

Cite as 2 WTD 139 (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)	
)	No. 87-15
)	
. . .)	Registration No. . . .
)	Tax Assessment No. . . .
)	Warrant No. . . .

RULE 113, RCW 82.04.050(1)(c) AND RCW 82.12.020: INGREDIENTS AND COMPONENTS. Under the "ingredients" exclusion from the definition of "retail sale", materials which supply essential ingredients to a finished product, and which become a part of that product, are not subject to use tax.

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: April 29, 1986

SUPPLEMENTAL TELEPHONE HEARING: December 9, 1986

NATURE OF ACTION

As a result of an audit covering the period from January 1, 1981, to December 31, 1984, the taxpayer was assessed use tax on the use of carbon electrodes. The electrodes were used by the taxpayer in producing steel products. The taxpayer paid the assessment and petitioned for a refund.

FACTS

Normoyle, A.L.J. (successor to M. Clark Chandler, Administrative Law Judge) -- The taxpayer manufactures and sells steel castings. Carbon electrodes are used in the manufacture of the steel, serving two purposes:

1. They supply carbon to the finished product; and
2. They conduct electricity, which provides heat necessary to make the steel product.

The taxpayer describes an electrode as looking like a "great big pencil lead". Each of the taxpayer's electrodes is eight inches in diameter and approximately

4 feet long. Three of the electrodes are threaded together and lowered into an electric-arc furnace. The furnace contains various scrap metals and other ingredients.

As the electrodes are lowered, they conduct electricity to create heat in the furnace, thereby melting the scrap metal. In the process of conducting electricity, the electrodes erode from the intense heat, adding carbon to the molten steel bath. They are, in fact, completely consumed in the process, either by the electric heat or by immersion into the molten mass.

The number of electrodes used in the manufacture of a given steel product will vary, depending on the type of steel being made. At the beginning of the steel making process, carbon from non-electrode sources, called carbon raisers, is added. Toward the end of the process, if more carbon is needed, electrodes will be added solely for their carbon content.

All of the taxpayer's products contain carbon, which supplies strength and durability. Without carbon, the product would be soft iron, something which the taxpayer does not manufacture.

The electrodes provide between approximately five and ten percent of the carbon in a finished product. In those products with the highest carbon content, carbon makes up approximately three percent of the finished product, with approximately five percent of that carbon being supplied by the electrode. In low alloy steel, carbon makes up approximately .25 percent of the finished product, with approximately ten percent of that carbon being supplied by the electrodes.

ISSUE

The sole issue is whether the use of the carbon electrodes in the manufacture of these steel and iron products is subject to use tax (RCW 82.12). The taxpayer claims that the electrodes are consumed in the manufacturing process, supply an essential ingredient, and, therefore, are not taxable.

DISCUSSION

In general terms, the use tax applies to the use of tangible personal property purchased at retail, if the user had not paid the retail sales tax. The use tax is imposed by RCW 82.12.020, which, in pertinent part, states as follows:

There is . . . levied and there shall be collected .
. . . a tax . . . for the privilege of using . . . as
a consumer any article of tangible personal property
purchased at retail . . . (Emphasis added)

RCW 82.12.010(5) incorporates the RCW 82.04.050(1)(c) definition of "retail sale". Thus, the key question is whether or not the purchase of electrodes was a retail sale. If not, the sales and use taxes do not apply.

RCW 82.04.050(1)(c) defines "retail sale", as follows:

. . . "retail sale" means every sale of tangible personal property
. . . to all persons . . . other than a sale to a person who . . . (c) purchases for the purpose for the 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, . . . (Emphasis added)

Under case law, and precedent established by the Board of Tax Appeals, the electrodes were not purchased at retail if the electrodes supply essential ingredients or components to the finished product. This is so even if:

- A. The electrodes are not used for the primary purpose of providing carbon;
- B. The carbon from the electrodes make up only a small percentage of the total ingredients contained in the final steel product; and
- C. Other carbon is added during manufacture.

Lone Star Industries, Inc. v. Department of Revenue, 97 Wn.2d 630 (1982); Bethlehem Steel Corp. v. Department of Revenue, Board of Tax Appeals, Docket No. 85-8 (1986).

Here, as in Bethlehem, the electrodes supply carbon, an essential ingredient in the type of steel products made by the taxpayer. Carbon adds strength and durability. Although the carbon content varies depending upon the type of steel product being made, all of the taxpayer's products contained carbon from the electrodes.

It is our conclusion, based on the above legal authority, and based on the facts as provided by the taxpayer, that the purchase of the carbon electrodes is not taxable under the retail sales or use tax statutes, because the electrodes supply carbon, a necessary ingredient in the steel produced by this taxpayer.

DECISION

The taxpayer's petition is granted. The Department shall issue a refund, with statutory interest, in the appropriate amount.

DATED this 15th day of January 1987.