

Cite as Det. No. 91-341, 12 WTD 327 (1991).

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

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For the Prior determination)	
of Tax Liability)	
)	No. 91-341
)	
. . .)	UNDISCLOSED TAXPAYER
)	WAC 458-20-100(9)
)	

[1] RULE 112 -- VALUE OF PRODUCTS -- OIL -- EXCHANGE AGREEMENTS -- PLATT'S. Absent actual sales, prices listed by independent publications such as Platt's or OPIS will be relied on to determine the value of petroleum products under exchange agreements in the oil industry.

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: . . .

NATURE OF ACTION:

The taxpayer requests the prior determination of tax liability regarding the value of products exchanged with other oil companies.

FACTS AND ISSUES:

Pree, A.L.J. -- The taxpayer is engaged in the business of producing, refining, and marketing petroleum and petroleum products. As a routine part of its business, it exchanges products with other oil companies to save transportation costs. Companies with excess inventory in one region will deliver product there and in return receive identical product in another region where it is needed. Products are exchanged on a like kind basis with quantities being the unit of exchange. The Department of Revenue and the courts have established that deliveries of product in Washington on an exchange basis to other refineries

are wholesale sales subject to the wholesaling-other business and occupation tax. The issue involves the valuation of exchange products so delivered.

In the past, the taxpayer has been instructed by the Department to assign a unit value to exchange deliveries equal to the average wholesale price to distributors in the region of delivery. Prices reported by "Platt's Oilgram" industry publication were deemed acceptable.

The taxpayer argues that Platt's Oilgram prices represent wholesale prices at the distributor level. It asserts that they are not comparable to the exchange transactions between producers. If no comparable sales exist, the taxpayer contends that the Department's rule provides for the use of a cost method.

In addition, it is the taxpayer's position that the definition of the tax measure, "Gross proceeds of sale" and "Value proceeding or accruing" show that it is the "consideration" expressed in terms of money received or accrued that is the proper measure of tax. The taxpayer contends that since the consideration in the case of exchange is inventory, then the inventory value rather than the distributor price is the proper tax measure.

DISCUSSION:

In 1962, an oil industry association on behalf of its many members which refined and/or marketed petroleum in this state sought a uniform basis upon which to report state tax liability for intercompany exchange transactions. After months of communication and meetings among its members, the association proposed that a formula be accepted for measuring state taxes based on Platt's Oilgram published prices. In response, the Department of Revenue (then referred to as the Tax Commission), wrote a letter dated April 6, 1964, which in pertinent part reads as follows:

The Tax Commission has completed study and discussion of the proposal to use the 1964 Washington Petroleum Product Unit Values, based on an average of Platt's Oilgram quotations as approved for use in the computation of ad valorem taxes by our Assessment Standards Section. It is proposed that the unit values be used for a year without change and then be adjusted for the following year according to the same formula.

The Commission is agreed that the schedule approved for ad valorem purposes based on unit values of petroleum products at terminals and at bulk plants in five zones in Washington for 1964 effectively overcomes the

objections raised in our letter of January 22, 1964. While the Commission feels that the unit values are somewhat low (approximately 10% below the unit prices at which petroleum products are sold on bid to the State of Washington) we are willing to approve the use of this schedule on a trial basis and subject to annual adjustment as proposed in your letter of August 8, 1962.

As intercompany exchanges will presumably be made at terminals, the terminal base rate will ordinarily be the measure of tax, but in those cases where exchanges are made other than at the terminal, the bulk plant rate for the location at which the exchange is made will be applicable.

In those cases where the Business and Occupation Tax on intercompany exchanges has not been reported for prior years, liability may be measured by the values approved by our Assessment Standards Section for such prior years, but since the 1964 values were computed on a formula which differed in some respects from those used in prior years, we will reserve the right to amend the measure of tax for such prior periods at the time of our next field audit to bring such values into line with the methods used to establish 1964 values. (Emphasis supplied)

We hope that the approved formula will turn out to be both convenient and accurate in the determination of the industry's liability on intercompany exchanges.

Platt's Oilgram is the source for the posted selling prices of finished petroleum prices. It is a McGraw Hill publication prepared independent of the oil industry. Platt publishes daily the posted selling prices of petroleum products at major market areas in the United States and elsewhere in the world. A Seattle report is prepared based on selling prices in Seattle. Transportation variables are then added to determine the value at various terminal or bulk plant locations within the state.

This formula has been applied for years for property tax valuation purposes as well as for business and occupation taxes by the Department of Revenue. It has been the best evidence of petroleum product valuation because for years various oil companies have been unwilling to reveal their actual refining costs. It provides the constitutionally mandated uniformity required for property tax valuation.

