

Cite as Det. No. 99-113, 19 WTD 85 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 99-113
)	
...)	Registration No. . . .
)	FY. . . /Audit No. . . .
)	

[1] RULE 244; RCW 82.08.0293: RETAIL SALES TAX – EXEMPTION -- FOOD – HERBS AND HERBAL EXTRACTS – DIETARY SUPPLEMENTS OR ADJUNCTS. If a bulk herb or herbal extract is “commonly and reasonably” expected to be used only as a dietary supplement or for medicinal purposes, it is subject to tax. In contrast, bulk herbs or herbal extracts that are “commonly and reasonably” expected to be used as a cooking ingredient, spice or tea are exempt food products. In determining whether an item is commonly and reasonably to be used for medicinal or dietary supplement purposes, the packaging of the item may be important.

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:

Retailer of bulk herbs, herbal extracts, and teas protests the assessment of retail sales tax on these items.¹²

FACTS:

C. Pree, A.L.J. (successor to Rene, A.L.J) -- The taxpayer is a retail store which sells bulk herbs, herbal extracts, teas, spices, oils, vitamins, books, cosmetics, skin care products, and miscellaneous other products. According to the Audit Division, the taxpayer combines various herbal extracts and labels and sells the extracts “for a perceived health benefit.”

¹Nonprecedential portions of this determination have been deleted.

²Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

The taxpayer was audited for the period of January 1, 1991, through December 31, 1994. The audit resulted in an assessment of retail sales tax or \$. . . , use tax of \$. . . , and interest of \$. . . . The assessment totaled \$. . . . The taxpayer does not protest the use tax assessment.

The taxpayer protests the assessment of sales tax on herbal extracts, combinations of herbal extracts, and bulk herbs used for teas. The taxpayer states that prior to September 1993, it was not collecting sales tax on sales of these products because it had been told in telephone conversations with the Department that these items were not subject to sales tax. After the Department published an article in Tax Topics in September 1993, the taxpayer assumed the law had changed and began collecting and paying retail sales tax on its herbal extracts, combinations of herbal extracts, and bulk herbs used for teas. The Audit Division relied on the article, in large part, in assessing retail sales tax for periods prior to September 1993.

The Tax Topics article provides in part as follows:

Herbs, herbal extracts, and other preparations which are taken in addition to natural or processed foods to supplement regular diets or provide for special needs are subject to retail sales tax. This includes any edible item sold for medicinal purposes. The form in which the preparation is sold is immaterial.

. . .

Included in the definition [of food products] are herbs, spices, and health foods. Thus, these items are generally not taxable.

Vitamins, tonics, and dietary supplements and adjuncts are specifically excluded from the definition of food products by both the law and the rule. Thus these items are taxable. . . .

[Based on Rule 244 it] might initially appear, therefore, that herbs and herbal extracts are exempt from retail sales tax even when they are sold as dietary supplements. However, it is a rule of law that exemptions from tax must be narrowly construed. With this in mind, the Department of Revenue has determined that the law does not extend the sales tax exemption to edible items, which are ingested for medicinal or other special purposes.

Thus, retail sales tax applies to any edible item sold for medicinal or other special purposes. Retail sales tax does not apply to any otherwise nontaxable food item which is sold merely for its nutritional value and/or because it tastes good. This means that in some cases the same product will be taxable in a different manner depending on how it is packaged and sold. For example, garlic packaged and sold, as a seasoning is exempt from retail sales tax. Garlic packaged and sold to control high blood pressure is subject to retail sales tax.

For a more detailed discussion of this issue, please see the Department's published determination, Det. No. 93-016, 12 [sic] WTD ____ (1993).

In assessing the tax, the Audit Division reasoned that the September 1993 Tax Topics article was a clarification of the law and not a law change. The Audit Division summarized its understanding of the article as stating that herbs, herbal extracts, and other preparations which are taken in addition to natural or processed foods to supplement regular diets or provide for special needs are subject to retail sales tax. Herbs, which are sold as food items, are not subject to retail sales tax. Thus, under the Audit Division's understanding, herbs and extracts sold as cooking ingredients, flavoring, snacks, or simply because they taste good, are not subject to retail sales tax.

