

Cite as Det. No. 14-0095R, 34 WTD 155 (2015)

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. 14-0095R
. . . )	
) )	Registration No. . . .
) )	

[1] RULE 194; RCW 82.04.460: B&O TAX – SERVICE AND OTHER ACTIVITIES – COST APPORTIONMENT – COSTS ASSIGNED BY FORMULA – SPECIFICALLY ASSIGNED COSTS – CHEMICALS AND BINDING REAGENTS. Chemicals and binding reagents that are used by a taxpayer to treat hazardous waste before the waste is deposited in an out-of-state landfill are not used to “maintain” real or personal property, and are therefore not specifically assigned costs. Instead, those chemicals and binding reagents are consumables that are apportioned by formula.

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.

Weaver, A.L.J. – A taxpayer that collected and transported hazardous waste from Washington customers to its own hazardous waste disposal site [out-of-state] petitions for reconsideration. The taxpayer requests the Department rule that the costs of certain chemicals and binding reagents it uses to bind and dry hazardous waste before depositing that hazardous waste in its [out-of-state] landfill be allocated to [that state]. Taxpayer’s petition for reconsideration is denied.<sup>1</sup>

### ISSUES

Whether for cost apportionment purposes, under WAC 458-20-194(e), the cost of chemicals and binding reagents applied to hazardous waste before that waste is put in a landfill are “real or tangible personal property costs” that are specifically assigned to the location of the property.

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

## FINDINGS OF FACT

The books and records of [Taxpayer] were audited by the Audit Division of the Department of Revenue for the period January 1, 2010 through May 31, 2010.<sup>2</sup> As a result of that examination, the above-referenced assessment was issued on August 6, 2012 in the total amount of \$. . . , which amount included \$. . . in service and other activities business and occupation (“B&O”) tax, \$. . . in interest, and a 5% assessment penalty of \$. . . Taxpayer filed a timely appeal of this assessment.

Taxpayer is a . . . corporation headquartered [out-of-state]. Taxpayer provides comprehensive special and hazardous waste management services to commercial and industrial customers . . . . Examples of “special waste” include industrial waste, asbestos containing materials, petroleum contaminated soils, treated wastes, incinerator ash, medical waste, demolition debris, and other materials requiring special handling in accordance with various federal, state, and local laws and regulations. “Hazardous waste” excludes “solid waste,” such as garbage, refuse, and rubbish, including recyclables. Taxpayer’s waste management service involves the transportation and disposal of hazardous waste.

Taxpayer owns and operates a secure hazardous waste landfill [out-of-state]. Taxpayer transports hazardous waste from receiving facilities to a disposal facility by both truck and rail. This facility is separate and distinct from a solid waste landfill and a recycling center, both also located in [the same vicinity], that are owned by Taxpayer’s affiliate. Taxpayer’s landfill receives hazardous waste primarily from . . . customers for treatment and disposal.

Under mandatory operating standards, only hazardous waste in a stable, solid form, which meets regulatory requirements, can be deposited in secure disposal cells. In some cases, hazardous waste can be treated before disposal. Generally, these treatments involve drying the liquids received with solid materials and chemical treatments to transform hazardous waste into inert material. These treatments are performed at the landfill location . . . with certain chemical and binding reagents.

With respect to its Washington customers, Taxpayer’s waste management service includes transporting hazardous waste from the receiving facility . . . by truck or rail (or directly from customer locations by truck) to Taxpayer’s landfill. . . . Once the waste is received at the landfill, Taxpayer treats and disposes of the waste, and then returns the intermodal containers . . . to Washington, for subsequent use by Taxpayer’s Washington customers.

