Cite as 5 WTD 179 (1988)

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition) D E T E R M I N A T I O N
for Correction of Assessment)
and Refund of) No. 88-155
)
)
) Registration No. . . .
[Taxpayer I]) Tax Assessments No. . . .
)
)
and)
)
) Registration No. . . .
[Taxpayer II]) Tax Assessments No. . . .
)
)
and)
)
) Registration No. . . .
[Taxpayer III]) Tax Assessment No. . . .
)

[1] **RULE 203 and RULE 106:** B&O TAX -- AFFILIATES -- CONSOLIDATED RETURNS -- CLAIMED JOINT VENTURE -- TRANSFER BETWEEN VENTURERS. When a joint venturer/member transfers a capital asset to a joint venture in exchange for an interest in that joint venture, the transfer will be deemed nontaxable. The law, however, makes no provision for filing of consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax.

[2] **RULE 208:** B&O TAX -- EXEMPTION -- RULE OF STATUTORY CONSTRUCTION -- ACCOMMODATION SALES. Exemption will

be denied when taxpayer records do not indicate sales were made to fill existing orders, additional costs are not separately invoiced and do not accurately represent those costs actually incurred by the taxpayer, and such "added costs" have never been submitted to the Department for a ruling. Yakima Fruit Growers cited in support of rule of statutory construction that statutes exempting a tax must be strictly construed in favor of the tax.

[3] **RULE 208:** B&O TAX -- WHOLESALING -- INTERCOMPANY TRANSACTIONS -- INTERCOMPANY TRANSFERS (LOANS) OF INVENTORY -- CLAIMED NOMINAL OR NO CONSIDERATION -- ACTUAL "REPAYMENT" IN KIND.
Business and Occupation Tax under the wholesaling classification held applicable to routine intercompany transfers of inventory for no and/or "nominal consideration" because (1) Business entities do not normally give away (or transfer for only a nominal return) substantial amounts of their inventory without a business purpose, such as the promise of value in return, and (2) The taxpayers' own records reflect that they had a reasonable expectation of regaining substantially what they gave to others in the systematic and routine intercompany exchanges here at issue. The fact that the in-kind transfers may not have been exactly identical in quantity or value, or that there were no written agreements requiring such exchanges, are not dispositive. Time Oil Co. v. State cited.

[4] **RULE 193A AND RULE 103:** B&O TAX -- INSTATE DELIVERY -- ULTIMATE OUT-OF-STATE DESTINATION. When taxpayers provided storage at their own Washington facilities at the request of affiliate-buyers pending their products' further sale and shipment by the buyer to out-of-state destinations, the taxpayers in accepting responsibility for storage were acting as agents of their affiliate-customers, and constructive delivery thus took place in this state. As Rule 193A points out, a product's ultimate destination being outside the state of Washington does not render its sale nontaxable if delivery to the buyer occurs in this state. Columbia Bean distinguished.

[5] **RULE 103:** B&O TAX -- SALES CONTRACTS -- DELIVERY CANCELLATION -- OUT-OF-STATE NEGOTIATIONS. When the

taxpayer, a dealer in hops, and another dealer during the course of a year had contracted to sell to each other identical amounts of hops at different prices, and when delivery requirements to each other were subsequently cancelled and the difference in the contract amounts paid to the taxpayer, the State of Washington had insufficient jurisdiction to tax the transaction as it had been originally negotiated since all contract negotiations had taken place between the parties' out-of-state headquarters and no delivery, and hence no "sale," had taken place within this state.

[6] **RULE 136:** B&O TAX -- MANUFACTURING -- HOPS -- PELLETS AND EXTRACT. Raw hops which have been processed into hops pellets and hops extract are "new, different, and useful articles" under the rationale of enumerated case law, because a significant change has been accomplished when the end products are compared with the article before it was subjected to the process.

[7] **RULE 136:** B&O TAX -- MULTIPLE ACTIVITIES EXEMPTION -- CONSISTENCY WITH RCW 82.04.440. Because the very language of the multiple activities exemption (i.e., "with respect to . . . manufacturing of the products so sold") required that one look to the individual transactions involved to determine proper tax treatment, no merit found in assertion that RCW 82.04.440 precluded taxpayers (otherwise taxable as wholesalers) from being taxable as manufacturers when goods shipped out-of-state.

[8] **RULE 136 and RULE 19301:** B&O TAX -- MULTIPLE ACTIVITIES EXEMPTION -- INVALIDATION. The RCW 82.04.440 multiple activities exemption was ruled unconstitutional in Tyler Pipe Industries, Inc. v. Washington Department of Revenue, 483 U.S. ____, 97 L.Ed.2d 199, 107 S.Ct. 2810 (1987). The issue of remedy was remanded to the Washington Supreme Court.

[9] **RULE 100, RULE 19301, RCW 82.04.4286 and RCW 82.32.060:** REFUNDS -- MULTIPLE ACTIVITIES EXEMPTION -- RETROACTIVITY. The Washington Supreme Court in National Can Corporation v. Department of Revenue and Tyler Pipe Industries, Inc. v. Department of Revenue, 109 Wn.2d 878 (1988) held that the U.S. Supreme Court decision in Tyler Pipe, which

invalidated the multiple activities exemption of the B&O tax, applied prospectively only, and that RCW 82.04.4286 and 82.32.060 did not require the State to refund taxes paid or excuse taxes owed before the court decision. Taxes are therefore lawfully due for periods prior to June 23, 1987 in accordance with the multiple activities exemption.

[10] **RULE 228:** PENALTIES -- ASSESSMENT -- LACK OF KNOWLEDGE. The fact that a taxpayer has not ascertained that tax is due and owing is not a circumstance for which penalties may be excused.

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: September 17, 1986

NATURE OF ACTION:

Petition by hops dealers for correction of assessments and refund of (1) wholesaling tax, (2) manufacturing tax, (3) a portion of the tax on processing for hire, together with penalties.

FACTS:

Burroughs, A.L.J.-- Taxpayers I (. . .) and II (. . .) are both New Jersey corporations in the business of dealing in hops, and are members of a foreign-owned affiliated group. The domestic "brother-sister" corporations in the group are all in the hops industry and own facilities in Washington State.

As a result of an audit covering the period from January 1, 1978 to December 31, 1984, Taxpayer I was assessed tax liability and interest in the respective amounts of $ . . . and $ . . . . These amounts have been partially paid.

As a result of an audit covering the period from January 1, 1977 to June 30, 1985, taxpayer II was assessed tax liability and interest in the respective amounts of $ . . . and $ . . . .

Taxpayer III (. . .) is unrelated to taxpayers I and II. As a result of an audit covering the period from January 1, 1980 to June 30, 1984, taxpayer III was assessed tax liability and interest in the amount of $ . . . , which amount has been paid in full.

