Cite as Det. No. 00-119, 20 WTD 117 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 00-119
	)	
. . .	)	Registration No. . . .
	)	Petition for Refund

RCW 82.04.240; RCW 82.04.450: B&O TAX -- PACKING MATERIALS -- PALLETS -- VALUE OF PRODUCTS MANUFACTURED. A manufacturer's separately-itemized charges for shipping pallets on which the manufacturer's product is held for sale, where title to the pallets passes to the customer upon delivery, are part of the value of the products manufactured, and therefore are part of the measure of the manufacturing B&O tax.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Beer manufacturer petitions for refund of manufacturing business and occupation (B&O) tax it paid on its separately-stated charges to wholesale customers for shipping pallets on which it delivered the packaged beer.[1]

FACTS:

Prusia, A.L.J. -- The taxpayer, . . ., owned and operated the . . . [Brewing Company] located in . . ., Washington. The taxpayer, through its . . . Division, was in the business of manufacturing and wholesaling beer.

The taxpayer's wholesale business consisted of the sale of packaged beer to distributors throughout the United States. After brewing the beer, the taxpayer packaged the beer in cans, bottles, kegs, cartons, and cases. For some wholesale sales, the taxpayer loaded the cases onto pallets for shipping. Pallets used for shipping were shrink-wrapped together with the packaged beer. The taxpayer then sold the entire shrink-wrapped package, consisting of cans, cartons,

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

cases, pallets, and shrink-wrap, to distributors who picked up the packages at the . . . brewery. The sales price included all associated packaging, but on the invoices to the customers the taxpayer separately-stated a charge for the sale of pallets. The wholesale sale to distributors was completed when distributors took possession and title of their purchases at the brewery dock.

When the taxpayer sold its palletized products to a distributor, it considered the transfer of the pallets to be a sale and accounted for the transfer as such. The charge for the pallets was not a "deposit," and the distributor was under no obligation to return the pallets to the taxpayer. If a distributor subsequently resold a pallet back to the taxpayer, the taxpayer treated the acquisition as a purchase of the pallet by the taxpayer and provided the distributor with a credit.

The taxpayer purchased the pallets from unrelated third parties. The taxpayer resold some pallets that did not meet its standards for shipping manufactured product. Pallets the taxpayer purchased were not imprinted with the company name.

In an audit report dated November 6, 1996, for the period January 1, 1991 through August 31, 1996, the Department of Revenue's Audit Division agreed with the taxpayer that the taxpayer purchased pallets for resale for purposes of sales and use tax. The Audit Division further concluded that the pallets, along with all other associated packaging materials (cans, bottles, boxes, etc.), became part of the product sold and must be included in the value of the products sold that is taxable under the manufacturing business and occupation (B&O) tax classification. Prior to the audit report, the taxpayer had reported under the manufacturing classification on all items except pallets. It had accounted for the pallets as fixed assets, and had paid retail sales and/or use tax on the pallets.

Upon completion of the audit investigation for the 1991 through August 1996 period, the Audit Division issued an assessment against the taxpayer. The audit assessment allowed the taxpayer credits for sales and use tax paid in error on pallets which became a component part of the product sold, and assessed manufacturing B&O tax on separately-stated pallet charges included in the total sales price of products. The assessment also assessed wholesaling B&O tax on those pallet charges for product sold at wholesale in the state, and allowed the taxpayer the multiple activities credit on charges that were subject to both manufacturing and wholesaling B&O tax. The taxpayer paid the assessment. Subsequent to the November 1996 audit report, the taxpayer included the separately-stated charges for pallets in the its manufacturing B&O tax base, and ceased paying retail sales and/or use tax on pallets it acquired and used for shipping.

On October 21, 1999, the taxpayer filed a petition for refund of the manufacturing B&O tax it had paid on pallet charges for the period January 1, 1991 through June 30, 1999, in the approximate amount of $. . ., plus interest. The petition contends the separately-stated pallet charges are not properly included in the measure of the taxpayer's manufacturing B&O tax. The petition contends the taxpayer does not manufacture the pallets, but rather purchases and then resells them to the taxpayer's wholesale customers. It contends the separate charge for the pallets should only be included in the measure of the wholesaling B&O tax.

In response, the Audit Division contends that manufacturing B&O tax was due on the separately-stated pallet charges, because the charges were part of the selling price of the manufactured product. Therefore, the taxpayer is not entitled to a refund of manufacturing B&O tax paid on the pallet charges during the refund period.