During the audit, the Audit Division disallowed Taxpayer’s alternative method of apportionment to report its service and other activities income. The alternative method of apportionment was not approved by the Department of Revenue. The Audit Division adjusted Taxpayer’s tax liability by apportioning its service and other activities income using the cost apportionment formula in accordance with WAC 458-20-194, and prior determinations, Det. No. 09-0285 and

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<sup>2</sup> Due to a change in UBI numbers for this entity, the Audit Division also issued a separate assessment (Document No. . . . ) for the period January 1, 2008 through December 31, 2009 under UBI No. . . . . A determination deciding the appeal of that assessment is being issued contemporaneously with this determination.

Det. No. 09-0285R, that were previously issued to Taxpayer. Taxpayer appeals the Audit Division's apportionment methodology.

The Department issued Det. No. 14-0095, on March 12, 2014. That determination affirmed the Audit Division's decision that the "Costs of Certain Chemicals and Binding Reagents" were "Costs Assigned by Formula" that were to be allocated between Taxpayer's sales to Washington and [out-of-state] customers. On reconsideration, Taxpayer argues that the costs of the chemicals and binding reagents were allocable to [the state where it is headquartered], because it bought those materials in [that state] and those chemicals and binding reagents were used exclusively in [within state].

### ANALYSIS

Washington imposes B&O tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220. Taxpayer's income is taxable under the service and other business activities ("service") B&O tax classification. RCW 82.04.290(2). Taxpayers who render services taxable under RCW 82.04.290 and maintain places of business both within and without Washington that contribute to the rendition of services are entitled to apportion their income between Washington and other states where the services are rendered. RCW 82.04.460; WAC 458-20-194(1)(a) ("Rule 194"). There is no dispute in this case that Taxpayer has taxable nexus in both Washington and [the state where it is headquartered] and that cost apportionment, rather than separate accounting, is the proper method to attribute Taxpayer's income between the two states. *See* Rule 194(2)(a), (3), (4). The dispute in this matter is the proper calculation of the cost apportionment ratio.

Cost apportionment is a formulary approach that looks at the cost of doing business within and without the state. A taxpayer's costs are used to calculate an apportionment ratio that is then applied to the taxpayer's worldwide income to determine the portion taxable in Washington. Rule 194(4) explains how the ratio is calculated:

The apportionment ratio is the cost of doing business in Washington divided by the total cost of doing business as described in RCW 82.04.460(1). The apportionment ratio is calculated under this section as follows. The denominator of the apportionment ratio is the worldwide costs of the apportionable activity and the numerator is all costs specifically assigned to Washington plus all costs assigned to Washington by formula, as described below. Costs are calculated on a worldwide basis for the tax reporting period in question. The tax due to Washington is calculated by multiplying total income times the apportionment ratio times the tax rate. Available tax credits may be applied against the result. Statutory interest and penalties apply to underreported income. For the purposes of this rule, "total income" means gross income under the tax classification in question, less deductions, calculated as if the B&O tax classification applied on a worldwide basis.

Rule 194(4)(a)(ii).

The cost apportionment methodology in Rule 194(4)(a)-(h) describes what costs are included in the cost of doing business. The rule explains that some costs are specifically assigned within or without the state, by location for example, and that other costs are assigned by formula. Taxpayer petitions for reconsideration of the holding in Det. No. 14-0095 that the cost of certain chemicals and binding reagents should be classified as “costs allocated by formula” instead of “specifically assigned costs” properly assigned [out-of-state].<sup>3</sup>

Taxpayer incurs costs of certain chemicals and binding reagents that it uses to bind and dry out the hazardous waste prior to the waste being deposited in its landfill. Taxpayer is required to maintain its landfill in compliance with numerous state and federal environmental laws and regulations, which require certain hazardous waste to be chemically treated and combined with binding reagents in order to dry it out before it is placed in the landfill. All the chemical treatment and binding processes occur at Taxpayer’s [out-of-state] landfill site.

For cost apportionment purposes, Rule 194(4)(e) requires that maintenance cost and taxes for specific real or tangible personal property be specifically assigned to the location of the property. Specifically, the rule reads as follows:

(d) **Specifically assigned costs.** Real or tangible personal property costs, employee costs, and certain payments to third parties are specifically assigned under (e) through (g) of this subsection.

