Cite as Det. No. 94-047, 14 WTD 210 (1995).

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. 94-047
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 244; RCW 82.08.0293: RETAIL SALES TAX -- FOOD PRODUCT EXEMPTION -- BREWING SUPPLIES. The food product exemption applies to the sale of products which are reasonably and commonly expected to be consumed by humans. In applying the exemption we look to the nature of the item being sold and not to where and how the item is sold.

[2] RULE 244; RCW 82.08.0293: RETAIL SALES TAX -- FOOD PRODUCT EXEMPTION -- BREWING SUPPLIES. Corn syrup, unhopped malt extracts, whole grains, yeast, and other items which are sold by a home brewing store and which are reasonably and commonly expected to be consumed by humans are subject to the exemption. Processing agents, hops, and home brewing kits which include nonfood items are not entitled to the exemption.

[3] RULE 193 and RULE 111; RCW 82.08.020: RETAIL SALES TAX -- FREIGHT CHARGES -- ADVANCES AND REIMBURSEMENTS. In general, shipping charges incurred by a retailer prior to the completion of the sale are part of the costs of doing business and cannot be deducted from the amount subject to retail sales tax.

[4] RCW 82.04.300: B&O TAX -- MONTHLY OR YEARLY EXEMPTION -- MULTIPLE BUSINESS ACTIVITIES. Where the income from a taxpayer's combined business activities exceeds the monthly or yearly gross exemption, no exemption based on the monthly or yearly exemption is allowed.

[5] RCW 82.32.110; RCW 82.32.100. The scope of an audit is not limited to the records initially provided by a taxpayer.

Rather, the Department is given broad authority to review a taxpayer's books and records in order to verify the accuracy of a return. Except for unregistered taxpayers or upon a showing of fraud or misrepresentation, the period of an assessment is limited to four years after the close of the tax year.

[6] RCW 82.32A.020; ETB 412.32.99: ESTOPPEL -- ORAL INSTRUCTIONS. A claim of estoppel must be proven by clear, cogent, and convincing evidence. More proof is needed to support an estoppel claim than alleged erroneous oral instructions by Department employees.

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.

NATURE OF ACTION:

Retailer of home brewing supplies protests assessment of deferred retail sales or use tax on supplies which can be consumed by humans as well as being useful in home brewing operations.[1]

FACTS:

Mahan, A.L.J. -- The taxpayer is the sole proprietor of a business. The taxpayer sells supplies which can be used in making beer at home. The taxpayer operates a retail store as well as a mail order business for the supplies.

The taxpayer's mail order catalog identifies the products which are sold by the taxpayer. Those items include books, equipment, whole grains, unhopped malt extracts, hops, yeasts, ingredients for processing beer (e.g., gypsum, calcium carbonate, Irish moss, and ascorbic acid), corn syrup, gelatin, brewer's licorice, and custom recipe kits. The kits include selected extracts, yeast, and hops which are sold for a single price. The taxpayer's order form has spaces for food and nonfood items and for the calculation of shipping charges. Washington residents are instructed to add retail sales tax to the cost of the nonfood items. Shipping is done through United Parcel Service.

In July of 1992, the Department of Revenue (Department) contacted the taxpayer about an audit to verify the accuracy of his state tax returns for the period of January 1, 1988 through December 31, 1991. The taxpayer protested the auditor's document request on privacy and other grounds. He also did not respond to several

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[1]Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

overtures for further information. As a result, a qualified audit was issued in December of 1992. The taxpayer subsequently contacted the Department and agreed to provide certain records, but not copies of his federal tax returns. The Department subsequently secured copies of those returns and discovered that the taxpayer also had income from real estate appraisal and management fees in 1990 and 1991 and from consulting and real estate sales in 1989.
Based on a review of the available records, the audit was amended. Under Schedule II, service B&O tax was assessed on unreported income from appraisals, management, consulting and real estate sales. The taxpayer had been asked to provide documentation showing he was a licensed real estate salesperson and indicating what portion of the income was received from commissions paid by a broker. No such documentation was presented. Under Schedule III, a credit was given for interstate sales which had not been deducted. Under Schedule IV, retail sales tax was assessed on unreported in-state freight charges. Under Schedule V, retail sales tax was assessed on hops, yeast, grains, and other items which the taxpayer had deducted as exempt food items.

