

Cite as Det. No. 99-198, 19 WTD 463 (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. 99-198 ¹
)	
...)	Registration No. . . .
)	FY. . . /Audit No. . . .
)	FY. . . /Audit No. . . .

[1] RULE 210 & RULE 136: B&O TAX – AGRICULTURAL EXEMPTION – LIQUID EGGS. The production of liquid eggs is the creation of a new, different, and useful substance. Notwithstanding the fact that a farmer does not combine liquid eggs with anything, (s)he loses the agricultural B&O exemption because (s)he engages in a manufacturing activity.

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:

Farm claims agricultural B&O exemption for liquid eggs.²

FACTS:

Dressel, A.L.J. – [Taxpayer] is a large farm. Its books and records were examined by the Department of Revenue (Department) for the period January 1, 1993 through September 30, 1997. As a result in Audit No. . . . , a tax assessment of \$. . . was issued. Audit No. . . . was also issued in the amount of \$. . . . The taxpayer appeals portions of both audits.

Chickens on the taxpayer's farm produce eggs. Most of the eggs are sold in the shell, but some are sorted out, shelled, heated to kill bacteria (pasteurized), pressurized for uniformity of texture (homogenized), and packed and sold as liquid eggs. Liquid eggs are produced, primarily, from eggs, which are in some way less marketable, or not marketable, as contrasted to eggs sold in the shell. Eggs which are checked (with fractures in the shell), are identified electronically (with

¹ The reconsideration determination, Det. No. 99-198R, is published at 19 WTD 468 (2000).

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

machinery) at the agricultural (or whole egg) plant, and are segregated and moved to the egg cracking operation to become liquid eggs. Also, smaller eggs may be used for liquid eggs and, more recently, a small quantity of eggs may be purchased off the farm for this purpose, as the demand indicates.

The liquid eggs produced on the farm go through the same process as the agricultural eggs. That is, they travel through the agricultural egg plant, being washed and inspected before they are identified and segregated for delivery to the nearby egg cracking plant, to be turned into liquid eggs.

Upon reaching the egg cracking plant, the outer shells are cleaned and placed on a breaking wheel, where the eggs are, again, inspected for blood (interior to the egg) and cracked by machine. The cracked eggs (yolk and white) are put through a fine tubular screen to remove any shell fragments, after which they move through a series of refrigerated pipes. They are then put through a process of pasteurizing (heated to kill bacteria) and homogenizing (to emulsify yolk and white).

The liquid eggs are then packaged in 30 pound bags (primarily) or buckets. This is equivalent to approximately 30 dozen eggs, or 1.1 dozen eggs per pound. Some of the liquid egg product is frozen. The shelf life of the refrigerated liquid eggs is approximately 21 days, whereas frozen "liquid" eggs last indefinitely. About 10% of the liquid eggs are frozen. Agricultural eggs (uncracked) have, approximately, a 90 day shelf life. The liquid eggs are sold, primarily, to bakeries and restaurants. An advantage of the liquid eggs, as opposed to whole eggs, is that the former is easier to ship.

In the audits the Audit Division of the Department deemed the taxpayer's production of liquid eggs a manufacturing activity, taxable under the Manufacturing classification of the business and occupation (B&O) tax. It reasoned that the taxpayer had produced "a new different, or useful substance."

The taxpayer, however, claims its sales of liquid eggs should be exempt of the B&O tax, as farm products sold at wholesale, per RCW 82.04.330. It contends, in essence, that it hasn't manufactured anything; rather, it has just removed the shell from whole eggs. It analogizes this operation with husking corn, cutting the tops off carrots, peeling onions, podding peas, and trimming asparagus and broccoli. The taxpayer claims those activities are not considered by the Department to be manufacturing, so producing liquid eggs should not be, either. In addition the taxpayer claims that the agricultural exemption of RCW 82.04.330 should be allowed unless a farmer uses his or her crops "as ingredients in a manufacturing process." The taxpayer claims that while its customers may do that down the line at a bakery or restaurant, the taxpayer does not; therefore, it is entitled to the exemption.

ISSUE:

Are sales of liquid eggs exempt from B&O tax under the agricultural exemption of RCW 82.04.330?

DISCUSSION:

Exemptions to a tax are narrowly construed; taxation is the rule and exemption is the exception. *Budget Rent-a-Car, Inc. v. Dept. of Revenue*, 81 Wa.2d 171, 174, 500 P.2d 764 (1972). *See also Dept. of Revenue v. Schaafe Packing Co.*, 100 Wa.2d 79, 83, 666 P.2d 367 (1983).

Statutes providing for the raising of revenue required by the state in carrying on its functions are vital to its welfare, and a person, natural or artificial, should not be declared exempt from the payment of a tax required of business generally, unless it clearly appears that the constitution and laws of the United States (or of the state) require such exemption.

North Pacific Coast Freight Bureau v. State, 12 Wa.2d 563, 122 P.2d 467 (1942), quoting with approval from *Fisher's Blend Station v. State Tax Commission*, 182 Wash. 163, 45 P.2d 942 (1935).

The exemption statute under consideration here is RCW 82.04.330.³ It reads, in part: **“Exemptions--Farmers--Agriculture.** This chapter shall not apply to any farmer that sells any agricultural product at wholesale. This exemption shall not apply to any person selling such products at retail.” “Agricultural product,” in turn,

. . . means any product of plant cultivation or animal husbandry including, but not limited to: A product of horticulture, grain cultivation, vermiculture, viticulture, or aquaculture as defined in RCW 15.85.020; plantation Christmas trees; turf; or any animal including but not limited to an animal that is a private sector cultured aquatic product as defined in RCW 15.85.020, or a bird, or insect, or the substances obtained from such an animal.

