Cite as Det No. 09-0209, 30 WTD 28 (2011)

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. 09-0209
	)	Registration No. . . .
	)	Document No. . . . ./Audit No. . . .
	)	Docket No. . . .

[1] Rule 214; RCW 82.04.4287: B&O TAX -- EXEMPTION — COMPENSATION FOR RECEIVING, WASHING, ETC., HORTICULTURAL PRODUCTS FOR PERSON EXEMPT UNDER RCW 8.04.330. Only income derived from washing, sorting, packing for growers directly is exempt from B&O tax under RCW 82.04.4287. Income from sorting and packing of apples for a fruit packing house is not exempt from B&O tax under RCW 82.04.4287 where the fruit packing house and the grower of the fruits were affiliated entities.

[2] RCW 82.04.280; WAC 458-20-182 – COLD STORAGE WAREHOUSE
Fruit storage is a separate business activity from receiving, washing, sorting, and packing fruits. Thus income derived from such activity is subject to the warehousing B&O tax under RCW 82.04.280 regardless of whether the taxpayer separately charges its customers on the cold storage services.

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.

Callahan, A.L.J. – A fruit packing house (Taxpayer) asserts that its fruit sorting and packing income is exempt from the service and other activities ("service") business and occupation (B&O) tax, alleging that its income was compensation for the "receiving, washing, sorting, and packing" of fruit from a grower. It also protests the warehousing B&O tax assessed on amounts derived from its storage of fruit claiming that this activity was not a separate business activity from its fruit sorting and packing business. Taxpayer also protests the deferred sales tax/use tax assessed on fruit bin rentals. We deny the petition.[1]

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

ISSUES

(1) Was Taxpayer's income from sorting and packing of apples for a fruit packing house exempt from B&O tax under RCW 82.04.4287 where the fruit packing house and the grower of the fruits were affiliated entities?

(2) Was Taxpayer's cold storage of fruit a separate activity from "receiving, washing, sorting, and packing" of fruit and thus subject to the warehousing B&O tax under RCW 82.04.280 or were they incidental to the sorting and packing activities?

(3) Was Taxpayer subject to the deferred sales tax/use tax on fruit bin rentals under WAC 458-20-210 (Rule 210)?

FINDINGS OF FACT

Taxpayer is a fruit packing house that sorts, packs and stores apples in Washington. The Department's Audit Division examined Taxpayer's books and records for the period of January 1, 2004 to December 31, 2007. Consequently, the Audit Division issued an assessment against Taxpayer on July 8, 2008 in the amount of $. . . . Taxpayer did not pay the assessment but petitioned the Department's Appeals Division for a correction of assessment. While the appeal was pending, the Audit Division issued a post audit adjustment (PAA) on July 22, 2009 based on the additional information Taxpayer submitted[2].

Taxpayer packs and stores fresh apples for its customers. The apple packing process begins with Taxpayer's customers putting their apples in bins Taxpayer placed in the orchards. Some bins were purchased by Taxpayer and some were provided by Taxpayer's customers. According to Taxpayer's website, Taxpayer dumps the apples from the bins into water in the pre-size line. . . . The apples are moved through a water flume of about 30 feet. The apples are then moved through the line without water in cup holders. Taxpayer sorts the apples for debris before it applies a fungicide mist treatment on them. Taxpayer dries the apples under fans and sorts them.

As we understand it, Taxpayer moves the apples into bins after the sorting process and places the apples in either controlled atmosphere storage or cold storage rooms. The apples in controlled atmosphere storage are treated with chemicals designed to extend the storage life of the apples and to prevent storage defects. During the controlled atmosphere storage process, the controlled atmosphere rooms are sealed, cooled, and the atmosphere is altered. The controlled atmosphere storage process arrests the ripening and natural deterioration of the apples for extended periods of time, up to ten or more months. The apples have to be placed in the controlled atmosphere storage for a minimum of 60 days before they are . . . packed for final distribution to growers.

[2] Taxpayer originally appealed the use tax/deferred sales tax on capital assets it purchased. The PAA is a reflection of the use tax/deferred sales tax on capital assets adjustment.

When the apples are ready for packing, they are removed from either cold storage or controlled atmosphere storage in the bins in which they were stored. The apples are removed from the bins, rinsed, and then washed in a solution with brushes. The apples are then dried and food grade wax is applied. The apples are then sorted according to various standards and placed in containers for shipment.

