

Cite as Det. No. 97-093ER, 17 WTD 126 (1998)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For)	<u>F I N A L</u>
Refund of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 97-093ER
)	
...)	Registration No. ...

- [1] RULE 260; RCW 82.23B.040: OIL SPILL RESPONSE TAX -- EXPORT -- JET FUEL. Sellers of jet fuel must establish that the fuel was actually sold for export. Certificates of export signed by the purchaser who exported the fuel, documents the fact that the taxpayer sold the petroleum product for export.
- [2] RULE 260; RCW 82.23B.045: OIL SPILL RESPONSE TAX -- INGREDIENT -- COKE -- SULFUR. Gaseous products used as ingredients of sulfur are not eligible for the credit.

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:

Taxpayer appeals the denial of credits with respect to the oil spill response tax.¹

FACTS:

Pree, A.L.J. -- The taxpayer refines crude oil at its Washington refinery. It pays the oil spill response tax on the crude oil received at its marine terminal. The taxpayer sells various refined products including commercial jet fuel and sulfur in Washington. The taxpayer requests credits for those products be applied to its oil spill response tax.

The Audit Division of the Department of Revenue (Department) performed a partial audit of the taxpayer's records. It reviewed the purchases, receipts, sales, and exports of crude oil and petroleum products subject to the oil spill response tax. Regarding the jet fuel sales, the Audit Division agreed to allow an export credit if the taxpayer provided wing tickets showing delivery into the wing tanks for direct flights scheduled to points outside of Washington. However, the Audit Division denied

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

the credit for non-wing sales to the airlines because of the lack of documentation to ensure the fuel was used in planes flying directly out of Washington. The Audit Division also denied a petroleum ingredient credit for sales of sulfur. We issued Determination No. 97-093 upholding the denial of the export credit. We also denied the credit for petroleum products as ingredients of the sulfur. The taxpayer has petitioned for reconsideration of the denied export and sulfur ingredient credits.

Jet fuel. The taxpayer ships jet fuel by pipeline from its Washington refinery to a Washington airport (the airport). A third party stores the fuel at the airport. The airport lease requires any fuel brought into the airport leave in the tank of an airplane. The airport refuelers state they only deliver jet fuel by truck to the fuel tanks of aircraft of various airlines. Their trucks are not licensed for use on public highways, and do not leave the airport.

The taxpayer sells jet fuel to airlines using one of the following four methods:

1. Rack - Immediately after the refueler (agent of airline) picks up jet fuel from the airport terminal rack by truck, the taxpayer invoices the airline for the rack volume lifted. The refueler then delivers the jet fuel to the aircraft for the account of the airline. The refueler provides a report to the airline of the volume picked up and delivered for its account.
2. Wing - The refueler receives jet fuel from the airport terminal rack and delivers the fuel into the wing of an airplane. The refueler provides the taxpayer with a wing sales volume. The taxpayer invoices the airline customer based on this volume.
3. Airline Truck - The airline purchases jet fuel from the airport terminal rack. The airline's own refueling trucks deliver the fuel to the plane. The taxpayer immediately invoices the airline for this volume.
4. Hydrant System - Deliveries for some airlines to their underground storage tanks are made from the third party storage tanks via underground pipelines into a hydrant delivery system to fuel planes only. Volumes are metered into the underground airline hydrant system, and invoices by the taxpayer are based on the pipeline meter ticket volume.

The taxpayer provided the Audit Division certificates of export² from each airline. The taxpayer also provided affidavits from various airlines to verify the fuel was actually exported in the tanks of the aircraft. There is no indication the certificates provided by the airlines were not taken in good faith. Finally, the taxpayer states it did not claim a credit for jet fuel sold to airlines F.O.B. pipeline. That fuel was not necessarily exported through the airport. Because the fuel was not sold at the airport, it could be redirected, and not exported.

² The certificates originally provided to the Audit Division matched the language of the form certificates in WAC 458-20-260, word for word. Following the first hearing, the taxpayer provided additional certificates from the airlines to verify the amount and periods for which the fuel was exported.

The taxpayer did not separately state the tax on its invoices to the airlines. In other words, the airlines did not pay the tax. Therefore, only the taxpayer could take the export credit against the tax it paid. Also, under the language on the certificates the airlines agreed to be liable for tax on any products that were not exported.

The taxpayer requests credit for jet fuel sold to airlines at airport in cases where the airlines provided export certificates to show the percentage of fuel exported. The Audit Division only allowed a credit for the wing sales, contending that none of the other deliveries were immediately destined for export.

