

Cite as Det. No. 15-0307R, 36 WTD 455 (2017)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 15-0307R
)	
...)	Registration No. . . .
)	

WAC 458-20-112, WAC 458-20-178; RCW 82.04.450, RCW 82.12.020: VALUE OF PRODUCTS, VALUE OF THE ARTICLE USED – COMPARABLE SALES – SIMILAR QUANTITY. Comparable external sales of asphalt products in similar quantities under *Texaco Refining and Marketing v. Dep’t or Revenue*, 131 Wn. App. 385 (2006) are measured on an individual sale basis, not total annual sales.

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.

Anderson, T.R.O. – An asphalt products manufacturer asks us to reconsider Determination No. 15-0307 sustaining Audit’s calculation of the value of asphalt products used in public road construction, and asserts that Audit overestimated the value of such asphalt products because Audit failed to account for a volume discount. Petition remanded for adjustment and denied in part.¹

ISSUES

Where manufactured asphalt products are transferred between divisions and used in public road construction, when should the Department use cost to value the products under RCW 82.04.450?

FINDINGS OF FACT

. . . (“Taxpayer”) is part of the . . . group of companies (. . .), which, “. . . has supplied aggregate and ready mixed concrete in the greater Western Washington region.”² Taxpayer is internally organized into two divisions: the Manufacturing Division and the Construction Division.

Taxpayer’s Manufacturing Division (“Manufacturing”) operates asphalt product manufacturing plants located in [Washington]. The plants manufacture approximately 19 different types of asphalt products and sell the products to external (roughly 100) and internal (Taxpayer’s

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

² . . . (last viewed October 23, 2015).

Construction Division (“Construction”)) customers.³ Taxpayer’s Construction Division engages in public road construction and heavy civil construction; it is (and was) Manufacturing’s top customer, consistently using a majority of its manufactured asphalt products.⁴ At issue here, is the value of asphalt products used by Construction in public road construction.

The Audit Division (“Audit”) of the Washington State Department of Revenue (the “Department”) reviewed Taxpayer’s books and records for the period of November 1, 2009, through June 30, 2013 (the “Audit Period”). During the Audit Period, Manufacturing charged for asphalt products based on a set price per ton; the price per ton varied throughout the Audit Period and was comprised of direct costs and a mark-up percentage. Direct costs included the costs of producing the asphalt, i.e., the cost of ingredients of the various types of asphalt, hauling, etc. The mark-up percentage was meant to account for indirect costs or overhead and profit, and it varied depending upon whether the asphalt products were being provided for Construction or external customers. Typically, the mark-up percentage was 10-15% above direct costs for Construction and higher for external customers – dependent upon ordering history, relationship, and historical and anticipated volumes.

Audit determined that the amounts Construction paid Manufacturing for asphalt products used in public road construction were not representative of the value of the asphalt products when compared to the amounts external customers paid. Audit looked at individual external sales, but determined that there were no external sales comparable to the internal sales to use by Construction because external customers purchased far less in total quantity when measured annually. To determine the value of asphalt products provided to Construction and used in public road construction, Audit calculated the cost per ton of three general types of asphalt products, based upon cost information and Taxpayer’s general ledger.⁵ Then, Audit compared its calculated costs to the prices paid by Construction, and in all cases, the calculated costs exceeded the price paid by Construction.

Ultimately, Audit issued Taxpayer an assessment in the amount of \$. . . , comprised of \$. . . in use tax, \$. . . in manufacturing B&O tax, and \$. . . in interest. The assessments of tax stem from the difference between Taxpayer’s reported value of asphalt products provided to Construction and Audit’s determined value of such asphalt products. For a majority of the Audit Period (November 1, 2009, [through] December 31, 2011), Audit determined the value to be the lowest price Manufacturing charged an external customer for comparable asphalt products (because the external sale price exceeded Audit’s calculated cost of the asphalt products).⁶ However, from

³ From November 1, 2009, through June 30, 2013, Taxpayer manufactured the following types of asphalt products: 131 HMA Class 3/8” – Modified; 132 HMA Impervious; 133 HMA Class 1/2” – Modified; 134 Class 3/8”; 135 HMA Class 1/2”; 136 HMA Class 3/4”; 137 HMA Class 1”; 138 HMA Class Porous – Special; 139 HMA Class Porous; 140 A.T.B.; 141; 142 Cold Mix Special; 143; 144; 145; 146; 147 Precoated Aggregate 3/8”; 148 Precoated Aggregate 1/2”; [and] 149 HMA Marshall Mix.

⁴ During the period at issue, construction used a total of 856,544.48 tons of asphalt products and a total of 599,322.16 tons of asphalt products were sold to all its external customers (combined).

