

# Excise Tax Advisory

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## Blending of Petroleum Products at Storage Terminals

### Purpose

This ETA provides guidance on the application of the sales and use tax exemption for machinery and equipment when petroleum products are manufactured at fuel storage terminals, and on the hazardous substance tax and petroleum products tax impacts with respect to this fuel blending manufacturing activity.

This ETA contains examples. These examples identify a number of facts and then state a conclusion. They are provided only as a general guide. The tax results of other situations must be determined after a review of all the facts and circumstances.

### What is Fuel Blending?

Petroleum product storage terminals may mix various blending components, such as fuel additives, ethanol, or dyes, into petroleum blendstock according to customer specifications to produce a finished petroleum product.

In some instances, the process involves mixing the various components in the fuel rack piping to create the new, finished petroleum product prior to entry into the fuel tanker. Another process involves pumping the petroleum blendstock and blending components separately into the fuel tanker and where the substances are mixed upon entry to fuel tanker.

### B&O Taxation of Fuel Blending

The process of incorporating blending components into petroleum blendstock is a manufacturing activity for business and occupation (B&O) tax purposes because it creates a new, different, or useful article of tangible personal property for sale or

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commercial or industrial use. See RCW 82.04.120. A fuel storage terminal that blends petroleum products on behalf of a third-party manufacturer may qualify as a processor for hire and be subject to the B&O tax at the rate applicable to processors for hire under RCW 82.04.280.<sup>1</sup> When the terminal owns the petroleum blendstock and blending components, it is a manufacturer and subject to the B&O tax at the rate applicable to manufacturers under RCW 82.04.240. See WAC 458-20-136 for more information on the B&O tax-reporting responsibilities of manufacturers and processors for hire.

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**Sales and Use Tax Exemption for Machinery and Equipment Used in Fuel Blending**

Under RCW 82.08.02565 and RCW 82.12.02565, manufacturers and processors for hire are eligible for the exemption from sales and use tax on machinery and equipment used directly in a manufacturing operation. This exemption is commonly referred to as the “M&E exemption.” The M&E exemption is subject to specific requirements, including the following:

- The purchaser/user of the machinery and equipment must be a manufacturer, processor for hire, or a tester for a manufacturer or processor for hire.
- The machinery or equipment must be used directly in a manufacturing or testing operation.
- The machinery or equipment must have a useful life of one year or more.
- The machinery or equipment must be used more than 50% of the time on manufacturing or testing operations.

“Machinery and equipment” generally means devices, industrial fixtures, support facilities. See RCW 82.08.02565(2)(a). Machinery/equipment that “conveys, transports, handles, or temporarily stores an item of tangible personal property at the manufacturing site” is considered to be “used directly” in a manufacturing operation. RCW 82.08.02565(2)(c)(ii). A fuel rack is a mechanism for delivering and mixing petroleum products from a terminal to a truck, trailer, railcar, or other means of non-bulk transfer. The fuel rack and associated tankage transports, handles, and temporarily stores petroleum blendstock and blending components at the manufacturing site, and therefore may be eligible for the M&E exemption if all other requirements are met.

A manufacturing operation generally begins with the raw materials and ends with processed material. In this case, the petroleum blendstock and blending components are the raw materials that will be processed into a new petroleum product.

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**Application of HST and PPT**

Chapter 82.21 RCW imposes an excise tax on the privilege of possessing hazardous substances, including petroleum products, in this state. This tax is referred to as the

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<sup>1</sup> Note, however, per WAC 458-20-136(3)(d), a person that provides 20% or more of the value of the materials or ingredients that become part of the produced product is considered a manufacturer rather than a processor for hire.

hazardous substance tax or HST. Chapter 82.23A RCW imposes an additional excise tax upon the privilege of possessing petroleum products in this state. This tax is called the petroleum products tax or PPT.

When a new petroleum product is created through the fuel blending process at a storage terminal, HST and PPT both apply to the newly manufactured product. The first possessor of the product in Washington is required to pay the HST and PPT. See RCW 82.21.010(1) and RCW 82.23A.005. Chapters RCW 82.21 and 82.23A define possession as “both actual and constructive possession.” See RCW 82.21.020(3) and RCW 82.23.010(2). “Possession” means the power to sell or use a hazardous substance/petroleum product or to authorize the sale or use by another of a hazardous substance/petroleum product within this state. RCW 82.21.020(3); RCW 82.23A.010(2). A manufacturer of a new petroleum product at a terminal in this state is the first possessor of a blended petroleum product. When a terminal operator blends fuel it owns, it is considered a manufacturer and is subject to the HST and PPT. A storage terminal that blends fuel as a processor for hire is not subject to HST and PPT on the blended product because it is not a first possessor of the product.

A credit may be taken by a manufacturer of a hazardous substance produced from ingredients or components that are themselves hazardous substances, and upon which the hazardous substance tax has been paid by the same person or is due for payment by the same person. 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. Please refer to WAC [458-20-252](#) for more information on this credit.

Properly licensed petroleum product exporters that remove petroleum products at the rack for direct delivery outside of Washington for use as fuel may be eligible for an exemption from PPT. RCW 82.23A.030(6)

Please see [WAC 458-20-252](#) for additional information on HST and WAC [458-20-281](#) for additional information on PPT.