All three corporations purchase hops, through their New York offices, from growers in Washington, Oregon, Idaho and some European locations. The hops are then sold to breweries in the United States and foreign countries. Prior to sale, the taxpayers store hops in their cold storage facilities in Washington. The hops are sold as "raw" hops, pellets, or extract. Pelletization and extraction are performed for taxpayers I and II primarily in Washington by affiliates, as these taxpayers do not own or operate any pelletization or extraction facilities in their own names. Taxpayer III operates its own extraction and pelletization facilities in Washington.

A substantial portion of the tax assessed taxpayers I and II under the wholesaling classification was based on sales invoices between themselves and another affiliate not here at issue. Taxpayers I and II share office space and many of their expenses in New York, and the three affiliated companies "share" employees there (some individuals are employed by one corporation but are also expected to regularly perform duties for the other companies). In the State of Washington, taxpayers I and II own separate buildings but share some of their equipment and inventory.

These three affiliated corporations, including taxpayers I and II, purchase hops under contracts which are entered into several years before the actual crops are harvested, and the total purchases of all affiliates are designed to meet the expected future needs of the entire group. Efforts are not made to allocate purchase contracts precisely among the affiliates because it is understood that if one group member contracts to sell hops of a particular variety or quality which it does not own, another affiliate will supply the hops required.

Taxpayer III operates its business in a similar manner, but is not affiliated with taxpayers I and II.

TAXPAYERS' EXCEPTIONS:

At the hearing, the taxpayers likened themselves to dealers in futures instead of manufacturers, and pointed out that, if they were exchanges, they wouldn't be taking title to the product sold, but instead would be paid a commission. It was submitted that they fall into the wholesaling category inadvertently, and that there had been a great deal of tax imposed for what were essentially bookkeeping entries.

Taxpayers I and II first object to the auditor's imposition of the wholesaling tax on intercompany transactions which the auditor determined were in fact "inventory loans." Hops were routinely transferred between the affiliated companies for no charge or a nominal charge of one cent per pound. The auditor reasoned that when a Washington corporation transferred property to another Washington corporation which then sold the property, and the first corporation was then later reimbursed in kind by the second corporation, a sale had occurred. RCW 82.04.040 defines a "sale" as

> ... any transfer of the ownership of, title to, or possession of property for a valuable consideration ....

Taxpayers I and II do not characterize these transfers as sales or "inventory loans." Although they recognize that, over an extended period of time, either the value or quantity of hops which one corporation transferred to another may have been substantially the same as the hops which it had received from the other, it was argued that such a result would have been neither prearranged nor anticipated. The transfers, thus, were effected solely for the purpose of filling orders from breweries, with no in-kind reimbursement expected; no obligation existed beyond payment of the amount invoiced by the transferer.

The taxpayers urge that the intercompany transactions be instead classified as joint venture transactions, as accommodation sales, or as "no charge or nominal charge" transfers. In the alternative, the taxpayers argue that an exemption applies to the sales since there was out-of-state delivery.

The argument of Taxpayers I and II that the transactions be considered nontaxable transfers to a joint venture is essentially as follows: The taxpayers are members of the same affiliated group and have ready access to all inventory owned by group members, regardless of which corporation may have legal title. Although technically separate entities, they do not in fact operate as such. They in effect conduct their businesses as a single business enterprise, sharing assets and expenses for the benefit of the group rather than for any individual corporate member.

The taxpayers contend that intercompany sales invoices simply represent transfers from one group member to another, which are technically required in order to pass legal title from the affiliated group (the claimed joint venture) to unrelated purchasers. These transfers are thus not in reality sales. They are part of a single transaction involving a sale by the "joint venture" to a third party. It is argued that imposing a tax on the first portion of the transaction results in an impermissible double taxation of the same sale.

Taxpayers I and II next argue that the transactions be considered nontaxable accommodation sales, relying on RCW 82.04.425. The taxpayers note that all members of the group are regularly engaged in the business of selling hops to breweries for resale as an ingredient of the beer they produce. They further note that, in most of the intercompany transactions, the amount paid to them did not exceed the total amounts which they had paid to acquire the hops.

Although the taxpayers admit that other invoices in their records indicate that they did in fact charge 2¢ or 3¢ more per pound than their acquisition costs, which fact might appear to make the statutory exemption unavailable, the taxpayers contend that under WAC 458-20-208 the seller in an accommodation sale is permitted to recover from the buyer "certain actual costs incurred by the seller and billed as such to the buyer."

The taxpayers argue that the small differences between the taxpayers' purchase and sales prices do in fact represent actual expenditures relating to the hop acquisitions: First, the taxpayers were required to, and did in fact, pay purchase commissions of 1½¢ per pound on all of the acquired hops. Second, the remaining price differential of ½¢ or 1½¢ per pound represents several additional acquisition costs, including the cost of inspection and analysis of the hops, local trucking and handling, and financing the purchase of the hops. The financing costs relate to cash advances which are paid to the growers, pursuant to their contracts each March, May and August.

The taxpayers do not bill these additional costs separately, but ordinarily add them to the per pound price payable to the growers so as to simplify billing calculations. These items are often too numerous to itemize and individual calculations are extremely time-consuming, inasmuch as some charges are payable per pound and others per bale. The interest factor relating to financing the purchases are also quite complex, inasmuch as there are three separate prepayments to the growers and frequent fluctuations in interest rates.

The experience of these corporations has been that the ½¢ or 1½¢ per pound charge is essentially accurate and fairly represents the additional acquisition costs. Furthermore, it was understood by the companies that the intercompany pricing was designed only to cover these costs and not to result in a profit on the transfers between affiliates. Finally, the added charges are de minimis and do not thwart the intention of the law, which is to exempt only non-profit transactions between dealers. Therefore, inclusion of these amounts in the selling price, rather than as separate items, should not preclude treatment of the sales as accommodation sales.

With regard to the final requirement of RCW 82.04.425, these sales were made as an accommodation, to enable the transferees (including unrelated dealers) to fill specific existing orders.

The taxpayers expressed the opinion, inasmuch as the auditor assumed that these transactions were taxable as inventory loans, that they were not given the opportunity during the course of the audit to establish their arguments as to accommodation sales.

Taxpayers I and II next argue that certain transactions should be considered nontaxable "no charge and nominal charge transfers." During the 1981 and 1984 sample periods, the taxpayers transferred hops to their affiliates for either no charge or a nominal charge of 1¢ per pound of hops. In 1981 there were five such transactions and in 1984 there were three. The total market value of these hops was $ . . . as compared to gross sales of $ . . . , during the 2-year period, or approximately 1.36% of sales.