The taxpayer protests the assessment on various grounds. First, he contends that many of the supplies he sells are common food items, e.g., yeasts, grains, and syrups which are used in bread making and for other purposes besides beer making. The taxpayer asserted that hops "are often used (in a tea) as a mild sedative, to help one sleep." At the hearing, the taxpayer also stated that he had been told that there is a recipe which uses hops as a flavoring. With respect to Irish moss, he stated that it is a powdered seaweed used in processing the beer.

The taxpayer further protests the assessment of retail sales tax on freight charges, that his income from real estate appraisals and sales was below the annual minimum, and that the scope of the audit should be limited to the documents he agreed to provide and should not include information discovered from a review of his federal income tax returns. The taxpayer further stated that he had received oral advice from an unnamed department employee that grains, sugars, syrups, and herbs, including hops, were not taxable.

ISSUES:

1. Whether common food items are subject to retail sales tax when sold by a business specializing in home brewing supplies.

2. Whether freight charges on in-state sales can be deducted from gross sales.

3. Whether the taxpayer owes B&O tax on income derived from working as an independent contractor with respect to real estate appraisals, consulting, and sales when the income from those services was less than $12,000 per year.

4. Whether the Department can assess taxes for years beyond the scope of the initial audit based on information discovered during the audit.

5. Whether the Department is estopped from assessing taxes based on oral advice allegedly given by its employees.

DISCUSSION:

[1] RCW 82.08.0293 exempts food sold for human consumption from retail sales tax as follows:

> (1) The tax levied by RCW 82.08.020 shall not apply to sales of food products for human consumption.
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> "Food products" include cereals and cereal products, oleomargarine, meat and meat products including livestock sold for personal consumption, fish and fish products, eggs and egg products, vegetables and vegetable products, fruit and fruit products, spices and salt, sugar and sugar products, coffee and coffee substitutes, tea, cocoa and cocoa products.
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> "Food products" include milk and milk products, milk shakes, malted milks, and any other similar type beverages which are composed at least in part of milk or a milk product and which require the use of milk or a milk product in their preparation.
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> "Food products" include all fruit juices, vegetable juices, and other beverages except bottled water, spirituous, malt or vinous liquors or carbonated beverages, whether liquid or frozen.
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> "Food products" do not include medicines and preparations in liquid, powdered, granular, tablet, capsule, lozenge, and pill form sold as dietary supplements or adjuncts.

Although the statute defines the term "food products" it does not define the qualifying phrase "for human consumption." Statutory terms not defined in the statute are given their ordinary meaning. City of Seattle v. Hill, 40 Wn. App. 159, 697 P.2d 596 (1985). Exemption statutes such as this must be narrowly construed. As stated in Budget Rent-A-Car, Inc. v. Department of Rev., 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972):

> Exemptions to the tax law must be narrowly construed. Taxation is the rule and exemption is the exception. Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it.

In the ordinary sense, a food product which is not commonly or reasonably expected to be used for human consumption would not be entitled to the exemption. For example, although some animal feed may be consumed by humans, it is not packaged and sold for human consumption. As such, it is not reasonably or commonly considered to be used for human consumption. A seller, however, is not required to inquire as to the intended use of the food product in order for the exemption to apply.

Pursuant to RCW 82.32.300, the Department promulgated WAC 458-20-244 (Rule 244). It provides that the intent of the legislature was to make the exemption applicable based on the nature of the item being sold, not on the place of sale. In this regard, it states:

> Effective on June 1, 1988, the law is changed regarding the exemption of retail sales tax and use tax on food products. Formerly, sales of food products were sometimes taxable depending upon how and where the products were sold. Under the changes in the law the intent is to tax such product sales or exempt them from tax in a uniform and consistent manner so that the tax either applies or not equally for all sellers and buyers. Generally, it is the intent of the law, as amended, to provide the exemption for groceries and other unprepared food products with some specific exclusions. It is the intent of the law to tax the sales of meals and food prepared by the seller regardless of where it is served or delivered to the buyer. Again, there are some specific exclusions. This section provides the guidelines for determining if food product sales are taxable or exempt of tax under the changed law. (Emphasis added.)

Accordingly, whether the items are sold at a home brewer's store or a grocery store is not determinative, it is the nature of the item being sold that is controlling. We do not look at where and how an item is sold, but whether the item is an unprepared food item which falls within the scope of the exemption. To be consistent, if the item is exempt for one seller it is exempt for other sellers of the same product.

