Cite as Det. No. 00-107, 20 WTD 98 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 00-107
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 182, RULE 214; RCW 82.04.4287, RCW 82.04.080, RCW 82.04.290; ETA 559: B&O TAX – RENT – FRUIT BINS. A fruit packer who receives and temporarily stores fruit in its bins is taxable under the service and other activities B&O classification on receipts designated as "bin rental."

[2] RULE 111, RULE 182, RULE 214; RCW 82.04.080, RCW 82.04.280; ETA 257: B&O TAX -- INSURANCE CHARGES – FRUIT WAREHOUSE. Receipts derived from separately stated insurance charges to growers, who own fruit stored in a warehouse, to cover the fruit packer's premiums for losses to the contents of the warehouse, are not "reimbursements," but taxable under the same classification as the receipts designated as warehouse charges.

[3] RULE 214; RCW 82.04.4287: B&O TAX – FRUIT GRADING. Payments from a cannery to a fruit packer, which authorized the fruit packer to grade and accept fruit on behalf of the cannery, were subject to B&O tax because the taxpayer was paid to accept the fruit for the cannery, not for the growers.

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:

A fruit packer protests the taxability of bin rental charges, insurance, grading services, and interest income.[1]

FACTS AND ISSUES:

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

M. Pree, A.L.J. -- . . . (taxpayer) washes, sorts, packs, and stores fresh fruit in Washington for growers. The Department of Revenue (Department) reviewed the taxpayer's books and records for the period from January 1, 1994 through December 31, 1997. On December 11, 1998, the Department's Audit Division issued the assessment referenced above. The taxpayer disputes $. . . of the $. . . assessment and paid the balance of $. . . .[2]

The taxpayer disputes the following conclusions by the Audit Division:

1. Bin charges are subject to business and occupation (B&O) tax.

2. Insurance charges are subject to B&O tax.

3. Grading and sorting pears destined for cannery production are subject to B&O tax.

4. The taxpayer's investment income is derived from activities that are similar to, or comparable to, those of banking, loan or security businesses and subject to B&O tax.

[1] ***Bins.*** Growers deliver their fresh fruit to the taxpayer in bins provided by the taxpayer. The taxpayer washes, sorts, and packs the fruit. Sorting involves separating fruit of high quality for sale to grocery stores from inferior quality fruit, which is sold to other companies that process the fruit into juice, pie filling, chips, etc. Grocery stores pay the growers a higher price for the high quality fruit than the processors pay for the inferior fruit. The Audit Division allowed the taxpayer to deduct bin charges for fruit delivered to the taxpayer, which the taxpayer processed.

The particular bin charges at issue relate to inferior fruit, which the taxpayer did not sort, wash, or pack. Growers would place inferior fruit in the taxpayer's bins understanding the taxpayer would not process the fruit. Normally, the fruit would be delivered from the grower's orchard to the taxpayer. The taxpayer would hold the fruit a short time, then ship it to a juice processor.[3]

The processors paid the taxpayer a "bin charge" in accordance with the processor's field policy."[4] Title to the fruit remained with the growers until the processor accepted the fruit.[5] The processor separately paid for the fruit.

The Audit Division assessed B&O tax under the service and other activities classification on the bin charges the taxpayer received from the processor. The taxpayer contends these charges were

[2] We recognize these numbers do not reconcile, the difference appears to be within the range of interest. When the PAA is issued, the taxpayer will be credited for tax and interest paid.

[3] If the taxpayer held the fruit for a period long enough to charge the grower a storage fee, the bin charges were taxed with the storage charges, under the lower warehousing rate.

[4] The processor had a pre-established rate it paid when it did not provide the bins.

[5] The taxpayer did not enter written contracts or have other written records to evidence the various obligations for these transactions. Rather, as the relationships developed over time, the parties developed these understandings, which the Audit Division does not dispute.

exempt under RCW 82.04.04287 and WAC 458-20-214(2) (Rule 214) because it derived the receipts from receiving the fruit for the growers. In the alternative, the taxpayer contends that if the bin charges are taxable, they should be taxed under the warehousing classification, rather than the service and other activities classification. The taxpayer reasons, the service it performs in conjunction with the bins, holding the fruit, is of a warehousing nature.

