Cite as Det. No. 03-0224E, 24 WTD 36 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment and For a Refund of	)	F I N A L E X E C U T I V E L E V E L D E T E R M I N A T I O N
	)	No. 03-0224E
. . .	)	Registration No. . . . FY. . ./Audit No. . . . . . ./Audit No. . . . 1994 Oil Spill Tax Assessment Docket No. . . .
. . .	)	Registration No. . . . . . ./Audit No. . . . Docket No. . . .

[1] RULE 260; RCW 82.32B.030: OIL SPILL TAX – EXCHANGE AGREEMENTS – DOCUMENTATION. A Certificate of Previous Payment of the Oil Spill Tax can be used to provide the information required under the statute for products received through an exchange.

[2] RULE 252; RCW 82.21.050: HST – CREDIT – FUEL SOLD IN TANKS. To the extent the taxpayer, a refiner, can produce export certificates from carriers, it is entitled to take the fuel-in-tank credit.

[3] RULE 260; RCW 82.32B.030: OIL SPILL TAX –PRESUMPTION OF PREVIOUS TAXATION. The presumption in Rule 260 that products loaded onto a vessel in Washington were previously taxed can be rebutted by the Department's showing, by a preponderance of the evidence, the amount of crude oil or petroleum products that were not previously taxed.

[4] RULE 252; RCW 82.21.050: HST – CREDITS – EXEMPTIONS – COMMINGLED PRODUCTS – BLENDING OF PRODUCTS. Under the applicable rule, different tax consequences result when hazardous substances are commingled in Washington as opposed to outside Washington, where tax was not previously paid. Similarly, the blending of hazardous substances with other hazardous substances or with non-hazardous substances can result in different tax consequences when the blending occurs in Washington as opposed to blending outside Washington, where tax was not previously paid.

[5] RULE 252; RCW 82.21.050: HST – WHOLESALE VALUE – PLATT'S. The HST rate is measured by wholesale value. In general, the wholesale value is the price paid by a wholesaler or retailer to a refinery or manufacturer. No deduction is allowed for transportation costs from the refinery. With respect to exchanges, prices listed in independent publications such as Platt's Oil Price Handbook can be used to establish the wholesale value of bulk exchanges.

[6] RULE 252; RCW 82.21.050: HST – GASOHOL. For purposes of the HST laws, denatured ethanol used to make gasohol is not considered to be a hazardous substance. Because the taxpayer combines a hazardous substance, gasoline, with a non-hazardous substance, denatured ethanol, to produce a new petroleum product, an oxygenated gasoline, it is subject to HST based on its wholesale price.

[7] RULE 121, RULE 252; RCW 82.04.120, RCW 82.21.050; ETA 109: MANUFACTURING B&O TAX -- HST – SELF-PRODUCED FUEL – STILL GAS – CATALYTIC COKE. Still gas produced and used by the taxpayer as a fuel is subject to tax, valued at the cost the taxpayer would have incurred to purchase a fuel of equivalent BTU value. In accordance with ETA 109, catalytic coke produced as a contaminate is not subject to B&O tax, even though it incidentally produces heat when consumed.

[8] RULE 113; RCW 82.04.050: RETAIL SALES TAX – INGREDIENTS OR COMPONENTS –CHEMICALS USED IN PROCESSING. Chemicals that leave residues in the finished product, which residues are not essential, necessary, or anything more than impurities, are not entitled to the ingredients or components exemption from retail sales tax. With respect to the chemicals used in processing exemption, the taxpayer has the burden to show that the primary purpose of the chemicals is to create a chemical reaction directly through contact with an ingredient of the new article being produced for sale.

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.

DIRECTOR'S DESIGNEE: Jacqueline M. Danyo

Mahan, A.L.J. – Oil refinery protests the assessment of Hazardous Substances Tax (HST), Oil Spill Response Tax (OST), and Petroleum Products Tax (PPT), the manner in which various export credits and the Multiple Activities Tax Credit (MATC) were applied, the disallowance of certain Machinery and Equipment (M&E) exemptions, and the disallowance of various retail sales tax exemptions for ingredients or chemicals used in manufacturing.[1] The refinery and a subsidiary that operates retail outlets selling petroleum products also protest the method of apportioning services claimed to be performed both inside and outside Washington. Based on the evidence and arguments before us, we grant in part, deny in part, and remand in part for further proceedings the taxpayer's petition for correction of the assessment and for a refund.[2]

ISSUES

1. When a taxpayer receives petroleum products on exchange from other refineries in Washington, and no invoice is provided for the exchange, and the taxpayer thereafter exports the products, can the taxpayer take an OST export credit for purposes of WAC 458-20-260(7)?

2. When a taxpayer sells fuel to third-parties operating vessels leaving the state and does not have a bill of lading or an export certificate identifying that the fuel is being exported, can the taxpayer take an OST or an HST export credit for fuel sold in tanks?

3. When the taxpayer ships product over water from one of its facilities in Washington to another facility in Washington, does the OST presumption in WAC 458-20-260(6) that such product was previously taxed apply when the taxpayer receives a portion of its product untaxed and that product is commingled with previously taxed product?

4. Should the Department fully allow credits or deductions taken for HST purposes on previously taxed products exported to Oregon, when those products are then commingled with other products or have other ingredients added, and then imported back into Washington by the taxpayer?

5. Should petroleum products manufactured in Washington and shipped outside the state be valued . . . in accordance with Platt's Oil Price Handbook & Oilmanac for purposes of the HST?

6. Is the taxpayer entitled to take an exemption under WAC 458-20-252(2) for previously taxed petroleum products when that product is combined with denatured ethanol to create gasohol?

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[1] Because the PPT was suspended during the audit periods at issue, no PPT was paid or assessed on the petroleum products at issue. Accordingly, we do not further address the taxpayer's PPT claims.

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

7. Should the amount of gasohol subject to OST be increased based on the increase in volume through the addition of denatured ethanol?

8. Should the taxpayer collect use tax on fuel used by unregistered vessels operating in Washington waters?

9. When the taxpayer manufactures as byproducts still gas and catalytic coke and consumes them as fuels in the refining process, are such byproducts subject to manufacturing B&O tax and HST and, if so, what is the measure of the tax?

10. Is the HST unconstitutional because the taxpayer owes tax when it imports products into Washington but does not owe tax when it purchases previously taxed products in Washington?

11. Should commission income from the sale of lottery tickets and money orders in Washington be apportioned?

12. Should an oil soluble demulsifier, water soluble blends of neutralizing amines, and oil soluble filming amines be exempt as either chemicals used in processing or ingredients and components?

13. In determining whether a loading rack, storage tanks, and control system at the taxpayer's sales terminal qualifies for the machinery and equipment exemption (M&E), should we use a "reason for purchase" test or compare the quantity of manufactured products and non-manufactured products flowing through the system?

FACTS

. . . (taxpayer) acquired a petroleum refinery in . . . , Washington and a network of service stations located in Washington. . . . [I]t later acquired the [store taxpayer] . . . and operates it as a wholly owned subsidiary. . . .

Petroleum refineries in Washington receive crude oil both by pipeline from Canada and over the water by vessel, primarily from Alaska. . . . This crude oil is refined into various products. These products may then be sold in Washington, exchanged with other petroleum companies in Washington, or exported. Products are commonly exported by vessel, as bunker fuel in the tanks of ships, and by pipeline. Products once exported may be commingled with other products or remanufactured and brought back into Washington. For example, refined products may be transported through the pipeline to a terminal [outside Washington], the product commingled with products from other sources, and then withdrawn from storage, and transported by barge to a terminal in . . . , Washington.

In general, refinery capacity in Washington exceeds demand for refined petroleum products in Washington. Accordingly, a significant amount of the taxpayer's refined products are exported from Washington. Most of the petroleum products manufactured by the taxpayer and exported

are sold or exchanged with other petroleum companies [outside Washington], or are sold from the taxpayer's [out-of-state] terminal to distributors. Generally, such products are shipped directly from the taxpayer's Washington refinery to the [out-of-state] sales terminals through the . . . Pipeline or by barge.

The Department of Revenue (Department) audited the taxpayer for the 1/1/94-12/31/94 and 1/1/95-12/31/97 periods and issued deficiency assessments . . . and a 1994 Oil Spill Tax Assessment . . . . The Department also audited the store taxpayer for the January 1, 1995 through December 31, 1998 period and issued deficiency assessment . . . . The taxpayers timely appealed the audit assessments and raised various issues on appeal. The facts relevant to the various issues are set forth below.

1. OST Export Credit for Exchanged Products.

The taxpayer received petroleum products on exchange from other refineries in Washington. Most of these products were received from its exchange partners through the . . . pipeline and were exported by the taxpayer through the pipeline [out-of-state]. The taxpayer's exchange partners did not invoice it for the Oil Spill Tax. Within the industry, invoices are not generated or issued for petroleum product exchanges. Rather, exchanges are later reconciled by confirmation letters or non-contemporaneous invoices. The taxpayer had blanket export certificates from some exchange partners. The taxpayer does not have any documentation to show whether its exchange partners initially received these products by barge, vessel, or pipeline or on what portion of the exchanged products they paid OST.

Under Schedule 4 of the 1994 Oil Spill Tax audit and Schedule 11 of the Oil Spill Tax audit for 1/1/95-12/31/97, the Department disallowed any oil spill credits taken for such exchanged products, due to the lack of invoices.

The taxpayer's exchange agreements may be continuing in nature (referred to as "evergreen" agreements) or spot exchange agreements. The agreements provide for "differentials" to the extent a cost, such as transportation costs, vary from the market base price for the petroleum product. The taxpayer contends that, within the industry, no differential is provided for environmental taxes because it is intended that the base always included taxes, a significant cost item.

A copy of an evergreen exchange agreement, dated July 1, 1999, provided that

> Each party agrees to prepare and transmit monthly to the other party a statement of exchange activity, supported by delivery tickets, inspection reports or other shipping documents, which present the transactions and differential calculations associated with this Agreement. Payment of net differentials and taxes, if any, and handling fees payable hereunder by both parties during each month will be made upon receipt of an invoice from the party to collect.