Sulfur. The taxpayer removes sulfur from crude oil and various feedstocks throughout the refining process. For every 1,000 barrels of crude oil, the taxpayer removes approximately 1.105 long tons of sulfur. The taxpayer states third parties use the sulfur to produce fertilizer and sulfuric acid. The taxpayer states that sulfur cannot be used as fuel because burning it produces the toxic substance, hydrogen sulfide. Selling or using petroleum products containing high levels of sulfur is prohibited by law.

We explained the sulfur refining process in detail in Determination No. 97-093. The information provided by the taxpayer, indicates the first step is to heat the crude oil. Heating separates "sour gases" containing hydrogen sulfide from other derivatives of the crude oil. The sulfur is derived from those sour gases.

The taxpayer requests a credit for the petroleum products used as ingredients of the sulfur. Credit was denied in the original determination because the sulfur was derived from the gas, not a liquid at normal atmospheric temperature and pressure. Determination No. 97-093 explained that to the extent the taxpayer could show the sulfur came from petroleum products as defined in the statute, the assessment could be revised. The taxpayer indicates some of the sulfur may be derived from liquid intermediate products, but has yet to submit any proof.

ISSUES:

1. How must taxpayers prove export sales to airlines for credit against the oil spill response tax?
2. May the taxpayer take an oil spill response tax credit for sulfur produced at its refinery?

DISCUSSION:

An oil spill response tax is levied upon the owner of crude oil or petroleum products upon the first receipt of the oil at a Washington terminal from a waterborne vessel or barge. RCW 82.23B.020 and .030. The taxpayer paid this tax on the crude oil that it refined in Washington. The taxpayer takes issue with the Audit Division's interpretation of the applicability of two credits against this tax in its situation.

[1] The first credit is statutorily authorized under RCW 82.23B.040, which provides:

Credit shall be allowed against the taxes imposed under this chapter for any crude oil or petroleum products received at a marine terminal and subsequently exported from or sold for export from the state.

The credit is not against a tax on an export activity as such. The taxpayer's activity should not be confused with the activity of placing goods in the export stream. That activity is exempt from business and occupation (B&O) tax under the Department's rules. See, WAC 458-20-193C and Coast Pacific v. Department of Rev., 105 Wn.2d 912, 719 P.2d 541 (1986). The taxpayer acknowledges its activity regarding the sale of jet fuel was not exempt from B&O tax. In most cases, the taxpayer did not deliver the fuel into the export stream. The taxpayer states it paid B&O tax on the jet fuel sales, and is not requesting a refund of B&O tax, only a credit for the oil spill response tax regarding the jet fuel exports. The taxpayer correctly stresses RCW 82.23B.040 is a statutory credit for product exported or sold for export, not an exemption from tax on the activity of selling for export.

The issue under consideration is whether the taxpayer is entitled to a credit from the oil spill response tax for products sold for export from the state. If the taxpayer proves it exported the fuel from the state, or the taxpayer proves that it sold the fuel for export, the taxpayer should be entitled to the credit. The Department, by rule, instructs taxpayers how to document that the product was exported. WAC 458-20-260 (Rule 260) provides in subsection (7)(d):

(d) A person claiming credit for sales for export under this subsection (7) must document the fact the product was placed into the export process. This fact may be shown by obtaining and keeping **any** of the following documentary evidence:

(i) A bona fide bill of lading in which the seller is the shipper/consignor and by which the carrier agrees to transport the product to the buyer at a destination outside this state; **or**

(ii) A written certification in substantially the following form:

Certificate of Export

I hereby certify that the crude oil or petroleum products specified herein, purchased by or transferred to the undersigned from (seller or transferor), have been received into the export stream and are for export for sale or use outside Washington state. I will become liable for any tax credit granted (seller or transferor) pertaining to any crude oil or petroleum products which are not so exported outside Washington state. This certificate is given with full knowledge of, and subject to the legally prescribed penalties for fraud.

Registration No.
(If applicable)

Type of Business

Firm Name.....

Registered Name
 (If different)

Authorized Signature

Title

Identity of Product
 (Kind and amount by volume)

Date ; or

(iii) . . .

(Emphasis supplied.)

The taxpayer considered the export certificates it provided sufficient proof for the credit. The jet fuel sold to airlines at the airport was exported to the extent acknowledged by the airlines on their certificates.

The Audit Division questions whether or not the taxpayer sufficiently proved it sold the jet fuel for export. The Audit Division only allowed the credit if the taxpayer demonstrated that its agents actually placed fuel into the tanks of planes making direct flights out of Washington. The Audit Division did not accept certificates of export signed after the audit period.