. . . According to the auditor's report, Taxpayer contracted with [a packing house] to sort and pack apples for growers. According to Taxpayer, it sorted and packed apples grown by [Company A]. Taxpayer states that [the packing house and Company A] are affiliated entities . . and [the packing house] "loaned funds to [Company A]" by paying Taxpayer directly for Taxpayer's sorting and packing of the apples at issue. Taxpayer also asserted in its August 5, 2008 petition to the Department that "[t]he payment is processed through another packing house. The service is for farmers but not the packer. The packing house merely loans funds from the farmer's account to pay for the washing and sorting. The packing house loans money to the farmer who pays [Taxpayer] to sort and wash." At hearing, Taxpayer alleged that growers, such as, [Company A] reimbursed . . . packing houses for the payments to [fruit-growing houses such as] Taxpayer through a "settlement" process where the packing houses deduct those costs from the amounts it pays the growers. Taxpayer claims, however, that it was sorting and packing apples for [Company A] (the grower) not for [the packing house] notwithstanding that [Company A] paid Taxpayer for these services.

During the audit period, Taxpayer reported these payments under the processing for hire B&O tax classification. Audit reclassified Taxpayer's income for sorting and packing apples from the processing for hire B&O tax classification to the service B&O tax classification. Taxpayer disagrees with the reclassification and further contends that it reported under the processing for hire B&O tax classification in error. Taxpayer asserts that income from its sorting and packing activities is exempt from B&O tax under RCW 82.04.4287 and WAC 458-20-214 (Rule 214) because the income was derived from "receiving, washing, sorting and packing" of fresh fruit for a grower ([Company A]). Taxpayer argues that the grower, [Company A], directed the apple sorting and packing process and it washed the apples as specified by the grower. Audit disagreed with Taxpayer, finding that Taxpayer sorted and packed the apples at issue for [the packing house], who was not the grower. Thus, Audit found simply because Taxpayer packed fruit for other packing houses, such as [the packing house], which in turn contract with growers to pack their fruit does not mean Taxpayer is packing fruit directly for the growers. Audit concluded that the packing is done for and paid for by other packing houses . . . not the growers,.

Taxpayer also stores apples for its customers. Audit advised Taxpayer that storage of the apples is a separate business activity taxable under the warehousing B&O tax classification. Audit assessed warehousing B&O tax, based on Taxpayer's costs to supply warehousing to its customers using a value representative of the industry. Audit explains that per bin charges for packing in the industry is about $85. The bin storage charge was allocated at $25 per bin based on conservative figures from the Washington Shipper/Growers.

Taxpayer objects to the assessment of B&O tax under the warehousing classification stating that it does not separately provide storage services to its customers and it does not bill its customers

for fruit storage. This, according to Taxpayer, is because storing the apples is incidental to the sorting and packing services it provided its customers. Further, Taxpayer claims it benefits from the storage, not the growers. Taxpayer asserts that it must store the apples due to their perishable nature while they are being processed for sale because it cannot pack or sell all of the fruit in a short timeframe. In short, Taxpayer asserts its fruit storage activity is not a separate warehousing and storage activity but rather it is incidental to its "receiving, washing, sorting, and packing of fruit" activity, which will be exempt from B&O taxation under RCW 82.04.4287 if the services are rendered to growers. Taxpayer asserts that was the case here with [the packing house] where the fruit washing and sorting services were actually rendered to a grower not [the packing house].

Audit also taxed Taxpayer on the use tax/deferred sales tax on fruit bins. Audit states although growers used the bins when they put the apples in them, the growers' use of the bins for the short period of time in the orchard was incidental to Taxpayer's use. Audit concluded that the bins were under Taxpayer's control for use in the receiving and storage of fruit and thus use tax/deferred sales tax is due on the bins pursuant to Rule 210. Taxpayer agrees that it was subject to use tax/deferred sales tax for bins that it purchased, but not for those that were owned by the growers. Taxpayer states that sometimes growers use their own fruit bins in their orchards and they bring the fruit to Taxpayer for sorting and packing with their own fruit bins. Taxpayer states it issued checks to growers for the fruit bins that were owned by them rather than applying credits to the customers' account. Taxpayer states that the checks were mistaken by Audit as payments for the rental of the fruit bins from its customers. Taxpayer provided copies of general ledgers from two growers . . . that showed depreciation schedules for fruit bins.

ANALYSIS

[1] The B&O tax is imposed for the privilege of engaging in business and is measured by the gross income of a business. RCW 82.04.220. RCW 82.04.220 states:

> There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

Therefore, any person engaged in business in Washington is subject to B&O tax unless it is entitled to an exemption. RCW 82.04.4287 provides for an exemption from tax for income received for the packaging of fresh perishable horticultural products. RCW 82.04.4287 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 provides a B&O tax exemption for "any farmer that sells any agricultural product at wholesale or to any farmer who grows, raises, or produces agricultural products owned by others, such as custom feed operations." Thus, the person referenced in RCW 82.04.330 is a qualified farmer and the exemption provided in RCW 82.04.4287 is for "any person" paid by a farmer (who qualifies as such under RCW 82.04.330) to receive, wash, sort and package fresh perishable horticultural products. Rule 214 implements the exemption provided by RCW 82.04.4287 and provides clarification as to which types of activities are exempt. In relevant part, Rule 214 provides:

> (2) Persons who derive income from receiving, washing, sorting, packing, or otherwise preparing for sale, perishable horticultural products for others are also subject to business and occupation tax, except when such activities are performed for the growers of such products (RCW 82.04.4287.)
>
> (3) Business and occupation tax. . . .
>
> > (d) Service and other business activities. Taxable with respect to: . . .
> >
> > > (iv) Charges for receiving, washing, sorting, and packing of fres perishable horticultural products and the material and supplies use therein, when performed for persons other than the growers thereof;

Therefore, a person's income derived from "receiving, washing, sorting, packing, or otherwise preparing for sale" perishable horticultural products is subject to service B&O tax unless the services are performed as an agent or independent contractor for growers who are exempt from B&O tax under RCW 82.04.330. Thus, we held in Det. No. 99-022, 19 WTD 542 (2000) that the B&O tax exemption in RCW 82.04.4287, as implemented in Rule 214, is limited to such services when provided only to growers.

Here, we find that Taxpayer did not provide its fruit sorting and packing services to a grower. The payments Taxpayer received for the fruit sorting and packing services were from [the packing house]. Taxpayer had no contract or agreement with the grower for the fruit packing services. The alleged fact that the grower paid back the funds that [the packing house] loaned the grower for the packing services did not create a contractual relationship between Taxpayer and the grower.

Taxpayer asserts, however, that [Company A and the packing house] are affiliated entities and therefore Taxpayer had contracted with [Company A] by virtue of its agreement with [the packing house]. Taxpayer offers no authority for this assertion. Further, we disagree with this assertion because each separately incorporated corporation is a "person" "within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals." WAC 458-20-203 (Rule 203); Det. No. 03-0148, 23 WTD 90 (2004). [Company A and the packing house] are two separate "persons" under Washington law. They are registered with the Washington Secretary of State as two separate businesses. They each have their own UBI numbers and for tax purposes,

they are treated as separate persons. Moreover, Taxpayer has not provided any evidence that it contracted with [the packing house] as [Company A]'s agent.

We find that there is no evidence that Taxpayer provided services directly for a grower, but rather Taxpayer performed services for a packing house. . . . As Taxpayer conceded in its August 5, 2008 letter, it received payments for services performed to the packing houses. The packing houses in turn deducted the costs in the "settlement" process with the growers.

The services that Taxpayer performed were for [the packing house], who is "someone other than" a grower, Taxpayer may not deduct those payments from the measure of its B&O tax under RCW 82.04.4287. "Exemptions to a tax law must be narrowly construed". *Budget Rent-a-Car vs. Dep't of Revenue*, 81 Wn.2d 171, 174 (1972). Therefore, we conclude that Audit correctly assessed service B&O tax on Taxpayer's income derived from sorting and packing services provided to [the packing house].

[2] We next address whether Taxpayer's fruit storage was a separate activity from its fruit sorting and packing business. 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. RCW 82.04.280 provides

> Upon every person engaging within this state in the business of . . . (4) operating a cold storage warehouse . . ., the amount of tax on such business shall be equal to the gross income of the business multiplied by the rate of 0.484 percent. As used in this section, "cold storage warehouse" means a storage warehouse used to store fresh and/or frozen perishable fruits . . . thereof, at a desired temperature to maintain the quality of the product for orderly marketing."

(Emphasis added). The Department's administrative rule implementing this statute is WAC 458-20-182 (" Rule 182"). Rule 182(2)(a) provides:

> (2) Business and occupation tax. Warehouse businesses are taxable according to the nature of their operations and the specific kinds of goods stored, as follows:
>
> > (a) Persons engaged in operating any "storage warehouse" or "cold storage warehouse," as defined herein, are subject to tax under the warehousing classification, measured by the gross income of the business. (See RCW 82. 04.280.)

As both the statute and the rule state, gross receipts accruing to persons engaged in operating any cold storage warehouse, which is defined as a place "used to store fresh and/or frozen perishable fruits at a desired temperature to maintain the quality of the product for orderly marketing." is taxed under the warehousing B&O tax classification. RCW 82.04.280. Taxpayer is not disputing that it stored the apples. Rather, it argues that the storage of the fruit was not a separate activity from the "receiving, washing, sorting, and packing" of the fruit activity and thus the fruit storage activity was not separately subject to the warehousing B&O tax. RCW

82.04.4287. In short, Taxpayer claims it was not engaged in the business of operating a cold storage warehouse.

The Supreme Court of Washington held in *Yakima Fruit Growers Ass'n* that warehousing and cold storage were separate activities from receiving, washing, sorting and packing fruits. The Court further held that while for qualifying persons under RCW 82.04.4287, the statute expressly exempted from B&O taxation amounts derived as compensation for "the receiving, washing, sorting and packing of fruit", the statute did not exempt such qualifying persons as to amounts received for warehousing and cold storage of fruit. *Yakima Fruit Growers Ass'n v. Henneford*, 187 Wash. 252, 60 P.2d 62 (1936). Applying the Court's decision in *Yakima Fruit Growers Ass'n*, we must conclude that cold storage is a separate activity from "receiving, washing, sorting, and packing" of fruit under RCW 82.04.4287 and does not qualify for the exemption provided therein.