Based on the Audit Division's understanding of the article, the Audit Division disallowed the taxpayer's exempt food deduction with respect to the portion of products the Audit Division determined to be nonfood items. The Audit Division explained, "These sales have been disallowed since they are sold for perceived health benefits and not as a food or food flavoring." However, the taxpayer's accounting records did not allow for a separation of items sold by product. The Audit Division estimated that 35 percent of the taxpayer's sales were taxable and 65 percent were nontaxable. (The Audit Division agreed to adjust the percentage if the taxpayer provided documentation of actual product sales.)

In support of its claim of a retail sales tax exemption for its sales of herbs and herbal extracts, the taxpayer relied on the following statement in WAC 458-20-244 (Rule 244):

Such substances as dried milk, powdered spices and herbs, brewers yeast, desiccated liver, powdered kelp, herbal extracts, and the like are not dietary supplements or adjuncts subject to tax."

(Emphasis the taxpayer's.)

The taxpayer notes that the industry is very confused regarding its tax reporting obligations in this area. Further, the taxpayer notes that in Det. No. 93-16, 13 WTD 170 (1993), the Department did not assess tax on herbal extracts. Instead, it simply imposed tax on herbs that were in capsules. The taxpayer recites the following portion of that determination: "[The taxpayer] states that the powdered herbs are being taxed but herbal extracts are not." The taxpayer responds:

Why would this retailer state that herbal extracts are not taxed if he was being assessed for back taxes on herbal extracts? In reading Det. No. 93-016, . . . we find the Department of revenue did not determine the store owed back taxes on herbal extracts. If you review this case, you will find the Department of Revenue was only assessing back taxes on capsule herbal products and not on herbal extracts.

The taxpayer concludes:

We are requesting that the Department of Revenue eliminate any back taxes they feel [the taxpayer] owes on herbal extracts and bulk herbs. [The taxpayer] has acted responsibly and should not be penalized for the Department of Revenue's lack of clarity in the determination of these rules.

ISSUE:

Whether the taxpayer's sales of herbal extracts and bulk herbs qualify for the exemption for food products set forth in RCW 82.08.0293.

DISCUSSION:

RCW 82.08.0293 provides in pertinent part as follows:

The tax levied by RCW 82.08.020 shall not apply to sales of food products for human consumption.

"Food products" include . . . spices and salt, sugar and sugar products, coffee and coffee substitutes, tea, cocoa and cocoa products. . . .

"Food products" do not include medicines and preparations in liquid, powdered, granular, tablet, capsule, lozenge, and pill form sold as dietary supplements or adjuncts.

WAC 458-20-244 (Rule 244) is the administrative rule interpreting the exemption. It provides in pertinent part as follows:

[T]he intent [of the law] is to tax such product sales or exempt them from tax in a uniform and consistent manner so that the tax either applies or not equally for all sellers and buyers. Generally, it is the intent of the law . . . to provide the exemption for groceries and other unprepared food products with some specific exclusions. . . .

"Food products" means only substances, products, and byproducts sold for use as food or drink by humans. The term includes, but is not limited to, the following items: . . .

Diet food, not including dietary supplements or adjuncts . . .

Extracts and flavoring for food . . .

Spices and herbs . . .

Tea . . .

"Nonfood products" means certain substances, which may be sold at food, and grocery stores and which may be ingested by humans but which are not treated as food for purposes of the tax exemptions. Tax exempt food products do not include any of the following nonfood products:

Dietary supplements or adjuncts as defined below . . .
 Nonprescription medicines . . .
 Tonics, vitamins . . .

"Dietary supplements or adjuncts" are medicines or preparations in liquid, powdered, granular, tablet, capsule, lozenge, or pill form taken in addition to natural or processed foods in order to meet special vitamin or mineral needs. Dietary supplements or adjuncts are not food products entitled to tax exemption Such substances as dried milk, powdered spices and herbs, brewers yeast, desiccated liver, powdered kelp, herbal extracts, and the like are not dietary supplements or adjuncts subject to tax

In Martinelli v. Department of Revenue, 80 Wn. App. 930, 938, 912 P.2d 521 (1996), the Washington Court of Appeals construed the term "carbonated beverage" for purposes of the exclusion of carbonated beverages from the food products exemption.³ The court found that carbonated fruit juices were subject to tax. In reaching its conclusion, the court provided guidance to be followed in construing the statute:

Where a term is not defined in a statute and no contrary intent is apparent in the statute, an appellate court should give the term its ordinary meaning. Nontechnical terms may be given their dictionary definitions. The court may use the ordinary dictionary definition when a term, including a compound term, is not defined in a statute.