⁵ The three general types of asphalt products are as follows: (1) Hot Mix Asphalt (“HMA”) 133 & 135 – a majority of Construction’s purchases; (2) Porous Asphalt 138 & 139; and (3) Cold Mix Asphalt 142.

⁶ Audit accounted for quantity in comparing external sales by establishing two lowest external prices for the asphalt products: One for orders of 1,000 tons or less and one for orders exceeding 1,000 tons.

January 1, 2012, [through] June 30, 2013, Audit determined the value to be its calculated cost (because the external sale price was less than Audit's calculated costs of such asphalt products).

Taxpayer appealed this assessment and asked us to cancel the assessment. First, because Construction used such a high volume of asphalt products, it was entitled to a volume discount – not reflected in Audit's cost calculations. Second, Audit should have accepted Taxpayer's internal sale price as the value because it reflected direct costs and indirect costs in the "mark-up." In Determination No. 15-0307, we sustained Audit's use of its determined costs as the values of the asphalt products and found that Audit had accounted for higher quantity purchases by establishing two external prices: one for orders of 1,000 tons or less and one for orders exceeding 1,000 tons. In addition, we determined that Taxpayer had not provided sufficient records to explain how the mark-up was calculated to include indirect costs, and, in the absence of sufficient records, sustained Audit's cost calculation. We hereby incorporate the facts of Determination No. 15-0307, but restate many, for ease of reading.

On reconsideration, Taxpayer asserts that Determination No. 15-0307 makes an error of law in holding that any volume discount is limited to the amount of the lowest external sale. Taxpayer states as follows:

Both RCW 82.04.450(2) and WAC 458-20-112 require, among other items, that any comparable must be "in similar quantities." As noted previously in the appeal, [Taxpayer's] largest customer purchased approximately 6% of total production of asphalt at \$50.48 per ton and [Taxpayer] valued approximately 64% of its total production at \$. . . per ton. That is a 12% discount for over ten times the volume, which would be a reasonable discount under the circumstances, and reflect a more accurate valuation based upon similar quantities.

In addition, during the hearing on reconsideration, Taxpayer provided significantly more information about its internal costs calculations. Taxpayer provided and explained a worksheet detailing the cost per ton for the month of December 2013, and stated that it had worked to reduce unallocated costs from 2009 to 2015. As relevant here, the cost spreadsheet has the following line items (Taxpayer's numbering): 10-Operating Plant, 15-Area Cleanup, 20-Maintenance, 25-Electrical Maintenance, 32-Feeding Plant, 34-Stockpiling & Loading, 40-Haul to Stockpiles, 42-Haul Material Sold, 43-Hauling Between Pits, 49-Hauling Liquid Asphalt, 50-Power to Plant, 51-Drying Cost – Natural Gas, 55- Depreciation, 60- Operating Scale, 62- Scale Maintenance, 64-QC/Testing, 72- Dust Control, 80- Liquid Asphalt, 82- Anti-Strip, 84- Aggregate (incl trucking), [and] 95- Marketing/Dues. The cost spreadsheet lists the respective costs for the month (here, December 2013) and year to date, for each of the three general types of asphalt products.

Many of the costs are tied to commodities that vary in price. For example, the cost of hauling material sold, between pits, and liquid asphalt, is dependent upon the cost of fuel powering the trucks doing the hauling. Similarly, power to the plant varies based on the price of electricity, the drying cost varies based on the price of natural gas, and the cost of liquid asphalt varies based on the cost of crude oil. To hedge against these costs, Taxpayer enters into futures contracts. However, Taxpayer's commitment to charge a specific price is limited to the specific bid and

contract. The bidding process is competitive and Taxpayer states that for every 20 bids it submits, it receives one contract to provide asphalt.

ANALYSIS

Public road construction is the activity of “building, repairing or improving any street, . . . which is owned by a municipal corporation or political subdivision of the state or by the United States and which is used or to be used primarily for foot or vehicular traffic, either as a prime contractor or as a subcontractor.” WAC 458-20-171; RCW 82.04.280(1)(b). Additionally, construction of roads dedicated to a city or county is also known as public road construction. Both prime and subcontractors engaging in public road construction are taxable under the public road construction classification of the business and occupation (“B&O”) tax on the total contract price. RCW 82.04.280.

Public road contractors are the consumers of the materials they incorporate as an ingredient or component of a road. RCW 82.04.190(3). Therefore, public road contractors must pay retail sales or use tax on all materials they place in, or on, the road as well as on equipment and supply purchases. WAC 458-20-171; WAC 458-20-134. This applies to materials whether they are purchased, provided by others, or manufactured/extracted by the contractor. Det. No. 03-0269, 23 WTD 182 (holding a public road contractor owes use tax on its use of rock materials taken from a county stockpile for no change).