Rule 260 does not require the taxpayer to place the products into the export stream. Rule 260 only requires that the product enter the export stream. The taxpayer notes the certificates are written in the past tense, implying a product can enter the export stream after the sale. As long as the seller or buyer signing the certificate acknowledges the product was received into the export stream, absent bad faith, a sale for export has been documented.

Subsection (7)(d) of Rule 260 specifically states persons claiming the credit for export sales may establish the fact that the product was sold for export by obtaining and keeping export certificates. The taxpayer obtained and kept export certificates.

There has been no showing that the airline certificates were inaccurate or taken in bad faith. Under the terms stated on the face of the certificates, the airlines agree to be liable for any tax in cases

where the fuel is not exported. Only the taxpayer was entitled to claim the credit on the jet fuel sales at issue.³

Therefore, when a taxpayer sells jet fuel, the fuel will be considered to be sold for export when all of the following conditions exist:

1. The fuel is sold at the airport on the condition that it could only leave in the fuel tanks of planes; and
2. All of the fuel handlers at the airport are only allowed to deliver the fuel into the tanks of aircraft; and
3. The taxpayer obtains certificates of export taken in good faith from the airlines actually exporting the fuel on direct flights destined outside of Washington. Certificates taken from airlines with scheduled flights to destinations within Washington may not claim 100% of the fuel was for export or use outside of Washington state. Those certificates are not taken in good faith; and
4. The taxpayer paying the tax does not invoice its customers for the tax; otherwise, this could allow the customers to claim the credit.

The Audit Division will review the taxpayer's certificates and allow a credit when these conditions are met.

[2] RCW 82.23B.045(2) provides a credit for:

Any person having paid the tax imposed by this chapter who uses petroleum products as a component or ingredient in the manufacture of an item which is not a fuel may claim a refund or credit against the tax imposed by this chapter.

WAC 458-20-260(9)(b) simply states:

³ Subsection (7)(a) of Rule 260 anticipates that parties other than the person paying the tax may take the credit if the person taking the credit has been invoiced for the tax. Only the person paying the tax is entitled to claim credits against the tax. The person receiving the oil at the marine terminal may not claim the credit if that person passes the tax on as specifically stated in its invoices to its customers. The customers are then paying the tax, which is then held in trust to be remitted to the state by the person receiving the product at the marine terminal. Any such invoice must state the amount of the tax passed on to the purchaser and identify the product to which the tax amount relates by type and quantity. The taxpayer did not separately state the tax to its airline customers. Therefore, the airlines would not be entitled to the credit claimed by the taxpayer.

The use of petroleum products as a component or ingredient in the manufacture of an item which is not a fuel.

The definition of "petroleum product" for the oil spill response tax (Chapter 82.23B RCW) does not include crude oil, which is separately defined. RCW 82.23B.010(2). The definition of "petroleum product" here is also different from the definition used for the other excise taxes. See, e.g., RCW 82.21.020(2). RCW 82.23B.010(7)⁴ reads:

"Petroleum product" means any liquid hydrocarbons at atmospheric temperature and pressure that are the product of the fractionation, distillation, or other refining or processing of crude oil, and that are used as, useable as, or may be refined as a fuel or fuel blendstock, including but not limited to, gasoline, diesel fuel, aviation fuel, bunker fuel, and fuels containing a blend of alcohol and petroleum.

The fact that sulfur is not a fuel is undisputed. Therefore, the issue is whether the taxpayer used petroleum products as an ingredient or component of the sulfur. The sulfur was derived from sour gas emitted from the initial distilling of crude oil. The sour gases are not liquid hydrocarbons at atmospheric temperature and pressure. They are gaseous. Likewise, crude oil does not fall within the statutory definition of petroleum products because it is not the product of the fractionation, distillation, or other refining or processing of itself.

Because the ingredient from the crude oil appears to be sour gases, which are not liquid but gases at atmospheric temperature and pressure, the taxpayer does not qualify for the ingredient or component exemption when it produces sulfur in this manner. The taxpayer will be given an opportunity to provide proof that any liquid hydrocarbons, other than the crude oil itself, are ingredients in the sulfur.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. An export credit will be allowed where the taxpayer has provided export certificates that meet the conditions outlined above. That is, when the taxpayer placed the fuel in the tanks of planes destined outside of Washington or when sales were made to airlines and handled in a way exclusively attributable to products sold for export as discussed above.

The credit for sulfur is denied except to the extent the taxpayer proves liquid hydrocarbons were ingredients.

DATED this 28th day of December, 1997.

⁴ RCW 82.23B.010 was amended in 1992. Subsection (7) was unchanged, however.