On audit, the approximate spot market value was assigned to these hops (ranging from 30¢ to 54¢ per pound) and the wholesaling tax was assessed on the transfers. The taxpayer has argued that tax was improperly imposed for the following reasons:

First, that no sales took place within the meaning of the statute, since RCW 82.04.040 defines a sale as ". . . any transfer of the ownership of, title to, or possession of property for a valuable consideration" (emphasis added). It is argued that, although transfers may have been made, nothing of value was received by the taxpayers or accrued to their benefit as a result of the transfers. Further, nothing was expected in return and the only persons who might have benefitted from the transactions were the transferees and their customers.

Second, according to RCW 82.04.270, the wholesaling tax is payable on the "gross proceeds of sales." This term is defined by RCW 82.04.090 as "consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued" (emphasis added). The taxpayer again argues that nothing of value was receivable or accrued by the taxpayer, and that there is no statutory authority for assessing tax based on the value to the transferee rather than the value to the taxpayer.

Taxpayers I and II then suggest the alternative argument that, even if intercompany sales are treated as falling within the wholesaling provisions, an interstate sales exemption should be recognized for goods later delivered by the affiliates to customers outside Washington.

Some of the hops sold by the taxpayers to its affiliates were in turn sold and delivered by those affiliates to breweries outside the State of Washington in "raw" hop form. On the date of the intercompany sales, the hops were in storage in the taxpayer/sellers' facilities in this state. The hops remained in these buildings until they were eventually shipped to the out-of-state breweries, and the affiliated buyers did not at any time take physical delivery of them.

The taxpayers note that, to establish interstate exemption from the wholesaling tax, WAC 458-20-193A (Rule 193A) requires documentary proof (1) that there was an agreement that the seller deliver the goods at a point outside the state and (2) that delivery did in fact take place out of state.

As to the first requirement, the taxpayers contend that all inventory transfers between their affiliates and them are made pursuant to oral agreements, and are evidenced only by sales invoices. As members of the same affiliated group, these corporations have traditionally conducted their intercompany transactions on an informal basis. They have assumed that extensive written documentation of the details of agreements between affiliates would be unnecessary, inasmuch as disputes within the group could not arise from these transactions.

Believing these transfers to be nontaxable for Washington purposes, they saw no need to create evidence of their intentions. The taxpayers argue that, under the circumstances, formal documentation should not be required and the oral agreement should be sufficient to establish the contract provisions required by Rule 193A.

Notwithstanding the absence of documentary proof, the taxpayers believe that it is manifest from the circumstances that the taxpayers were not expected to transfer possession and title of the hops to their affiliates, but were to ship the hops to the breweries to whom the affiliates had sold. First, because of the brother-sister relationships, there was no business purpose in transferring possession of the hops in Washington to their affiliates. On the contrary, to do so would have accomplished no more than creating additional cost to the group. More importantly, the affiliates made these purchases to fill existing orders and knew at that time that the breweries required out-of-state delivery. It was understood among the affiliates that this delivery would be made directly from the taxpayers' storage facilities to the common carrier.

It is argued that shipping documents should satisfy the second requirement of Rule 193A, namely that delivery did in fact take place out of state. Although the bills of lading named the affiliate-purchasers as consignors of the hops, this was done only because the ultimate purchaser had dealt solely with one of these corporations and had no dealing with the taxpayers as to these transactions. This procedure is ordinarily followed, whether the intermediary is an affiliated corporation, as in this case, or an unrelated hop dealer. The naming of the consignor is done strictly for purposes of identification by the purchaser and was not intended to have any legal impact.

Taxpayers I and II cite Columbia Bean and Produce Co., Inc. v. Dept. of Rev. BTA 80-35 (1982) as being dispositive of the argument that their affiliates could be listed as shippers without being deemed to have taken possession of the hops, and that the exemption for interstate (or foreign) shipment would thus apply. In that case, it was established that the appellant had been accustomed to listing the broker or intermediary as shipper so that the third party recipient would know who had ordered that shipment for them. The taxpayers point out that the Board of Tax Appeals in that case rejected the Department's argument that the intermediary took possession in Washington solely by being named as shipper.

The Board stated, "appellant should not be denied exemption for failure of technical compliance . . . where proof of the issue concerned has been established by other means." An important factor, according to the taxpayers, was that the appellant's "shipping procedures are under their control and discretion and are not affected by the contract or agreement with purchasers."

Taxpayer II additionally objects to the imposition of wholesaling tax on a 1981 invoice which, in fact, represented a settlement for the cancellation of two contracts (one for a purchase and one for a sale) with a non-affiliate. Although the invoice appears on its face to give effect to both contracts, the taxpayer has submitted backup correspondence between the parties demonstrating that the contracts between them had in fact been cancelled and that the agreed upon hops deliveries had not been made. The taxpayer submits that since a sale was not made and that activity related to the cancellation settlement had no nexus with the State of Washington, the transaction was not properly subject to the business and occupation tax.

All three taxpayers object to the imposition of the manufacturing tax to their out-of-state sales of hops in pellets and extract form, which products are produced at other "processing" facilities located in the State of Washington in the cases of taxpayers I and II, or at taxpayer III's own facilities.
All of the taxpayers' out-of-state sales (as evidenced by out-or-state deliveries by the taxpayer) of pellets and extract were treated by the auditor as taxable under the manufacturing classification of the business and occupation tax. The taxable measure was the full value of the products sold, as evidenced by sales invoices from the taxpayers to their customers. Some of these products were made from hops grown in Oregon, which were purchased by the taxpayers from farmers in that state and held in the taxpayers' Oregon storage facilities for some time prior to shipment into Washington.

The pelletization process changes natural baled hops from a soft cone form into dense firm pellets. The process reportedly does not involve the use of any chemicals, as the cones are first milled into a powder, homogenized in a mixer, and transferred to a pellet mill where the form of the finished product is produced. The pellets then go through a cooler, and then are collected in a silo, weighed and packed in 44 pound pouches.

The taxpayers submit that the primary advantage of pelletization relates to the removal of oxygen from the hops, which prevents chemical changes which would otherwise occur. It also permits more accurate weighing of the product, due to the removal of both air and extraneous materials such as dirt and twine. Neither of these benefits can be obtained by other methods of packing "raw" hops. Due to the decrease in the original product's volume, shipping and handling are somewhat easier, although this is apparently only an additional advantage which could otherwise be accomplished by "double baling."

The taxpayers contend that even though pelletization might appear to cause a significant change in the hops, the change is really superficial and does not alter the hops fundamentally or make the hops more suitable for use by the breweries, other than by preserving the quality and ensuring accurate weight of the product purchased. The only major difference is that different equipment is used for feeding each type of product into the brewing vats.

