

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment	)	<u>D E T E R M I N A T I O N</u>
	)	
	)	No. 98-190
	)	
...	)	Registration No. . . .
	)	FY . . ./Audit No. . . .
	)	

[1] RULE 136; RCW 82.04.260(7); RCW 82.04.270: B&O TAX – PERISHABLE MEAT PRODUCTS. A person who slaughters and processes poultry is not selling the same processed meat product when he adds other foods items to the poultry to produce new or different food products, such as chicken Kiev or chicken marsala for example. Therefore, the person does not qualify for the special B&O tax classification and rate contained in RCW 82.04.260(7). Instead, the manufacturing B&O tax rate and classification found in RCW 82.04.270 applies.

[2] RULE 136; RCW 82.04.260(7): WHOLESALING B&O TAX – PERISHABLE MEAT PRODUCTS. Perishable meat products that are not manufactured or processed by a wholesaler must be perishable when sold in this state by the wholesaler in order for the special B&O tax classification and rate contained in RCW 82.04.260(7) to apply to the wholesale 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.

NATURE OF ACTION:

A foreign corporation (the taxpayer) that sells processed poultry and other foods products in Washington protests the assessment of wholesaling business and occupation (B&O) tax on its gross proceeds of sales.<sup>1</sup>

FACTS:

De Luca, A.L.J. -- The taxpayer raises, slaughters, and processes poultry outside the State of Washington. It sells the processed poultry nationwide, including wholesale sales in Washington.

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

The taxpayer's products include raw chicken and chicken parts. Some of the raw chicken products are boneless and others are skinless. Other processed chicken products include . . . , and similar chicken products that include cheese, sauce, and/or other ingredients.

The taxpayer sells some other international-style food products, including . . . . The taxpayer purchases these food products from other out-of-state manufacturers for resale. The taxpayer has described these latter items as a "very small", indeed, "insignificant", portion of its sales.

The Audit Division (Audit) of the Department of Revenue (the Department) reviewed the taxpayer's books and records for the period January 1, 1992 through June 30, 1995 and assessed \$ . . . in wholesaling B&O tax and related interest. The assessment included a credit of \$ . . . in B&O taxes that the taxpayer paid under the special tax classification and rate for slaughtering, breaking, and/or processing perishable meat products and selling the same at wholesale. See Document No. FY . . ./Audit No. . . .

In its report, Audit stated that the term "processing" as used in RCW 82.04.260(7) "means grinding, seasoning, packaging and similar terms." In order to qualify for the special classification and rate, Audit declared . . .

the sole purpose of an additive must be to enhance the meat, such as spices. The addition of other foods changes the nature of the product from meat to some other item, such as a prepared meal or main course. Even though meat is the main (and most expensive) ingredient in such products, they are not perishable meat products of themselves and therefore do not qualify for the [special] classification.

Audit added that approximately 30% of the taxpayer's sales were raw chicken (frozen or refrigerated). Audit agreed that the lower tax rate and special B&O tax classification applied to those sales. Thus, sales of raw chicken (frozen or refrigerated) are not at issue. Conversely, Audit reclassified the remainder of taxpayer's gross proceeds of sales to the wholesaling B&O tax and applied its corresponding higher tax rate as provided in RCW 82.04.270.

#### TAXPAYER'S EXCEPTIONS:

The taxpayer quotes RCW 82.04.260(7) and WAC 458-20-136(10) (Rule 136) for the special B&O tax classification and rate provision for persons engaged in the business of slaughtering, breaking, and/or processing perishable meat products and/or selling the same at wholesale only. The taxpayer argues the statute and rule clearly provide that the special rate applies to all meat processing activities. The taxpayer further contends that neither the statute nor the rule places any restrictions on the definition of processing, and the special classification and rate cover all meat products. The taxpayer asserts it is apparent under the provisions of RCW 82.04.260(7) that processing a perishable meat product includes breasting or battering chicken, etc. The taxpayer cites Streng v. Clarke, 89 Wn.2d 23, 569 P.2d 60 (1977) for the holding that words in a statute, unless otherwise defined, should be given their usual and ordinary meaning.

