Cite as Det. No. 13 WTD 119 (1993).

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

In the Matter of the Petition For Executive Level Reconsideration of	)	F I N A L D E T E R M I N A T I O N
	)	No. 92-219ER
. . .	)	Registration No. . . . . . ./Audit No. . . . . . ./Audit No. . . .

[1] RULE 100 -- RCW 82.32.160/170: APPEALS -- JUST AND LAWFUL DECISIONS -- EX PARTE CONTACTS. The review proceedings authorized by Chapter 82.32 RCW are informal, non-APA, internal review proceedings which are intended to achieve just and lawful results. Such proceedings are not governed by the APA or Court rules of procedure and, by their nature entail ex parte contacts and communications.

[2] RULE 100: APPEALS -- SUPPLEMENTAL DETERMINATIONS -- PETITIONS FOR RECONSIDERATION. Henceforth, unless expressly provided for by statute or rule, the Department of Revenue will not issue supplemental determinations under any circumstances. Where mistakes of fact or errors of law can be identified, the appropriate administrative remedy is a petition for reconsideration.

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:

Executive level reconsideration on protest of Supplemental Determination No. 92-219S which reversed, in part, Determination No. 92-219 in that it excluded application of the Extracting B&O tax to logging road construction in which rock was being stockpiled for later use, and reinstated retail sales tax.

FACTS AND ISSUES:

Faker, A.D. -- . . . . [Taxpayer] requested a refund of business and occupation tax and retail sales tax relative to the preparation of rock for use on private logging roads. In response, the Department of Revenue (Department) issued Determination No. 92-219 [in August 1992], substantially granting taxpayer's request. [In December 1992] the Department's Interpretation and Appeals (I&A) Division, on its own motion, issued Supplemental Determination No. 92-219S. In it, I&A limited the prior decision by ruling that the crushing and stockpiling of rock for future use on a logging road was a retail sale activity when a charge was made for such service. I&A did so without having convened a further hearing on the matter and without soliciting further arguments from either taxpayer or the Department's Audit Division, which issued the original assessment.

The pertinent facts of this case are stated in Determinations 92-219 and 92-219S. For the sake of convenience we will summarize them here. Taxpayer owns . . . timber land. To log these areas it must build roads. Its practice was to hire third party contractors to do this work. Part of the work activity entailed collecting, crushing, blasting, or otherwise processing rocks for use on the logging roads. While generally recognizing logging road construction as an extracting activity for purposes of the B&O tax, the Department's auditors judged this rock preparation activity (collectively referred to hereafter as "rock crushing") as not sufficiently related to logging road construction so as to be similarly B&O tax classified. Consequently, they taxed charges for rock crushing as a retailing activity subject to retail sales tax. Taxpayer appealed, and in Determination No. 92-219 we ruled that the phrase "logging road construction" was broad enough to include rock crushing. We granted taxpayer's petition for refund.

Following the issuance of Determination No. 92-219, I&A was advised by the Department's auditors that much of the rock at issue was stockpiled for later use.[1] We responded with

[1]Following the decision in Determination No. 92-219S, taxpayer produced evidence indicating the rock at issue was not stockpiled.

Determination No. 92-219S in which we limited our earlier decision to rock which was crushed and used concomitantly on a logging road in furtherance of a timber harvest operation. We ruled that a charge for the crushing and stockpiling of rock for later use is a retail sale.

Taxpayer has appealed Determination No. 92-219S for executive level reconsideration. It raises several arguments. It states the Department is without authority to issue a supplemental determination, as it did in Determination No. 92-219S. It suggests that there were ex parte contacts between the Department's auditor and I&A's Administrative Law Judge (ALJ) who issued both 92-219 and 92-219S. Taxpayer argues that it was only because of those ex parte contacts that the supplemental determination was issued. Those communications, in effect, became an internal appeal of the original determination by the Department itself. The Department has no appeal rights under WAC 458-20-100 (Rule 100). The supplemental determination, therefore, should not have been issued. Finally, says the taxpayer, even if the Department was allowed to appeal an I&A decision, the "appeal" in this case was not submitted until some three months after Determination No. 92-219 was issued, well after the 30 day time limit prescribed in Rule 100.

