Cite as 5 WTD 327 (1988)

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. 88-188
. . .)	Registration No. . . .
)	Tax Assessment No. . . .
)	

[1] **RULE 122 AND RCW 82.04.050(6):** SALES/USE TAX -- FERTILIZER EXEMPTION -- HOPS -- COIR YARN. Coir yarn is a rope-like material used by hops farmers in the above ground level growth of hop vines. The fact that after such use the yarn is plowed into the ground with the harvested vines does not make it exempt of sales/use tax as a fertilizer.

[2] **RULE 155:** SALES/USE TAX -- TANGIBLE PERSONAL PROPERTY -- EFFECTIVE DATE OF RULE 155 -- COMPUTER SOFTWARE -- LICENSE TO USE. Payments for a license to use computer software were subject to Service B&O tax prior to the amendment of Rule 155, effective August 7, 1985. After that date, such licenses are deemed retail sales subject to Retailing B&O and retail sales or use tax. Accord: Det. No. 87-359, WTD ____ (1987),

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 16, 1986

NATURE OF ACTION:

Petition protesting assessment of sales/use tax on the purchases of a computer software system and a special rope utilized by the taxpayer for the growing of hops.

FACTS AND ISSUES:

Dressel, A.L.J. -- . . . (taxpayer) is a grower/dealer of hops. Its books and records were examined by the Department of Revenue (Department) for the period January 1, 1981 through June 30, 1985. As a result the above-captioned tax assessment was issued for excise tax and interest totalling $ . . . . A post-assessment adjustment resulted in that figure being trimmed to $ . . . . Of that amount $ . . . has been remitted by the taxpayer. $ . . . plus additional interest remains outstanding pending this Determination.

The auditor has assessed use (deferred sales) tax on something called "coir yarn." Coir yarn is used by the taxpayer to support growing hop plants. The yarn is apparently strung from ground level to overhead cables which are supported by a trellis. The hop vines then grow upward along this rope-like extension. According to the taxpayer, after the hops are harvested, the vines and the yarn are removed from the trellis and plowed into the ground where they function as a soil nutrient.

The taxpayer argues that coir yarn is, therefore, fertilizer. Its written argument on this point reads as follows:

> WAC 458-20-122 (Rule 122) exempts fertilizer from retail sales tax if it is "sold to a person for the purpose of commercial production of agricultural products." Fertilizer is defined in Rule 122 as "a substance which increases the productivity of the soil by adding plant food or nutrients which improve and stimulate plant growth." Inasmuch as coir yarn is used by the taxpayer as a nutrient, it is a fertilizer within the meaning of Rule 122.
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> The fact that the yarn is purchased for a dual purpose should not make this exemption unavailable. The utility of coir yarn as a fertilizer is significant to the taxpayer and virtually all the yarn is in fact ultimately put to this use, other

> than a small amount which cannot be removed from the vines and thus becomes part of the product sold.
>
> This situation is unlike purchases for the dual purpose of use and subsequent resale, where the ultimate disposition of the article does not determine taxability. This result is required for purchases for resale because of statutory language barring a resale exemption where there is "intervening use" by the purchaser (RCW 82.04.050.5). However, the applicable statutory provision does not contain similar wording regarding exempt use of fertilizer. Both RCW 82.04.050.15 and WAC 458-20-122 merely require that fertilizer be used "for the purpose of producing for sale any agricultural products." Neither provision requires that this be the sole use or the initial use.
>
> The taxpayer's purchases of coir yarn should be exempted from tax, as it is purchased for use as a fertilizer in growing hops for sale.

In support of its position the taxpayer has provided a letter written by the manager of the Hop Growers of America, Inc. He states in part:

> Coir yarn is a vegetable material, thus biodegradable. It is chopped with vine waste and returned to fields as an important humus and mulch, with some fertilizer benefit. These factors, together with strength, are the main attractions of coir yarn as a product to hop growers.

The other area of disagreement arising out of the audit has to do with the taxpayer's acquisition and use of a computer software system. Initially, the taxpayer contended that the software was custom designed rather than "canned" or "off-the-shelf" and, therefore, its purchase of the system was not subject to retail sales tax nor is its present use of the system subject to use tax. At the hearing in this matter, the taxpayer's representatives were asked to provide some documentation establishing that the system was, in fact, custom designed. The taxpayer responded that it had no knowledge of what portion of the program was custom designed for its needs. The taxpayer's representatives then took the position that the sale of the subject software was either a transfer of intangible property rights or the furnishing of services not withstanding the requirement in WAC 458-20-155

(Rule 155) that software be custom designed in order for the sale of same to be subject to Service B&O tax. The taxpayer pointed out that it did not actually purchase the software, but rather received a nontransferable, nonexclusive license to use it. The taxpayer further argued that even if the same software had been used previously by another client, that fact did not necessarily mean that the system under consideration was not a service rendered to the taxpayer as opposed to the sale of tangible personal property. The taxpayer used the analogy of a will drawn by an attorney. Even though the attorney may have used the same will form for a previous client, that did not mean that the income from the will drawn for the second client was the result of a retail sale. Such income would still be considered service with the physical will itself simply designated as a physical, tangible representation of the legal service provided. The income from the second will or the third will or the fourth will or whatever would be considered by the Department to have been generated as the result of a service even though the same form for the will would have been utilized in each instance. The taxpayer argues that the same line of reasoning should be applied to the subject software.