[2] ***Insurance.*** The taxpayer insures the fruit it stores, which is owned by the growers. In the event of a fire or other casualty, the taxpayer is responsible to the growers for losses while the taxpayer stores the fruit. For instance, when the roof of one of the taxpayer's facilities collapsed, the insurance company paid the taxpayer for the fruit damaged. The taxpayer in turn, paid the growers for their fruit lost.

The taxpayer paid the insurance company the premiums, and was listed as the sole beneficiary under the policy. The insurance company determined the premiums based upon the taxpayer's estimate of fruit in storage. The taxpayer charged each grower an amount per bin for insurance. It appears, the bulk of the insurance is for the fruit in storage, rather than the inventory being washed, sorted, and packed.

The Audit Division assessed B&O tax under the service and other activities classification on the taxpayer's receipts from the growers for insurance. The taxpayer argues these receipts are exempt because it contends it was the growers' agent when it purchased the insurance. In the alternative the taxpayer contends the insurance should be considered part of the storage fees taxable under the warehousing classification. The taxpayer also notes it is unique in the manner it separately charges for insurance. Other fruit packers may recover their insurance costs through storage fees, taxable under the warehousing rate, or exempt receipts from washing, sorting, packing or otherwise preparing the fruit for sale for the growers.

[3] ***Grading of pears.*** Normally, the taxpayer washes, sorts, grades, packs, and ships the fruit to buyers, who upon receipt may accept or reject the fruit. Until accepted by the buyers, the growers continue to own the fruit. Other canneries may have their own employees inspecting and accepting fruit at the taxpayer's facility. However, the taxpayer has an unwritten understanding with one cannery, where the arrangement differs slightly. After receiving pears, the taxpayer grades them according to the cannery's standards. Pears meeting a specified grade are deemed accepted by the cannery and shipped to the cannery for processing. That cannery issues separate checks for the fruit and the grading to the taxpayer.

If the taxpayer does not give the pears a grade sufficient to meet the cannery's standards, they are not shipped to the cannery. The growers direct the taxpayer regarding what to do with the pears,[6] which the taxpayer did not accept for the cannery. The cannery does not pay the taxpayer for grading these pears, which do not meet the cannery's standards. In other words, that cannery only pays the taxpayer to grade accepted pears.

[6] The pears may be sorted, and re-graded, or otherwise processed and sold to other buyers.

The Audit Division assessed service and other activities B&O tax on the grading fees paid by the cannery. The taxpayer contends these receipts should be exempt under RCW 82.04.04287, reasoning the grading services were for the growers. The Audit Division concluded the services were for the cannery, and therefore, did not meet the exemption requirement that they be performed for the growers.

The taxpayer notes, other than how it is paid, the grading services it performs are similar to the services provided for apple growers. We note an additional distinction, however. The taxpayer's grading constitutes acceptance of the pears by the pear cannery.

[4] ***Investment income.*** The taxpayer has a substantial line of credit with a bank. Affiliate orchards and other growers use funds from the line of credit for their operations. They sign notes with the taxpayer, agreeing to repay the borrowed amounts at a rate slightly higher than the rate the bank charges the taxpayer. The taxpayer also uses surplus funds generated from fruit sales in September to lend to growers to cover storage until January.

The taxpayer's interest income from these loans did not exceed 5% of its receipts for three of the four years during the audit period. The Audit Division assessed B&O tax on the interest for the year in which the taxpayer's income exceeded 5% under ETB 571.

The taxpayer states, while under ETB 571 the taxpayer's income from the one year was only 5.89% of receipts, the taxpayer's activities were not similar to, or comparable with those of a "banking, loan, or security business." The Audit Division came to the opposite conclusion.