The extraction process, in which machinery is used to extract, concentrate and stabilize the hop flavoring substances, reportedly changes the hops into a viscous resin. The hops pass through grinding, conveying, solvent extractor, evaporators, packaging tanks and can fillers. Although no chemicals are added to the hops, a solvent is used to extract resins and oils from the hops and is then removed by evaporation. The taxpayer contends that extraction does not make the hops more suitable for the brewing process.

The taxpayers have presented extensive legal argument in support of their positions that the changes involved in these processes do not constitute the statutory definition of "manufacturing" as interpreted by the courts, in that there must be a "significant change ... when the product is compared with the article before it was subjected to the process" Bornstein Sea Food v. Washington, 60 Wn.2d 169, 373 P.2nd 483 (1962). The taxpayers further contend that the auditors' application of the tax does not comply with the Rule 136 requirement that the activity must give the raw materials "new forms, qualities, properties, or combinations," and the rules caveat that "[t]he term 'to manufacture' does not include activities which are merely incidental to nonmanufacturing activities."

The taxpayers have presented argument regarding the RCW 82.04.440 multiple activities exemption and Rule 136, part of which implements that statutory exemption. The taxpayers contend that, under the statute, the manufacturing tax is not applicable to persons otherwise taxable as wholesalers, and that the law does not contemplate dissimilar treatment of local and out-of-state sales. The taxpayers argue that Rule 136, which requires that wholesalers who sell in interstate or foreign commerce are taxable under the manufacturing classification, is an attempt to completely reverse the statutory scheme as to interstate and foreign sales and should be deemed invalid.

The taxpayers contend that the differential treatment of those who sell in-state and those who sell out-of-state discriminates against interstate and foreign commerce and thus violates the Commerce Clause and the principles of Due Process set forth in the United States Constitution.

Taxpayers I and II request abatement of all penalties included on the assessments. It was their good faith belief that registration and payment of these taxes was not required, inasmuch as virtually all its sales involved out-of-state delivery or transfers to affiliated corporations.

Taxpayer II has additionally claimed that several invoices which were classified as wholesaling or as processing for hire in fact were interstate sales of hops pellets. Although the taxpayer has not requested reclassification at this time, inasmuch as there would be no tax impact unless the manufacturing issue is resolved in its favor, the taxpayer would like to reserve the right to reclassify certain transactions in that event.

Finally, taxpayer III has claimed that two of its invoices were misclassified for tax purposes. The first invoice dated November 7, 1983 was a charge to a customer for hops which the taxpayer then pelletized for the customer before shipment. The second invoice dated November 22, 1983 represented the separate charge for the pelletization. The pellets were delivered to the customer out of state. Taxpayer III contends that the two invoices, taken together, should be exempt from the manufacturing tax for the reasons already argued, and treated as one single exempt transaction - that of an interstate sale.

ISSUES:

This case presents twelve issues for our resolution:

1. Whether the transfers to the taxpayers' affiliates were nontaxable transfers to a joint venture.

2. Whether the transfers to the taxpayers' affiliates were nontaxable accommodation sales.

3. Whether the transfers to the taxpayers' affiliates were nontaxable "no charge and nominal charge transfers."

4. Whether the transfers to the taxpayers' affiliates were nontaxable "out of state" sales.

5. Whether the settlement for the cancellation of two sales contracts was properly taxable under the wholesaling classification of the business and occupation tax.

6. Whether the pelletization and extraction of hops are activities properly classified as "manufacturing" under the Washington Revenue Act.

7. Whether Rule 136 contradicts the RCW 82.04.440 multiple business activities exemption.

8. Whether Rule 136 violates the Commerce Clause of the United States Constitution.

9. Whether Rule 136 violates the principles of due process of the United States Constitution.

10. Whether penalties on the assessments should be abated.

11. Whether certain invoices classified as manufacturing, or as processing for hire, in fact represented the sales of hop pellets.

12. Whether two invoices - one classified as wholesaling and the other manufacturing - should be combined into one single transaction and considered an exempt sale in interstate commerce.

DISCUSSION:

We will preface our discussion of the various issues presented in the taxpayer's petition with some observations regarding the operation of the Washington Revenue Act in general, and its application to transactions between related business entities in particular.

The most distinctive feature of the business and occupation tax prescribed by Chapter 82.04 RCW is that it is a tax on gross proceeds, and not a net income tax. Consequently, profitability of the business engaged in is not a factor in determining tax liability.

To illustrate, RCW 82.04.040 defines "sale" as

> any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a "sale at retail" or "retail sale" under RCW 82.04.050. [Emphasis added.]

Persons engaged in the business of making "sales," whether at wholesale or retail, are liable for the payment of tax measured by "gross proceeds of sales," defined at RCW 82.04.070 as

> the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses. [Emphasis added.]

RCW 82.04.090 defines "value proceeding or accruing" as

> the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued.

Accordingly, it is of no significance that amounts or property received by the taxpayers as compensation for the transfer of goods might not equal or exceed the amounts expended by the seller, resulting in a net profit. The taxpayer-seller is taxable, nonetheless, on the full amount received as compensation.

Nor is common ownership or unity of business purpose relevant to our determination of whether transactions involving the taxpayers and their affiliates are taxable. RCW 82.04.030 defines "person" as

> any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate,

> firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, political subdivision of the state of Washington, corporation, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof.

Moreover, WAC 458-20-203 provides in pertinent part:

> Each separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals.
>
> Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. <u>This applies to each corporation in an affiliated group, as the law makes no provision for filing of consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax.</u>
> [Emphasis added.]

We have no reason to doubt the taxpayers' assertions that their relationships with their affiliates is that of one big happy family, but the legislature has not seen fit to exclude transactions between separately organized business entities, however closely related they may be. The taxpayers' shareholders, among themselves and in combination with others, have elected to transact business through a variety of separately organized business entities, and, in so doing, have secured whatever financial and competitive advantages inherent in that arrangement. We have no authority to now disregard these distinctions for purposes of determining excise tax liability.

With the foregoing general principles in mind, we now address the specific issues raised in this appeal.

<u>TRANSFERS TO A JOINT VENTURE</u>

[1] As to the taxpayers' argument that the intercompany transfers at issue were nontaxable transfers to a joint venture, we must disagree.

An exemption relating to joint ventures is contained in WAC 458-20-106 (Rule 106), which provides in pertinent part:

> A transfer of capital assets to or by a business is deemed not taxable to the extent the transfer is accomplished through an adjustment of the beneficial interest in the business. The following examples are instances when the tax will not apply.
>
> . . .
>
> (5) Transfers of capital assets to a partnership or joint venture in exchange for an interest in the partnership or joint venture; or by a partnership or joint venture to its members in exchange for a proportional reduction of the transferee's interest in the partnership or joint venture.