ISSUE:

Should the separately-itemized charges for pallets be part of the measure of the taxpayer's manufacturing B&O tax?

DISCUSSION:

The taxpayer was a manufacturer of beer. RCW 82.04.240 imposes the B&O tax on manufacturers, as follows:

> Upon every person . . . engaging within this state in business as a manufacturer; as to such persons the amount of the tax with respect to such business shall be equal to the value of the products, including byproducts, manufactured . . . .
>
> The measure of the tax is the value of the products, including byproducts, so manufactured regardless of the place of sale or the fact that deliveries may be made to points outside the state.

Purchases of tangible personal property for the purposes of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component, are not "retail sales." RCW 82.04.050. A manufacturer who purchases property that it incorporates into a product it manufactures does not pay retail sales tax on the purchase, and the property becomes part of the value of the product manufactured. A person who purchases tangible personal property for the purpose of resale as tangible personal property in the regular course of business, without consuming the property in producing a new article for sale and without intervening use, does not owe retail sales tax on the purchase, and the subsequent resale is subject to retailing B&O tax (and retail sales) if at retail, and subject to wholesaling B&O tax if at wholesale. *See* RCW 82.04.050(1), RCW 82.08.020, RCW 82.04.060, RCW 82.04.220, RCW 82.04.250, and RCW 82.04.270.

Were the pallets in question part of the "value of the products manufactured," and therefore part of the measure of the taxpayer's manufacturing B&O tax, or were they property purchased for resale to the distributors, and therefore properly included solely in the measure of the tax on wholesaling?

RCW 82.04.450 specifies how the value of products manufactured is to be determined for purposes of the manufacturing B&O tax. It provides, in pertinent part: "The value of products, including byproducts, extracted or manufactured shall be determined by the gross proceeds derived from the sale thereof whether such sale is at wholesale or retail . . . ." *See also* WAC 458-20-112 (Rule 112). The term "gross proceeds of sales" means "the value proceeding or

accruing from the sale of tangible personal property . . . 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 expenses whatsoever paid or accrued and without any deduction on account of losses." RCW 82.04.070; Rule 112.

What items were included in the "gross proceeds" from the taxpayer's sale of beer? The taxpayer did not simply sell beer which it poured into containers provided by its customers. It wholesaled beer in containers and cartons, shrink-wrapped with a pallet for shipping. The whole bundle was what was held for sale. The gross proceeds of the sale included the pallet. Thus, RCW 82.04.450 directs that the charge for the pallet be included in the measure of the manufacturing B&O tax.

The taxpayer argues that the phrase "the value of the products, including byproducts, manufactured" in RCW 82.04.240, and the phrase "from the sale thereof" in RCW 82.04.450, limit the measure of the manufacturing B&O tax to the value of the products the taxpayer itself manufactures, i.e., beer. Because the taxpayer did not manufacture the pallets, gross proceeds from their sale were not proceeds of sales from the business of being a manufacturer. We disagree. The measure of the manufacturing B&O tax is not limited to components the taxpayer manufactures from scratch. The measure of the tax is determined by the gross proceeds of sales of the finished product. The gross proceeds of sales include numerous items the taxpayer did not itself manufacture. Neither RCW 82.04.450 nor Rule 112 allows any deduction from the value of items manufactured for parts obtained from others that are incorporated into the finished product. Det. No. 88-37, 5 WTD 107 (1988); Det. No. 92-034, 12 WTD 77 (1993).

Moreover, the fact that the value of manufactured products is to be determined by the gross proceeds of sales implies that the manufacturing process is not considered complete until the product is in a saleable condition. When viewing the total activity of the taxpayer, the palletizing and other packaging must be considered an integral part of its manufacturing process. The taxpayer had to package the beer in order for the beer to be in a saleable condition for distributors. The packaging clearly added value to the extent the beer was not a completely manufactured product until it was packaged into a form necessary for sale.

Treating the charges for the pallets as part of the selling price of the product is consistent with the treatment of the charges for sales and use tax purposes. In Det. No. 88-440, 7 WTD 43 (1988), the Department noted that it "has long taken the position that packing materials, including pallets, are not subject to [sales or use] 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."[2] Subsection (2)(c) of WAC 458-20-115 (Rule 115) specifically provides