The issues then are two in number: (1) Is coir yarn exempt of retail sales tax as a fertilizer; and (2) was the taxpayer's acquisition of a computer software system a service or a retail sale?

DISCUSSION:

RCW 82.04.050 reads in part:

> (6) The term [retail sale] shall not include . . . , nor shall it include sales of feed, seed, fertilizer, and spray materials to persons for the purpose of producing for sale any agricultural product whatsoever, including milk, eggs, wool, fur, meat, honey, or other substances obtained from animals, birds, or insects . . . (Brackets added.)

"Fertilizer" is defined in WAC 458-20-122 (Rule 122) as follows:

> The word "fertilizer" means a substance which increases the productivity of the soil by adding plant foods or nutrients which improve and stimulate plant growth.

Together the cited statute and rule provide for an exemption from the retail sales tax. Statutes that provide for exemption from taxation must be strictly construed. This principal of statutory construction was restated by the Washington Supreme Court in *Catholic Archbishop v. Johnston,* 89 Wn.2d 505, 573 P.2d 793 (1978). At page 507 the court said:

> [1] It is well established in this state that "an exemption in a statute imposing a tax must be strictly construed in favor of the application of the tax and against the person claiming the exemption . . . " in re *Allstate Construction Company,* 70 Wn.2d 657, 665, 425 P.2d 16 (1967).
>
> Further, "the burden of showing qualification for the tax benefit afforded . . . rests with the taxpayer. And, *statutes which provide for [exemption] are, in case of doubt or ambiguity, to be construed strictly,* though fairly and in keeping with the ordinary meaning of their language, against the taxpayer." *Group Health Co-Operative v. State Tax Commission,* 72 Wn.2d 422, 429, 433 P.2d 201 (1967). (Emphasis added.)

[1] "Coir" is defined in Webster's II, New Riverside University Dictionary as: "Fiber obtained from a coconut husk, used to make rope and matting." No mention is made in that dictionary definition of the use of coir or coir yarn as a fertilizer. Indeed, from the evidence adduced in this matter, we believe that the use of this material as a fertilizer is a very secondary one. The manager of the Hop Growers of America stated that coir yarn has "some fertilizer benefits." The taxpayer's representatives stated that his client also uses other fertilizers to aid the growth of its hops. Finally, the Department's auditor in this matter, was advised by a hop farmer in the Yakima area that coir yarn was thrown away after its use as an aerial vehicle for the growth of hops. It is, therefore, our conclusion that this latter use is the primary one for coir yarn and that its use as a fertilizer is only incidental.

While we agree with the taxpayer's argument that neither RCW 82.04.050 or WAC 458-20-122 require that a substance alleged to be exempt of retail sales tax as fertilizer be used initially and/or exclusively as a fertilizer, we believe that the previously-cited principle of statutory construction to the effect that tax exemptions are narrowly construed requires

us to deny the exemption is this case. Certainly, the primary use of the product is as a rope strung within a trellis framework for the purpose of giving the hop vines a place to grow. The plowing of the coir yarn into the earth, if it is actually done, appears to be an afterthought or a solution for the disposal of the material after it has served its primary purpose. Furthermore, its effectiveness as a fertilizer is questionable. The fact that it is bio-degradable does not make it a fertilizer. This combination of factors convinces us that the material has been properly subjected to use tax per RCW 82.12.020 and WAC 458-20-178.

On the issue relating to coir yarn, the taxpayer's petition is denied.

[2] On the computer software issue the taxpayer has argued that its client purchased a service rather than tangible personal property and, therefore, it is not liable for sales/use tax. With respect to this issue the taxpayer will be granted complete relief but on a different basis than the one which it argued. An examination of the agreement under which the taxpayer acquired the software reveals that the taxpayer, in fact, had a nontransferable, nonexclusive license to use the software. As to whether income from such a license to use is subject to retail sales tax, the Department has already spoken. In Determination No. 87-359, WTD _____, (1987), an Administrative Law Judge representing this division wrote:

> Prior to the adoption of revised Rule 155 in 1985, however, transfers of computer software under license to use agreements were treated as professional services not subject to sales or use tax. The Department distinguished the license to use from a lease or sale because a license to use did not convey unconditional possession or use to the customer.
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> The Department reconsidered its position and revised Rule 155 effective August 7, 1985. The rule [now] states all licenses to use standard, pre-written software are sales of tangible personal property. (Brackets added.)

The audit period here under consideration is January 1, 1981 through June 30, 1985. Plainly, all of that period precedes the referenced amendment to Rule 155. At the time the taxpayer made the payments in question, the Department had not

yet changed its position vis-a-vis the license to use computer software. That being the case, the payments made by the taxpayer for the software at issue will subjected to neither sales nor use tax.

As stated earlier, effective August 7, 1985 the rule states all licenses to use standard, pre-written software are considered sales of tangible personal property. The acquisition and use of such software is now subject to either sales or use tax. Further details are found in the rule, ...

On the issue of computer software, the taxpayer's petition is granted.

DECISION AND DISPOSITION:

The taxpayer's petition is denied in part and granted in part.

DATED this 13th day of April 1988.