

Cite as Det. No. 12-1030, 33 WTD 458 (2014)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
)	No. 12-0103
... )	Registration Nos. . . . , . . . , . . . , and . . .
)	
)	

[1] RCW 82.04.050(1)(a)(iii): RETAIL SALES TAX – INGREDIENT OR COMPONENT EXEMPTION – RESTAURANTS. Ingredient or component exemption from retail sales tax does not apply to food prepared by restaurant.

[2] WAC 458-20-136; RCW 82.04.110; RCW 82.04.120: MANUFACTURING – RESTAURANT FOOD PREPARATION. Food preparation by restaurant does not constitute manufacturing.

[3] RULE 113; RCW 82.04.050(A)(A)(ii): RETAIL SALES TAX – INGREDIENT OR COMPONENT EXEMPTION – CHARCOAL. Charcoal used to alter or improve food does not qualify for the retail sales tax exemption as an ingredient or component of tangible personal property because using charcoal to heat and cook food constitutes intervening use.

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.

Sohng, A.L.J. – Restaurants protest assessment of retail sales tax on . . . purchases of charcoal used to cook meat and vegetables . . . The petition is denied in part, granted in part, and remanded in part.<sup>1</sup>

ISSUES

1. Does the ingredient or component exemption from retail sales tax provided for in RCW 82.04.050(1)(a)(iii) apply to restaurants?

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

2. Does charcoal used to alter or improve personal property qualify for the exemption from retail sales tax as an ingredient or component of tangible personal property under RCW 82.04.050(1)(a)(ii)?
3. . . .
4. . . .

FINDINGS OF FACT

[Taxpayers] are Washington limited liability companies, each of which operated a fine dining restaurant [in Washington]. The Audit Division examined Taxpayers’ books and records for the period January 1, 2005, through March 31, 2009 (the “Audit Period”). On April 6, 2011, the Audit Division issued Assessment Nos. . . . against Taxpayers in the following amounts:

. . .

Charcoal Issue

Taxpayers use . . . charcoal briquettes (the “Charcoal”) to grill meat, seafood, and vegetables on its grills. Cooking times range from approximately five to forty minutes, depending on what is being grilled and the degree of doneness that the customer requests. The Charcoal is added to the grill throughout the course of the evening through a custom feed system, which maintains the proper level of heat.

The Charcoal is comprised primarily of softwoods (such as pine or spruce) that have been heated and compressed, which are then mixed with ground coal and other ingredients and shaped into briquettes. Taxpayers claim that they specifically chose the [Charcoal] brand for the distinct flavor it imparts to the meat, seafood and vegetables grilled at their restaurants. Taxpayers cite a blind taste test of 796 people, sponsored by the [Charcoal] Company in 2000, in which tasters preferred food cooked over [Charcoal] to those cooked over gas.

Taxpayers did not pay any retail sales tax on the Charcoal they purchased during the Audit Period. The purchases were recorded as a fuel expense on the Taxpayers’ federal income tax returns and financial statements.

. . .

## ANALYSIS

1. Does RCW 82.04.050(1)(a)(iii) Apply to Items Purchased to Prepare Food Served in a Restaurant?

In this case we are concerned only with the purchase of items used to prepare food as part of the operation of a restaurant facility. Taxpayers claim that their purchase of Charcoal should be exempt from retail sales tax on the grounds that it imparts a specific flavor to the food that is grilled, and as such, becomes an ingredient or component of the final product that is exempt from sales tax under RCW 82.04.050(1)(a)(iii) (the “ingredient or component exemption”). The Audit Division argues that RCW 82.04.050(1)(a)(iii) is inapplicable because Taxpayers are not manufacturers.

The ingredient or component exemption of RCW 82.04.050(1)(a)(iii) excludes from the definition of retail sale:

Purchases for 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;

(Emphasis added.)

In giving effect to the legislature's intent in enacting a statute, the statute as a whole must be considered and harmonized with related statutes. *See, e.g., Stewart Carpet Serv., Inc. v. Contractors Bonding & Ins. Co.*, 105 Wn.2d 353, 715 P.2d 115 (1986); *State v. Bernhard*, 108 Wn.2d 527, 741 P.2d 1 (1987); *Dep't of Ecology v. Campbell & Gwinn L.L.C.*, 146 Wn.2d 1, 11, 43 P.3d 4 (2002). One such related statute is RCW 82.04.120(1), which defines the term “to manufacture” as:

[A]ll 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. . . .

(Emphasis added.) Because RCW 82.04.050(1)(a)(iii) contains the same operative language as that found in the statutory definition of “to manufacture,” we conclude that the legislature intended that the ingredient or component exemption from retail sales tax apply only to taxpayers that are engaged in “manufacturing,” as defined by RCW 82.04.120(1).

