

BEFORE THE INTERPRETATION AND APPEALS DIVISION
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 of)
) No. 88-440

)
. . .) Registration No. . . .
) Document No. . . .
) Audit No. . . .

RULE 136: B&O TAX -- PROCESSING FOR HIRE -- PACKING OF SEAFOOD. The packing of seafood belonging to others is taxable under the processing for hire classification when performed in conjunction with other processing activities.

RULE 115 AND RULE 136: USE TAX -- PACKING MATERIALS -- USE BY PROCESSORS FOR HIRE. The use of articles of tangible personal property solely as packing materials by processors for hire is not subject to use tax.

RCW 82.12.0263 AND RULE 134: USE TAX -- EXEMPTION -- FUEL USED BY ITS MANUFACTURER -- ICE USED FOR COOLING. The use of ice by its manufacturer to cool a product or a work area is not use as a fuel. Such use is not exempt of use tax.

RULE 155: USE TAX -- STANDARD, PREWRITTEN SOFTWARE --INCIDENTAL MODIFICATION. Incidental customization of standard, prewritten software does not transform it into custom software. Use tax applies to the use of such software. 4 WTD 327 (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 28, 1988

NATURE OF ACTION:

The taxpayer petitioned for a correction of an assessment issued as the result of a routine audit.

ISSUES:

Potegal, A.L.J. -- The taxpayer is in the business of handling, processing, and holding in cold storage fresh and frozen seafood. It does not own any of the seafood upon which these services are performed.

The taxpayer takes exception to the assessment in the following respects:

1. Packing Income. In Schedules II and III of the original audit report, the taxpayer objects to the reclassification of certain income from the cold storage warehousing classification of the business and occupation tax to the service and other activities classification of the business and occupation tax. The income was from items identified on customer billings as packing. The taxpayer agrees that this income should not have been reported as cold storage warehousing. Instead, it should have been reported under the processing for hire classification of the business and occupation tax. According to the taxpayer, its packing activities always took place in conjunction with, and as a necessary component of, its processing activities.

2. Packing Materials. The taxpayer objects to the assessment of use tax or sales tax under Schedules VI, VII and VIII of the original audit report on the use or sale of packing materials. With respect to Schedule VI, the taxpayer contends that its occasional sales of pallets and plastic totes were to wholesalers and were not subject to sales tax because they were sales for resale. With respect to Schedules VII and VIII, the taxpayer contends that its purchase and use of pallets, totes, boxes and liners were subject to neither sales nor use tax because these items were used in the taxpayer's processing for hire activities and were thus purchased for resale.

3. Ice. Under Schedules IX-A and IX-B of the original audit report, the taxpayer objects to the assessment of manufacturing classification business and occupation tax and use tax on its manufacture and use of ice under two circumstances. The first circumstance is ice used as a packing material. Here, the taxpayer asserts that use tax does not apply for the same reason that it does not apply to the packing materials in Schedules VII and VIII. Manufacturing business and occupation tax would not apply because the ice is manufactured for sale to the taxpayer's customers. The second circumstance is ice used to keep products fresh or cold in its own facility. The taxpayer apparently concedes that business and occupation tax is due but contends that use tax does not apply because the ice is used as a fuel to cool the product or work area. Under RCW 82.12.0263 such use is exempt of tax.

4. Software. The taxpayer objects to the assessment of use tax under Schedule X of the original audit report on the acquisition and use of an item from . . . which the taxpayer contends is custom computer software. WAC 458-20-155 provides that the purchase and use of such items is not subject to use tax.

DISCUSSION:

The taxpayer's objections will be discussed in the same order set forth above.

1. Packing Income. The taxpayer performs myriad processes on its customers' seafood. Among these are washing, dressing, freezing, vacuum packing, grading, heading, steaking, packing and re-packing, glazing, filleting, portioning, microwave tempering, pre-cooking, battering and breading, inspection and quality assurance, and crab claw scoring. In no case is the seafood merely packaged or re-packaged. There is always some other process which the seafood has undergone.

At a minimum, the seafood goes through a grading, glazing, quality control and packing process. Grading, with respect to salmon, involves separating fish by species, skin color, meat color, quality and weight. Glazing is described as follows in the taxpayer's memorandum:

This process is used to clear or prevent dehydration, oxidation, loss in flavor and texture, off color formation and alterations in color which can be the result of inadequate freezing, poor frozen storage conditions, prolonged storage

duration, inadequate glazing, or a combination of these. The process involves several different methods of application, but the end result is to coat the seafood with a protective coating. The solution to coat the seafood is a pre-determined corn syrup solution adjusted to a desired consistency for percent of volume pick-up. The corn syrup glaze has an elastic characteristic to help prevent chipping and bare spots.

Whether the packing component of these activities constitutes processing for hire is the issue to be decided.

WAC 458-20-136 is the department of revenue's duly adopted rule regarding manufacturing and processing for hire. By virtue of RCW 82.32.300 this rule has the force and effect of the law. The rule states in part:

The term "processing for hire" means the performance of labor and mechanical services upon materials belonging to others so that as a result a new, different or useful article of tangible personal property is produced for sale or commercial or industrial use. Thus, a processor for hire is any person who would be a manufacturer if that person were performing the labor and mechanical services upon that person's own materials.