[2] Rule 244 in relevant part describes items subject to the exemption as follows:

> (2) Definitions. As used herein and for purposes of the sales tax and use tax exemptions, the following definitions apply:

> (a) "Food products" means only substances, products, and byproducts sold for use as food or drink by humans. The term includes, but is not limited to, the following items:
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> . . . Cereal products
> . . . Extracts and flavoring for food
> . . . Flour
> . . . Spices and herbs
> . . . Honey, Sugar, sugar products, sugar substitutes
> . . . Syrups
> . . . Tea
> . . . Yeast. . . .

Rule 244 in relevant part also describes items which could be ingested but which are not subject to the exemption as follows:

> (b) "Nonfood products" means certain substances which may be sold at food and grocery stores and which may be ingested by humans but which are not treated as food for purposes of the tax exemptions. Tax exempt food products do not include any of the following nonfood products:
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> Alcoholic beverages
> . . . Beer or wine making supplies
> . . . Dietary supplements. . . .

Whereas the specific limitation for dietary supplements is found in the statute, there is no specific limitation for beer and wine making supplies. Given the statutory provision that the retail sales tax "shall not apply to sales of food products for human consumption" and the express intent that distinctions are not made on "how and where" the food product is sold, we must construe the exception for beer and wine making supplies as applying only to those items which are not also commonly and reasonably expected to be ingested by humans for nourishment. If an item is only used in beer and wine making, it is subject to retail sales tax.

In the present case, bulk items such as corn sugar, gelatin, and whole grains are clearly exempt. Similarly, the unhopped malted grains which are commonly used in making breads are exempt from sales tax. Brewer's yeast is also exempt.[2] Items which are used for processing of the beer, such as Irish moss, gypsum, and calcium, are not exempt. Similarly the hops are not exempt. Although the taxpayer states that he believes there is a bread

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[2]Brewer's yeast is identified under the food exemption rule as an item which is not to be considered a food supplement and which is subject to the deduction.

recipe that uses hops, we do not find that hops are commonly and reasonably expected to be consumed by humans as a foodstuff, herb, or spice. This conclusion is supported by the dictionary definition of hops, that is, "[t]he dried, ripe flowers of this plant, containing a bitter, aromatic oil and used in brewing beer." The American Heritage Dictionary of the English Language 634 (1980). We have been presented with no evidence that hops are commonly or reasonably considered to be a food, herb, or spice used for human consumption, rather than for the making of beer.

The potential use of hops as a sedative does not make them nontaxable. The sales tax exemption does not apply to dried or powdered herbs used for perceived health benefits. Det. No. 93-016, 13 WTD 167 (1993); John Bastyr College v. Department of Rev., BTA Docket No. 37685, 9 WTD 300-1 (1990). With respect to unconventional food items which might be edible, we held:

> [T]he legislature did not indicate an intention to extend the exemption to items which, while arguably edible, were not conventional food products. Despite several legislative sessions, no such expansion has been added to the law.

Hops, even if arguably edible, do not fall within the scope of what is commonly considered a conventional food product.

In his kits, the taxpayer combines taxable and nontaxable items for sale to his customers for one price. They are marketed as a specialty item for making beer and not as an item for human consumption. The fact that a component of the product may be a food item does not make the complete product as sold a food item. The Department also has no basis to bifurcate the taxable from the nontaxable. Accordingly, retail sales tax is due on the entire price.

[3] The retail sales tax is imposed on each retail sale based on the "selling price." RCW 82.08.020(1). The term "selling price" is defined to include all consideration without the deduction of any expenses, including "delivery charges." RCW 82.08.010(1). Delivery charges on which retail sales tax must be paid include UPS charges, express freight charges, one-day service, or other related service charges. Det. No. 89-237, 7 WTD 316 (1989). Under most circumstances, a taxpayer is responsible for collecting retail sales tax on delivery charges. As stated in WAC 458-20-110 (Rule 110):

> Amounts received by a seller from a purchaser for freight and delivery costs incurred by the seller prior to completion of sale constitute recovery of costs of doing business and must be included in the selling price or gross

> proceeds of sales reported by the seller regardless of whether charges for such costs are billed separately and regardless of whether the seller is also the carrier. . . .Delivery costs incurred after the buyer has taken receipt of the goods are not part of the selling price when the seller is not liable to pay or has not paid the carrier. It must be clearly shown that the buyer alone is responsible to pay the carrier for the delivery costs to be excluded from the taxable value of the selling price.

Whether the taxpayer's clients are contractually obligated to reimburse the taxpayer for such charges is not the test. Similarly, the test is not whether the taxpayer made a profit or charged a mark up on the services. There are many instances where a taxpayer bills a customer for the actual cost of a component of the service without acting as an agent of the client. Accordingly, the in-state freight charges are taxable.