Copies of monthly invoices specifying reimbursement of taxes, if any beyond the base price, were not supplied.[3]

The taxpayer has a letter from one of its exchange partners indicating, upon knowledge and belief, that "all appropriate taxes that are due on petroleum products" were paid by that partner on products exchanged with the taxpayer. According to the taxpayer, this exchange partner does not receive any product through the pipeline from Canada and, accordingly, the partner's product was previously subject to the OST.

2. HST and OST Export Credit for fuel Sold in Tanks.

Under schedule 12 of the Oil Spill Tax audit, the Department disallowed export credits taken on sales of bunker fuel for which the taxpayer did not provide documentation to show that this fuel was placed into the export stream. Some of the transactions listed in this schedule were for fuel that was placed aboard vessels or barges at the taxpayer's marine terminals for shipment to other marine terminals in this state. Such transactions are not at issue (the taxpayer has not disputed this portion of the assessment), only transactions where the taxpayer alleges export took place through fuel sold in tanks.

The taxpayer provided a letter from one carrier that stated "all of our vessels operating in and around [Washington] made arrival in the State of Washington with ample bunkers to carry them through their respective port call." This was true even when the carrier bunkered fuel in Washington. Some of the fuel buyers were not registered with the Department and some were foreign flag vessels.

At the second hearing, the taxpayer produced original records for one bunker fuel transaction. Those documents included a bill of lading showing an out-of-state destination and an export certificate. Following the hearing, the taxpayer provided certificates and invoices for other bunker fuel transactions.

3. OST Presumption and Commingled Products.

Under schedule 15 of the Oil Spill Tax audit, the Department assessed OST on a portion of refined petroleum products that the taxpayer shipped by barge or vessel from its [Washington] refinery to its [Washington] sales terminals. The amount of product subject to tax was based on the average amount of crude oil that the taxpayer received through pipeline from Canada and on which OST had not been previously paid.

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[3] The taxpayer also provided an undated page of Additional Provisions that further provided:

> In those cases where law or regulation imposes upon the delivering party the obligation to pay such taxes or inspections fees, the receiving party shall promptly reimburse the other party for the net amount of such taxes or inspection fees paid by the other party, which would include the benefits of any discounts or allowances that the taxing agencies might allow.

4. HST on Products Exported and Then Imported.

Under schedule 26 of the regular audit, the Department denied a portion of the deductions taken by the taxpayer for HST . . . purposes. In its details of differences and instructions to the taxpayer, the Department identified the following errors in the taxpayer's computation of its HST liability:

> 1) You have not performed a separate computation for each different grade of gasoline. For instance, while you export large amounts of subgrade gasoline [outside Washington] none of this product is imported back into the state of Washington. You should not therefore be including these gallons as previously taxed product in computing the percentage of imports that have been previously taxed.
>
> 2) You have included your Washington transfers to other Terminals [outside Washington] from which imports are not being made in your previously taxed import computation. For instance, while you do not import products from the [out-of-state] terminal . . . , you include the gallons you transfer to this location as previously taxed in your computation of imports previously taxed.
>
> 3) You have included gallons exported from Washington directly to [out-of-state] customers as previously taxed in computing your previously taxed imports. These gallons should not be included in this calculation since you do not import these gallons.
>
> 4) You generally have not included receipts from others at your [out-of-state] terminal in your computation of previously taxed imports. It is presumed that such receipts have not been previously taxed unless you can provide documentation that such receipts have been previously taxed.
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> In addition to the above errors, you have also made an error by applying your previously taxed percentage computation to import receipts from others [outside Washington]. As indicated above, it is presumed that these receipts have not been previously taxed unless you can provide documentation that such receipts have been previously taxed. This documentation may consist of previously taxed certificates from your vendors indicating the amount of such receipts which have been previously subjected to the HST.

The Department then computed the amount of imports previously subject to HST on a formulary basis, as follows:

> 1) The gallons of product you received at your [out-of-state] terminal from Washington was divided by your total receipts of that product at that terminal location.
>
> 2) The resulting percentage was then multiplied by the shipments from this terminal that were imported to your Washington locations.
>
> 3) These gallons were multiplied by the value of these products to derive the previously taxed deduction on these imports allowable.

In a prior 1993 audit, the taxpayer was instructed that previously taxed certificates given to the taxpayer by two Washington refineries were sufficient for credits to be given for previously taxed product sent to . . . Washington from [outside Washington] by the taxpayer.

5. Value of Exported Products for B&O and HST purposes; Value of Sales in Washington for HST Purposes.

Under schedules 5 and 27 of the regular audit, the Department assessed additional manufacturing B&O tax and HST, respectively, based on the Department's valuation of the products exported by the taxpayer.

For 1994 and part of 1995 the taxpayer did not report any manufacturing B&O tax on products manufactured at their [Washington] refinery and shipped out of state. For other parts of the 1/1/95-12/31/97 audit, the taxpayer used a single weighted average refinery gate price to value their pipeline shipments of gasoline outside Washington and did not separately value each grade of gasoline and each non-gasoline product, i.e. diesel fuel and jet fuel. . . .

The taxpayer argues that valuation should be based on either cost or on the lowest delivery price after deduction of transportation costs. When the taxpayer delivers the product to [out-of-state city] by barge, transportation costs are 5 cents per gallon as opposed to 1 and ½ cents per gallon transportation costs when the . . . pipeline is used to transport the products. Because of the large volumes of product that it ships to itself [outside Washington], the taxpayer asserts that the sales reported in Platt's do not provide examples of comparable sales.

6. HST Credits or Exemptions for Gasohol.

The taxpayer sells gasohol for automobile spark-ignition engines. Gasohol is a mixture of denatured ethanol and gasoline. Although the taxpayer reported HST on the gallons of gasoline that it sold, the measure of the tax was not increased as a result of the addition of the denatured ethanol. No HST was paid on the denatured ethanol when it was first possessed in Washington. Under schedule 28 of the regular audit, the Department assessed additional HST, based on the increase in volume from the addition of denatured ethanol to the gasoline.

Under schedule 34 the Department denied the HST credit for gasoline acquired from previous possessors in this state that the taxpayer blended with ethanol. The vendors, not the taxpayer, had paid the HST on those products.

Denatured ethanol is an ethyl alcohol compound that has been combined with small amounts of gasoline to make it unfit to drink but still usable as a fuel source. Gasohol and denatured ethanol are made up of the same ingredients, although in inverse proportions. Denatured ethanol is made up of approximately 95% ethanol and 5% gasoline. Gasohol on the other hand is made up of

approximately 90% gasoline and 10% denatured ethanol, in accordance with American Society for Testing and Materials standards (ASTM D-4806-99).[4]

7. Measure of Gasohol for OST Purposes.

The taxpayer pays a third-party in Washington to denature enthanol. The Department did not assess any additional OST resulting from the addition of denatured ethanol to gasoline for shipments of gasohol by the taxpayer by barge or vessel from one point in Washington to another. The taxpayer seeks a refund to the extent it paid OST on the entire volume of gasohol. The taxpayer bases its claim on the presumption that the product was previously taxed.

8. Use Tax on Fuel Sold to Unregistered Taxpayers Leaving the State.

The taxpayer sells bunker fuel to ships leaving the state, including to ships that are not registered with the Department. The taxpayer regularly accepted certificates from unregistered carriers stating that none of the fuel purchases will be consumed within the territorial boundaries of Washington. The Department did not assess additional tax, but instructed the taxpayer that, in the future, such certificates would not be accepted. The Department provided the following future instruction.

> ETA 562 provides a formula that should be used by vessels operating in interstate or foreign commerce for reporting their HST liability. We indicate that the chief engineers of carriers not registered with the Department should make similar estimates to determine that portion their fuel purchases that will be consumed within this state for use tax purposes. You should then charge them the use tax based on those estimates.

9. B&O and HST Taxation of Still Gas and Coke.

In Schedule 2 of the regular audit the Department assessed manufacturing B&O tax on the value of still gas (flare gas), catalytic coke, butane, and propane manufactured as byproducts in the petroleum refining process and consumed as fuel in the operation of the taxpayer's refinery. In Schedule 33 the Department assessed HST on what it considered to be the value of these products.

[4] The taxpayer in its arguments refers to the use of "denatured fuel ethanol." Denatured ethanol that is used to make gasohol is sometimes referred to as denatured fuel ethanol, because of impurities in the ethanol product that may be used in gasoline production. *See* ASTM D-4806-99. Under subsection 3.2.3 of that standard, the term "fuel ethanol" is defined to mean "ethanol with impurities common to its production (including water but excluding denaturants)." For purposes of this determination, we use the term "denatured ethanol" to include denatured fuel ethanol. The taxpayer in its arguments also refers to another product, "fuel ethanol." That product is comprised of approximately 75% to 85% of denatured ethanol and 15% to 25% of gasoline or other hydrocarbons and used in certain engines, in accordance with ASTM D-5798-98a. The taxpayer does not produce or market this latter product, and it is not further discussed in this decision.

The Department determined the value of catalytic coke for January through December 1995 based on the average West Coast prices from the publication "Pace Petroleum Coke Quarterly." The value for subsequent periods of this audit was estimated at $ . . . per ton. The coke values used by the Department included transportation costs.

The taxpayer does not have a coker at its refinery and, accordingly, does not produce green coke for its own use or for sale to others.

The still gas, also known as refinery gas, has excess sulfur and must be processed in order for it to be burned as a fuel. It also has free hydrogen, which limits transportation of the gas and its marketability. The taxpayer produced and consumed the still gas at its refinery, and it incurred no transportation costs for the still gas.

The taxpayer generally reported and paid tax on the value of the still gas. They valued this gas based on the BTU equivalent value of their natural gas purchases. They then deducted amine (a derivative of ammonia) production costs. The Department accepted the taxpayer's valuation of the still gas with the exception of the amine deduction because the taxpayer "did not explain to us what this deduction from the valuation was all about."

