

Cite as 2WTD 379 (1987)

BEFORE THE INTERPRETATION AND APPEALS SECTION
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 Refund of)	
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. . .)	Registration No. . . .
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- [1] **RULE 113, RCW 82.04.050 (1)(c) AND RCW 82.04.190 (1)(c):**
INGREDIENT OR COMPONENT.
The "primary purpose test" test does not apply to the
"ingredients or components" exemption.
- [2] **RULE 113, RCW 82.04.050 (1)(c) AND RCW 82.04.190 (1)(c):**
INGREDIENT OR COMPONENT.
A substance may qualify as an "ingredient or component"
even though it contributes only a small percentage of the
total ingredients involved in producing the finished
product.
- [3] **RULE 113, RCW 82.04.050 (1)(c) AND 82.04.190 (1)(c):**
INGREDIENT OR COMPONENT.
A substance may qualify as an "ingredient of component"
even though it undergoes a chemical reaction during the
manufacturing process.
- [4] **RULE 113, RCW 82.04.050 (1)(c) AND RCW 82.04.190 (1)(c):**
INGREDIENT OR COMPONENT.
A substance may qualify as an "ingredient or component"
even though only a small portion of the substance ends up
in the finished product.
- [5] **RULE 113, RCW 82.04.050 (1)(c) AND RCW 82.04.190 (1)(c):**
INGREDIENT OR COMPONENT -- COAL -- COKE -- ASH -- CEMENT.
Coal or coke used in production of cement qualifies as
and "ingredient or component." Although used primarily
as a fuel to provide heat, coal and coke each contribute

ash, a necessary constituent of finished cement, traceable in the finished product and identifiable as having been directly provided by the coal and coke.

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: February 26, 1987

NATURE OF ACTION

Manufacturer petitions for a refund of use tax paid on coal and coke used in the production of cement.

FACTS AND ISSUES

Rosenbloom, A.L.J. -- The sole issue is whether use tax applies to coal and coke purchased for use in manufacturing cement. The taxpayer, who has paid use tax on such items in the past, now petitions for a refund asserting that they qualify for the so-called "ingredients or components exemption."

The taxpayer manufactures cement. Coal and coke are used primarily as fuels to provide the necessary heat. The coal and coke are first ground to a fine consistency. The mixture is ignited and blown into a kiln with a blast of air. The flames heat a mixture of various ingredients already present in the kiln. The residual ash from the combustion of the coal and coke remains with these ingredients and is present in the finished product. The ash content of cement ranges between 1.5% to 3%, depending upon the type of cement.

The presence of ash, in combination with other substances, affects the strength, setting time, and other characteristics of the cement. These characteristics can be determined by controlling the relative proportion of ash to other substances present in the finished product. This can be accomplished by adjusting the ratio of coal to coke (coal has a higher ash content than coke), or by introducing additional ash during the manufacturing process. The taxpayer obtains ash from electrical power plants for this purpose. For many formulations of cement, however, coal and coke are the sole source of ash.

DISCUSSION

A tax is imposed on each retail sale in this state. RCW 82.08.020. However, excluded from the definition of "retail sale" are

. . . purchases for the purpose of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component or is a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale.

RCW 82.04.050 (1)(c).

In a similar fashion, a use tax is imposed upon the use of tangible personal property as a consumer, RCW 82.12.020. But the term "consumer" is defined to exclude any person who purchases or uses tangible personal property for the purpose

. . . of consuming such property in producing for sale a new article of tangible personal property or a new substance, of which such property becomes an ingredient or component or as a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale.

RCW 82.04.190 (1)(c).

The practical effect of RCW 82.04.050 (1)(c) is to create separate retail sales tax exemptions, which may be referred to for convenience as the "ingredients or components exemption" and the "chemicals used in processing exemption." RCW 82.04.190 (1)(c) creates corresponding use tax exemptions.

WAC 458-20-113 implements the foregoing statutes. Until its most recent revision, the rule provided in part

INGREDIENTS OR COMPONENTS. The sale of articles of tangible personal property which physically enter into and form a part of a new article or substance produced for sale does not constitute a retail sale. This does not exempt from the retail sales tax the sale of articles consumed in a manufacturing process

which do not enter into and become a physical part of the new article produced for sale, such as fuel used for heating purposes, oil for machinery, sandpaper, etc.