The rule also defines the term "to manufacture" to include:

. . . 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 . . .

Underscoring ours.

Under the rule, a person performing manufacturing-type activities on materials belonging to others is taxable as a processor for hire. Both "packing" and "packaging . . . of . . . fish" are specifically defined as being manufacturing activities. This is precisely what the taxpayer does with seafood belonging to others. Considering this, and also the fact that packing performed by the taxpayer is always in conjunction with other manufacturing-type activities, the correct category to report the packing income is processing for hire.

The taxpayer's petition will be granted as to this item.

2. Packing Materials. With respect to Schedule VI, to the extent that the taxpayer can prove that sales were made to buyers who provided resale certificates or that sales were accomplished by delivery to out-of-state destinations the taxpayer is entitled to relief. This is strictly a factual matter and is referred back to the audit staff for verification.

In Schedule VII, tax was assessed on the purchase and use of pallets and totes. The taxpayer concedes that use tax is due with respect to those pallets and totes which it used in ways other than or in addition to as packing materials. On the other hand, those pallets and totes which were only used as packing materials would not be subject to tax.

The department of revenue has long taken the position that packing materials, including pallets, are not subject to tax when a manufacturer or processor for hire delivers these items, along with a product, to customers and no substantial non-manufacturing use has taken place. See, for example, ETB 340.08.115,

As in Schedule VI, this is a factual matter in which the burden of proof lies with the taxpayer. This is referred back to the audit staff for verification of the quantity of pallets and totes not subject to tax.

In Schedule VIII, tax was assessed on the purchase and use of packing materials including boxes and liners. All of these items were used by the taxpayer in its capacity of processor for hire. Consequently, it is not liable for tax. The assessment will be adjusted accordingly.

3. Ice. With respect to ice used as a packing material, we agree that business and occupation tax and use tax are not due for the same reasons that other packing materials were not taxed in item 2.

With respect to the use of ice to cool products in the taxpayer's own facility, we are unable to agree that the exemption provided by RCW 82.12.0263 applies. That statute states:

The provisions of this chapter shall not apply in respect to the use of fuel by the extractor or

manufacturer thereof when used directly in the operation of the particular extractive operation or manufacturing plant which produced or manufactured the same.

In order for the use of the ice to be exempt it must be used as a fuel. The statute does not define the meaning of fuel. Where a statute does not define certain words therein, they must be accepted in their ordinary and everyday meaning. Herring Magic v. U.S., 258 F.2d 197 (C.A. Wash., 1958). Resort may be had to dictionaries to ascertain the common meaning of statutory language. Garrison v. Washington State Nursing Bd., 87 Wn.2d 803 (1976).

The American Heritage Dictionary defines "fuel" to mean, "Something consumed to produce energy, esp.: a. A material such as wood, coal, gas, or oil burned to produce heat." The ice as used by the taxpayer in this circumstance is the opposite of a fuel. It consumes rather than produces energy. That is why it has the effect of cooling the air surrounding it.

In interpreting this law we are guided by the principle that provisions for exemption from tax are construed in favor of the tax and against the person claiming the exemption. Yakima Fruit Growers v. Henneford, 187 Wn. 252, 60 P.2d 62 (1936). It would take an extremely liberal and imaginative construction to determine that the ice in question here is a fuel. The taxpayer's petition will be denied on this question.

4. Software. The taxpayer purchased a computer system from . . . , an out-of-state company. The system included both software and hardware. In Schedule X of the audit report the audit staff listed three items for which . . . billed the taxpayer. Use tax was assessed on each of these items. One, listed as HP Computer System, has been acknowledged by the taxpayer to represent a charge for hardware. The taxpayer does not object to tax on this item. The other two items, listed respectively as Passive Locator System and Maintenance Agreement, represent charges for custom software, according to the taxpayer, and should not be taxed.

The contract between the taxpayer and . . . provided that total software charges were \$32,500. Of this amount, \$20,000 was for a standard, prewritten program known as Another \$9,000 was for other, apparently standard, prewritten

programs identified as Accounts Receivable System, Accounts Payable System and General Ledger. The Passive Locator System, which the taxpayer asserts is custom software, is described in the contract as system customization. The charge for the Passive Locator System was \$3,500. The taxpayer was charged \$3,712.50 for the Maintenance Agreement. Under the contract, maintenance services include modifications and enhancements to the system, reasonable consultation services and additional system tapes for new enhancements to the system.

This issue is governed by the decision in 4 WTD 327 (1987), . . . The taxpayer's petition will be denied as to this item.

DECISION AND DISPOSITION:

1. Packing Income. The taxpayer's petition is granted.
2. Packing Materials. The taxpayer's petition is granted subject to verification by the audit staff in accordance with the DISCUSSION section of this determination.
3. Ice. The taxpayer's petition is granted in part and denied in part. The audit staff will make the appropriate adjustments.
4. Software. The taxpayer's petition is denied.

In due course, an amended assessment will be issued to the taxpayer.

DATED this 22nd day of November 1988.