(e) **Property costs.**

(i) **Definitions.** Real or tangible personal property costs are defined to include:

(A) Depreciation as reported on the taxpayer's books and records according to GAAP, provided that if a taxpayer does not maintain its books and records in accordance with GAAP, it may use tax reporting depreciation. A taxpayer may not change its method of calculating depreciation costs without approval of the department;

(B) Maintenance and warranty costs for specific property;

(C) Insurance costs for specific property;

(D) Utility costs for specific property;

(E) Lease or rental payments for specific property;

(F) Interest costs for specific property; and

(G) Taxes for specific property.

(ii) **Assignment of costs.** Real or tangible personal property costs are assigned to the location of the property. Property in transit between locations of the taxpayer to which it belongs is assigned to the destination state. Property in transit between a buyer and seller and included by a taxpayer in the denominator of the apportionment ratio in accordance with its regular accounting practices is assigned to the destination state. Mobile or movable property located both within and without Washington during the measuring period is assigned in proportion to the total time within Washington during the measuring period. An automobile assigned to a traveling employee is assigned to the state to which the employee's compensation is assigned below or to the state in which the automobile is

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<sup>3</sup> We note that, effective June 1, 2010, Washington adopted a new market-based single factor receipts apportionment methodology codified at RCW 82.04.462.

licensed. Where a business contracts for the maintenance, warranty services, or insurance of multiple properties, the relative rental or depreciation expense may be used to assign these costs.

Rule 194(4)(d), (e) (emphasis added).

On reconsideration, Taxpayer takes the position that the costs of the chemicals and binding reagents should be allocated to [the state where it is headquartered], because it purchases the chemicals [out-of-state] for use exclusively at its landfill site . . . . Det. No. 14-0095 held that the costs were properly classified as “Costs Assigned by Formula,” rather than “Specifically Assigned Costs,” because the costs of the chemicals and binding reagents were not incurred for the “maintenance” of either real or personal property. . . .

In other words, now, on reconsideration, Taxpayer argues that it is irrelevant whether the chemicals and binding reagents are used for “maintenance” of real or personal property. Taxpayer takes the position that the chemicals and binding reagents are themselves “personal property” and the cost of that personal property is to be assigned to the location of the property.

We are not persuaded by Taxpayer’s argument. The types of “real or personal property” that are to be specifically assigned are enumerated in Rule 194(4)(e)(i). As we held in Det. No. 14-0095, the costs of the chemicals and binding reagents that Taxpayer uses to treat hazardous waste are not used for “maintenance” of real property, nor are they used for “maintenance” of personal property. . . . Indeed, the costs of chemicals and binding reagents purchased by Taxpayer do not fit within any of the enumerated categories of “real or tangible personal property costs” listed in Rule 194(3)(e)(i). They are not maintenance costs, insurance costs, utility costs, lease or rental payments, interest costs, or taxes. *See* Rule 194(4)(e)(i)(A)-(G).

The chemicals and binding reagents are simply consumables used in Taxpayer’s business and the costs of those items are costs of doing business. Because the costs of those consumables are not specifically assigned under Rule 194(4)(e), they are instead correctly assigned by formula under Rule 194(4)(h).<sup>4</sup> For these reasons, we affirm Det. No. 14-0095 on this issue.

#### DECISION AND DISPOSITION

Taxpayer’s petition for reconsideration is denied.

Dated this 9th day of October 2014.

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<sup>4</sup> [Costs not specifically assigned under (e) through (g) of this subsection and not excluded from consideration by (c) of this subsection are assigned to Washington by formula. These costs are multiplied by the ratio of sales in Washington over sales everywhere. For example, if a business has one thousand dollars in other unassigned costs and sales of ten thousand dollars in each of the four states in which it has nexus under Washington standards (including Washington), twenty-five percent (\$10,000/\$40,000), or two hundred fifty dollars of the other costs are assigned to Washington.]