

Cite as Det. No. 07-0082, 26 WTD 231 (2007)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
)	No. 07-0082
)	
. . . )	
)	Registration No. . . .
)	FY . . ./Audit No. . . .
)	Docket No. . . .
)	

RULE 136; RCW 82.04.120: MANUFACTURING B&O TAX -- MANUFACTURING -- DEFINITION -- SIGNIFICANT CHANGE -- PITCH-MELTING PROCESS. A taxpayer's coal tar pitch melting process did not constitute a manufacturing activity where the liquefied pitch did not change chemically or functionally, did not change in value, and any change in the pitch's physical state was only temporary.

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.

Okimoto, A.L.J. – A taxpayer that heats solid coal tar pitch to 400 degrees Fahrenheit in order to convert it to a liquefied form for sale to customers, protests additional manufacturing business and occupation (B&O) taxes and penalties assessed on interstate sales. We hold that Taxpayer's melting activity does not constitute manufacturing.<sup>1</sup>

### ISSUES

- 1) Is Taxpayer's process of buying solid coal tar pitch, heating it upwards to 400 degrees Fahrenheit, and selling it as liquefied pitch constitute manufacturing under RCW 82.04.120 and WAC 458-20-136?
- 2) If so, is Taxpayer entitled to a machinery and equipment (M&E) retail sales tax exemption under RCW 82.08.02565 for equipment purchased during the audit period?

### FINDINGS OF FACT

[Taxpayer] is based [outside of Washington]. Taxpayer imports and sells coal tar pitch in flake, rod, prill, and liquefied form to customers. Taxpayer's books and records were examined by the

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 2001, through June 30, 2005. The examination resulted in additional taxes, interest and penalties being assessed . . . .

Although based [outside of Washington], Taxpayer has a melting plant located in a warehouse . . . in Washington. Coal tar refineries in [a foreign country] produce a liquefied pitch by-product. Coal tar pitch (pitch) is defined as:

A residue produced by distillation or heat treatment of coal tar. It is a solid at room temperature, consists of a complex mixture of numerous predominantly aromatic hydrocarbons and heterocyclics and exhibits a broad softening range instead of a defined melting temperature. *IUPAC Compendium of Chemical Terminology* 2<sup>nd</sup> ed. (1997) <http://www.iupac.org/goldbook/C01121.pdf>.

The refineries cool the liquid pitch into solid form, which they sell to Taxpayer for delivery at Taxpayer's [Washington] warehouse. Taxpayer receives the solid pitch in different shapes; i.e., rods, prills, and flakes. If a customer's manufacturing operation needs solid pitch, Taxpayer repackages the pitch into bags or loads the pitch into trucks and railcars for delivery to the customers. Dust and vapors emanating from the solid pitch are highly toxic and long term exposure can lead to significant health problems.<sup>2</sup> If the customer's manufacturing operation requires liquid pitch, Taxpayer converts the solid pitch to liquid by placing it into a large container-type melter and applying heat to the pitch. The pitch is gradually heated to 250 degrees Fahrenheit where it begins to melt. Taxpayer must heat the pitch to 400 degrees Fahrenheit before it can be pumped, however. At that temperature, the pitch becomes fluid and is pumped into tanker trucks or tanker railcars and delivered to the customer. During this melting process, toxic dust and chemicals vaporize upwards and some small amount of moisture is lost, but Taxpayer asserts that no other chemical or molecular changes occur. The pitch is simply now in a liquefied form instead of a solid prill, flake, or rod. The dust and vapors are captured by pollution control equipment located above the melter and re-inserted into the melting process.

Taxpayer maintains that the reason Taxpayer liquefies the pitch is to make it compatible with its customer's manufacturing process. Some customers handle the pitch in its solid form all the way through their process; others take solid pitch, melt it, and handle it as a liquid through their process; and still others take liquid pitch and can only process it as a liquid. Once liquefied, Taxpayer pumps the pitch into specially equipped tanker railcars.<sup>3</sup> During the trip the pitch solidifies. Once the customer's manufacturing site is reached, the customers utilize the specially equipped tanker cars to re-heat the pitch and pump it into the customer's manufacturing operation. Taxpayer's primary customers are . . . companies where the pitch is used as a binder for making carbon electrodes.

Although Taxpayer acknowledges that it takes a significant amount of energy to heat the solid pitch into a liquid, it argues that the melting process does not affect the pitch's marketability, demand, or price for its products. Taxpayer states that the price of the pitch is negotiated on a

<sup>2</sup> See *Report on Carcinogens*, 11<sup>th</sup> ed.; U.S. Department of Health and Human Services, Public Health Service, National Toxicology Program. <http://ntp.niehs.nih.gov/index.cfm>.

<sup>3</sup> Short trips can be handled by insulated tanker trucks.

case by case basis depending on a variety of factors and is not affected by whether it is liquefied or not. Taxpayer submitted several sales invoices of both solid pitch and liquefied pitch. Sometimes, the sales price per ton of the liquefied pitch was higher but sometimes the sales price per ton was lower. Although Taxpayer maintains that there is no difference in solid pitch and liquid pitch, some competitors believe that liquid pitch is much safer for workers to handle during storage and transportation.<sup>4</sup>

Denial of Refund claim on retail sales tax paid on improvements to melter:

In the alternative, if Taxpayer's pitch-liquefying process is determined to be manufacturing, Taxpayer argues that it is entitled to a refund of retail sales tax paid on equipment purchased and installed onto the melter used in the pitch-liquefying process. Taxpayer submitted a refund request to Audit on . . . , 2005, which Audit denied pending a definitive ruling that Taxpayer's pitch-liquefying process constituted a manufacturing activity.