Thus, when a joint venturer/member transfers a capital asset to a joint venture in exchange for an interest in that joint venture, the transfer will be deemed nontaxable. Such, however, is not the case here. First, the transfer was of inventory, not of capital assets. Second, the transfers were not to a joint venture, but to other affiliated corporations whom the taxpayers now claim were members of a joint venture.

A "joint venture" is commonly defined by Washington courts as an association of two or more persons as a common enterprise for profit. It requires "(1) a contract, (2) a common purpose, (3) a community of interest, (4) equal right to a voice, accompanied by an equal right of control." Carboneau v. Peterson, 1 Wn.2d 347, 95 P.2d 1043 (1939). Other states have promulgated similar definitions.

Even were the taxpayers able to offer evidence that a joint venture did in fact exist under the laws of the state of Washington or any other state, however, we would still be constrained to note that the transfers at issue (even if they had been of capital assets) were in fact not made to and reflected in the books the claimed "joint venture" entity. Instead, the books of the taxpayers and their affiliates were adjusted as transfers occurred in their own names, and those individual entities' respective net worths altered accordingly.

Because the law makes no provision for filing of consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax, the taxpayers' argument on this point must fail.

NONTAXABLE ACCOMMODATION SALES

[2] As to the taxpayers' claim that the intercompany transfers were excludable from the tax under WAC 458-20-208 (Rule 208) as accommodation sales, we must respectfully disagree. The exemption for accommodation sales is provided by RCW 82.04.425, which reads as follows:

> This chapter shall not apply to sales for resale by persons regularly engaged in the business of making sales of the type of property so sold to other persons similarly engaged in the business of selling such property where (1) the amount paid by the buyer does not exceed the amount paid by the seller to his vendor in the acquisition of the article and (2) the sale is made as an accommodation to the buyer to enable him to fill a bona fide existing order of a customer or is made within fourteen days to reimburse in kind a previous accommodation sale by the buyer to the seller. . . .

WAC 458-20-208 (Rule 208) provides as follows:

> The term "accommodation sales" means only sales for resale by persons regularly engaged in the business of making sales of the type of property so sold to other persons similarly engaged in the business of selling such property where (1) the amount paid by the buyer does not exceed the amount paid by the seller to his vendor in the acquisition of the article and (2) the sale is made as an accommodation to the buyer to enable him to fill a bona fide existing order of a customer or is made within fourteen days to reimburse in kind a previous accommodation sale by the buyer to the seller.
>
> The "amount paid by the seller to his vendor" may under some circumstances include certain actual costs incurred by the seller and billed as such to the buyer in addition to the invoice cost of the article sold at an accommodation sale. The facts concerning such added costs must be submitted to the department of revenue for specific rulings. . . .

> . . . Each seller claiming this deduction must retain as a part of his sales records sufficient evidence to prove the nature of the transactions.

In our opinion the taxpayers' claim for exemption from tax on the basis of Rule 208 is not well founded. In order to qualify for the deduction, there must be strict compliance with its requirements, since it is a legal axiom that statutes exempting a tax must be strictly construed in favor of the tax. Yakima Fruit Growers Association v. Henneford, 187 Wash. 252 (1936).

Rule 208 requires that taxpayers retain in their files records as to the nature of these transactions. Although the taxpayer has asserted that the sales were made in order to fill existing orders, it is questionable whether adequate documentation to support this fact was kept in the taxpayers' records. Further, additional costs were not separately billed, nor, by the taxpayers' own admission, accurately determined to be those actually incurred by the taxpayers in each case. Finally, the facts regarding such "added costs" have never been submitted to the Department for a ruling.

Accordingly, the taxpayers' petition as to this issue must be denied.

NO CHARGE/NOMINAL CHARGE TRANSFERS

[3] The taxpayers have objected to the classification of their intercompany transfers as wholesale sales (transfers for resale), arguing that hops were routinely transferred by them to their affiliates for no charge or a nominal charge. They contend that even though over an extended length of time they may have recovered either the value or quantity of hops which they had previously transferred, that this result was neither prearranged nor anticipated. The taxpayers urge that such transfers were made with no in-kind reimbursement or additional payment expected, and were thus not in exchange for consideration.

RCW 82.04.040 defines a sale as "a transfer of the ownership of, title to, or possession of property for a valuable consideration . . .". Further, under RCW 82.04.140, "[b]usiness includes all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly. Thus, "business" is not limited to those activities which result in profit. Finally, under RCW 82.04.090, the tax measure "value proceeding or accruing" includes "other property expressed in terms of money, actually received or accrued."

In reviewing the audit files, we must agree that the transfers here at issue - both from and to the taxpayers - were routine, and further note that they were not financially insignificant. We are further constrained to note that business entities do not normally give away (or transfer for only a nominal return) substantial amounts of their inventory without a business purpose, such as the promise of value in return.

These observations, coupled with the taxpayers' own records which reflect that other entities to whom the taxpayers had previously transferred inventory likewise routinely transferred inventory to them, indicate that the entities involved had a reasonable expectation of regaining substantially what they gave to others in these systematic and routine intercompany exchanges. The fact that the in-kind transfers may not have been exactly identical in quantity or value, or that there were no written agreements requiring such exchanges, are not thought to be dispositive of the issue.

Because the taxpayers transferred inventory to their affiliates, and had a reasonable expectation that they would receive similar inventory from their affiliates, we hold that the auditor properly determined that a sale had taken place, and that the proper measure of the tax was the fair market value of the goods transferred to the taxpayer. See Time Oil Co. v. State, 79 Wn.2d 143, 483 P.2d 628 (1971).

OUT-OF-STATE SALES

[4] As to the taxpayers' argument that many of the intercompany sales qualified for the interstate sales deduction, we must respectfully disagree.

Article I, Section 8 of the Constitution of the united States declares that "[t]he Congress shall have power to regulate commerce with foreign nations, and among the several states, . . ." This pronouncement is typically referred to as the "Commerce Clause."

WAC 458-20-193A (Rule 193A), an administrative rule having the force and effect of law, provides in pertinent part:

> Where tangible personal property is delivered to the purchaser in this state, the sale is subject to tax under the retailing or wholesaling classification,

> even though the purchaser intends to and thereafter does transport or send the property out of state for use or resale there, or for use in conducting interstate or foreign commerce. It is immaterial that the contract of sale or contract to sell is negotiated and executed outside the state, that the purchaser resides outside the state, or that the purchaser is a carrier. . .