(Citations omitted.) The court also determined that the narrow rule of construction applicable to exemptions applies to the food products exemption. 80 Wn. App. at 940.

Webster's New Unabridged Dictionary provides the following definitions:

Herb . . . 1. any seed plant whose stem withers away to the ground after each season's growth, as distinguished from a tree or shrub whose woody stem lives from year to year. 2. Any such plant used as a medicine, seasoning, or food: mint, thyme basil, and sage are herbs.

Herbal . . .pertaining to herbs.

³The court was construing the use tax exemption for food products. RCW 82.12.0293. However, that statute is substantially the same as the retail sales tax exemption provision.

Extract . . . 3. A concentrated form, whether solid, viscid, or liquid, of a food, flavoring, etc.; as vanilla *extract*.

(Emphasis original.)

The taxpayer relies on Det. No. 93-16, supra, in support of its argument that herbal extracts are exempt from tax. As the taxpayer notes, in that determination, we understood that retail sales tax was not assessed with respect to the taxpayer's sales of herbal extracts. That determination involved a taxpayer that operated a health-food store, which included in its inventory dried and powdered herbs. The products were sold in bulk, in glassine envelopes and in capsules. The protested sales involved products that contained only the dried or powdered herbs. The items at issue were sold in bottles carrying the notation "Guaranteed Pure Herb Food" or "100% Pure Herb Food." Some or all of the products were sold as combinations for weight loss or control and waste elimination. The items were pyssillum musk (in capsules and in bulk), butternut blend capsules, passionflower capsules, chickweed capsules, and echinachea capsules.

We analyzed the issue as follows:

Vitamins and minerals are subject to tax. RCW 82.08.0293 states that tax-exempt food products do not include "preparations in . . . powdered, . . . capsule . . . and pill form sold as dietary supplements or adjuncts." However, the statute also includes spices in its "nonexclusive" list of exempt food products.

Rule 244 expands on the statute to explain the application of the law. It has not been overturned by a court. There has been no amendment to RCW 82.08.0293 indicating that the legislature concluded that Rule 244 exceeded its original intent. Rule 244 clearly states, without qualification, that the exemption applies to "spices and herbs." . . .

In the taxpayer's case, the herbs are natural products, which humans can ingest. Nothing is being done to them other than drying them and turning them to powders for addition to food, addition to water as teas and other drinks, or powders put into capsulized form so they can be taken alone. They are not being changed in content, only in form, from their natural state. It is also true, as shown in The People's Herbal, The Healing Herbs, and The Healing Foods, that many popular spices and herbs, as do other foods, have perceived health benefits: thyme is used mainly as a seasoning, but it also has antiseptic, expectorant and bronchodilator effects and releases gas, making it effective for use in colic and flatulence; ginger can be used to relieve pain; garlic can lower blood pressure, relieve insect stings, and earaches; cayenne pepper is used as a laxative.

However, it is a rule of law that exemptions to a tax are narrowly construed; taxation is the rule and exemption is the exception. Budget Rent-a-Car vs. Department of Rev., 81 Wn.2d 171, 174 (1972). In this case, the legislature clearly did not extend the sales tax exemption to

every item that could possibly be ingested safely by humans. Here, we are persuaded by the literature and taxpayer's comments that they are being used for their perceived health benefits, not as a source of food.

We note, finally, that the rule separates vitamins, medicines and preparations which are taken for special purposes from spices and herbs:

(c) "Dietary supplements or adjuncts" are medicines or preparations in liquid, powdered, granular, tablet, capsule, lozenge, or pill form taken in addition to natural or processed foods in order to meet special vitamin or mineral needs.

We find the taxpayer's foods are "preparations" which are being taken in addition to natural or processed foods in order to meet supplement diets or provide for special needs. . . .