The taxpayer also cites Det. No. 89-38, 7 WTD 125 (1989) to show the Department has broadly interpreted the statute when it deemed the rendering of animal carcasses into hides and tallow to be the processing of perishable meat products and subject to the lower tax rate. The taxpayer quotes the determination where it states that “it is the manufacturing activities which qualify for this treatment.” 7 WTD at 127. The taxpayer, apparently, infers from this quote the principle that manufacturing activities alone trigger the lower tax rate.

The taxpayer further argues that Audit wrongly implies its products are not perishable. The taxpayer explains that it spends millions of dollars every year in freezer costs to preserve its products in a marketable state.

Finally, the taxpayer contends that the audit method used by Audit lacked “statistical integrity” and, therefore, the tax assessment was invalid.

#### ISSUES:

1. Does processing raw chicken and then combining it with other ingredients to make food items, such as the various chicken dishes described above, satisfy the requirements for the special B&O tax classification and rate for processing perishable meat products and selling the same at wholesale?
2. Does the selling at wholesale by the taxpayer of [food products], etc. that are produced by other vendors and sold to the taxpayer for resale qualify for the special B&O tax classification and rate?
3. Was the Department’s audit statistically invalid and, therefore, was the tax assessment inaccurate?

#### DISCUSSION:

The statute that governs the special B&O tax classification and rate for perishable meat products is RCW 82.04.260(7), which provides:

(7) Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale only and not at retail; as to such persons the tax imposed shall be equal to the gross proceeds derived from such sales multiplied by the rate of 0.138 percent.

Rule 136 is the rule that implements the statute and it declares in pertinent parts:

(1) Definitions. "The term 'to manufacture' embraces 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, . . . ." (RCW 82.04.120.) It means the business of producing articles for sale, or for commercial or industrial use from raw materials or prepared materials by giving these matters new forms, qualities, properties, or combinations. It includes such activities as making, fabricating, processing, refining, mixing, slaughtering, packing, curing, aging, canning, etc. It includes also the preparing, packaging and freezing of fresh fruits, vegetables, fish, meats and other food products, . . . and the curing of animal hides and food products.

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(10) The special classification and rate for slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale (RCW 82.04.260(7)) combines manufacturing and nonmanufacturing activities into a single taxable business activity. For persons who break, slaughter, and/or process meat products for others, the statutory classification and rate are applicable to the value of products so processed and delivered to customers within this state and to interstate or foreign customers. The mere wholesale selling of perishable meat products not manufactured by the vendor is subject to the statutory classification and rate only upon gross receipts from sales within this state. Interstate or foreign sales are deductible from gross proceeds of sales.

As noted, the taxpayer cited Det. No. 89-38, supra, for its statement that it is manufacturing activities, e.g. processing perishable meat, that qualify for the special tax classification and rate. Rule 136(10) supports that statement to the extent it declares the special tax classification and rate combine manufacturing and non-manufacturing activities into a single taxable business activity. However, the taxpayer's reliance on this statement is misplaced because merely processing a perishable meat product does not necessarily mean that manufacturing activity and subsequent sale will always result in the special classification and rate. As we explained in Det. No. 88-329, 6 WTD 321 at 333-334 (1988):

It is the Department's position that the manufacturing B&O tax does not apply to the intermediate substances which are produced during any manufacturing/refining process where such substances inhere in the end product being manufactured or refined. Such intermediate possessions and uses are not deemed to be industrial or commercial use when they occur on-line, within the continuing manufacturing/refining process. It is only when any such intermediate substance is withdrawn from the process for sale or some different industrial or commercial use that the B&O tax applies to the value of such substances. In short, the B&O tax does not apply to every substance produced at each and every step or stage within a continuous production process. The tax applies only to the value of the end-product.