RCW 82.04.213. Thus, the natural egg of a chicken qualifies as an agricultural product. Subsection two of the same statute defines “farmer.” “ ‘Farmer’ does not include a person using such products as ingredients in a manufacturing process” Id.

The taxpayer cites several dictionary definitions for the proposition that “ingredients” are “a number of diverse items which are combined, as in baking.” It argues that the B&O tax should not apply to eggs “unless and until they are combined with other elements.” Since the taxpayer only separates the shell from the rest of the egg and does not combine what is left with anything else, it takes the position that it is not disqualified as a “farmer,” according to the statutory definition.

³ See also WAC 458-20-210.

In stressing this theory, the taxpayer overlooks the definition of “to manufacture,” found elsewhere in Chapter 82.04 RCW. RCW 82.04.120 reads, in part:

"To manufacture" embraces all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use

RCW 82.04.120 is implemented by WAC 458-20-136 (Rule 136), which, after repeating the above definition, goes on to state:

It [to manufacture] means the business of producing articles for sale, or for commercial or industrial use from raw materials or prepared materials by giving these matters new forms, qualities, properties, or combinations. It includes such activities as 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 . . .

[1] Liquid eggs have a new form, certainly, as compared to whole eggs. They are liquid and contained in large bags or buckets, as contrasted to whole eggs in their familiar shells. They have a different utility as well in that they are suitable for large, commercial baking operations. Liquid eggs can be transported in quantity more easily than “conventional” eggs. Bakers can simply pore a bucket or bag of liquid eggs into their baking mixture, a process that is infinitely more convenient than cracking individual eggs and adding them one at a time. Liquid eggs have developed a specialized market. To this market they are “a different or useful substance.” See RCW 82.04.120, *supra*. See also *Bornstein Seafoods, Inc. v. State*, 60 Wa.2d 169, 373 P.2d 483 (1962).⁴

While we acknowledge that if one read only RCW 82.04.213, one might be left with the impression that the only way a farmer could disqualify him or herself as a farmer would be if he or she *combined* an agricultural product with other substances, but if one takes a broader view of the statutory scheme, one doesn’t necessarily reach that same conclusion. It is a well-known principle of statutory construction that statutes are to be construed, wherever possible, so that no clause, sentence or word shall be superfluous, void, or insignificant. *UPS v. Dept. of Revenue*, 102 Wa.2d 355, 361, 362, 687 P.2d 186 (1984). All of the provisions of the act must be considered in their relation to each other and, if possible, harmonized to insure proper construction of each provision. *Burlington Northern v. Johnston*, 89 Wa.2d 321, 326, 572 P.2d 1085 (1977). We harmonize the exemption and the definition of “to manufacture” to conclude that a farmer will retain the exemption of RCW 82.04.330, if the farmer, otherwise, qualifies under that statute *and* does not

⁴ In *Bornstein* the Washington Supreme Court found that the proper test to determine whether the process of preparing certain food products for sale falls within that portion of this section [RCW 82.04.120] embracing the application of labor or skill to produce a new, different, and useful article, is whether significant change has been accomplished in the end product, that is, as it appears at the time it is released by one performing the process, when compared with the article before it was subjected to the process.

conduct a manufacturing activity with the agricultural product in question. This taxpayer's production of liquid eggs *is* manufacturing, therefore, its sale of same is *not* exempt of the B&O tax.

Our conclusion vis-a-vis the agricultural exemption and manufacturing is consistent with previous authority. For instance, in *Stokley-Van Camp, Inc. v. State*, 50 Wa.2d 492, 312 P.2d 816 (1957), the court found that a corporation, which was engaged in business of preparing fresh fruit and vegetables for packaging and freezing, actually packaging and freezing them, and selling them at wholesale, was liable for payment of business and occupation tax as a manufacturer. According to ETA 241.04.136, the brine curing, washing, pitting, sizing, and sorting of cherries is manufacturing. *Det. No. 88-155*, 5 WTD 179 (1988), holds that the processing of raw hops into hop pellets and hop extract creates a new, different, and useful article. Not to be forgotten is the famous pea-splitting case, *McDonnell and McDonnell v. State*, 62 Wa.2d 553, 383 P.2d 905 (1963), wherein the Supreme Court concluded that splitting peas is manufacturing. *See also* ETA 174.04.136. Each of these taxpayers, handling agricultural products, was found to be manufacturing and liable for the B&O tax. Arguably, none of them altered their particular agricultural commodity very much, yet each was deemed a manufacturer.

We agree with the taxpayer that it is difficult to know where to draw the line in this area. Why should the husking of corn and the topping of carrots not be manufacturing when the aforementioned activities are manufacturing? We suggest that it is a matter of degree. Husked corn and topped carrots are not very different from those same vegetables, *au naturel*. Liquid eggs, certainly, bear less of a resemblance to whole eggs and, as previously stated, have a different utility. While certain generalizations may be relied upon in making these judgments, we sense that rulings on whether agricultural products are manufactured will continue to be made on a case-by-case basis. As to liquid eggs, we conclude that they are manufactured.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 23rd day of June 1999.