The production of asphalt at a location away from the construction job site is a manufacturing activity. RCW 82.04.110, .120; ETA 3071.2009.⁷ Public road contractors who manufacture asphalt for commercial use are subject to manufacturing B&O tax measured by the value of asphalt manufactured. RCW 82.04.240; RCW 82.04.450. Use tax is also due on the value of asphalt used. ETA 3071.2009; WAC 458-20-134(4); WAC 458-20-171.

The measures of taxes for manufacturing B&O tax and the use tax [are similar]. RCW 82.04.450 defines the “value of products” for purposes of B&O tax as follows:

(1) The value of products, including by-products, extracted or manufactured shall be determined by the gross proceeds derived from the sale thereof whether such sale is at wholesale or 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 by-products by the seller, except:

(a) Where such products, including by-products, are extracted or manufactured for commercial or industrial use;

⁷ The production of asphalt at the construction job site is inseparable from the construction, improving, or repairing of a publicly owned road. ETA 3071.2009 (reissued 2/2/09). The ETA explains that “when the temporary mixing plant is built after the award of the contract, the measure of the use tax is determined by the value of the materials used to create the asphalt or concrete and will not include the labor or overhead costs associated with mixing the asphalt or concrete.” Further, the manufacturing B&O tax will not apply. *Id.* Taxpayer did not argue that this was applicable.

(b) Where such products, including by-products, are shipped, transported or transferred out of the state, or to another person, without prior sale or are sold under circumstances such that the gross proceeds from the sale are not indicative of the true value of the subject matter of the sale.

(2) In the above cases the value shall correspond as nearly as possible to the gross proceeds from the sales in this state of similar products of like quantity and character, and in similar quantities by other taxpayers, plus the amount of subsidies or bonuses ordinarily payable by the purchaser or by any third person with respect to the extraction, manufacture, or sale of such products: . . . The department of revenue shall prescribe uniform and equitable rules for the purpose of ascertaining such values.

WAC 458-20-112 further explains how to determine the “value of products” where products are manufactured for commercial or industrial use:

[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.

Use tax is imposed on the value of articles used. RCW 82.12.020(4)(a); WAC 458-20-134(4). RCW 82.12.010(7)(a) similarly defines the “value of the article used,” in pertinent part:

“Value of the article used” is the purchase price for the article of tangible personal property, the use of which is taxable under this chapter. . . . In case the article used is acquired by lease or by gift or is extracted, produced, or manufactured by the person using the same or is sold under conditions wherein the purchase price does not represent the true value thereof, the value of the article used is determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character under such rules as the department may prescribe.

WAC 458-20-178(3) adds only that the quantity of the articles sold should also be considered in determining value.

To summarize, the “value of products” is determined by the gross proceeds of sales. For purposes of valuation under WAC 458-20-112, a sale must be from the taxpayer to another person – not, merely a transfer to a different division or business location. Det. No. 89-326, 8 WTD 39 (1989) (“In accordance with Rule 458-20-112 then, the “value of products” will be based on the sales price when finally sold by a taxpayer. Thus, internal pricing between a taxpayer’s divisions or

locations will not be a basis for establishing a product's value for manufacturing tax purposes – only the final sales price to another person.”) Where there are no proceeds of sales, the product should be valued by comparable sales. “A comparable sale is one to (1) comparable purchasers (2) at comparable locations (3) under comparable conditions of sale and (4) involve similar quality products (5) in similar quantities. The comparison required need not be exact, but rather ‘as nearly as possible.’” *Texaco Refining and Marketing v. Dep't or Revenue*, 131 Wn. App. 385, 398-399 (2006) (citations omitted). And, in the absence of sales of similar products as a guide to value, the value may be determined on a cost basis.

On reconsideration, we find no reason for Audit to substitute calculated cost to determine the value of asphalt products because there are comparable external sales. Initially, Audit and Taxpayer experienced difficulty finding comparable sales under the *Texaco Refining and Marketing* definition because quantity was measured on an annual basis (Construction's purchase of 64% vs. the largest external customer's purchase of 6%) and there was not a purchaser of similar quantity. However, upon reconsideration, we find the quantity should be measured on an individual job basis – meaning, we look to an individual Construction job and compare it to an individual external customer job. This individual job comparison is more accurate because the price Taxpayer charges for its asphalt products varies by the job and is not tied to any specific period of time, i.e., a year. Thus, because comparable sales are available to determine the value of Taxpayer's asphalt products, we need not determine the value of such products based on cost. Accordingly, we remand this matter to Audit for adjustment consistent with these findings.

DECISION AND DISPOSITION

We are remanding the case to the Audit Division (Operating Division) for adjustment based on records you have already provided.

Dated this 8th day of June 2016.