing or sale satisfies and perfects the exemption requirements stated in Rule 252 as to that possession. Accordingly, we find that this possession was exempt from the hazardous substance tax.

Rule 252(4)(d) further provides:

> (ii) The tax will not apply with respect to any possession of any hazardous substance purchased, extracted, produced or manufactured outside this state which is shipped or delivered into this state until the interstate transportation of such substance has finally ended in the state. Thus, out of state sellers or producers need not pay the tax on substances shipped directly to customers in this state. The customers must pay the tax upon their first possession unless otherwise expressly exempt.
>
> (iii) Out of state sellers or producers will be subject to tax upon substance shipped or delivered to warehouses or other in state facilities owned, leased, or otherwise controlled by them.

Pursuant to the above Rule 252, we further find that to the extent that the taxpayer's reimportation of the finished fuel is sold and shipped directly to a retail dealer located within Washington, the taxpayer is not liable for the HST. The taxpayer is, however, subject to the HST on all fuel shipped to in-state warehouses or other facilities controlled by the taxpayer prior to actual sale. The taxpayer's petition is granted on this issue subject to verification by the Audit Division.

Schedule XVIII: <u>Disallowed Exchange Delivery Deductions</u>.

Rule 252 specifically states:

> (iv) The exemption for possessions of petroleum products for export sale or use as fuel may be taken by any person within the chain of distribution of such products in this state. To perfect its entitlement to this exemption the person possessing such substances(s) must take from its buyer or transferee of the substance(s) a written certification in substantially the following form:

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[3]These products consisted of different grades of gasoline, diesel and jet fuels.

Certificate of Tax Exempt Export Petroleum Products

> I hereby certify that the petroleum products specified herein, purchased by or transferred to the undersigned, from (seller or transferor), are for export for use or sale outside Washington state as fuel. I will become liable for and pay any hazardous substance tax due upon all or any part of such products which are not so exported outside Washington state. This certificate is given with full knowledge of, and subject to the legally prescribed penalties for fraud and tax evasion.

In Det. No. 88-329, 6 WTD 321, (1988) the Department further clarified that purchasers or transferees of fuel products were not precluded from giving export certificates even though not all of the purchased fuel would in fact be exported. Accordingly, based on the above Rule 252 and Det. No. 88-329, we agree that the taxpayer is relieved from HST liability for all sales or transfers of fuel products to its exchange partners for which it has received a validly executed export certificate.

However, we are also concerned with the auditor's allegations that the taxpayer has issued export certificates on its exchange purchases and that no HST has been paid on exchange sales or purchases by any oil company even though no exportation has taken place.

First, we note that the issuance of export certificates is a two-edged sword. Whereas, it relieves the seller of liability for the HST, it also simultaneously transfers that liability to the purchaser/issuer. Through issuance of the blanket export certificate the issuer has voluntarily accepted the HST liability and all related documentary requirements. Thus, it is liable for HST if the purchased fuel product is not subsequently exported and also bears the burden of providing documentation that the purchased fuel was in fact exported.

Based on the above analysis, we believe that the HST assessed in Schedule XVIII should be deleted only to the extent that the taxpayer can show that either:

1) If the taxpayer has issued blanket export certificates on exchange purchases, it has documentation showing that the fuel products were actually exported, or

2) The taxpayer has a validly executed export certificate issued by its customer for the fuel product sold, or

3) The taxpayer has a validly executed "certificate of HST previously paid" issued by the seller in addition to actual documentation provided by the seller showing the taxable value, the amount of tax paid, and the date of the return on which the tax was previously paid or similar documentation showing that the tax was in fact previously paid. Accordingly, this issue is remanded to the Audit Division for further investigation.

DECISION AND DISPOSITION:

The taxpayer's petition is sustained in part and remanded in part. The matter will be remanded to the Audit Division for adjustments consistent with this determination.

DATED this 28th day of April 1992.