[2] In Det. No. 90-302, 10 WTD 101 (1990), the Department noted that it "has consistently interpreted pallets as falling within [WAC 458-20-115's] definition of packing materials and taxable in the same manner." We note that pallets thus are distinguished from dunnage, although they may take the place of dunnage during shipping. Taxation of the sale or use of dunnage is explained in WAC 458-20-117 (Rule 117). The term "dunnage" means "any material used for the purpose of protecting or holding in place cargo or freight during transportation by any carrier of property, and which is not an integral part of the carrier itself," such as wood blocks, separating strips, and

that title to containers for beverages and food sold at retail will be deemed to pass to the customer along with the contents, and the "amounts charged for the containers are **part of the selling price**." In Det. No. 90-302, 10 WTD 101 (1990), the Department held that a cardboard box manufacturer's separately-itemized charges for pallets were part of the selling price of the product where title passed to the customer upon delivery. While Rule 115 and these determinations concern sales or use tax, the principle that when title to packaging materials passes to the customer upon delivery, the charges for the packaging materials are part of the selling price of the product, is equally applicable to the manufacturing B&O tax. (Emphasis added.)

Subsection (5)(c) of Rule 115 provides: "The use tax applies to the use of pallets by a manufacturer or seller where the pallets will not be **sold with the product**, but are for use in the manufacturing plant or warehouse." (Emphasis added). The clear implication of this section is that pallets a manufacturer sells with the product are to be considered part of the selling price of the product.

We note that the Department has addressed the specific question presented in the property tax context, and reached a similar conclusion. In Property Tax Bulletin 90-3 (1990), the Department provided the following guidance for property tax purposes:

> PACKAGING MATERIALS -- DEFINITION: "Packaging materials" means and includes all boxes, crates, bottles, cans, bags, drums, cartons, wrapping papers, cellophane, twines, gummed tapes, wire, bands, excelsior, wastepaper, and all other materials in which tangible personal property may be contained or protected within a container for transportation or delivery to a purchaser.
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> DUNNAGE -- DEFINITION: The term "dunnage" means any material used for the purpose of protecting or holding in place cargo during shipping by any type of carrier. Examples of these type materials are: wood blocks, timbers, separating forms, bulkheads, double floors, or any other type of bracing or support structures.
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> **BUSINESS CATEGORIES:**
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> **MANUFACTURING/PROCESSING**
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> PACKAGING SUPPLIES: The location in the production stream is the determining factor whether packaging materials are inventory or supplies.

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bracing. Rule 117 distinguishes "dunnage" from "packing material" as follows: "Dunnage generally does not remain with the cargo that is being transported and will not be delivered to the person who will ultimately receive the cargo. On the other hand, packing materials are generally part of the total package containing the cargo and are ultimately delivered to the customer as part of the cargo or merchandise."

> When manufactured or processed products are considered a final sale by the manufacture or processor, all packaging materials in which the product is held for sale **becomes a part of that product and is considered inventory for resale**. An example of packaging components used to contain a product held for sale might include some or all of the following: individual wrappings of each item; cardboard used for layering; the package containing each item; the box holding numerous individual items; staples, banding, glue, or other material used to seal the box; **pallets holding numerous boxes which might also be sealed in plastic and or banded together for shipping**.
>
> If the product has not been completed and is packaged for shipment to another step in the manufacturing process where it will be repacked, the materials or containers used to ship the product from one step to another are considered supplies. Containers may be considered equipment if they are returned and are reusable by the shipper.

(Emphasis added.)

While statutes, rules, and interpretations applicable to property tax do not control excise tax treatment, the Department may properly look to the property tax treatment for insight. *See Western Ag Land Partners et al. v. Dept. of Revenue*, 43 Wn. App. 167, 716 P.2d 310 (1986).

The taxpayer argues that the shipping pallet and the manufactured product were separate and distinct articles, which was the reason for charging the distributors a separate and distinct amount for the pallets. It argues that the pallets were not like packaging material, such as cans, bottles, and kegs, because the latter held the product until eventual use by the retail customer, whereas the pallets were only in temporary contact with the beer, and were separated from the beer after shipment. We agree that, factually, the pallets differed from bottles, cans, and kegs, in that they generally were not part of the packaging that reaches the retail customer. However, we see that as a distinction without a difference for manufacturing B&O tax purposes. The pallets were part of the packaging at the time the beer was sold at wholesale, which is when the value of the products manufactured is to be determined. RCW 82.04.450; Rule 112.

We conclude that the taxpayer's separately-itemized charges for pallets sold with its packaged beer products were part of the measure of its manufacturing B&O tax. Therefore, the taxpayer is not entitled to the requested refund of B&O tax it paid on charges for pallets.

DECISION AND DISPOSITION:

The taxpayer's petition for refund is denied.

Dated this 21st day of June, 2000.