ARTICLES PURCHASED FOR DUAL PURPOSES. Where an article purchased services a dual purpose, tax liability under the retail sales tax is determined by the primary purpose for which the article is purchased. The fact that a portion of the article purchased actually becomes a physical part of the new article produced for sale is not in itself sufficient to constitute the sale thereof a sale at wholesale, unless such use is the primary purpose for which the article was purchased. Thus, the sale of coal to a cement manufacturer which is used primarily as a fuel for producing heat is a taxable retail sale even though the ash from the burned coal is blown into the cement mixture and actually remains an ingredient thereof. Likewise the sale of coke to a foundry to produce heat for melting iron or steel is a taxable retail sale, although a secondary purpose in using coke is to introduce carbon in to the metal.

However, the Washington State Supreme Court held that the Rule exceeded the bounds of RCW 82.04.050 insofar as it purported to apply a "primary purpose test" to both the ingredients or components exemption and the chemicals used in processing exemption, Lone Star Industries, Inc. v. Department of Revenue, 97 Wn2d 630 (1982). The court ruled that primary purpose test appearing in RCW 82.04.050 applied only to chemicals used in processing and that the attempt to extend the primary purpose test to ingredients or components by way of the rule exceeded the Department's administrative authority.

In the Lone Star case, the court considered the application of the retail sales tax to iron grinding balls and firebrick used in manufacturing cement. The primary purpose of the iron grinding balls is to grind a mixture of various ingredients to a fine consistency. This grinding action wears away 90% of each grinding ball thus adding iron, a necessary ingredient of cement, to the mixture. The primary purpose of the firebrick is to line the kiln in which the ground mixture is heated. During the heating process, 50% of the firebrick fuses with the contents of the kiln and ultimately becomes a part of the finished product. The court held that the iron grinding balls and the firebrick qualify as an "ingredient or component" even

though they are purchased primarily for use in the manufacturing process and even though they contribute only a small percentage of the total ingredient involved in the production of cement. The court thus concluded that neither the iron grinding balls nor the firebrick were subject to retail sales tax.

In Van Dyk v. Department of Revenue, 41 Wn. App. 71 (1985), the Washington Court of Appeals, Division Two, considered the application of use tax to the coke used in manufacturing iron products. The primary purpose of coke is to supply heat. Coke is 92% carbon, most of which is burned off in the manufacturing process. However, a small portion of the carbon (4 - 13%) ends up in the finished product. The court held that coke qualifies as an "ingredient or component" even though it is used primarily to provide heat, even though only a small portion winds up in the finished product, and even though it undergoes a chemical reaction during the manufacturing process. The court thus concluded that the coke was not subject to use tax.

In 1986, the Department amended WAC 458-20-113 by deleting the language concerning articles purchased for dual purposes and by adding the following:

(3) Also, the definition of retail sale does not exclude consumables purchased for use in manufacturing, refining, or processing new articles for sale merely because some constituents of the consumables may also be traceable in the finished product, which are impurities or undesirable or unnecessary constituents of the finished product.

(4) For articles to qualify for sales and use tax exemption as ingredients or components or products produced for sale, such articles or their constituents must be traceable in the finished product and identifiable as having been directly provided by the article claimed for exemption.

[1,2] Based upon the taxpayer's testimony, we agree that coal and coke both qualify as an "ingredient or component" within the meaning of RCW 82.04.190 (1)(c). Clearly, coal and coke are used primarily as sources of carbon, which burns to provide heat; however, the primary purpose test does not apply to the "ingredient or component exemption." Lone Star Industries, Inc. v. Department of Revenue, supra. Nor is it of any significance that the ash contributed by the coal or

coke is only a small percentage of the total ingredients involved in the production of cement. Id.

[3,4] Furthermore, coal and coke are not disqualified merely because they undergo chemical reactions during the manufacturing process, or because only a small portion of them winds up in the finished product. Van Dyk v. Department of Revenue, supra.

[5] Both coal and coke contain ash, a "constituent (of coal or coke) . . . and traceable in the finished product, identifiable as having been directly provided by" the coal or coke. WAC 458-20-113(4). In fact, coal or coke is the sole source of ash for certain cement formulations. Ash is not an "impurity, or undesirable or unnecessary constituent" of cement. WAC 458-20-113(3). To the contrary, the amount of ash present in the finished product affects such characteristics as setting time, strength, etc. Furthermore, certain cement formulations require the addition of ash from other sources.

We conclude that the use of coal and coke in the production of cement in the manner described by the taxpayer is not subject to use tax.

DECISION AND DISPOSITION

The taxpayer's petition for refund is granted. The Audit Section shall verify the amount claimed and advise the taxpayer of the credit or refund due.

DATED this 17th day of March 1987.