10. Constitutionality of HST.

No specific facts apply to this issue.

11. Apportionment of Commission Income.

Under schedule 18 of the regular audit and schedule 2 of the store taxpayer's audit, the taxpayers were assessed additional service and other activities B&O tax on income from various activities. Income subject to tax included commissions on sales of Washington State lottery tickets and sales of money orders at Washington locations.

12. Chemicals Used in Processing and Ingredients or Components.

Under schedule 24 of the regular audit, the Department allowed credits for various chemicals used in processing. It did not allow credits for the following chemicals:

- [Separation Chemical.] This taxpayer uses this chemical primarily to aid in the separation of a crude oil and water emulsion. Although most of Embreak 2W160 is removed during the refining process, a small portion may not be recovered and may become a non-essential component in the finished product.

- [Reaction Chemicals.] The taxpayer adds these chemicals during the refining process to cause a reaction with hydrochloric acids that have been previously released in the refining process. They neutralize the acid compounds to prevent corrosion to equipment surfaces. These products react with the hydrochloric acids and convert these acids into salts. The salts

are later removed during the distillation process. Although most of [reaction chemicals] are removed during the refining process a small portion may not be recovered and may become non-essential components in the finished product.

- [Dispersant Chemicals.] The taxpayer adds these chemicals in the refining process as "dispersants" and to form a corrosion resistant film on equipment surfaces. These chemicals are ultimately worn away as the petroleum products pass through the equipment and, at that time, they become a non-essential component in the finished product.

Although they are not necessary components in the final product, the taxpayer considers these chemicals to be "desirable" because they add small amounts to the volume of the product sold and the product is sold based on volume.

13. M&E Exemption on Loading Rack and Control System.

During the audit period, the taxpayer purchased capital assets for its [Washington] terminal. Under schedules 70 and 71 of the regular audit, the Department assessed deferred retail sales or use tax on the capital assets purchased for the [Washington] terminal and denied M&E exemptions on some of the capital purchases.

It is undisputed that the taxpayer engages in manufacturing activity at the sales terminals when it blends ethanol and gasoline to produce oxygenated gasoline (gasohol) and when it blends different grades of gasoline to produce a mid-grade gasoline. It also sells unblended products at the sales terminals and those sales do not involve any manufacturing activity.

The capital purchases for the [Washington] Terminal included a loading rack control system, a loading rack, tank farm piping, storage tanks, high level alarms, and rack vapor combustion system. Although the loading rack and control system are used for blending gasoline, the majority of the product flowing through the system is not blended.

ANALYSIS

1. OST Export Credit for Exchanged Products.

RCW 82.23B imposes an oil spill response tax and an oil spill administration tax (OST) for the privilege of receiving crude oil or petroleum products at a marine terminal in this state from a waterborne vessel or barge operating through or upon the navigable waters of this state. The tax is levied on the owner of the crude oil or petroleum products immediately after receipt into the storage tanks of a marine terminal in Washington.

OST applies only to the first receipt of crude oil or petroleum products into the storage tanks of a marine terminal in this state. RCW 82.23B.030 exempts the subsequent receipt into storage tanks at a marine terminal in this state for previously taxed product. This exemption applies even though the previously taxed product is refined or processed prior to subsequent transportation and receipt into

storage tanks. Rule 260(6).[5] A law provides a credit for petroleum products received at a marine terminal and subsequently exported or sold for export. RCW 82.23B.040.

[1] In order for a purchaser of previously taxed product to take the credit, Rule 260(7)(a) requires the purchaser, including a person taking the products in exchange, to have an invoice showing that the purchaser paid the tax to the seller:

> An export credit may be taken by any person exporting or selling for export any previously taxed product who has paid the tax on such product to a marine terminal operator or the Department. An export credit may also be taken by any person who has purchased previously taxed product and who subsequently exports the product or sells the product for export, provided that such person has been invoiced for and has paid the tax to its seller. Any such invoice must state the amount of the tax passed on to the purchaser and identify the product to which the tax amount relates by type and quantity.

(Emphasis added.) A person claiming the export credit must also document the fact that the product was placed into the export process. *Id.*

Here there is no issue regarding the products being placed into the export process. Primarily at issue is evidence that the tax was passed on to the taxpayer and the amount of the tax that was passed on to the taxpayer. Even if the amount charged included tax as part of the exchange, as the taxpayer contends, there were no invoices issued indicating the amount of the tax paid and the tax amounts as they related to type and quantity. Most but not all of the taxpayer's exchange partners received some product through the pipeline from Canada. So, like the taxpayer, a portion of the product they exchanged with the taxpayer was not previously taxed and no credit could be given for that percentage.

Rule 260 during the period at issue did not explicitly address the availability of the credit when, at the time of the transactions, no contemporaneous invoices as such were issued and an unknown percentage of exchanged product was not previously taxed. We must consider whether, consistent with the statute and the regulatory framework, other evidence can satisfy the invoice requirement found in the rule.

Rules of statutory construction apply to administrative rules and regulations. *State v. Burke*, 92 Wn.2d 474, 478, 598 P.2d 395 (1979). If a rule's meaning is plain on its face, then the court must give effect to that plain meaning. Under the "plain meaning" rule, examination of the statute in which the provision at issue is found, as well as related statutes or other provisions of the same act in which the provision is found, is appropriate as part of the determination whether a plain meaning can be ascertained. *Department of Ecology v. Campbell & Gwinn, L.L.C.*, 146 Wn.2d 1, 10, 43 P.3d 4 (2002); *C.J.C. v. Corporation of the Catholic Bishop of Yakima*, 138 Wn.2d 699, 708-09, 985 P.2d 262 (1999). A term in a regulation should not be read in isolation

[5] Rule 260 was amended, effective August 26, 2002. Unless stated otherwise, reference to Rule 260 in this decision is to the Rule in existence during the periods at issue.

but rather within the context of the regulatory and statutory scheme as a whole. *ITT Rayonier, Inc. v. Dalman*, 122 Wn.2d 801, 807, 863 P.2d 64 (1993).

In construing Rule 260, we note that it was amended, effective August 26, 2002. It now provides for the use of a Certificate of Previous Payment of the Oil Spill Tax, as a means to address the problem encountered by the taxpayer. Rule 260 (9)(a) (2002). Although not in effect for the period at issue, we conclude such a certificate reasonably provides the information required under the statute for products received through an exchange. This matter is remanded to the Audit Division. Within 60 days from the date of this determination, the taxpayer in order to receive credit must provide Certificates of Previous Payment of the OST on a monthly or an annualized basis for the periods under review.

2. HST and OST Export Credits for Fuel Sold in Tanks.

a. HST

The HST is imposed upon the privilege of possessing hazardous substances, other than small amounts [other than petroleum and pesticide products], in Washington. RCW 82.21.010; 82.21.030. The stated intent is to "impose a tax only once" for each hazardous substance "possessed in this state and to tax the first possession" of those substances. RCW 82.21.010. WAC 458-20-252 (Rule 252), addresses the application of the HST.

[2] The law provides a fuel-in-tank credit for fuel not consumed in Washington.[6] The credit "shall be allowed in accordance with rules of the department of revenue for taxes paid under this chapter with respect to fuel carried from this state in the fuel tank of any airplane, ship, truck, or other vehicle." RCW 82.21.050(1). Rule 252(5)(b)(vi)-(ix) addresses the fuel-in-tank credit.

In order to avoid the need for sellers to file amended tax returns to account for fuel products that end up subject to the credit, sellers may take exemption certificates from buyers for export sales or use as fuel outside Washington, even when the buyer will not export all of the product it purchases. *See* Excise Tax Advisory 540.04.22.252 (ETA 540). Refiners are specifically identified as parties entitled to take a certificate when they sell directly to buyers.[7]

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[6] The HST applies to fuel consumed in Washington when the fuel is transported from other states into Washington or purchased in Washington. Det. No. 97-17, 16 WTD 211 (1997).

[7] With respect to who is entitled to use the credit, Rule 252(5)(b)(vii) states:

> This certificate may be executed and provided to <u>any possessor</u> of fuel in this state, <u>throughout the</u> <u>chain of distribution</u>, with respect to fuel which ultimately will be sold and delivered into any carrier's fuel tanks in this state. <u>Thus, refiners or manufacturers will take such certificates directly from carriers</u> or from their wholesale purchasers who will sell to such carriers. Similarly, fuel dealers and distributors will take such certificates from carriers to whom they sell such fuel. These certificates must be retained as a permanent part of such seller's business records.

(Emphasis added.)

To the extent the taxpayer did not receive certificates from the purchasers, the liability for the HST remained the obligation of the taxpayer. Because the taxpayer was able to produce certain export certificates and bills of lading subsequent to the audit, this matter is remanded to the Audit Division. To the extent the export certificates cover disallowed credits, the taxpayer would be entitled to a credit on remand.

b. OST

Rule 260(7)(c) provides for an OST export credit when a person sells a previously taxed product for export when, as a necessary incident to a contract of sale, the seller agrees to and does deliver the previously taxed product for export. Products for export include fuel in the purchaser's tank:

> Sales of petroleum products by delivery into the fuel tank of a vessel or other vehicle in quantities greater than one hundred gallons will be considered placed into the export stream, provided the vessel or vehicle is immediately destined for a point outside this state and the seller obtains and keeps the documentary evidence provided in (d) of this subsection.

Id. Unlike with the HST fuel-in-tank credit, there is no requirement for the purchaser to calculate the amount of fuel consumed in Washington for purposes of the OST export credit.

In subsection (d) of Rule 260(7), documentation supportive of an OST export credit consists of either a "a bona fide bill of lading in which the seller is the shipper/consignor and by which the carrier agrees to transport the product to the buyer at a destination outside the state" or an export certificate. *See generally* Det. No. 97-093ER, 17 WTD 126 (1998).

Because the taxpayer was able to produce certain export certificates and bills of lading subsequent to the audit, this matter is remanded to the Audit Division. To the extent the export certificates cover disallowed credits, the taxpayer would be entitled to a credit on remand.