The issue to be decided in this request for executive level reconsideration is whether the Department may issue a supplemental determination on its own motion, based upon after-acquired information, several months after the original determination, without giving the adversely affected party notice or opportunity for argument.

DISCUSSION:

The issue before us provides the welcomed opportunity to address and resolve questions about the Department's authority and actual practices involving internal communications (so-called ex parte contacts) and clarifications of its own rulings. We will address them in that order.

The special review, appeal, and decision making authority of the Department for excise tax matters derives primarily from Chapter 82.32.RCW.

RCW 82.32.160 provides:

> Any person having been issued a notice of additional taxes, delinquent taxes, interest, or penalties assessed by the department, may within thirty days after the issuance of the original notice of the amount thereof or within the period covered by any extension

> of the due date thereof granted by the department petition the department in writing for a correction of the amount of the assessment, and a conference for examination and review of the assessment. The petition shall set forth the reasons why the correction should be granted and the amount of the tax, interest, or penalties, which the petitioner believes to be due. The department shall promptly consider the petition and may grant or deny it. If denied, the petitioner shall be notified by mail thereof forthwith. If a conference is granted, the department shall fix the time and place therefor and notify the petitioner thereof by mail. After the conference the department may make such determination as may appear to it to be just and lawful and shall mail a copy of its determination to the petitioner. If no such petition is filed within the thirty-day period the assessment covered by the notice shall become final.
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> The procedures provided for herein shall apply also to a notice denying, in whole or in part, an application for a pollution control tax exemption and credit certificate, with such modifications to such procedures established by departmental rules and regulations as may be necessary to accommodate a claim for exemption or credit.

(Emphasis ours.)

RCW 82.32.170 makes the same provisions for review, hearing, and decisions pertaining to petitions for refund of taxes paid.

The Department has implemented these statutory provisions through the adoption and amendment of WAC 458-20-100 (Rule 100) governing administrative appeals of excise tax disputes. The statutes provide for a "review" to achieve a "just and lawful" result. The procedure developed to achieve this result is the non-adversarial hearing and decision-making process explained in Rule 100. Also, under the statutes, the granting of petitions for such review, hearing, and written decisions is discretionary with the Department. It is the long established policy of the Department to grant such petition requests when taxpayer customers raise disagreements with the facts or documentary evidences involved or there is a clear justiciable issue requiring legal interpretations of the Revenue Act or excise tax rules. The Department is charged with achieving a "just" result, not only one which is legally correct. In short, the administrative appeal procedure is calculated to do the right thing, under the law. As a practical matter, the system works. Up to 95% of excise tax disputes are successfully resolved

through the Rule 100 procedures, without recourse to costly, time-consuming, and seldom satisfactory tax litigation in the Courts.

Under the earlier referenced statutes, the "review" called for refers to an internal review by the Department itself, separate and apart from its function of assessing and collecting taxes. It does not mean an external review independent of the Department. Such external review is provided by the adversarial appeal functions of the State Board of Tax Appeals and the Courts. However, the Department's Rule 100 procedures, by their very nature, are informal proceedings which are not explicitly governed by the hearing rules of the Administrative Procedures Act (APA) or sanctions against ex parte communication such as Canon 3(A)(4) of the Code of Judicial Conduct. In fact, Legislative committees have examined these informal, internal, tax appeal procedures in detail in connection with APA amendment proposals and have not seen fit to include them within the ambit of that Act.

[1] Ex parte Contacts:

The information gathered at a hearing from a taxpayer is itself ex parte in that the tax assessing agents of the Department do not have an opportunity to verify, refute, or comment on the taxpayer's testimony or hearing statements. To achieve a "just and lawful" result, it often becomes necessary for the Administrative Law Judge reviewer to contact the division or agent of the Department assessing the tax when, for example, the information presented by the taxpayer appears to be in conflict with that of the assessing agent or when other clarifications are necessary. This is the only reasonable process by which "just and lawful" tax results can occur. Implicit in the non-adversarial nature of the process are the investigative needs and duties of the ALJ which include exparte contact with that part of the Department which is responsible for the assessment.