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## Examples

### Example 1:

#### Facts:

- GB Petroleum stores its petroleum products at a third-party storage terminal located in Washington owned by Big Storage and sells to distributors who pick up the product at the Big Storage terminal rack.
- Big Storage terminal blends both hazardous and nonhazardous substances into the petroleum blendstock for all its customers including GB Petroleum. The petroleum blending creates a new petroleum product that is created at the storage terminal rack.

- The storage terminal furnishes materials constituting less than 20% of the value of all the ingredients that become a part of the new petroleum product.
- Big Storage terminal's machinery and equipment (e.g., fuel rack and associated tankage transports) are used in blending operations more than 50% of the time and have useful life of more than one year.

#### **Result**

- *Big Storage:* The fuel storage terminal location is a manufacturing site and Big Storage is a processor for hire. The terminal's machinery and equipment have a useful life of more than one year. The machinery and equipment are also directly used more than 50% of the time in the fuel blending manufacturing operation, i.e., to convey, transport, handle, and temporarily store tangible personal property at the manufacturing site. Big Storage may claim the M&E exemption for the machinery and equipment that it uses in the manufacturing operation.
- *GB Petroleum:* The product manufactured at the rack is a new petroleum product subject to HST and PPT. GB Petroleum must report the newly manufactured petroleum product as a hazardous substance but may take a credit for any HST it has already paid upon first possession of the petroleum blendstock and hazardous substance blending components. GB Petroleum also owes PPT on the wholesale value of the newly manufactured petroleum product, and there is no credit available for any PPT paid on the blendstock. Because HST and PPT are paid by the first possessor, and GB Petroleum pays the HST and PPT on the new petroleum product, the storage terminal and/or the distributor do not owe HST or PPT.

#### **Example 2:**

##### **Facts**

- ABC Petroleum sells petroleum blendstock to Rainier Terminals. ABC Petroleum paid HST and PPT on the petroleum blendstock it sold to Rainier Terminals.
- Rainier Terminals stores the petroleum blendstock and blends it at the rack located in Washington according to its customer specifications with both hazardous and nonhazardous blending components it purchased from outside the state. Rainier Terminals paid HST upon its first possession of hazardous substance blending components it purchased from outside the state. The petroleum blending creates a new petroleum product that is created at the storage terminal rack.
- Rainier Terminal's machinery and equipment (e.g., fuel rack and associated tankage transports) are used in a manufacturing operation more than 50% of the time and the machinery and equipment have a useful life of more than one year.

### Result

- The blended fuel is a new manufactured petroleum product. Because it purchases the blendstock and therefore owns more than 20% of the materials, Rainier Terminals is a manufacturer. The rack location is a manufacturing site. Rainier Terminal's machinery and equipment have a useful life of more than one year. The machinery and equipment are also directly used more than 50% of the time in the fuel blending manufacturing operation. Rainer Terminals may claim the M&E exemption for machinery and equipment used in the manufacturing operation.
- Rainier Terminals has first possession of the new petroleum product. Rainier Terminals must report HST on the newly manufactured petroleum product but may take a credit for the HST already paid upon its first possession of hazardous substance blending components it purchased from outside the state. Rainier Terminals cannot take a credit for the HST paid on the ABC Petroleum blendstock. Rainier Terminals must pay PPT on the wholesale value of the new petroleum product.

### Example 3:

#### Facts:

- Giant Petroleum is a large multinational company, which owns and operates its own refineries, pipelines, storage terminals, distribution, and retail outlets.
- Giant Petroleum pays HST on the petroleum blendstock, which travels to its storage terminal located in Washington via a pipeline.
- The petroleum blendstock is blended with nonhazardous blending components as it is pumped into the fuel tanker truck. The petroleum blending creates a new petroleum product that is created at the storage terminal rack.
- Giant Petroleum's machinery and equipment (e.g., fuel rack and associated tankage transports) are used in this manufacturing operation more than 50% of the time and have a useful like of more than one year.

#### Results

- The fuel terminal location is a manufacturing site and Giant Petroleum is a manufacturer. The terminal's machinery and equipment have a useful life of more than one year. The machinery and equipment are also directly used more than 50% of the time in the fuel blending manufacturing operation. Giant Petroleum may claim an M&E exemption for the machinery and equipment used to manufacture the new petroleum product. The fuel tanker is not part of the manufacturing process, and the M&E Exemption does not apply to the tanker.

- Giant Petroleum must report HST and PPT on the wholesale value of the new manufactured petroleum product. A credit may be taken for the HST Giant previously paid on the petroleum blendstock.

**Example 4:**

**Facts**

- Terminus is a third-party petroleum storage terminal located in Washington that temporarily stores petroleum on behalf of XYZ Petroleum before it is transported to an XYZ Petroleum terminal for blending.
- No blending occurs at the Terminus storage terminal

**Result**

- Terminus is engaged in the activity of warehousing and is subject to B&O tax under the warehousing classification.
  - Terminus is not entitled to the M&E exemption on any machinery or equipment it uses to store the petroleum because it is not a manufacturer or processor for hire.
  - Terminus owes no HST or PPT on the petroleum that is owned by XYZ Petroleum and stored XYZ Petroleum's behalf.
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