Cite as Det. No. 93-118, 13 WTD 262 (1994).

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

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 93-118
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .

[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.

[2] RULE 252; RCW 82.22.020: HAZARDOUS SUBSTANCE TAX -- INTERMEDIATE PRODUCTS. Gasoline and propane used to operate refinery equipment are not intermediate products exempt from hazardous substance tax under Rule 252(7)(b).

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.

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NATURE OF ACTION:

An oil refiner petitions for correction of assessment of hazardous substance and petroleum products taxes on products used at the production plant . . . as well as the value used for large volume exchanges both for hazardous substance, petroleum products, and business and occupation taxes.

FACTS AND ISSUES:

Pree, A.L.J. -- [The taxpayer] is engaged in the business of refining petroleum products. It has a refinery in Washington where it refines crude oil into various products.

. . . .

[The taxpayer] protested the use of its wholesale prices listed at its truck terminal to value large exchanges of various products for hazardous substance, petroleum products, and business and occupation taxes. [It also] protested the assessment of hazardous substance tax and petroleum products tax on waste refinery gas produced and burned at the refinery.

. . . .

[The taxpayer] often exchanged its products with other oil companies for their products. The taxpayer agrees that these transactions were taxable, but disputes the value placed on them. The auditor used the taxpayer's wholesale prices charged to buyers at its truck terminals for wholesale purchases of its products. The taxpayer argues that in the case of large barge or pipeline exchanges, its wholesale prices for these products did not accurately reflect their value because of the difference in quantity. The taxpayer contends these products should be valued under its cost method.

[The taxpayer] states that it should be entitled to a refund of hazardous substance tax and petroleum products tax on products that it says were consumed in the manufacturing process. In the original petition these products were identified as refinery waste gas and off-spec propane gas which were consumed while still in the manufacturing activity. The petition cross references assessment schedules . . . identifying these as refinery gas and off-spec propane used in production. Actually, the issue pertaining to those schedules involved commercial grade propane and gasoline used to operate equipment around the refinery. No adjustment was made in the assessment involving refinery waste gas.

DISCUSSION:

[1] The first issue concerns the proper value of the taxpayer's products used for the assessment of business and occupation, hazardous substance, and petroleum products taxes. The auditor based the assessment on the taxpayer's posted prices for wholesale products at its truck terminal. The taxpayer now indicates that these prices do not reflect the value of its large volume barge or pipeline exchanges. It advocates using a method based on its costs to arrive at these values. We believe that to do so would be incorrect regarding most of its exchanges.

WAC 458-20-112 (Rule 112) provides that products should be valued by the gross proceeds of their sales which is the value proceeding or accruing from the sale of tangible personal property without any deduction on account of the cost of property sold. RCW 82.04.450 provides that the business and occupation tax value of products should be determined by the gross proceeds of sales in every instance in which a bona fide sale of such products is made, and whether sold at wholesale or at retail. Where products are exchanged or sold under circumstances such that the stated gross proceeds from the sale are not indicative of the true value of the subject matter of the sale, the value shall correspond as nearly as possible to the gross proceeds from other sales at comparable locations in this state of similar products of like quality and character, in similar quantities, under comparable conditions of sale, to comparable purchasers, and shall include subsidies and bonuses.

The final paragraph of 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.

(Emphasis supplied.)

This paragraph is only applicable in the absence of sales of similar products. Except for partially refined crude oil, sales of similar products existed during the audit period. The cost method should only be used for valuing the partially refined crude oil, and then only when the gross proceeds of sales cannot be determined by what the taxpayer received.

The taxpayer argues that a cost method of valuation should be used to value its products in the exchange transactions as well as other instances where tax was imposed. It objects to the use of Platt's Oilgram or other reports as comparable sales for the following reasons:

1. It believes that the cost basis has always been the preferred pricing mechanism by the Department of Revenue.

2. The wholesale prices include profit margins and do not account for overhead and transportation costs.

3. The product is not sold in large quantities for Platt's purposes.

4. Platt's numbers are not available until 60-90 days until after the monthly return is due.

5. [The taxpayer] relied on prior audit instructions and a letter [from the Audit Division].

None of these points are supported by fact or law. First, Rule 112 expresses a preference for the comparable sales method of valuation over the cost method. Only in the absence of sales of similar products may the value be determined under the cost method.

. . . .