However, just as the ex parte communication is implicit in the process, the information gained through such communications during a review, when important to the result, must be made available to the taxpaying customer whose liability is being reviewed. Thus, if the determination is the result of ex parte communications within the Department, the determination may be issued only after an opportunity has been afforded the taxpayer to verify, refute or comment on the information. Taxpayers have this opportunity at the time the assessment is originally made. The same reasoning applies when an assessment is under review or is remanded for correction. When information is received ex parte which has not been included in the written explanation of the basis for any deficiency assessment and, on review, it becomes the basis for supporting any assessment, the entire

appeal and review process is best served when the information is given to the taxpayer with an opportunity to verify, refute, or comment upon the new or different information.

Accordingly, it is the policy of the Department, and is hereby announced as its precedent, to notify taxpayer customers of all information however acquired, which has a direct bearing upon any administrative appeal decision and to allow the taxpayer customer a full opportunity to respond before the decision is rendered.

[2] Supplemental Determinations:

Historically, for more than 20 years, the I&A Division has issued "supplemental" determinations on rare occasions upon the request of taxpayers or upon its own motion. These documents have been deemed necessary to further clarify, explain, or provide guidance for implementing the decisions included in original determinations issued by ALJs. The Department simply used this tool as a service aid to taxpayers and its own employees on those rare occasions when it was agreed between all of the persons with a stake in the results that further guidance was beneficial for all. Moreover, except for the instance of Supplemental Determination No. 92-219S, at issue here, the Department has never issued a supplemental determination which substantively and retroactively changed the tax result or ruling of the original determination to a taxpayer's detriment. To do so calls into question the basic due process rights of a taxpayer to be heard on the matters in dispute. More egregiously, to do so without notice to the taxpayer is perceived as an outright denial of those rights.

Most importantly, there is not now, nor has there ever been, any WAC rule provision or written agency policy governing the use or issuance of "supplemental" determinations. Henceforth, unless expressly provided for by statute or WAC rule, the Department will not issue supplemental determinations under any circumstances. If taxpayers believe that original Determinations are incorrect because of identifiable mistakes of fact or errors of law, petitions for reconsideration are the appropriate administrative remedy.

None of the foregoing should imply that any taxpayer is entitled to the internal review contemplated by RCW 82.32.160 or 170 and Rule 100 as a matter of constitutional or statutory right. The granting of such petitions for review, hearing, and determination is a matter strictly within the discretion of the Department. Again, it is the Department's established policy, as contemplated in Rule 100, to grant such timely filed petitions for review and the attendant hearing and determination procedures when tax

issues and/or applications are fairly disputed under the facts or laws.

Based on the foregoing discussion, Supplemental Determination No. 92-219S is hereby voided ab initio, and Determination No. 92-219 is reinstated. Prospectively, from the 1989 end of the second audit period at issue, Retailing B&O and retail sales tax, as opposed to Extracting B&O tax, will be applied to charges for crushing rock which is stockpiled for more than three years.[2] More particularly, in order to be considered as part of the extracting activity of logging road construction, rock must be applied to a road within three years of its preparation and that road must be used for logging purposes no later than three years after the rock is prepared. These tax classifications will turn upon the taxpayer's actual practices for stockpiling and using rock, subject, of course, to future audit confirmation.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. The Audit Division will issue an amended assessment(s) implementing the conclusions reached in this determination and Determination No. 92-219 in the form of an additional credit for the disputed item(s).

DATED this 13th day of October 1993.

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[2]Under prevailing and undisputed Audit Division guidelines, the building of logging roads for timber harvesting is an inseparable part of the log extracting activity, subject to Extracting B&O tax. However, private road construction in any other context is a sale at retail. Within the custom of the logging industry, logging roads are usually constructed several years in advance of the logging activity to enhance road surface stability (the "settling" factor). Thus, charges for road construction, including rock crushing, treating, and stockpiling are taxable as retail sales if performed more than three years from the date of actual log extracting and hauling over such roads.