The next inquiry is whether Taxpayers are engaged in manufacturing. In a related statute, the machinery and equipment exemption found in RCW 82.08.02565, a manufacturer's purchase of machinery and equipment used directly in a qualifying “manufacturing operation” is generally exempt from sales tax. A “manufacturing operation” is defined as “the manufacturing of articles,

substances, or commodities for sale as tangible personal property....” RCW 82.08.02565(2)(f). The statute further provides that a manufacturing operation “does not include the preparation of food products on the premises of a person selling food products at retail.”<sup>2</sup> Thus, the statute expressly provides that food preparation for retail sale on premises is not a manufacturing activity.

. . . WAC 458-20-136 (“Rule 136”), the administrative regulation that applies to manufacturing and processing for hire, is silent as to food preparation by restaurants. Historically, cooking and serving food by a restaurant have not been considered manufacturing activities. For example, in *Bornstein Sea Foods, Inc. v. State*, 60 Wn.2d 169, 171-72, 373 P.2d 483 (1962), the Washington Supreme Court quoted a previous version of Rule 136:

The term “to manufacture” does not include activities which are merely incidental to non-manufacturing activities. Thus, the following do not constitute manufacturing: washing and screening of coal, or the bucking and yarding of logs, by the extractors thereof; pasteurizing and bottling of milk by a dairy; cooking and serving of food by a restaurant; the mere cleaning and freezing of whole fish; repairing and reconditioning of tangible personal property for others, etc. . . .”

*Id.* at 172 (emphasis added). Rule 136 has since been revised and the phrase “activities which are merely incidental to non-manufacturing activities” no longer appears in the rule. However, we find nothing under either Rule 136, RCW 82.04.110, .120 (the statutes pertaining to manufacturers and manufacturing), or case law that supports the proposition that food prepared and served by a restaurant constitutes manufacturing.

WAC 458-20-119 (“Rule 119”), the administrative rule that explains the taxes due on the sales of meals, and WAC 458-20-124 (“Rule 124”), the administrative rule that explains the taxes due on the sale of meals by restaurants, provide further guidance. Neither Rule 119 nor Rule 124 states that the sale of meals is subject to the manufacturing B&O tax classification. Rather, both rules provide that sales of meals are taxed under the retailing B&O tax classification and that retail sales tax is generally due thereon. This provides further support to our conclusion that restaurants cooking and serving food are generally not engaged in manufacturing. Because Taxpayers are not manufacturers, the ingredient or component exemption of RCW 82.04.050(1)(a)(iii) is inapplicable. Taxpayers’ petition is denied as to this issue.

## 2. Charcoal – Alteration or Improvement of Personal Property

The next inquiry concerns Taxpayers’ argument that the purchase of Charcoal qualifies for the exemption provided in RCW 82.04.050(1)(a)(ii). Excluded from the definition of retail sale are sales of tangible personal property to a person who:

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<sup>2</sup> Recent amendments to RCW 82.08.02565 retroactively limit the M&E deduction to taxpayers reporting under the manufacturing B&O tax classification. See 2011 Wash. Laws ch. 23, §1; RCW 82.08.02565(2)(e).

Installs, repairs, cleans, alters, imprints, improves, constructs, or decorates real or personal property of or for consumers, if such tangible personal property becomes an ingredient or component of such real or personal property without intervening use by such person.

*Id.* (emphasis added.) Thus, to be considered an ingredient or component of personal property under this exemption, there can be no intervening use. Here, Taxpayers use the Charcoal to first heat the food they serve to their customers and then to flavor the food. Using the Charcoal as a fuel to heat and cook the food constitutes intervening use by Taxpayers and, therefore, the exemption provided by RCW 82.04.050(1)(a)(ii) does not apply. *See* WAC 458-20-113.<sup>3</sup> Because of such intervening use, an analysis of whether the Charcoal actually becomes an ingredient or component in the food is unnecessary. Taxpayers' petition is denied as to this issue.<sup>[4]</sup>

3. . . .

4. . . .

#### DECISION AND DISPOSITION

Taxpayers' petition is denied in part, granted in part, and remanded to the Audit Division for recalculation of the Assessments identified above consistent with this Determination.

Dated this 24th day of April, 2012.

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<sup>3</sup> [For authorities discussing "intervening use" or what constitutes "use," *see* RCW 82.12.010(6); *Mayflower Park Hotel, Inc. v. Dep't of Revenue*, 123 Wn. App. 628, 632-33, 98 P.3d 534 (2004); *Seattle Filmworks, Inc. v. Dep't of Revenue*, 106 Wn. App. 448, 458, 24 P.3d 460 (2001).]

<sup>4</sup>[Effective October 1, 2013, sales of charcoal and other items that impart flavor to food that are completely or substantially consumed by combustion during the cooking process are exempt from sales and use tax. [Laws of 2013, 2<sup>nd</sup> sp. Sess., ch 13, part V]. The exemption expires July 1, 2017. *Id.*]