Second, the comparable sales method compares sales prices to determine the value of the products. Costs, profits, or losses are irrelevant under this method. We are only trying to determine the value of similar products. The taxpayer is in business to make a profit, and we presume that its business dealings including these exchanges are entered into for that purpose. If the locations of the comparable sales are different from the products exchanged, an adjustment will be made for transportation.

Third, Platt's does include large quantity pipeline and barge sales. These are comparable in quantity to the taxpayer's exchanges.

Fourth, Platt's figures for the first day of the month are available within a week. Tax returns are not due until the 25th day of the following month.

Finally, Rule 112 has expressed the Department's preference for using sales of similar products over a cost basis since 1970. The prior audit instructions to this taxpayer express a similar preference. It is the taxpayer, not the Department that has advocated changing the rules. Only when the taxpayer represented to the Department that similar sales did not exist, did the Department accept a cost method. That was the case in the [Audit Division's] letter. The Chief of Audit only allowed use of cost valuation with respect to transferred product (partially refined crude). The taxpayer had represented that there were no comparable sales of that product at that time. Other products exchanged could only be valued using cost valuation in the absence of an established market price. Establish market prices for the products at issue exist in Platt's Oilgram Price Report as well as Oil Price Information Service (OPIS).

It may be helpful to review the evolution of the Department's position regarding this issue. 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's 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 . . .

(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.

Regarding this assessment, except for the partially refined crude oil, sales of similar products and in similar quantities such as gasolines, diesel, and jet fuel are reflected in Platt's Oilgram. As an alternative to its actual wholesale prices at its truck terminal, for large scale exchanges the taxpayer may use Platt's Oilgram or OPIS. 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.

In the alternative, if a Platt's measure is unavailable or not similar for the product the taxpayer gives up, but the product received by the taxpayer can be readily valued using Platt's or OPIS, the measure of tax used is the value proceeding and accruing to the taxpayer as the gross proceeds of the sale. For instance, if the taxpayer were to enter an arm's length exchange of partially refined crude oil in Washington for a pipeline quantity of unleaded 87 in Los Angeles, we can look to the Platt's value of the unleaded 87 it received Los Angeles to determine the value or the gross proceeds of sale for the partially refined crude in Washington.

[2] Hazardous substance tax is imposed on the privilege of possession of hazardous substances in this state. RCW 82.21.030. Included in the statutory definition of hazardous substance under RCW 82.21.020 are petroleum products defined in that section as:

> (2) "Petroleum product" means plant condensate, lubricating oil, gasoline, aviation fuel, kerosene, diesel motor fuel, benzol, fuel oil, residual oil, liquefied or liquefiable gases such as butane, ethane, and propane, and every other product derived from the refining of crude oil, but the term does not include crude oil.

The petroleum products tax is imposed in a similar manner under RCW 82.23A.020 using an identical definition of petroleum products in RCW 82.23A.010(2). The propane and gas consumed by the taxpayer in Washington is clearly subject to both taxes. They are products derived from the refining of crude oil possessed by the taxpayer in Washington.

The taxpayer refers to WAC 458-20-252(7)(b) as authority for exemption from the hazardous substance and petroleum products taxes. That section provides in part:

> When any hazardous substance(s) is first produced during and because of any physical combination or chemical reaction which occurs in a manufacturing or processing activity, the intermediate possession of such substance(s) within the manufacturing or processing plant is not considered a taxable possession if the substance(s) becomes a component or ingredient of the product being manufactured or processed or is otherwise consumed during the manufacturing or processing activity.

(Emphasis as supplied by taxpayer.)

We see nothing intermediate about the taxpayer's possession of the gasoline and propane used by the taxpayer to operate equipment. They were produced and consumed specifically as fuel to operate equipment. Taken in context, the language of the rule only intends to exempt those products which are never withdrawn from the process in the plant as final products, but are consumed as intermediate products. The gasoline and propane were consumed as final products. Certainly, there is no statutory exemption for such products. The clear intent of RCW 82.21.020 was to impose the Hazardous Substance tax on every product derived from the refining of crude oil. The assessment reflects the intended application of the statute.

DECISION AND DISPOSITION:

The taxpayer's petition is denied. The taxpayer may request that the auditor adjust the assessment within thirty days of issuance of this determination using Platt's or OPIS to value the exchanged products. If such a request is made, a revised assessment will be issued.

DATED this 19th day of April 1993.