3. OST Presumption and Commingled Products.

[3] The taxpayer receives both taxed and untaxed crude oil at its Washington refinery. Taxed and untaxed crude oil are commingled and then refined into other petroleum products. This makes it difficult to precisely trace what shipments of refined petroleum products have been previously taxed for OST purposes. The Department established on an average basis the amount of untaxed crude oil in the taxpayer's products. The Department then applied the percentage of untaxed crude receipts to the taxpayer's waterborne shipments to itself in Washington to determine the portion of these shipments that were subject to OST.

In response, the taxpayer contends that all fuel that shipped from its [Washington] refinery by barge or vessel to its [Washington] sales terminals are exempt from the Oil Spill Tax due to the presumption in Rule 260(6)(a)(i), which provides:

> All crude oil or petroleum products loaded on a vessel and shipped from a point within this state will be presumed, subject to rebuttal, to be previously taxed product. The subsequent receipt at a point within this state of such product will be treated as exempt from the tax.

Whether a rebuttable presumption is overcome is a question for the trier of fact. *See, e.g., In re Estate of Riley,* 78 Wn.2d 623, 479 P.2d 1 (1970). Although certain presumptions can only be overcome by clear, cogent, and convincing evidence, such a higher standard of proof generally applies only to presumptions that have a strong policy base. K. Tegland, 5 Wash. Prac., *Evidence Law and Practice* § 301.14 –301.15 (4th ed.). Otherwise, a presumption has the effect of shifting the burden of proof and does not change the quantum of proof necessary to overcome the presumption. *Id.*

In this case there is no strong policy base to the presumption and the effect of the presumption is to shift the burden to the Department. The quantum of proof necessary for the Department to overcome the presumption is unchanged. In order to overcome this presumption the Department must show, by a preponderance of the evidence, the amount of crude oil or petroleum product that was not previously taxed. Based on the undisputed evidence, we conclude the Department has met its burden to establish that a specific portion of the waterborne shipments the taxpayer receives in Washington was not previously taxed product and, therefore, subject to tax.

The taxpayer contends that the Department failed to rebut the presumption because of how others were treated. The taxpayer argues that the Department did not assess additional OST on the taxpayer's products received at marine terminals operated by others, but only at terminals operated by the taxpayer. Whether others were assessed or could have been assessed additional OST is not an issue before us and could simply result from the Department being unable to meet its burden of proof in such cases. Here, the evidence before us shows the taxpayer received at its marine terminals products that were both taxed and untaxed and the amount of untaxed product on a percentage basis.

[4] The taxpayer further argues that the Department is relying on a presumption (that a proportionate amount of each shipment involved untaxed product) to rebut a presumption and to determine the measure of the tax. In considering this issue, we look to the weight of the evidence and do not require a tracing of the actual amounts of untaxed product in each shipment. Where a calculation of taxable and exempt income cannot be made with mathematical certainty, the Department, acting with reasonable prudence and circumspection with regard to all of the circumstances of the taxpayer's business, allocates income in a reasonable manner, the burden shifts to the taxpayer to show that the Department's calculation is unreasonable, excessive, or has been arbitrarily and capriciously achieved. *See Smith v. State*, 64 Wn.2d 323, 339**,** 391 P.2d 718 (1964). After the Department overcame the presumption, the burden shifted to the taxpayer. But the taxpayer did not meet its burden to show the Department acted in an unreasonable manner in determining the amount of additional OST that became due on commingled products.

The taxpayer further argues that the shipments were not subject to tax because a "prudent person" would first ship previously taxed product to itself in order to minimize its tax liability, and ship

untaxed products to others, is not persuasive. The taxed and untaxed products were commingled and it would be a fiction to consider only previously taxed products as being shipped to the taxpayer. In making this argument, the taxpayer relied on Det. No. 88-329, 6 WTD 321 (1988), which is not controlling. Det. No. 88-329 concerned HST liability in certain "rare cases" not at issue here.

Moreover, that determination is of questionable validity today. Rule 252 was subsequently amended and superceded that decision. As discussed further below, Rule 252 does not support the fictional treatment of commingled products, as advanced by the taxpayer. This conclusion is consistent with the holding by the Board of Tax Appeals in *Chevron USA, Inc. v. Department of Rev.*, Doc. No. 99-94 (Bd. of Tax Appeals 1999). In Doc. No. 99-94, the Board similarly concluded the Department is not bound by Det No. 88-329, because the decision was superceded by later rules.

Accordingly, the taxpayer's petition on this claim is denied.

4. HST and MATC on Products Exported and Then Imported.

The taxpayer contends the Department erred in not allowing HST credits or exemptions on products shipped [outside Washington], which were then commingled (where no new product was created) or blended with other products (where a new product was created), and then shipped back into Washington.[8] Once in Washington, the product may be sold or combined with another product, creating a new product for sale in Washington.

. . . [D]ifferent fact scenarios may result in different tax consequences under the applicable rule. Two fact patterns involve the commingling of products, where no new product is created. Such commingling can occur either in Washington or [outside Washington]:

(a) The taxpayer commingles it products with other manufacturer's products (which may or may not have originated in Washington), upon which tax was previously paid on all of the products that were commingled.
(b) The taxpayer commingles it products with other manufacturer's products (which may or may not have originated in Washington), upon which tax was not previously paid on some of the products that were commingled.

Four additional fact patterns involve blending or manufacturing, where new products are created for sale. The blending can occur either in Washington or [outside Washington]:

(c) The taxpayer blends a hazardous substance, upon which it was the first possessor in Washington and upon which tax was paid, with a nonhazardous substance, creating a new product possessed by the taxpayer.

[8] The taxpayer also asserts that similar issues are raised with respect to OST. But the OST provisions provide for an export credit, unlike the HST, which does not have an export credit available. No similar claim for credits or exemptions for previously paid OST are at issue in this section.

(d) The taxpayer blends a hazardous substance, upon which it was not the first possessor in Washington and upon which tax was paid, with a nonhazardous substance, creating a new product possessed by the taxpayer.
(e) The taxpayer blends a hazardous substance, upon which tax was paid, with a different hazardous substance upon which tax was previously paid, creating a new product.
(f) The taxpayer blends a hazardous substance, upon which tax was previously paid, with a different hazardous substance, upon which tax was not previously paid, creating a new product.

Each of these fact patterns will be discussed in turn below. In subsection (g), we will also discuss the possible application of the MATC on products exported [outside Washington] and imported into Washington.

a. Exemptions for hazardous products from different sources, upon which tax was paid, and commingled [out-of-state] or [in] Washington.

Rule 252(4) provides that any "successive possessions of any previously taxed hazardous substances are tax exempt." Evidence of previously taxed products may be in the form of certificates taken in good faith or other documentation that establishes proof of prior payment:

> (i) Any person who possesses a hazardous substance which has been acquired from any other person who is registered with the department of revenue and doing business in this state may take a written statement certifying that the tax has been previously paid. Such certifications must be taken in good faith and must be in the form provided in the last part of this section. Blanket certifications may be taken, as appropriate, which must be renewed at intervals not to exceed four years. These certifications may be used for any single hazardous substance or any broad classification of hazardous substances, e.g., "all chemicals."
>
> (ii) In the absence of taking such certifications, the person who possesses any hazardous substance must retain proofs that it purchased or otherwise acquired the substance from a previous possessor in this state. It is not necessary for subsequent possessors to obtain certificates of previously taxed hazardous substances in order to perfect their tax exemption. Documentation which establishes any evidence of previous tax payment by another person will suffice. This includes invoices or billings from in state suppliers which reflect their payment of the tax or simple bills of lading or delivery documents revealing an in state source of the hazardous substances.

Because of the different sources for products commingled [outside Washington], it may be appropriate to require separate blanket certificates for products purchased or supplied [outside Washington] as opposed to blanket certificates for products supplied or purchased in Washington. But in this case, for products the taxpayer purchased in Washington, shipped [outside Washington], and then shipped back into Washington, the Department allowed an exemption. As the Department states: "any products received from another person in this state were presumed to have been previously taxed. [The taxpayer] was allowed this credit on that portion of fuel that it exported and then re-imported." Accordingly, this fact scenario is not at

issue in this case except as to the possible purchase of products [outside Washington], on which tax may have been previously paid by the [out-of-state] supplier, and commingled [outside Washington]. To the extent that separate blanket certificates or other acceptable evidence is presented, the taxpayer may be entitled to some adjustment on the HST.

b. Exemptions for products from different sources, upon which tax was not previously paid on some of the products, and commingled [out-of-state] or [in] Washington.

With respect to commingled products from different sources where some of the product was not previously taxed, the taxpayer first argues that it is entitled to the "prudent person" analysis set forth in Det. No. 88-329 in determining the exemptions for previously taxed products. As discussed above, the Department is not bound by the prudent person presumption in Det. No. 88-329. Rather, WAC 458-2-252 (12) represents the Department's position with respect to the interpretation of the HST in effect during the audit period. It states:

> Hazardous substances untraceable to source. Various circumstances may arise whereby a person will possess hazardous substances in this state, some of which have been previously taxed in this or other states and some of which may not. In such cases formulary tax reporting may be used, only upon a special ruling by the department of revenue.
>
> (a) Example. Fungible petroleum products from sources both within and outside this state are commingled in common storage facilities. Formulary reporting is appropriate based upon volume percentages reflecting the ratio of in-state production to out-of-state production or other form of acquisition.

The Department employed a formula similar to the one given as an example in determining the amount of the credits available for commingled products. We conclude there is no basis for the taxpayer to substitute its formula, one based on the presumption set forth in Det No. 88-329, even if it had requested a special ruling from the Department. The formula employed by the Department more accurately reflects how the taxpayer and similarly situated taxpayers conducted their business. A similar conclusion was reached by the Board of Tax Appeals in *Chevron USA, Inc. v. Department of Rev.*, Doc. No. 99-94 (Bd. of Tax Appeals 1999).