The taxpayer disagrees with the Audit Division's conclusion that it is similar to a financial institution and should be taxed accordingly. Both the taxpayer and the Audit Division recognize the Washington Supreme Court is considering the issue of what constitutes a financial business. *See Simpson Inv. Co. v. Department of Rev.,* 92 Wn.App. 905, 965 P.2d. 654 (1998), *petition for review granted* 137 Wn.2d 1032 (1999). We expect the Court's decision in the near future, and will allow the Audit Division an opportunity to resolve this issue with the taxpayer on remand based on the Court's interpretation of "financial business" under similar circumstances.

. . .

ISSUES:

1. Are the bin charges for fruit delivered to other processors taxable, and if so, under which classification?
2. Are the taxpayer's receipts for insurance taxable, and if so, under which classification?
3. Did the taxpayer perform its pear grading services for the growers or for the cannery?

DISCUSSION:

[1] ***Bins.*** Unless an exemption or deduction exists, the payments (measured by the number of the taxpayer's bins used to deliver fruit to the processors) from other processors to the taxpayer

would be included in the taxpayer's measure of tax. Value proceeds to the taxpayer under RCW 82.04.090, which constitutes the gross proceeds of sales under RCW 82.04.070 or gross income under RCW 82.04.080.

The taxpayer seeks to deduct these payments under RCW 82.04.4287, which provides:

> In computing tax there may be deducted from the measure of tax amounts derived by any person as compensation for the receiving, washing, sorting, and packing of fresh perishable horticultural products and the material and supplies used therein when performed for the person exempted in RCW 82.04.330, either as agent or as independent contractor.

RCW 82.04.330 exempts farmers, or more specifically in this case, the growers. It does not include the other canneries. The other canneries pay the taxpayer to use its bins for receiving and temporarily storing fruit they will process. The taxpayer is not performing this service for the growers. The growers do not pay the taxpayer for this service; the canneries pay. Because the service is performed for the canneries, we lack any statutory basis for deducting or excluding these "bin charges."

Normally, the rent received for the use of tangible personal property such as the bins would be considered a retail sale under RCW 82.04.050, subject to retail sales tax under RCW 82.08.020. As the "seller," the taxpayer would be required to collect the tax from the processors, and would be liable for the sales tax if the taxpayer failed to collect the tax under RCW 82.08.050.

However, the Department recognizes with respect to fruit packers, bin charges are simply additional income related to the receipt and storage of the fruit. ETA 559.08.214. We must analyze the nature of the services the taxpayer provided regarding the use of these bins. While the bins are delivered to the taxpayer, the taxpayer does not perform the processing, cold storage, or packing services normally offered. Rather, the processors pay the taxpayer to receive, and hold the bins for a short period of time possibly in a sheltered area. If cold storage is required, the growers pay for the storage as an additional charge.

Receipts from certain warehouse or storage activities are taxable under a different classification than receipts for other services. *See* RCW 82.04.280 and RCW 82.04.290. The Department's Rule 182 (WAC 458-20-182) and RCW 82.04.280 distinguish between the taxability of receipt for cold storage of fruit and other fruit warehouse activities. Because the processors are not paying the taxpayer for cold storage activities, the receipts are subject to tax under the service and other activities classification. Rule 182(2)(c). The Audit Division properly assessed B&O tax on the bin charge receipts from other processors.

[2] ***Insurance.*** Growers pay the taxpayer amounts billed on the taxpayer's invoices. Under RCW 82.04.080 receipts, however designated, constitute gross income of the business without any deduction for expenses. The insurance at issue is the taxpayer's expense.

The taxpayer bills the growers on a separate line for a pro rata portion of its insurance premiums. The premiums, in part, are based upon the amount of the growers' fruit the taxpayer has in cold storage. The taxpayer indicates it may be liable as a commission merchant or in another capacity to pay growers for fruit losses in the event of a casualty while in storage. In fact, the taxpayer did use the insurance proceeds to pay growers for fruit losses due to a casualty.

WAC 458-20-111 (Rule 111) allows taxpayers to exclude advances and reimbursements. However, Rule 111 limits this application:

> The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.

The taxpayer contends the pro rata charges it makes to the growers are excludable as "reimbursements" for the premiums it paid. The taxpayer has the liability to pay the premiums. The taxpayer is the named insured, and solely responsible for the premiums. There is no designation that the taxpayer is an agent for anyone regarding these premiums. Similarly the taxpayer in its own capacity, not as agent for the insurance company, is responsible to pay for losses to the growers' fruit in the event of losses from damages to the taxpayer's warehouse.