As the facts demonstrate, Taxpayer operates a cold storage warehouse where the apples are stored in controlled atmosphere storage. The apples are treated with chemicals designed to extend the storage life of the apples and placed in controlled atmosphere storage process arrests the ripening and natural deterioration of the apples for a minimum of 60 days. In other words, Taxpayer operates a storage activity as defined under RCW 82.04.280 quoted above to "store fresh and/or frozen perishable fruits . . . thereof, at a desired temperature to maintain the quality of the product for orderly marketing." Cold storage is a separate business activity from washing and sorting business activity because the former one can be performed without the latter. Therefore, the cold storage alone is a separate business activity that is subject to the warehousing B&O tax under RCW 82.04.280.

Taxpayer also argues that it was not subject to the warehousing B&O tax because it did not charge its customers for cold storage of the fruit and, therefore, Taxpayer reasons, its customers were not benefited by the Taxpayer's cold storage of the fruit. The term "business" as used in RCW 82.04.140 "includes all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." Apples are perishable items and will not be marketable if they are not placed in cold storage before packing. Taxpayer operates a cold storage facility that stores the fruit. Plainly Taxpayer stored the fruit with the object of gain, benefit, or advantage to itself and to its customers. In other words, Taxpayer engages in the business of providing cold storage. Fruit storage is a separate business activity from receiving, washing, sorting and packing fruits as recognized by the Supreme Court of Washington in *Yakima Fruit Growers Ass'n*. Under RCW 82.04.220, all persons engaged in business activities in Washington are subject to B&O tax unless the activity is specifically exempted. Under RCW 82.04.280, it is quite clear that Taxpayer is subject to the tax imposed as to its activities of fruit cold storage. *Fruit Growers Ass'n*, 187 Wash. at 259. Since, as Taxpayer claims, apples cannot be packed without cold storage, the services Taxpayer rendered to its customers included cold storage. Because of the unique nature of the apple sorting and packing business, i.e. the apples cannot be marketable without cold storage, cold storage activity has its own market value. Thus, whether Taxpayer chooses to separately charge its customers on the cold storage services has no bearing on whether Taxpayer is engaging in the business of providing cold storage. We therefore, conclude that Taxpayer operates a cold storage business

activity and Taxpayer's cold storage of fruit is a separate activity from "receiving, washing, sorting, and packing" of fruit under RCW 82.04.4287; and thus is subject to the warehousing B&O tax for under RCW 82.04.280. We conclude, therefore, that Audit correctly assessed Taxpayer warehousing B&O tax on its cold storage activity.

Next we address whether Taxpayer rented fruit bins and if so whether these rentals are subject to the use tax/deferred sales tax. Rule 210 explains

> Fruit packers often itemize their charges to farmers for various services related to the packing and storage of fruit. An example is a charge for the bins which the packer uses in the receiving, sorting, inspecting, and storing of fruit (commonly referred to as "bin rentals"). The packer delivers the bins to the grower, who fills them with fruit for eventual storage in the packer's warehouse. Charges by fruit packers to farmers for such bin rentals do not constitute the rental of tangible personal property to the farmer where the bins are under the control of the packer for use in the receiving, sorting, inspecting, and storing of fruit. These charges are income to the packer related to the receipt or storage of fruit. The packer, as the consumer of the bins, is subject to retail sales or use tax on the purchase or use of the bins.

Rule 210 is clear that Taxpayer is the consumer of the fruit bins it uses in its sorting and packing business. Taxpayer provided no evidence that sales tax was paid when the fruit bins were purchased or that it paid use tax when it first used the bins. On appeal, Taxpayer produced copies of general ledgers from two growers . . . general ledgers claiming that these "contain depreciation schedules" which demonstrate some of the fruit bins Taxpayer used were owned by the growers. We cannot determine from the general ledgers Taxpayer provided whether the deferred sales tax or use tax on fruit bins that Audit assessed were owned by these grower. Therefore, we conclude that Taxpayer has failed to demonstrate that sales tax were paid on these fruit bins and it is subject to the use tax/deferred sales tax on such bins. The assessment is sustained.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 10th day of August 2009.