The taxpayer also contends it is entitled to an exemption for the petroleum products that [out-of-state] vendors shipped from their [out-of-state] locations to the taxpayer's . . . , Washington terminal. As noted by the Department, the taxpayer has not supplied the Department with any blanket certifications of previously taxed hazardous substances to cover such products. Ultimately it becomes a fact question with respect to an exemption for previously taxed products. The taxpayer bears the burden to establish entitlement to an exemption from tax. As stated in *Budget Rent-A-Car, Inc. v. Department of Rev*., 81 Wn.2d 171, 174- 75, 500 P.2d 764 (1972), "Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it." The taxpayer has not met its burden in this case for an exemption to apply to these particular shipments.

c. Credit for hazardous substances, upon which the taxpayer was the first possessor in Washington and upon which tax was paid, blended [out-of-state] or [in] Washington with a nonhazardous substance (e.g., denatured ethanol), creating a new hazardous product sold by the taxpayer in Washington.

Under the terms of Rule 252(5)(a)(iii), HST is due on the value of the end product, with a credit for tax previously paid on the hazardous ingredients, so long as the taxpayer was the first possessor in Washington of both the hazardous ingredient and the petroleum-based end product. In such scenarios, Rule 252(5)(a) provides for a HST credit as follows:

> A credit may be taken by any manufacturer or processor of a hazardous substance produced from ingredients or components which are themselves hazardous substances, and upon which the HST has been paid by the same person or is due for payment by the same person.
>
> . . .
>
> (iii) This credit may be taken only by manufacturers who have the first possession in this state of both the hazardous ingredients and the hazardous end product.

To the extent the evidence shows the taxpayer created products [outside Washington] in this manner (e.g., blended gasoline first possessed by the taxpayer in Washington with denatured ethanol), it would be entitled to the credit. The Department was under the belief that no such blending occurred [outside Washington]. The issue is remanded to the Audit Division. To the extent the taxpayer has adequate evidence to support such a claim, it must be supplied to the Department within 60 days of the date of this decision.

d. Credits for hazardous substances, upon which the taxpayer was not the first possessor in Washington and upon which tax was paid, blended with a nonhazardous substance, creating a new product possessed by the taxpayer in Washington.

Under the terms of Rule 252(5)(a)(iii), tax is due on the value of the end product, with no credit due for tax previously paid tax on the hazardous ingredients, if the taxpayer was not the first possessor in Washington of both the hazardous ingredients and the petroleum-based end product. Accordingly, the taxpayer would not be entitled to a credit in this fact scenario, whether blending occurred in Washington or [outside Washington].

e. Taxation of a new product created [out-of-state] or [in] Washington by blending hazardous products, upon which tax was previously paid.

Under Rule 252(7)(a), no additional tax is due on a hazardous end product when the ingredients were hazardous and tax was previously paid on the ingredients. It provides:

> [t]he term "product" is defined to mean only an item or items which contain a combination of both hazardous substance(s) and nonhazaradous substance(s). The term does not include

> combinations of only hazardous substances. Thus, possessions of substances produced by combining other hazardous substances upon all of which the tax has previously been paid will not again be taxable.

To the extent the evidence shows the taxpayer created products [outside Washington] in this manner (e.g., blended different grades of gasoline upon which tax had been previously paid), no additional tax would be due. But, as noted by the Department in its instructions to the taxpayer, the taxpayer has not supplied the Department with any blanket certifications of previously taxed hazardous substances or other documents to cover such products shipped into Washington. Given the various sources for ingredients, the fact that the taxpayer may have exported a product [outside Washington] does not automatically mean that product was used to produce a product that was then imported into Washington. Ultimately it becomes a fact question upon which the taxpayer bears the burden of proof. To the extent the taxpayer has adequate evidence to support such a claim, it must produce such evidence to the Audit Division within 60 days from the date of this decision.

f. Taxation of a new product created [out-of-state] by blending hazardous products, upon which tax was previously paid on some, but not all, of the ingredients.

Under this scenario, tax would be due on the value of the end product, because tax had not been paid on some of the ingredients. Rule 252(7). Whether the taxpayer would receive a credit for previously paid tax would depend on whether the taxpayer first possessed the hazardous ingredient in Washington and had paid the HST on that ingredient.

This result, however, would not occur if blending occurred in Washington, because a taxpayer would first owe tax on a hazardous ingredient possessed in Washington upon which tax had not been paid. Because tax would be due on the possession in Washington of the hazardous ingredient upon which tax had not been paid, the scenario would be taxed as set forth in the previous scenario. Under that scenario, tax would not be due on the value of the end product because tax had been paid on the hazardous ingredients.

Because of this difference, the taxpayer contends the provision discriminates against interstate commerce. *See Tyler Pipe Industries, Inc. v. Dept. of Revenue*, 483 U.S. 232 (1987). To overcome this possible concern, the taxpayer urges us to allow a credit for previously paid tax without regard to whether the taxpayer was the first possessor of the ingredient in Washington. In other words, the taxpayer asks us to invalidate a portion of Rule 252(5)(a)(iii). With respect to such arguments, "an administrative body does not have the authority to determine the constitutionality of the law it administers; only the courts have that power." *Bare v. Gorton*, 84 Wn.2d 380, 383, 576 P.2d 379 (1974); *see also* Det. No. 92-295R13 WTD 166 (1993). Accordingly, we decline to address the taxpayers' argument in this regard.

g. MATC

At the latest hearing in the case, the taxpayer also asserted that additional multiple activities B&O tax credits (MATC) may be due on ingredients manufactured in Washington (upon which manufacturing B&O tax was paid) shipped [outside Washington], blended with other ingredients, and the final product sold in Washington (upon which wholesaling or retailing B&O tax was paid). The MATC provides in relevant part as follows:

> (1) Every person engaged in activities which are within the purview of the provisions of two or more of sections RCW 82.04.230 to 82.04.290 [which includes manufacturing B&O tax], inclusive, shall be taxable under each paragraph applicable to the activities engaged in.
>
> (2) Persons taxable under RCW 82.04.250 [or] 82.04.270 [Retailing or Wholesaling B&O tax] . . . with respect to selling products in this state shall be allowed a credit against those taxes for any (a) manufacturing taxes paid with respect to the manufacturing of products so sold in this state, . . .

RCW 82.04.440; *see also* WAC 458-20-19301 (Rule 19301). For example, manufacturing taxes paid in another state on products manufactured both within and without the state can be used as a credit against Washington wholesaling or retailing B&O tax when the goods are subsequently sold in this state. Rule 19301(3)(e).

The rule, however, provides that the person seeking the credit must be the one who was obligated to pay the taxes:

> The person claiming the credit(s) must be the same person who is legally obligated to pay both the taxes which give rise to the credit(s) is claimed. The MATC is not assignable.

Rule 19301(4)(b).

The rule further provides that the credit is product-specific:

> The business activity subject to tax, and against which the credit(s) is claimed, must involve the same ingredients or products upon which the tax giving rise to the credit(s) was paid. The credits must be product-specific.

Rule 19301(4)(d).

Therefore, manufacturing B&O tax paid by the taxpayer on petroleum products used to manufacture products that are ultimately sold in another state may not be used as a credit against Washington retailing or wholesaling B&O taxes paid by the taxpayer on products sold here. Rather, the taxpayer is only entitled to the MATC for the portion of the manufacturing B&O tax that is attributable to petroleum products that become part of the finished products ultimately sold in this state. The taxpayer bears the burden of establishing entitlement to the credit.

The rule, however, does provide for the possibility of a proportionate credit when fungible items are commingled:

> Special circumstances may arise where it is not possible to specifically identify ingredients or products as they move from production to sale (e.g., fungible commodities from various sources stored in a common warehouse). In such cases the taxpayer should seek advance approval from the department, in writing, for tax reporting and credit taking on a test period, formulary, or volume percentage basis, subject to audit verification.

Rule 19301(8)(b). On the record before us, it is difficult to ascertain whether some of the petroleum products produced by the taxpayer in Washington were commingled with other products [outside Washington] and, thereafter, a new product created, which the taxpayer sold in Washington. The taxpayer will be given sixty days to produce documentation supporting any additional multiple activities tax credit in this regard.

5. Value of Exported Products for B&O and HST purposes; Value of Sales in Washington for HST Purposes (Taxpayer's Original Issue 13).

[5] The taxpayer asserts the Department erred in its method of valuing exported products and in-state sales. The challenged valuation methodology applies to both the HST and the B&O tax.

The rate of the HST "shall be seven-tenths of one percent multiplied by the wholesale value of the substance." RCW 82.21.030. The term "wholesale value" is defined to mean "the fair market wholesale value, determined as nearly as possible according to the wholesale selling price at the place of use of similar substances of like quality and character, in accordance with rules of the Department." RCW 82.21.020(5). Under the rule promulgated by the Department, the term "wholesale value" is further defined to mean:

> "Wholesale value" is the tax measure or base. It means the fair market value determined by the wholesale selling price.
>
> In cases where no sale has occurred, wholesale value means the fair market wholesale value, determined as nearly as possible according to the wholesale selling price at the place of use of similar substances of like quality and character. In such cases the wholesale value shall be the "value of the products" as determined under the alternate methods set forth in WAC 458-20-112.

Rule 252(2)(g) (emphasis added). WAC 458-20-112 (Rule 112) defines the term "value of products" for B&O tax purposes, in accordance with RCW 82.04.450. It provides the following alternative methods of valuing goods transported out of the state, or to another person, without prior sale:

> [T]he value shall correspond as nearly as possible to the gross proceeds from other sales at comparable locations in this state of similar products of like quality and character, in similar quantities, under comparable conditions of sale, to comparable purchasers, and shall include subsidies and bonuses.

> 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 or article extracted or manufactured, including direct and indirect overhead costs.

To the extent the taxpayer seeks a valuation other than the price actually paid by a wholesaler or retailer for sales in Washington, its claim is denied. When there are actual sales, the "wholesale value," is the "price paid by a wholesaler or retailer to a refinery or manufacturer." Det. No. 88-329, 6 WTD 321 (1988); Rule 252(2).