The Department addressed a similar situation with respect to grain warehouses in ETA 257.16.182:

> The Tax Commission noted that the insurance which the taxpayer was required to provide was taken in his name rather than the name of the customer. Hence, the taxpayer was not making an advance for his customer for which he would be reimbursed (Rule 111) but was, in effect, collecting from each customer the prorata share of one of his expenses of doing business. It was immaterial to the determination of tax liability that this expense was billed separately or that it was billed at exact cost. Therefore, the Commission held that the insurance charges added by a public grain warehouse to customer's invoices were a part of the gross income of the business as defined in RCW 82.16.010(12) and must be included in the measure of the Public Utility Tax.

Separately stated insurance charges may not be deducted. They remain the responsibility of the storage company, and the premiums constitute a nondeductible cost of doing business. *See also* Det. No. 91-164, 11 WTD 337 (1991).

We note the business in ETA 257 was a grain warehouse, and its receipts subject to public utility tax. The insurance charges were similarly taxed, and not classified separately under the service and other activities classification.

The taxpayer's insurance premiums are based upon the amount of fruit is has in cold storage. Its receipts for cold storage are subject to B&O tax under the warehousing classification per RCW

82.04.280(4). The insurance charges added by the taxpayer to its invoices for cold storage of perishable fruit are part of the gross income from cold storage, and therefore, should be taxed under the warehousing classification (RCW 82.04.280), rather than the service and other activities classification.

[3] ***Grading of pears.*** Subsection (2) of Rule 214 provides that persons who receive and otherwise prepare for sale, perishable agricultural products (fresh fruit) are subject to B&O tax except when such activities are performed for growers and thereby exempt under RCW 82.04.04287. Therefore, if we determine the receipts were from grading services performed for the growers, they would be exempt.

By giving fruit an appropriate grade, the taxpayer accepts the fruit on behalf of the cannery.[7] In this instance, "grading" equals "acceptance." It cannot "accept" the fruit to be delivered to the cannery, for the grower. In the capacity of grading acceptable fruit, the taxpayer acts as the cannery's agent, not the grower's agent. The cannery pays the taxpayer for this service, separating it from payments to the growers for their fruit.[8]

The taxpayer's role changes when it accepts the fruit payment as agent of the growers. It has a duty to them for the fruit payment. However, we must not confuse accepting money for the growers, with accepting fruit for the cannery. Rule 214 distinguishes for **whom** the services are performed. Because the cannery pays the taxpayer to grade (accept) pears on the cannery's behalf, and not on the growers' behalf, the grading payments are not exempt under RCW 82.04.4287. In this instance, it does not grade the pears for the growers.

DECISION AND DISPOSITION:

We deny the taxpayer's petition in part. The Audit Division correctly assessed B&O tax on the bin charges paid by other processors as well as on the taxpayer's receipts for grading pears from the cannery on whose behalf the taxpayer accepted the pears.

. . .

However, the assessment taxed the receipts billed as insurance under the wrong classification. We remand the assessment to the Audit Division to reclassify the receipts under the warehousing classification (RCW 82.04.280), rather than the service and other activities classification.

The Supreme Court's expected decision in *Simpson Investment Company, Inc.* should provide the guidance necessary for the taxpayer and the Audit Division to resolve the issue of whether the taxpayer was a "financial business." If the taxpayer and the Audit Division do not agree on this issue, the taxpayer should appeal this issue, [and] we will consider it with the benefit of the

[7] We distinguish this grading activity, which constitutes acceptance by a specific cannery, from that of grading and sorting fruit for the growers for future sale, where the taxpayer lacks any agency relationship with the buyer.

[8] The taxpayer is not compensated by the cannery for unacceptable fruit. The growers may pay the taxpayer to further process the fruit. Payments from growers for those services are not in dispute.

Supreme Court's interpretation, and any response the Audit Division and the taxpayer wish to make.

Dated this 9th day of June, 2000.