[4] The taxpayer's total income is used for determining whether the statutory minimum for B&O tax purposes has been exceeded. The fact that the taxpayer earned additional income from business pursuits not associated with his primary business activity does not entitle him to separately treat such income. As stated in RCW 82.04.300:

> [w]here one person engages in more than one business activity and the combined measures of the tax applicable to such businesses equal or exceed one thousand dollars per month, no exemption or deduction from the amount of tax is allowed by this section.

Accordingly, the taxpayer is not entitled to deduct the amounts earned as a real estate appraiser and related activities from the measure of the tax he owes. The records do not show whether some of this additional income was earned as a licensed salesperson where a broker paid the B&O tax on the commissions. If that was the case the taxpayer would be entitled to deduct the commissions he earned as an associate broker. See RCW 82.04.255. To the extent the taxpayer is able to demonstrate to the Audit Division that some of the income was earned from such commissions, the taxpayer can deduct such amounts from his income.

[5] There is nothing in the applicable statutes or rules which limit the scope of an audit to the records initially provided by a taxpayer. By statute the Department is given broad authority to review a taxpayer's books and records. RCW 82.32.110. In turn, the Department is required to consider tax information privileged and confidential. RCW 82.32.330. Although the taxpayer may believe that the Department's record request was intrusive, the statutes provide a reasonable balance between the

right to privacy and the Department's right to verify the accuracy of a return.

Except for unregistered taxpayers or upon a showing of fraud or misrepresentation, the period of an assessment is limited to four years after the close of the tax year. RCW 82.32.100. The Department may also enter into closing agreements which could have the effect of limiting the scope of an audit. RCW 82.32.350. In the present case, the scope of the audit was within these limitations, and there was no written agreement which limited the scope of the audit.

[6] The elements of an estoppel claim are:

> (1)an admission, statement, or act inconsistent with a claim afterward asserted, (2) action by another in reasonable reliance upon that act, statement or admission, and (3) injury which would contradict or repudiate the prior act, statement or admission.

Colonial Imports, Inc. v. Carlton Northwest, Inc., 121 Wn.2d 728, 734, 853 P.2d 913 (1993); Harbor Air Serv., Inc. v. Board of Tax Appeals, 88 Wn.2d 359, 560 P.2d 1145 (1977); Department of Rev. v. Martin Air Conditioning, 35 Wn. App. 678, 668 P.2d 1286 (1983). An estoppel claim must be proven by clear, cogent and convincing evidence. Colonial Imports, supra at 734. Such claims cannot be lightly invoked against the state as a means to deprive the state of the power to collect taxes. Kitsap-Mason Dairymen's Assoc. v. Tax Comm., 77 Wn.2d 812, 818, 467 P.2d 312 (1970)("The state cannot be estopped by unauthorized acts, admissions, or conduct of its officers."). The doctrine of estoppel also cannot be asserted to enforce a promise which is contrary to the statute. King County Employees' Assoc. v. State Employees' Retirement Bd., 54 Wn.2d 1, 11-12, 336 P.2d 387 (1959).

The Department of Revenue has taken the position that oral instructions alone do not provide the quantum of proof necessary to sustain an estoppel claim. It set forth its reasons in Excise Tax Bulletin 419.32.99 (ETB 419), as follows:

> (1) There is no record of the facts which might have been presented to the agent for his consideration.
> (2) There is no record of instructions or information imparted by the agent, which may have been erroneous or incomplete.
> (3) There is no evidence that such instructions were completely understood or followed by the taxpayer.

This position has consistently been upheld by the Board of Tax Appeals. Professional Promotion Services, Inc. v. Department of Revenue, BTA Docket No. 36912, 9 WTD 219 (1990); see also, Det. No. 92-004, 11 WTD 551 (1992) and the determinations cited therein.

In this case the evidence presented by the taxpayer does not clearly demonstrate that the source of the taxpayer's misunderstanding in fact originated with written instructions from the Department. Accordingly, his estoppel claim must fail.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. Food items sold by the taxpayer are exempt from retail sales tax. As described above, not all items claimed by the taxpayer as being exempt are exempt. The case is remanded to the Audit Division for amendment in accordance with this Determination. At that time, the taxpayer may present evidence showing whether some of his additional income was from commissions earned as a licensed real estate salesperson. It remains the taxpayer's burden to show which amounts are exempt.

DATED this 15th day of March, 1994.