In response, the taxpayer argues that the wholesale value should be determined at the place of first possession, that is, at the refinery. Because the Washington sales occur at the place of delivery (WAC 458-20-103), away from the refinery, the actual price does not accurately reflect the wholesale value at the refinery. Based on this argument, the taxpayer asserts that delivery costs from the refinery to the point of delivery should be deducted from the actual selling price. But the rule specifically provides that the wholesale value is "the fair market value determined by the wholesale selling price." Rule 252(2)(g). The statute specifically authorizes the Department to establish rules for determining the wholesale value. Under the rule promulgated by the Department, no allowance is made for deducting transportation costs in determining the measure of the tax for Washington sales.

The taxpayer further argues the Department erred in using Platt's Oil Price Handbook & Oilmanac in setting the wholesale value for exports by pipeline or barge both to itself and to other producers under exchange agreements. In Det. No. 93-118, 13 WTD 262 (1994), we ruled that, absent actual sales, prices listed by independent publications such as Platt's can be relied on to determine the wholesale value of petroleum products delivered under exchange agreements. The taxpayer in that case, as here, argued that cost should be used. In discussing cost, Det. No. 93-118 reviewed various industry-related problems in using cost and stated that "we are not convinced that accurate cost figures are available, nor do we believe that they would accurately reflect the value of the products exchanged." *See also Shell Oil Co. v. Department of Rev.*, No. 93-28 (Bd. of Tax Appeals 1997). As a result of these problems, we concluded that, absent actual sales, the bulk barge and pipeline sales listed in Platt's more accurately reflect the wholesale value of exchanged products. The same holding applies in the present case, even if the taxpayer was able to produce cost figures.

The taxpayer next argues that, even if exports involving exchanges are valued in accordance with Platt's, it cannot be used to value transfers from the taxpayer to itself. It argues that Platt's does not report "similar quantities, under comparable conditions of sale, to comparable purchasers," as required by Rule 112. The taxpayer bases its argument on the large volume of transfers that it makes to its terminals [outside Washington] on a monthly or annual basis. It contends that the bulk sales reported in Platt's are significantly less than the cumulative volumes of such transfers. However, we remain unconvinced that the transfers when made (not on a cumulative basis) are not in quantities comparable to the bulk sales reported in Platt's. . . . Based

on the evidence before us, we conclude that Platt's presents the best evidence of wholesale value for the petroleum products that the taxpayer exports to itself outside Washington.

A potential issue, however, remains whether transportation charges were appropriately deducted. Rule 112 provides that, for exported products, transportation charges "may be deducted from the gross proceeds of sales so much thereof as the taxpayer can show to be actual transportation costs from the point at which the shipment originates in this state to the point of delivery outside the state." . . . We understand Platt's reports sales at the place of sale, in this case [out-of-state], and do not specifically include transportation charges in the amounts reported. But if the taxpayer incurs actual transportation charges in delivering the products [out-of-state], such actual costs can be deducted from gross sales [for B&O tax purposes], in accordance with Rule 112.

In the future, to the extent the taxpayer can show actual transportation charges from the point originating in Washington to the point of delivery outside the state it can deduct such actual transportation charges from the gross proceeds of sale. To the extent the gross proceeds of sale are calculated solely by using Platt's and no actual transportation occurs (for example, with certain exchanges), transportation charges cannot be deducted.

6 and 7. HST Exemption for Gasohol; Measure of Gasohol for OST Purposes.

[6] The taxpayer next contends that HST should not be imposed on the possession of gasohol. It arrives at this contention by first claiming that denatured ethanol is a "petroleum product" (a hazardous substance) and that the blending of denatured ethanol with gasoline, another hazardous substance, to create gasohol does not result in a new hazardous substance subject to HST. Accordingly, whether it does the blending here on previously taxed and untaxed products or it does the blending outside Washington, it contends no additional HST is due. The taxpayer misreads the applicable law.

Although gasoline is specifically identified as a petroleum product subject to HST, denatured ethanol is not so identified. The term "petroleum product" is defined at WAC 458-20-252(2)(b) to mean:

> "Petroleum product" means any plant condensate, lubricating oil, crankcase motor oil, gasoline, aviation fuel, kerosene, diesel motor fuel, benzol, fuel oil, residual fuel, asphalt base, liquefied or liquefiable gases, such as butane, ethane and propane, and every other product derived from the refining of crude oil, but the term does not include crude oil.

The term "derived from the refining of crude oil" is further defined to mean:

> The term "derived from the refining of crude oil" as used herein, means produced because of and during petroleum processing. "Petroleum processing" includes all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to crude oil or any byproduct of crude oil so that as a result thereof a fuel or lubricant is produced for sale or commercial or industrial use. "Fuel" includes all combustible gases and

> liquids suitable for the generation of energy. The term "derived from the refining of crude oil" does not mean petroleum products which are manufactured from refined oil derivatives, such as petroleum jellies, cleaning solvents, asphalt paving, etc. Such further manufactured products become hazardous substances only when expressly so designated by the director of ecology.

WAC 458-20-252(2)(b)(i) (emphasis added).

The taxpayer purchases the denatured ethanol from a third-party vendor. It neither produces it because of and during petroleum processing nor produces it for sale as a fuel. Rather, the taxpayer's vendor manufactures a refined oil derivative through the blending of small amounts of gasoline, as a denaturant, with ethanol. Such products are not considered to be hazardous substances subject to the HST. In contrast, when the taxpayer uses denatured ethanol to create a new petroleum product, the new product is a hazardous substance. In its operations, the taxpayer combines a hazardous substance, gasoline, with a non-hazardous substance, denatured ethanol, to produce a new petroleum product, an oxygenated gasoline. This oxygenated gasoline is subject to the HST based on its wholesale price. *See* Rule 252(1).

To read the rule as the taxpayer suggests would result in any substance that might be used as a fuel (such as alcohol not produced through a petroleum refining process) becoming a hazardous substance simply by the addition of a small amount of gasoline, regardless of how the product is actually produced or sold. We find no support for such a reading under the plain wording of the rule.

As to any increase in OST resulting from the addition of denatured ethanol to gasoline in Washington and subsequent shipment between ports in Washington, the taxpayer has the same problem discussed in subsection 3, *supra*. Accordingly, we deny the taxpayer's petition with respect to the imposition of additional HST and a refund of OST on gasohol products.

8. Use Tax on Fuel Sold to Unregistered Taxpayers Leaving the State.

RCW 82.08.0261 provides an exemption from retail sales tax for bunker fuel sales to interstate and foreign carriers, even though possession is taken in Washington. But use tax becomes due for the fuel used in Washington. WAC 458-20-175 (Rule 175), explains and implements this tax exemption for persons engaged in the business of operating as a private or common carrier by air, rail, or water in interstate commerce. Rule 175 has specific provisions for use tax on consumable goods, such as bunker fuel, that are purchased by foreign carriers. Foreign carriers that are registered with the state are allowed to pay the use tax that becomes due directly to the state. But carriers not registered with the Department are required to pay the use tax to the seller.

Under the rule, sellers must collect from unregistered buyers the amount of use tax applicable to that portion of the fuel that will be consumed within this state:

> [W]here consumable goods, such as ice, bunker fuel, or lubricants are purchased by or for carriers not registered with the Department, and delivered on board a carrier regularly engaged in interstate or foreign commerce for consumption while both within and without the territorial boundaries of the state of Washington, the seller is required to collect from the buyer the amount of use tax applicable to that portion of the products sold which will be consumed within this state.

Id. If the taxpayer does not obtain a certificate identifying the amount of fuel consumed in Washington and collect the tax from unregistered buyers, the full amount is presumed subject to use tax.

> It will be presumed that the entire amount of the goods purchased will be consumed within this state unless the seller obtains from the buyer a certificate certifying as to the amount thereof which will be consumed while within the territorial boundaries hereof.

Id. Excise Tax Advisory 562.21.23A (ETA 562) provides a formula for use by vessels operating in interstate or foreign commerce for reporting their HST liability. The Department instructed the taxpayer, in the future, to have vessels use the same formula for identifying the amount of fuel consumed in Washington for use tax purposes.

Under Rule 175, in the absence of the taxpayer collecting use tax from unregistered carriers on the bunker fuel consumed in Washington, estimated in accordance with ETA 562 or by another means, the full amount of bunker fuel is presumed subject to use tax. Accordingly, we sustain the Department's future instructions to the taxpayer. In the future, the taxpayer should collect use tax from unregistered carriers on the amount of fuel consumed in Washington. Otherwise, use tax may be due on the full value of the bunker fuel sold to unregistered carriers leaving the state.

9. Manufacturing B&O Tax and HST on Still Gas and Coke.

[7] As part of the refining process, the taxpayer produces still gas and catalytic coke as byproducts of its operations. The taxpayer contends that the still gas and catalytic coke are not subject to tax because they have no market value. To the extent they are subject to tax, the taxpayer contends the Department erred in its valuation method.

a. Still Gas

RCW 82.04.120 imposes the manufacturing B&O tax upon "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 . . . ." Byproducts produced by the taxpayer for commercial or industrial use by the taxpayer are subject to manufacturing B&O tax. *See, e.g.,* Det. No. 89-551, 9 WTD 031 (1989).

RCW 82.04.210 defines a "byproduct" as

> any additional product, other than the principal or intended product, which results from extracting or manufacturing activities and which has a market value, without regard to whether or not such additional product was an expected or intended result of the extracting or manufacturing activities.

The term "market value" as used in this definition is not defined. RCW 82.04.450, however, includes byproducts in the definition of the term "value of products" as follows:

> (1) The value of products, including byproducts, extracted or manufactured shall be determined by the gross proceeds derived from the sale thereof whether such sale is at wholesale or at retail, to which shall be added all subsidies and bonuses received from the purchaser or from any other person with respect to the extraction, manufacture, or sale of such products or byproducts by the seller, except:
>
> (a) Where such products, including byproducts, are extracted or manufactured for commercial or industrial use;
>
> (2) In the above cases the value shall correspond as nearly as possible to the gross proceeds from sales in this state of similar products of like quality and character, and in similar quantities by other taxpayers . . . .