The Commerce Clause thus does not prohibit state taxation of such a sale. It is a purely intrastate transaction because the sale is completed (i.e., delivery occurs) within this state. The rule continues,

> Where the seller agrees to and does deliver the goods to the purchaser at a point outside the state, neither retailing nor wholesaling business tax is applicable. Such delivery may be by the seller's own transportation equipment or by a carrier for hire. In either case for proof of entitlement to exemption the seller is required to retain in his records documentary proof (1) that there was such an agreement and (2) that delivery was in fact made outside the state. Acceptable proof will be:
>
> (a) The contract or agreement AND
>
> (b) If shipped by a for hire carrier, a waybill, bill of lading or other contract of carriage by which the carrier agrees to transport the goods sold, at the risk and expense of the seller, to the buyer at a point outside the state; or
>
> (c) If sent by the seller's own transportation equipment, a tripsheet signed by the person making delivery for the seller and showing the (1) buyer's name and address, (2) time of delivery to the buyer, together with (3) signature of the buyer or his representative acknowledging receipt of the goods at the place designated outside the state of Washington. (Emphasis added.)

Similar documentary proofs for the exemption of foreign sales are contained in WAC 458-20-193C:

> In all circumstances there must be (a) a certainty of export and (b) the process of export must have started.

It is of no importance that title and/or possession of the goods pass in this state so long as delivery is made directly into the export channel. To be tax exempt, the seller must document the fact that he placed the goods into the export process. That may be shown by the seller obtaining and keeping in his files any one of the following documentary evidence:

(1) A bona fide bill of lading in which the seller is shipper/consignor and by which the carrier agrees to transport the goods sold to the foreign buyer/consignee at a foreign destination; or

(2) A copy of the shipper's export declaration, showing that the seller was the exporter of the goods sold; or

(3) Documents consisting of;

(a) Purchase orders or contracts of sale which show that the seller is required to get the goods into the export stream, e.g., "f.a.s. vessel;" and

(b) Local delivery receipts, tripsheets, waybills, warehouse releases, etc., reflecting how and when the goods were delivered into the export stream; and

(c) When available, United States export or customs clearance documents showing that the goods were actually exported; and

(d) When available, records showing that the goods were packaged, numbered, or otherwise handled in a way which is exclusively attributable to goods for export.

Thus, where the seller actually delivers the goods into the export stream and retains such records as above set forth, the tax does not apply. <u>It is not sufficient to show that the goods ultimately reached a foreign destination; but rather, the seller must show that he was required to, and did put the goods into the export process.</u> (Emphasis provided.)

We have examined the taxpayers' petition as to this matter, and the two representative invoices and related shipping documents which were submitted with one of the petitions. We are constrained to note that neither of the invoices reflects an agreement that the hops be delivered by the taxpayers outside of the state, or that the taxpayers bore the risk of expense or loss in such shipments. Neither was the taxpayer the consignor on any of the shipping documents.

One set of documents contains no information on the invoice (invoice #30 dated December 1, 1978) as to the hops' probable destination or ultimate buyer, and we note from the taxpayer's petition and accompanying shipping documents that these same hops remained in storage in the taxpayer's facility until May (prepaid by the affiliate-buyer) and June (freight collect) of the next year when they were finally shipped out of state to the affiliate-buyer's customer.

Although the second set of documents, invoice #32 (also dated December 1, 1978), does reference the affiliate-buyer's intended purchasers, there is neither evidence that such designations were binding on either the taxpayer or the affiliate, nor is there any delivery requirement. Subsequent shipments to one of the intended buyers (in the USSR) appear not to have been made until the end of February and March, and documents regarding shipments to the other referenced buyers were not submitted. Interim storage was again provided by the taxpayer. The taxpayer was not the consignor on the shipping documents.

Clearly, the taxpayers have retained and provided no documentary proof that there was an agreement to deliver out-of-state, or that there was actual out-state (or foreign) delivery by them at their own risk and expense. Although the taxpayers would have us waive the documentary proof requirements and instead rely on the circumstances surrounding their transactions, we must decline to do so. The technical proof requirements outlined by Rules 193A and C are mandatory and important to the proper administration of taxes in this state.

The taxpayers have cited Columbia Bean, supra. as being applicable to their situations. Certain circumstances of that case, however, are clearly distinguishable from the facts in the situation here at issue. In Columbia Bean, the Board of Tax Appeals received into evidence documentation which demonstrated that the appellant was required by the purchaser to deliver goods out-of-state to a consignee. Further, the appellant had continued to bear the risk of any loss of goods prior to final delivery. The Board was ultimately satisfied, from the documentation presented, that the appellant was responsible for out-of-state shipment. No such documentation exists in this case.

Accordingly, we must deny the taxpayers' petition regarding this issue.

SETTLEMENT FOR CANCELLATION OF CONTRACTS

[5] Taxpayer II's invoice (No. 1517) dated October 23, 1981 reads as follows:

We invoice you for:	U.S. DOLLARS
100,000 lbs. of Yakima Clusters, Crop 1981 contract 81..82 dated 9/4/1980 at $3.36/lb.	336.000.00
We credit you for: Your contract No. 89781 dated 3/13/79 our purchase contract 811001 100.000 lbs. of Yakima Clusters, Crop 1981 at $1.17/lb.	-(117,000.00)
Total due us:	219,000.00

The backup letter also dated October 23, 1981, written by Taxpayer II to the party it invoiced reads in pertinent part as follows:

> As per our recent telephone conversation we enclose herewith two invoices covering the Yakima Clusters that we have on contract with your firm.
>
> We have taken the liberty of splitting the contract and offsetting the portion, or 100,000 lbs., against the purchase contract we have had with [your firm] dating back to March 1979.
>
> The difference of $219,000 is covered by invoice No. 1517 for which we would appreciate your remittance. We have not bothered to assign any specific lots to this billing since no physical movement of this inventory is involved. . . .

The above documentation indicates that the taxpayer in March 1979 executed a purchase contract for the delivery of 100,000 pounds of hops from an unrelated company for $1.17 a pound. A year and a half later, in September 1980, that same company executed a purchase contract with the taxpayer for the same amount and type of hops at the rate of $3.36 a pound. It appears that the parties eventually agreed that instead of each delivering the same quantity and type of hops to the other at their respective contract rates, it would be simpler for both to simply excuse delivery requirements, keep their own hops, and offset the contract amounts. Thus, the taxpayer invoiced and was paid the difference between the two contract amounts.

The auditor taxed the full amount of the taxpayer's original invoice before the offset. The taxpayer, on the other hand, contends that no amount relating to these contracts is taxable since the contracts were cancelled, a sale was not made, and the cancellation settlement had no nexus with the State of Washington.

Although we do not agree that the contracts themselves were cancelled (if so, there would have been no basis on which to invoice the contract difference), the requirement for delivery of hops in Washington by the taxpayer was in fact cancelled. Because the taxpayer negotiated the contracts at issue from its out-of-state headquarters, and because the taxpayer's delivery requirement to Washington was cancelled, we agree with the taxpayer's argument that this state is without nexus or jurisdiction to tax the transaction. The taxpayer's petition as to this point is therefore granted.