It continues to reflect a basis for arriving at unit values which are as accurate as possible in the absence of actual values of

petroleum products exchanged. It must be recalled that it was the association's claimed absence of actual values which was given by the association itself for requesting the adoption of some other accurate formula. The Department of Revenue did not intend to allow nor did it have authority to allow the use of any formula in lieu of actual gross proceeds of sale, which would contravene the scope and intent of the statutory definition of "value of products." That is, although the Department possessed clear authority to issue administrative guidelines to implement the defining statute, it clearly lacked the authority to issue arbitrary or capricious guidelines which would obviate legislative mandate or intent. RCW 82.04.450 defines "value of products" as follows:

(1) The value of products, including byproducts, extracted or manufactured shall be determined by the gross proceeds derived from the sale thereof whether such sale is at wholesale or at retail, to which shall be added all subsidies and bonuses received from the purchaser or from any other person with respect to the extraction, manufacture, or sale of such products or byproducts by the seller, except:

(a) Where such products, including byproducts, are extracted or manufactured for commercial or industrial use;

(b) Where such products, including byproducts, are shipped, transported or transferred out of the state, or to another person, without prior sale or are sold under circumstances such that the gross proceeds from the sale are not indicative of the true value of the subject matter of the sale.

(2) In the above cases the value shall correspond as nearly as possible to the gross proceeds from sales in this state of similar products of like quality and character, and in similar quantities by other taxpayers, plus the amount of subsidies or bonuses ordinarily payable by the purchaser or by any third person with respect to the extraction, manufacture, or sale of such products: PROVIDED, That the value of a product manufactured or produced for purposes of serving as a prototype for the development of a new or improved product shall correspond: (a) To the retail selling price of such new or improved product when first offered for sale; or (b) to the value of materials incorporated into the prototype in cases in which the new or improved product is not offered for

sale. The department of revenue shall prescribe uniform and equitable rules for the purpose of ascertaining such values.

(Emphasis supplied.)

Since the association insisted that there were no actual cash wholesale transactions and that there were no comparable prices by which to gauge the value of petroleum products exchanged, the association and the Department agreed that the values established using Platt's Oilgram quotations would satisfy statutory requirements. The correspondence through which this agreement was achieved reflects that both the association and the Department had every intention of preserving the tenor and scope of RCW 82.04.450. Both the association and the Department qualified the applicability to situations where Platt's would approximate true market values. Neither the association nor the Department intended to adopt a formula which would do violence to RCW 82.04.450.

Recently, we have become aware of another publication, OPIS (Oil Pricing Information Service), which also compiles and lists wholesale values for various petroleum products. OPIS offers its subscribers a computerized service and lists many of the new products currently exchanged.

The taxpayer requests that it be permitted to use inventory values. We presume these are the figures shown as inventory on the taxpayer's books. These are derived from the taxpayer's costs in producing or acquiring products. They do not necessarily reflect arms-length transactions, nor do they include indirect overhead costs as required under WAC 458-20-112 (Rule 112).

We are not convinced that accurate cost figures are available, nor do we believe that they would accurately reflect the value of the products exchanged. In the oil industry it is not uncommon for products to be obtained from international affiliates. We cannot accept those transactions as reflecting arms-length fair market value. Estimates offered by other divisions of the company itself are also suspect. Indirect overhead costs of these conglomerates would be extremely difficult to determine. In light of these problems, absent actual sales, the Department will accept values prepared by organizations independent of the oil industry (such as Platt's or OPIS) before considering any cost figures offered by an interested taxpayer.

While the Platt's or OPIS figures represent producer to distributor wholesale prices rather than producer to producer wholesale prices, we believe that they more accurately reflect

the value of the products exchanged than any cost figures. It would seem that no producer would take delivery of a product that it did not produce unless it was likely to sell it readily to a distributor. That price to the distributor is the price reflected in Platt's. Unless the taxpayer can prove the differential between the producers and the distributors, the Platt's value corresponds as nearly as possible to the value of the products exchanged and is therefore, the proper measure of the tax.

DECISION AND DISPOSITION:

Absent actual sales, prices listed by independent publications such as Platt's or OPIS will be relied on to calculate the value of petroleum products under exchange agreements in the oil industry. That value should be used as their tax measure. Taxpayers are entitled to request a ruling pursuant to WAC 458-20-100(9). Normally, a taxpayer would be permitted to rely upon the ruling for reporting purposes and to support their reporting methods in the event of an audit. The identity of the taxpayer has not been disclosed in this request for a ruling, and the ruling is based upon only the facts that were disclosed by the taxpayer's representative. Since we are unable to inform the taxpayer of any future changes in our position, this ruling only binds the department while its position is unchanged. It is effective for future application by the taxpayer until such a change, but will not necessarily be binding on the Department because we are unable to notify the taxpayer should the position of the Department change. It also shall not be binding if there are relevant facts which are in existence but not disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes.

DATED this 27th day of December, 1991.