Accordingly, the manufacturing B&O tax is imposed on the value of all products or byproducts that are either produced for sale or produced for commercial or industrial use that result from the manufacturing process. WAC 458-20-121 (Rule 121) further provides that persons who produce their own fuel to generate heat, steam, or electricity are subject to the manufacturing B&O tax on the value of the fuel. We have also specifically held that still gas, as a byproduct, is subject to manufacturing B&O tax. Det. No. 89-551, 9 WTD 031 (1989); *see also Texaco v. Department of Rev.*, No. 70-4 (Bd. of Tax Appeals 1970).

The BTA in *Texaco* concluded that the market value for byproducts produced for commercial or industrial use could be determined on a basis other than commercial sales of the products:

> Thus under exceptions (1) and (2) [of RCW 82.04.450] a market value for byproducts can be established on a basis other than that of commercial sales prices. Commercial sales prices appear as only one basis of establishing market value. We are of the opinion the exception (1) of this statute is definitely applicable to the appellant's refinery gas in issue in this appeal . . . . We are of the opinion the comparison made by the respondent between the value placed upon refinery gas and the commercial charges made for natural gas meets the requirements of the last paragraph of RCW 82.04.450.

Recognizing the lack of a commercial market for still gas, the BTA in *Texaco* upheld the following assessment valuation:

> In making the comparison with natural gas, the difference in the qualities of the two gases was taken into consideration. The value placed upon the gas by the appellant's refinery was used in establishing the assessment made by the respondent.

Id. The Department similarly valued the still gas based on the value placed on the gas by the taxpayer, with the exception of the deduction for amine production taken by the taxpayer. No explanation or support for the amine deduction was presented during the audit or on appeal.

As to the imposition of HST on still gas, in *Shell Oil Co. v. Department of Rev.*, No. 93-28 (Bd. of Tax Appeals 1993), the Board ruled that the Department correctly assessed HST on refinery gas produced and consumed by a taxpayer. We see no basis for a different outcome here.

The costs of producing the still gas, including the cost of removing sulfur from still gas, are not amounts to be deducted in setting the market value, as the taxpayer suggests. Rather, the market value "shall correspond as nearly as possible to the gross proceeds from sales in this state of similar products of like quality and character." RCW 82.04.450. The market value of the still gas to the taxpayer is the cost the taxpayer would have to pay if it did not produce still gas and had to buy natural gas with an equivalent BTU value to operate its plant.

b. Catalytic Coke

The taxpayer also contends the Department improperly assessed tax on the taxpayer's catalytic coke. The Department assessed tax on the catalytic coke produced at the taxpayer's refinery based on the average West Coast prices from the publication "Pace Petroleum Coke Quarterly" for green coke. In addressing this issue, we must distinguish between different types of coke.

Two marketable products are commonly derived in the petroleum refining process, "green coke" and "calcinated coke." Both of these products are solid, nearly pure carbon products resulting from petroleum processing and refining. The primary difference between the two products is that calcinated coke is simply green coke that undergoes a secondary processing step to remove the few hydrocarbons that remain in the raw product. Calcinated coke is commonly sold for use in the aluminum industry. A third type of coke can be produced, "catalyst coke," which is deposited on the catalyst used in the refining process. This coke is generally considered to be not recoverable, and it usually ends up being burned as a refinery fuel. The California Energy Commission defines the term "catalyst coke" as follows:

> In many catalytic operations (e.g.. catalytic cracking), carbon is deposited on the catalyst, thus deactivating the catalyst. The catalyst is reactivated by burning off the carbon, which is used as a fuel in the refining process. This carbon coke is not recoverable in a concentrated form.

(Definition found at http://www.energy.ca.gov/oil/refinery_outpout.definitions.html*). See also* Det. No. 97-093, 17 WTD 121 (1997), which generally describes the processes that produce green coke at a refinery.

Excise Tax Advisory 109.04.135 (1966) (ETA 109) provides that "catalytic coke" produced as a contaminant was not subject to manufacturing B&O tax even though it was incidentally used to produce steam for internal use. The catalytic coke at issue in the present case was a contaminate, which was incidentally used as a fuel in the catalyst recovery process. It falls within the scope of ETA 109. The taxpayer's petition with respect to catalytic coke (also referred to as catalyst coke) is granted.

10. Constitutionality of HST.

The taxpayer advanced no specific constitutional argument and cited to no authority. As courts have noted, "[I]n the absence of argument and citation to authority, we will not consider these issues." *Trohimovich v. State*, 90 Wn. App. 554, 558, 952 P.2d 192 (1998), *citing J-U-B Eng'rs, Inc. v. Routsen*, 69 Wash. App. 148, 152, 848 P.2d 733 (1993). *See U.S. Oil & Refining Co. v. Department of Rev.*, No. 21674-4-II, 1998 Wash. App. LEXIS 1540 (Wa. App. June 12, 1988). In that decision, the court found the HST did not violate the constitutional provision at issue. See also *Bare v. Gorton*, 84 Wn.2d 380, 383, 526 P.2d 379 (1974), in which the court stated that "An administrative body does not have authority to determine the constitutionality of the law it administers; only the courts have that power." Accordingly, the taxpayer's constitutional challenge to the HST is denied.

11. Apportionment of Commission Income.

At the second hearing, the taxpayer withdrew this claim.

12. Chemicals Used in Processing and Ingredients or Components.

[8] A retail sales tax is imposed on each retail sale within the state. RCW 82.08.020. Excluded from the definition of a "retail sale" is a sale of tangible personal property:

> [F]or the purpose of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component or is a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale. . . .

RCW 82.04.050(1)(c). A similar provision is provided for use tax purposes. RCW 82.12.020. These provisions create two distinct exclusions from tax: (1) the ingredients or components exclusion, and (2) the chemicals used in processing exclusion. *Van Dyk v. Department of Rev.*, 41 Wn. App. 71, 702 P.2d 472, (1985). The taxpayer contends that certain chemicals used

during the refining process are not subject to retail sales or use tax because they qualify either as ingredients or components or as chemicals used in processing.

a. Ingredients or components.

The ingredient or component exclusion is implemented by WAC 458-20-113 (Rule 113). The rule, in part, states:

> (2) Ingredients or components. The sale of articles of tangible personal property which physically enter into and form a part of a new article or substance produced for sale does not constitute a retail sale. This does not exempt from the retail sales tax the sale of articles consumed in a manufacturing process which do not enter into and become a physical part of the new article produced for sale, such as fuel used for heating purposes, oil for machinery, sandpaper, etc.
>
> (3) Also, the definition of retail sale does not exclude consumables purchased for use in manufacturing, refining, or processing new articles for sale merely because some constituents of the consumables may also be traceable in the finished product, which are impurities or undesirable or unnecessary constituents of the finished product.

(Emphasis added.)

At issue is whether the chemicals, which may leave a residue in the finished product, should be considered ingredients or components. In general, courts have applied the exclusion to essential ingredients, even ones supplied in small amounts. *See, e.g., Lone Star Industries v. Department of Rev*., 97 Wn.2d 630, 647 P.2d 1013 (1982*); Van Dyk v. Department of Rev.,* 41 Wn. App. 71, 702 P.2d 472 (1985); *see also Weyerhaeuser Co. v Department of Rev.,* 16 Wn. App. 112, 118, 553 P.2d 1349 (1976) ("fuel used in the manufacturing process which incidentally become part of the product manufactured may not be exempt from the sale or use tax.").

In *Lone Star*, the Department assessed retail sales tax on grinding balls and firebricks used in the cement manufacturing process. The manufacturer placed iron grinding balls with raw materials and the rotation of the balls ground the raw materials into a fine residue. Eventually, the grinding balls degraded into the raw materials. Firebricks insulated the outer walls of the kiln and eventually degraded into the raw materials during the firing process. Because the primary purpose of the grinding balls and firebricks was to act as tools, the Department contended they did not qualify as ingredients or components. The Washington Supreme Court held that the law did not support a primary purpose test for the ingredients or components exemption. With respect to the statutory requirements, the *Lone Star* Court instead held:

> Although the grinding balls and firebrick provide only a small percentage of the total ingredients involved in the production of cement, the ingredients they do supply are no less necessary to the production of cement. The important fact is that the iron grinding balls and firebrick actually supply essential ingredients or components of the finished product and not whether the percentage supplied is large or small.

(Emphasis added.) Courts from other jurisdictions have also adopted an "essential" or similar test. *See, e.g., Nucor Corp. v. Herrington, 212 Neb. 310, 322 N.W.2d 647 (1982); North Star Steel Co. v. Iowa Dept. of Rev.,* 380 N.W.2d 677 (1986); *Nucor Corp. v. Balka*, 5 Neb. App. 85, 555 N.W.2d 344 (1996).

The taxpayer argues the chemicals at issue are desirable because the product is sold by volume and the residues add volume, albeit in very small amounts. It does not argue that the residues are essential, necessary, or anything more than impurities in the finished product. But impurities that simply add a little volume to the finished product are not essential ingredients or components. Taken to its logical conclusion, the taxpayer's argument would have the machinery, which wears away over time, be considered an exempt ingredient or component. We do not construe the applicable statues and rules so as to reach such a strained result. Statutes should be construed so as to avoid strained or absurd consequences. *Wright v. Engum*, 124 Wn.2d 343, 351-52, 878 P.2d 1198 (1994).

Consistent with Rule 113(3), we conclude the chemicals at issue are impurities, non-essential, and unnecessary constituents of the finished product. Accordingly, the ingredients or components exemption does not apply to the chemicals at issue in this case.

b. Chemicals used in processing.

