

Cite as Det. No. 02-0199, 24 WTD 147 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| In the Matter of the Petition For Refund |) | <u>D E T E R M I N A T I O N</u> |
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| |) | No. 02-0199 ¹ |
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| ... |) | Registration No. . . . |
| |) | FY . . . /Audit No. . . . |
| |) | FY . . . /Audit No. . . . |
| |) | Docket No. . . . |

RULE 112; RCW 82.04.230, RCW 82.04.240: B&O TAX: VALUE OF PRODUCTS. All costs, including certain period costs, must be included in the calculation of “value or products.”

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.

STATEMENT OF THE CASE:

Lewis, A.L.J. -- Taxpayer appeals the method the Audit Division used to calculate the value of products subject to extracting business and occupation (“B&O”) tax.²

ISSUE:

Did the Audit Division correctly compute the value of Taxpayer’s production of [alloy] by including all costs?

FINDING OF FACTS:

. . . Taxpayer produces [an alloy]. The process of producing [alloy] requires the mining and transportation of ore to the mill where the [metals] are recovered The [alloy] is then transported to a third party refinery [outside Washington] where it is further processed into [the

¹ The reconsideration determination, Det. No. 02-0199R, is published at 24 WTD 151 (2005).

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

finished product]. The [finished product] is then sold by Taxpayer All of Taxpayer's sales occur outside Washington.

The Audit Division of the Department of Revenue ("Department") audited Taxpayer's books and records for the period January 1, 1995 through December 31, 2000. During the audit period, Taxpayer reported its business and occupation ("B&O") tax obligation under the extracting B&O tax classification.³ Taxpayer computed the value subject to B&O tax using the gross proceeds of sales method, whereby the number of [metal] ounces contained in the [alloy] were multiplied by the average monthly . . . price of [metal] to arrive at the value of the product subject to Washington's B&O tax. As part of the audit, Taxpayer requested that the Audit Division recalculate the value of [metal] produced using a cost basis, rather than gross proceeds. The Audit Division used a cost basis that included all Taxpayer's business costs.

Taxpayer disagreed with the Audit Division's cost method of computing value of the [metal] produced, particularly the use of all business costs. On December 18, 2001, Taxpayer filed a petition for refund requesting that the Audit Division compute the value of the product using a [standard] format.

. . . . The [standard] was subsequently adopted by the accounting industry and is now a generally accepted accounting practice in the [metal] producing industry.⁴

The [standard] is a uniform standard for use by [metal] producing companies to report production costs on a per-ounce basis. The [standard] allows . . . investors a tool to make meaningful comparison of [metal] mining companies' operating costs. The [standard] method that Taxpayer advocates computes the cash operating cost per ounce of [metal] by excluding certain non-cash period costs such as: royalties, amortization of the mine and milling start-up costs, depreciation of machinery and equipment, and provision for reclamation of the land costs.

ANALYSIS:

Manufacturers and extractors are generally taxed upon the value of the products they manufacture or extract. RCW 82.04.230 and RCW 82.04.240. The "value of the products" is generally the gross proceeds of the sales from the product, whether sold at wholesale or retail. However, in cases where no wholesale or retail sale is made, a taxpayer must use comparable sales to determine its tax base. RCW 82.04.240(2) prescribes how the value is to be determined when there are comparable sales in the state:

... the value shall correspond as nearly as possible to the gross proceeds from the sales in this state of similar products of like quality and character, and in similar quantities by

³ At its Washington location, Taxpayer both mined and processed ore into [alloy]. Therefore, Taxpayer performed both extracting and manufacturing activities. However, rather than reporting under both the extracting and manufacturing classifications and utilizing the Multiple Activities Tax Credit ("MATC"), Taxpayer reported solely under the extracting classification and did not utilize the MATC.

⁴

other taxpayers, plus the amount of subsidiaries or bonuses ordinarily payable by the purchaser or by any third person with respect to the extraction, manufacture, or sale of such products...

RCW 82.04.050 only addresses valuation when there is evidence of comparable sales made within Washington. Det. No. 89-326, 8 WTD 39 (1989). . . . [T]here are no comparable sales for [alloy] in Washington. If no comparable sales exist, WAC 458-20-112 ("Rule 112") allows a taxpayer to use a cost basis to determine the value of its products:

In the absence of sales of similar products as a guide to value, such value may be determined upon a cost basis. In such cases, there shall be included every item of cost attributable to the particular article extracted or manufactured, including direct and indirect overhead costs.

Here, the dispute centers on what costs should be included in computing the value of the product. The Audit Division included all costs of the business, reasoning that the value of the product must include every component of cost incurred to produce the item.⁵ Taxpayer reads Rule 112 as allowing exclusion of certain period costs and maintains that the [standard], which allows excluding certain period costs, should be used to determine the value of the [metal] it produces.⁶

We conclude that the Audit Division correctly computed the value of the product using Taxpayer's total mining and milling costs. We recognize the existence and importance of an industry standard that allows exclusion of certain period costs in computing the cost per ounce of [metal]. The standard, however was adopted for the limited purpose of allowing a potential investor . . . to easily compare financial statements of different [metal] producing companies. The fact that this standard has widespread use within the financial community does not require its use for purposes of determining Taxpayer's Washington B&O tax liability.

Financial reports and tax reports have different purposes and are prepared using different mixes of revenue and cost figures. Thus, the income shown on a company's financial statements is not necessarily the same for either federal or state tax reporting purposes. While the [standard] may be the standard for financial statement reporting, those same standards are not the standard for reporting Washington's B&O tax. Washington's legislature and Department of Revenue have adopted their own standards for computing costs of production. Thus, we reject Taxpayer's general argument that the financial statement accounting conventions should govern the computation of value of product for computing Washington's B&O tax.

⁵ The Audit Division's method is similar to the gross proceeds of sale, which provides no deduction for a taxpayer for any of its business costs.

⁶ Period costs are costs a business incurs tied to the passage of time and not linked to production. For instance, a company incurs depreciation expense based on the passage of time. The amount of the expense is not linked to production.

We also reject Taxpayer's reading of Rule 112 that allows for excluding some of the costs of producing the product when computing the value of the product. Taxpayer focuses on the last sentence of Rule 112, which states:

In such cases, there shall be included every item of cost attributable to the particular article extracted or manufactured, including direct and indirect overhead costs.

Taxpayer argues that had the Department meant that all costs be included in the computation of value of the product, the sentence would have stopped at the comma. Furthermore, Taxpayer argues that Rule 112, by including the phrase "including direct and indirect overhead costs," allows for the exclusion of certain period costs. We disagree. Rule 112 requires that all costs of production be included in the computation. In direct contrast to Taxpayer's conclusion, the phrase "including direct and indirect overhead costs" emphasizes that not just direct costs of the product should be considered, but that all costs of the product including both direct and indirect overhead costs be considered.

The costs that Taxpayer requests be excluded are the costs that Rule 112 requires be included. The royalties are direct overhead costs. The amortization of the start-up costs, the depreciation, and the accrual for reclamation of the land are indirect overhead costs necessary for Taxpayer to operate the mine and mill in Washington. Based on our reading of Rule 112 we affirm the Audit Division's method of computing the value of Taxpayer's product.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 27th day of November, 2002.