PELLETIZATION AND EXTRACTION OF HOPS AS "MANUFACTURING."

[6] The taxpayers have asserted that the pelletization and extraction of hops does not constitute "manufacturing" under the Washington Revenue Act. We disagree.

WAC 458-20-136 (Rule 136) provides in pertinent part as follows:

> "The term '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, and shall include the production

> or fabrication or special made or custom made articles." (RCW 82.04.120) It means the business of producing articles for sale, or for commercial or industrial use from raw materials or prepared materials by giving these matters new forms, qualities, properties, or combinations. It includes such activities as making, fabricating, processing, refining, mixing, slaughtering, packing, curing, aging, canning, etc. It includes also the preparing, packaging and freezing of fresh fruits, vegetables, fish, meats and other food products, the making of custom made suits, dresses, and coats, and also awnings, blinds, boats, curtains, draperies, rugs, and tanks, and other articles constructed or made to order. It also includes the generation or production of electrical energy for resale or consumption outside the state.

The Washington Supreme Court has, throughout the years, established guidelines to determine what activities are to be considered "manufacturing" under this state's excise tax laws. In J & J Dunbar and Company v. State, 40 Wn.2d 763 (1952), the court held that the activity of screening and filtering raw whiskey constitutes manufacturing. The following rationale was used:

> . . . in the process through which the whiskey is put by Old Monastery Company labor and skill are applied by hand and machinery to the whiskey and that as a result, a different and useful substance of commerce is produced. A raw whiskey, not suitable for consumption as a beverage, is converted into one that is capable of being used as such.

In Stokely-Van Camp, Inc. v. State, 50 Wn.2d 492 (1957), the process of preserving by freezing an already edible food was found to constitute manufacturing. The court again compared the product before and after the process in question:

> It seems to us that frozen packed fruits and vegetables are new, different, and useful articles of trade or commerce compared with the articles brought to respondent's plants from the fields, because they are changed into a form in which they may be kept usable for months or years under proper refrigeration by the retailer and the ultimate consumer.

This test was further articulated in Bornstein Sea Foods, Inc. v. State, supra., in which case the cutting of whole fish into fish fillets was held to be a manufacturing activity:

> 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. (Emphasis added.)

The following year, that court held that the operation of splitting peas was manufacturing. McDonnell & McDonnell v. State, 62 Wn.2d 553 (1963). The following rationale was used:

> The preparation or processing of the peas and the effect upon them closely approximates the situation with respect to the preparation and processing of bottom fish involved in the Bornstein case. We are convinced that the reasoning and the holding of Bornstein is applicable and controlling in the instant case.
>
> We realize that the criterion stressed in Bornstein -- namely, whether there has been a significant change -- is somewhat general in nature and may seem easier as a matter of articulation than as a matter of application. Nevertheless, as we stated in Bornstein, the end product -- that is, the product or substance as it is released or sold by the one performing the process -- must be compared with the substance initially received by that processor. 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."
>
> In utilizing the aforementioned factors, it is necessary to bear in mind the admonition in Bornstein that "in short, we have come to the position now where we are classifying as 'manufacturing' activities which realistically are

> not manufacturing in the ordinary sense at all." That is, the definition in RCW 82.04.120 of the term manufacture and its tax scope is subject to legislative determination. This determination is not necessarily confined to a classical or orthodox definition of manufacturing, which, in common understanding, usually would connote a spinning, knitting, sewing, sawing, synthesizing, assembly or other fabrication process.

In 1965 the Washington Supreme Court adopted the collective rationale of these four cases to determine that the changing of green coffee beans, useful only to coffee processors, to a roasted and blended coffee, a usable item, was a manufacturing activity. Continental Coffee Company v. State, 66 Wn.2d 194 (1965).

Raw hops which have been processed into hops pellets and hops extract are "new, different, and useful articles" under the rationale of these cases. This is because a significant change has been accomplished when the end products are compared with the article before it was subjected to the process. Raw hops are in two hundred pound bales. Pellets, on the other hand, can be packaged in packages, and extract in little jars. At the very least, there is a substantial difference in how these three products are shipped, stored and handled. Brewers, depending on their facilities, will prefer or require one form over the others. Pellets and extract have been enhanced in value over the raw hops in baled form. Finally, the processes by which raw hops are transformed into either pellets or extract are extensive. Accordingly, there has been, under the applicable tests, a "significant change" accomplished by the taxpayers' processing of raw hops into pellets and extract. Therefore, a "new, different, and useful substance" has been created and manufacturing has taken place.

RULE 136 AND THE MULTIPLE BUSINESS ACTIVITIES EXEMPTION

[7] The taxpayer has argued that, under the multiple activities exemption statute, the manufacturing tax was not properly applicable to persons taxable as wholesalers, and that the law itself did not contemplate the dissimilar treatment of local and out-of-state sales which Rule 136 set forth. We disagree.

RCW 82.04.440 provided in pertinent part as follows:

> (1) Except as provided in subsections (2) and (3) of this section, every person engaged in activities which are in the purview of the provisions of two or more of sections RCW 82.04.230 to 82.04.290, inclusive, shall be taxable under each paragraph applicable to the activities engaged in.
>
> (2) Persons taxable under RCW . . . 82.04.270 [wholesalers] shall not be taxable under RCW . . .82.04.240 [manufacturing] . . . with respect to . . . manufacturing of the products so sold.
> (Brackets and emphasis added.)

Under this statutory scheme, then, when products were manufactured and sold in-state, receipts from such sales were taxable under the wholesaling classification of the business and occupation tax only, and the taxpayer would be exempt under the manufacturing classification under subparagraph (2), since wholesaling tax was properly due. When products were manufactured in-state but sold and delivered out-of-state, however, such sales would be taxable under the manufacturing classification only, since the Commerce Clause precluded imposition of the wholesaling tax.

Because the very language of the multiple activities exemption (i.e., "with respect to . . . manufacturing of the products so sold") required that one look to the individual transactions involved to determine proper tax treatment, we find no merit in the taxpayer's assertion that RCW 82.04.440 precluded taxpayers who were manufacturers from ever being taxable as wholesalers.

MULTIPLE ACTIVITIES EXEMPTION AND THE COMMERCE CLAUSE

[8, 9] The taxpayer has contended that the differential treatment accorded those who sell in-state and those who sell out-of-state is unconstitutional under the Commerce Clause as set forth in the United States Constitution.