We find that the legislature has made the decision to draw the tax-exemption line between preparations taken in addition to the foods eaten for flavor, nutrition, or survival. Because tax exemptions must be narrowly construed, we do not believe we have the authority to speak for the legislature in interpreting this statute more broadly, particularly where the legislature has not disturbed Rule 244, the administrative rule implementing its action.

Thus, as the taxpayer notes, Det. No. 93-16 accepted the taxpayer's statement that its herbal extracts were not being subjected to tax. The determination did nothing to clarify that this treatment of herbal extracts might have been incorrect. Further, herbs and herbal extracts are specifically listed in the rule as exempt, without clarification that the exception to exemption for medicine and dietary supplements may preclude exemption. Thus, for periods prior to the date of the determination issued to the taxpayer in this case, we find that the taxpayer acted reasonably in not charging sales tax on herbs and herbal extracts.

Det. No. 94-047, 14 WTD 210 (1995), provides additional guidance for determining whether a particular item is exempt under RCW 82.08.0293. In that determination, the Department held that certain items sold by a retailer of home brewing supplies were exempt food products. We reasoned:

In the ordinary sense, a food product which is not commonly or reasonably expected to be used for human consumption would not be entitled to the exemption. For example, although some animal feed may be consumed by humans, it is not packaged and sold for human consumption. As such, it is not reasonably or commonly considered to be used for human consumption. A seller, however, is not required to inquire as to the intended use of the food product in order for the exemption to apply.

. . .

Accordingly, whether the items are sold at a home brewer's store or a grocery store is not determinative, it is the nature of the item being sold that is controlling. We do not look at where and how an item is sold, but whether the item is an unprepared food item, which falls

within the scope of the exemption. To be consistent, if the item is exempt for one seller it is exempt for other sellers of the same product.

...

Given the statutory provision that the retail sales tax "shall not apply to sales of food products for human consumption" and the express intent that distinctions are not made on "how and where" the food product is sold, we must construe the exception for beer and wine making supplies as applying only to those items which are not also commonly and reasonably expected to be ingested by humans for nourishment. If an item is only used in beer and wine making, it is subject to retail sales tax.

In the present case, bulk items such as corn sugar, gelatin, and whole grains are clearly exempt. Similarly, the unhopped-malted grains, which are commonly used in making breads, are exempt from sales tax. Brewer's yeast is also exempt.⁴

Thus, while we note that herbs and herbal extracts are specifically included as exempt items in the rule, the rule also provides that dietary supplements are subject to tax. In harmonizing these two provisions, we find that if a bulk herb or herbal extract is "commonly and reasonably" expected to be used only as a dietary supplement or for medicinal purposes, it is subject to tax. In contrast, bulk herbs or herbal extracts that are "commonly and reasonably" expected to be used as a cooking ingredient, spice or tea are exempt food products. In determining whether an item is commonly and reasonably to be used for medicinal or dietary supplement purposes, the packaging of the item may be important. For example, as we held in Det. No. 93-16, herbs sold in capsules would not be entitled to the exemption. These items would not "commonly and reasonably" be expected to be used as a cooking ingredient, spice, or tea. See Det. No. 94-47.

In summary, if the herbs and herbal extracts are not commonly used as cooking ingredients, spice, or tea, or if they are packaged and labeled as sold for medicinal or dietary supplement purposes, they would be subject to retail sales tax. If the items are commonly used for cooking ingredients, spices, or teas and they are not packaged and labeled as sold for medicinal or dietary supplement purposes, they would not be subject to tax. For example, garlic sold in bulk would not be subject to tax, because it is commonly used as a cooking ingredient, and it is not packaged or sold as for medicinal dietary supplement purposes. However, garlic sold in capsules would be subject to tax because its packaging indicates it is being sold for dietary supplement or medicinal purposes, rather than flavoring.

DECISION AND DISPOSITION:

⁴Brewer's yeast is identified under the food exemption rule as an item which is not to be considered a food supplement and which is subject to the deduction.

The taxpayer's petition for correction of assessment of the retail sales tax assessment is granted.
The unprotested use tax portion of the assessment is sustained.

Dated this 30th day of April 1999.