In order for the chemical used in processing exemption to apply, "the primary purpose of such chemical" must be to "create a chemical reaction directly through contact with an ingredient of a new article being produced for sale." RCW 82.04.050(1)(c).[9] Accordingly, the chemical must both create a chemical reaction through direct contact with an ingredient of a new article being produced for sale and the chemical reaction must be the primary purpose for using the chemical. *See e.g., Pacific Northwest Alloys, Inc. v. State,* 49 Wn.2d 702, 306 P.2d 197 (1959); *Northwest Steel Rolling Mills, Inc. v. Department of Rev.*, 40 Wn. App. 237, 698 P.2d 100 (1985).

In *Pacific Northwest Alloys*, the taxpayer sought to exempt as a chemical used in processing carbon electrodes used to manufacture metal alloys. The Supreme Court concluded the electrodes did not qualify for the chemicals used in processing exemption, because the primary

[9] WAC 458-20-113 (Rule 113) defines the term "chemical used in processing" as follows:

> (6) "Chemicals used in processing" carries its common restricted meaning in commercial usage. It includes only chemical substances which are used by the purchaser to unite with other chemical substances, present as ingredients or components of the articles or substances being processed, to produce a chemical reaction therewith, as contrasted with merely a physical change therein. A chemical reaction is one in which there takes place a permanent change of certain properties, with the formation of new substances which differ in chemical composition and properties from the substances originally present, and usually differ from them in appearance as well. It is not necessary that all of the new substances which are formed be present in the final completed article or substance which is sold; one or more of such new substances resulting from the chemical reaction may be removed or drawn off in the processing.

purpose of the electrodes was not to create a chemical reaction, but rather to furnish the mechanical means by which the electrical current was introduced into the furnace. The court analogized the electrodes to tools that wear away during the manufacturing process and incidentally enter into the products manufactured.

In *Northwest Steel Rolling Mills*, the taxpayer manufactured new steel products from scrap steel, which it first melted and refined in electric arc furnaces. The refining process included the removal of impurities from the scrap steel through the use of slagging chemicals, calcium carbonate, calcium oxide, and a combination of silicon oxide and magnesium oxide. The slagging chemicals were added to the scrap steel after it was melted and reacted with impurities in the molten steel to form slag, which settled to the bottom of the molten mass. The purified steel then became the material for the new products.

In describing the process, the Court of Appeals stated: "As the chemicals are mixed with the melted scrap, they can be said to contact the ingredients of the final products. The chemical reaction, however, is with the impurities rather than with the steel ultimately used by Northwest to make the articles it sells." 40 Wn. App. at 239. Under such circumstances, the court held that the exemption did not apply to the process used by Northwest, and reasoned:

> The exemption applies only to chemicals that "create a chemical reaction directly through contact with an ingredient of a new article being produced". "Directly" means "without any intervening space and time" *Webster's Third New International Dictionary* 641 (1969)); "through," when used in this context, means "by reason of: on the basis of: because of". *Webster's Third New International Dictionary* 2384. Consequently, the exemption covers only those chemicals that react *because of* their contact with an *ingredient* of the new product. Finding 5 says only that, although the chemicals contact ingredients of the final product, they *react* with impurities in the mixture. It must follow that the reaction takes place because of contact with the impurities, not because of contact with the ingredients. The trial court did not find that the reaction occurs "through [because of] contact" with an ingredient of the final product. Therefore, the exemption does not apply.

40 Wn. App. at 240-41.

In the present case, the taxpayer argues that the chemical used in process exemption applies and provides the following explanation of the function of [separation chemical]:

> An oil soluble demulsifier that is injected into the desalting process to react with the emulsifying surfactants to create a non-emulsifying complex, thereby, aiding in the dehydration of the oil and removing the water soluble contaminants (Salts) from the crude oil prior to distillation. The product reacts at the surface tension level of the emulsion exchanging electrons to aid in the removal of surfactants from the oil.

This description is insufficient for determining whether the chemical qualifies for the exemption. It is unclear whether there is a chemical reaction (as defined in Rule 113) and, if a chemical reaction occurs, whether the reaction is with natural surfactants (surface acting ingredients) or other contaminants that are removed during the desalting process. If a chemical reaction takes place because of contact with the impurities the exemption would not apply.

The taxpayer bears the burden to establish entitlement to an exemption from tax. As stated in *Budget Rent-A-Car, Inc. v. Department of Rev*., 81 Wn.2d 171, 174- 75, 500 P.2d 764 (1972), "Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it." The taxpayer has not met its burden for this chemical.

The taxpayer provided the following explanation of the function of [reaction chemicals]:

> A water soluble blend of neutralizing amines that is injected into the vapor overhead line in the Crude Fractionation Tower to neutralize the acids (HCL and other acids) that are produced in the distillation process, whereby, reducing the corrosive nature of the stream. The reaction produces an amine salt, removing the acids from the naphtha stream resulting in an improved stream for further refining into gasoline.

Under this description, the reaction is with acid contaminants that are removed following the distillation process. As in *Northwest Steel Rolling Mills* the purpose of the chemical reaction is to remove the impurities rather than to create the products sold and, therefore, the exemption does not apply.

The taxpayer provided the following explanation of the function of [dispersant chemicals]:

> An oil soluble filming amine which functions as a dispersant and a filmer in the process. This product prevents the process from reacting with ammonium chloride salts that would increase the contaminates (FeS) in the process stream by donating hydrogen to form an oxide. The secondary function of this product is to provide a sulfide barrier to the equipment surfaces.

This description is insufficient for determining whether the chemical qualifies for the exemption. It is unclear whether there is a chemical reaction as defined in Rule 113. If used as a firming agent to avoid corrosion on equipment surfaces, it would not appear to qualify for the exemption. If a chemical reaction occurs, it is further unclear whether the reaction takes place because of contact with either impurities in the process stream or with the iron in the equipment, neither of which would result in the exemption applying. Again, the taxpayer has not met its burden to show that the chemical used in processing exemption applies to these chemicals.

In response, the taxpayer provided a non-specific and summary affidavit that simply concludes the various chemicals "react with a chemical substance that is present as an ingredient of the article being processed." It does not express how or to what degree the alleged reaction takes place. Because of its sketchy and incomplete nature, the affidavit actually adds weight to the

conclusion that the alleged chemicals used in processing probably do not qualify for the exemption. It leads us to conclude that the primary purpose of such chemicals are for purposes other than to create a chemical reaction directly through contact with an ingredient of the new article being produced for sale. Accordingly we deny the taxpayer's claim.

13. M&E Exemption on Loading Rack.

RCW 82.08.02565 and 82.12.02565 provide retail sales and use tax exemptions, respectively, for equipment sold to or used by a manufacturer where such equipment is "used directly in a manufacturing operation."

Under these provisions, equipment need not be used exclusively in manufacturing to qualify for exemption. But in order for machinery and equipment to qualify for the exemption, the majority of the use (as measured by the percentage of time, revenue, or volume of products derived, or other reasonable measure) must be in the manufacturing operation. Det. No. 00-026, 19 WTD 941 (2000). The legislative history of the M&E exemption supports this conclusion. As summarized in Det. No. 00-026:

> In the 1999 revision of RCW 82.08.02565, the legislature and Governor considered whether a "majority use" test must be met for machinery and equipment to qualify for the exemption. After the legislation was introduced as House Bill 1887, the Department advised the House Finance Committee that the Department applies a majority use test to determine whether dual use machinery and equipment qualifies for exemption. Thus, the House was aware that the Department applied a majority use test under the existing language in RCW 82.08.02565 when the House retained the relevant statutory language.
>
> After the bill passed the House, the bill's sponsors in the Senate discussed the majority use test. One senator questioned the absence in the bill of the dual use standard regarding qualifying and nonqualifying use. Another senator explained that such language was not necessary because the Department's administrative practice was to apply a "majority use" test. The senator concluded, "It is within the administrative authority of the Department to use this standard, both for the past and in the future."
>
> The bill passed the Senate without changes to the applicable language. Finally, the Governor expressed his understanding of the bill in his veto message:
>
> > ESHB 1887 clarifies the scope of a tax exemption and is very important. Taxpayers who are eligible for the exemption, as well as our state and local governments, need the certainty that this bill will provide. I have assumed, as did the legislature (as indicated by our respective balance sheets), that there is no fiscal impact associated with sections 1 through 4 of the bill. That is based on the continuing application of the "majority use" standard for machinery and equipment that has both qualifying and nonqualifying uses. The majority use standard affords meaningful use of the exemption to taxpayers, is fair, and is a

> reasonable way to administer the exemption consistent with the law, legislative intent, and promotion of economic development in our state. I strongly support the Department of Revenue's continued use of this standard.

(Footnotes omitted.)

Thus, if the majority use of the rack control system and related equipment was for non-manufacturing purposes, the exemption does not apply. Under criteria involving time, revenue, or volume the equipment at issue in this case would not qualify for the exemption.

The taxpayer, however, argues that a different standard should be used, that is, the "reason the item was purchased." It asserts that the reason some of the valves and equipment were purchased was to be able to blend different grades of gasoline and, from this assertion, concludes that the entire system should be exempt.

We conclude that such a test would not provide certainty or a reasonable means to administer the law. It would introduce an element of subjectivity into the administration, by looking into the taxpayer's intent, rather than to actual use. It is also not a standard contemplated by the legislature, as discussed above. We also do not find it reasonable to look at the intent behind the purchase of one component as a means to determine the taxation of the capital purchases as a whole. In contrast, the standard used by the Department provides an objective and reasonable means to administer the law. Accordingly, we deny the taxpayer's petition as to an M&E exemption.

DECISION AND DISPOSITION:

a. Taxpayer . . . :

The petition of taxpayer . . . is granted in part (§ 9(b)), remanded in part for further proceedings (§§ 1, 2(a), 2(b), 4(a), 4(c), 4(e), 4(g)), and denied in part (all remaining issues). The taxpayer has sixty days from the date of this decision to provide additional documents as specifically provided in the decision.

b. [Store] Taxpayer . . . :

The petition of [store] taxpayer . . . is dismissed as a result of the withdrawal at the hearing of the only issue involving that taxpayer.

Dated this 24th day of June 2003.