In Tyler Pipe Industries, Inc. v. Washington Department of Revenue, 483 U.S. ___, 97 L.Ed.2d 199, 107 S.St. 2810 (1987) the U. S. Supreme Court invalidated the multiple activities exemption, RCW 82.04.440, as violative of the commerce clause and remanded the case to the Washington Supreme Court to decide the issue of remedy.

On January 28, 1988, the Washington Supreme Court issued its opinion in National Can, Docket No. 51910-2 and Tyler Pipe, Docket No. 51110-1. The Court ruled that the U. S. Supreme Court's decision in Tyler Pipe should be applied prospectively only from the date the opinion was issued, June 23, 1987, and that RCW 82.04.4286 and 82.32.060 did not require the State to refund taxes paid or excuse taxes owed before the court decision.. Thus, taxpayers are properly subject to Washington's B&O tax for periods prior to this date. The taxpayers' petitions as to this issue are therefore denied.

MULTIPLE ACTIVITIES EXEMPTION AND DUE PROCESS PRINCIPLES

The taxpayers have challenged the validity of RCW 82.04.330, and Rule 136 as it relates to the multiple activities exemption, on the basis that they offend the principles of due process contained in the United States Constitution. However, since the multiple activities exemption has been found to be unconstitutional as violative of the commerce clause, the issue of due process raised by the taxpayer is now moot and will not be further addressed herein.

PENALTIES

[10] The taxpayer has objected to the imposition of penalties since it was their good faith belief that tax was not due. We must hold otherwise.

The Department of Revenue is granted only limited discretion by the legislature with respect to the abatement of penalties. RCW 82.32.090 provides for the assessment of a penalty for the nonpayment of an assessment when due:

> If payment of any tax due is not received by the department of revenue by the due date, there shall be assessed a penalty of five percent of the amount of the tax; and if the tax is not received within thirty days after the due date, there shall be assessed a total penalty of ten percent of the amount of the tax; and if the tax is not received within sixty days after the due date, there shall be assessed a total penalty of twenty percent of the amount of the tax. no penalty so added shall be less than two dollars. [Emphasis added.]

The legislature, through its use of the word "shall" in the language of RCW 82.32.090, has thus made the assessment of interest and penalties mandatory. The mere fact of nonpayment within a specified time period requires the penalty provisions to be applied.

As an administrative body we are given no discretionary authority to cancel penalties. Our only authority to waive penalties is found in RCW 82.32.105, which provides as follows:

> If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any interest or penalties imposed under this chapter with respect to such tax. The department of revenue shall prescribe rules for the waiver or cancellation of interest or penalties imposed by this chapter. Notwithstanding the foregoing the amount of any interest which has been waived, canceled or refunded prior to May 1, 1965 shall not be reassessed according to the provisions of this chapter. (Emphasis added.)

The Department has adopted WAC 458-20-228 (Rule 228) to implement RCW 82.32.105. The rule provides, in pertinent part:

> The following situations will constitute the only circumstances under which a cancellation of penalties will be considered by the department:
>
> 1. The return was filed on time but inadvertently mailed to another agency.
>
> 2. The delinquency was due to erroneous information given the taxpayer by a department officer or employee.
>
> 3. The delinquency was caused by death or serious illness of the taxpayer or his immediate family, or illness or death of his accountant or in the accountant's immediate family, prior to the filing date.
>
> 4. The delinquency was caused by unavoidable absence of the taxpayer, prior to the filing date.
>
> 5. The delinquency was caused by the destruction by fire or other casualty of the taxpayer's place of business or business records.

6. The taxpayer, prior to the time for filing the return, made timely application to the Olympia or district office, in writing, for proper forms and these were not furnished in sufficient time to permit the completed return to be paid before its delinquent date.

7. The delinquent tax return was received under the following circumstances:

a. The return was received by the department with full payment of tax due within 30 days after the due date; i.e., within the five percent penalty period prescribed by RCW 82.32.090, and

b. The taxpayer has never been delinquent filing a tax return prior to this occurrence, unless the penalty was excused under one of the preceding six circumstances, and

c. The delinquency was the result of an unforeseen and unintentional circumstance, not immediately known to the taxpayer, which circumstances will include the error or misconduct of the taxpayer' employee or accountant, confusion caused by communications with the department, failure to receive return forms timely, and delays or losses related to the postal service.

d. The delinquency will be waived under this circumstance on a one-time basis only.

The fact that taxpayers have not ascertained that tax is due and owing, then, is clearly not a circumstance for which penalties might be excused. It is the obligation of persons engaged in business within this state to correctly inform themselves of the tax consequences of their activities. This Department maintains a staff of qualified personnel to whom inquiries regarding such matters may be addressed, and information is freely available without charge. Had the taxpayer inquired, it would certainly have been advised that it was required to register with the Department and to report and pay taxes.

Consequently, the taxpayers' mistaken belief that it was not subject to Washington tax liability cannot be construed as a circumstance beyond their control.

Incidentally, the Department has not inferred any intent to evade payment of the tax from the taxpayer's failure to register and report taxable income. If such had been the case, then a much more severe penalty would have been imposed under RCW 82.32.050, which provides in part:

> If the department finds that all or any part of the deficiency resulted from an intent to evade the tax payable hereunder, a further penalty of fifty percent of the additional tax found to be due <u>shall</u> be added. (Emphasis supplied.)

The taxpayers' petitions as to this issue are denied.

<u>CLASSIFICATION OF CERTAIN INVOICES</u>

Taxpayer II has claimed that several invoices which were classified as manufacturing or processing for hire were actually for the interstate sales of hops pellets. Since we have not resolved the manufacturing issue in the taxpayer's favor, and because the manufacturing and wholesaling tax rates were identical, this issue need not be resolved as the requested reclassification would result in no tax benefit to the taxpayers.

Taxpayer III has claimed that two of its invoices - one for the sale of and the other for the pelletization of the same hops - should be considered as one transaction exempt of tax under both the manufacturing and wholesaling classifications, since the manufacturing tax should not apply and the completed pellets were delivered to the customer out-of-state. Again, because we have not resolved the manufacturing issue in the taxpayers' favor, and because the manufacturing and wholesaling tax rates were identical, this issue will not be addressed since combining the invoices into one transaction would still result in the same amount of tax liability.

DECISION AND DISPOSITION:

The taxpayers' Petitions for Correction of Assessment and Refund are denied.

Tax Assessment No. . . . is sustained and refund denied.

Tax Assessment No. . . . is sustained and refund denied.

Tax Assessment No. . . . in the unpaid amount of $ . . . , plus unwaived interest of $ . . . , for a total of $ . . . , is due for payment by April 15, 1988.

Tax Assessment No. . . . is sustained except as to issue number 5 herein. The Audit Section will issue an amended assessment, payment of which will be due on the date thereon.

Tax Assessment No. . . . is sustained and refund denied.

DATED this 16th day of March 1988.