ANALYSIS

Persons who manufacture in this state . . . are taxable under the manufacturing B&O tax classification based on the value of the articles manufactured. RCW 82.04.240; WAC 458-20-136 (Rule 136). RCW 82.04.120 broadly defines the term "to manufacture." It provides:

To manufacture" embraces all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use . . . .

In *Bornstein Sea Foods, Inc. v. State*, 60 Wn.2d 169, 373 P.2d 483 (1962), the Washington State Supreme Court held that a manufacturing activity had occurred when workers transformed whole fish into individual fillets for freezing and sale. The court articulated the test for determining whether a new, different, or useful article has been produced by stating:

We think the test that should be applied to determine whether a new, different, and useful article has been produced is whether a significant change has been accomplished when the end product is compared with the article before it was subjected to the process. By the end product we mean the product, as it appears at the time it is sold or released by the one performing the process.

*Id.* at 175

A year later, in *McDonnell & McDonnell v. State*, 62 Wn.2d 553, 383 P.2d 905 (1963), the court similarly held that preparing and processing whole peas into split peas was a manufacturing activity. In *McDonnell*, the court identified specific factors to be considered when comparing the product before and after a taxpayer completed its activities:

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<sup>4</sup> <http://www. . . .>

In making this comparison, consideration should be given to the following factors: among others, changes in form, quality, properties (such changes may be chemical, physical, and/or functional in nature), enhancement in value, the extent and the kind of processing involved, differences in demand, et cetera, which may be indicative of the existence of a "new, different, or useful substance."

. . .  
*Id.* at 557.

Consequently, Taxpayer's issue becomes whether Taxpayer's process of placing solid pitch prills, rods, or flakes into a large melter and heating it upwards to 400 degrees Fahrenheit results in a "significant change" when the liquefied pitch is compared to the solid pitch materials from which it was derived.

Applying the significant change test of *Bornstein*, to the factors identified in *McDonnell*, we note that there is a temporary change in the physical state of the materials when the individual solid pitch prills, rods and flakes are compared to the liquefied pitch delivered to the customer. This change, however, is only temporary, since the liquefied pitch returns to a solid state during transportation and must be re-heated before it can be pumped out. Similarly, there is a temporary change in the physical properties of the pitch which allows the liquefied pitch to flow. The quality of the pitch, however, remains the same. In addition, the chemical and functional nature of the pitch remains the same. We also note that the extent and kind of processing involved in Taxpayer's pitch-melting process is neither elaborate nor complex. In addition, although Taxpayer incurs energy costs to heat solid pitch to 400 degrees, sales invoices submitted by Taxpayer indicate that the sales price of the liquefied pitch is not necessarily greater than the solid pitch. Consequently, we find that melting the pitch does not significantly change its value. Regarding differences in demand, Taxpayer states that some customer's manufacturing operations do not have the ability to liquefy the solid pitch and must buy only the liquefied version of Taxpayer's products. In addition, at least one of Taxpayer's competitors states that the liquefied pitch is a "state-of-the-art" product that is significantly safer to workers during storage and transportation. Consequently, Taxpayer's pitch-melting process may increase demand for Taxpayer's pitch products by making it safer to handle and available to more customers.

Based on an evaluation and balancing of the above factors, we conclude that Taxpayer's process of melting solid pitch into liquid pitch does not result in a significant change when the pre-processed materials are compared to the final liquefied product sold to its customers. In arriving at this conclusion, we note that there is no significant chemical or functional change, there is no apparent change in value, and, although there is a change in the physical state, it is only temporary. It is also often primarily for transportation purposes. Accordingly, we conclude Taxpayer's pitch-melting process does not constitute a manufacturing activity within the meaning of RCW 82.04.120. See Det. No. 94-255, 14 WTD 092 (1994) (temporarily compressing hay for transportation purposes was not manufacturing.) Finally, the auditor's reliance on *McDonnell & McDonnell v. State*, 62 Wn.2d 553, 383 P.2d 905 (1963), is distinguishable from Taxpayer's case, since McDonnell's activity of splitting peas resulted in a

permanent physical change in the product. In this case, Taxpayer's activity of heating pitch results in only a temporary change in physical state, not a permanent physical change in the product. See also *McDonnell & McDonnell v. State*, 62 Wn.2d at 553 and *Bornstein Sea Foods, Inc. v. State*, 60 Wn.2d at 169, discussed *infra*, which also involved a permanent physical change in the products.

Because we conclude that Taxpayer's pitch-melting process does not constitute a manufacturing activity and grant its petition, we need not address Taxpayer's alternative arguments.

#### DECISION AND DISPOSITION

Taxpayer's petition is granted. Taxpayer's file is remanded to Audit for adjustment consistent with this determination.

Dated this 3rd day of April 2007.