(Emphasis supplied.) Merely because a portion of the taxpayer's final products involved the intermediate step of processing perishable meat does not mean that the end products qualify as

processed meat for purposes of RCW 82.04.260(7) and its special tax classification and rate. In other words, the taxpayer asserts that the gross proceeds from the sale of all its products that contain processed meat qualify for the special rate. However, the Department cannot ignore the character of the end products merely because those products contain chicken or meat that is processed from a perishable state and is added as an ingredient in an intermediate step to create a new and different product. As Det. No. 88-329, supra, explains, the intermediate steps do not control the applicable B&O tax classification and tax rate. Instead, the manufacturing process, as it results in the sale of the end products, is what is taxed.

Accordingly, WAC 458-20-112 (Rule 112) states in part:

IN THE CASE OF BONA FIDE SALES OF PRODUCTS. The law provides (RCW 82.04.450), that under the extracting and manufacturing classifications of the business and occupation tax the value of products extracted or manufactured shall be determined by the gross proceeds of sales in every instance in which a bona fide sale of such products is made, and whether sold at wholesale or at retail.

(Emphasis added). Thus, the manufacturing activity that results in the end product is what is taxed and the tax due is measured by the applicable rate multiplied by the gross proceeds from the sale of the end products. RCW 82.04.260(7).<sup>2</sup>

[1] Therefore, we do not agree that the taxpayer's [food products] etc. qualify as meat products pursuant to the statute, although they contain chicken. The taxpayer markets these manufactured products not merely as perishable chicken that has been processed, but as new and different food products that include processed chicken as one of the ingredients in combination with other food items. Processing the chicken is merely an interim step in manufacturing new, different, or useful substances, which are the various manufactured products described above. Although the processed chicken may be the most expensive ingredient in those products, it is, as noted, only one of the ingredients. In short, the taxpayer is processing perishable meat products, for example, when it slaughters its chickens and removes their skins or bones, but it is not "selling the same" when it combines the chicken parts with other food items to produce, new or different products such as chicken Kiev. RCW 82.04.260(7).

The present taxpayer's end products are distinguishable from the end products referenced in the rendering plant cases discussed in Excise Tax Advisory (formerly Bulletin) 403.04.135 and Det. No. 89-38, supra, which is cited by the taxpayer. Those taxpayers qualified for the perishable meat-processing rate, although their end products were non-edible and, in some instances, no longer perishable because the rendering plants processed and sold strictly meat products without combining

<sup>2</sup> Of course, we assume the sales are bona fide and the intermediate substance is not withdrawn from the manufacturing process. Det. No. 88-329, supra.

them with other ingredients. Those end products consisted entirely of meat or, more specifically, meat by-products, and are entirely different from the products the present taxpayer manufactures and sells. The present taxpayer's products clearly are not strictly by-products of meat processing. Instead, as noted, they are new and different products that contain chicken only as an ingredient combined with other ingredients, such as breading, cheese, batter, sauce, or vegetables, etc.

We hold that the taxpayer's sales of food products to which it adds processed chicken as an ingredient in combination with other foods items do not qualify for the special tax classification and rate contained in RCW 82.04.260(7). Instead, the proper rate is in the wholesaling B&O tax classification found in RCW 82.04.270.

For the same reasons, we find that the other food products the taxpayer sells, such as . . . do not qualify for the special tax classification and rate. These end products are meals that contain beef or chicken as only one ingredient that is combined with other food items. Although these food products may contain processed meat, they are new or different products compared to the mere processing of perishable meat that is not combined with other food items like rice, beans, tortillas, vegetables, etc. Again, the taxpayer is not "selling the same" perishable meat products when the processed meat is combined with other food items. RCW 82.04.260(7). We find that RCW 82.04.270 provides the applicable tax classification and rate for these food kits. We note that some of these items or products may not even contain meat.

[2] Additionally, perishable meat products that are not manufactured by a wholesaler must still be perishable when sold in this state. If such products are not perishable when sold at wholesale, they do not qualify for the special classification and rate. See Rule 136(10), which provides: "The mere wholesale selling of perishable meat products not manufactured by the vendor is subject to the statutory classification and rate only upon gross proceeds from sales within this state." Thus, products not manufactured, but sold by wholesalers, must both qualify as processed meat products, and be perishable (i.e. require refrigeration or freezing) when sold in this state. However, the mere fact that a food product with meat is perishable because it requires refrigeration or freezing does not mean that the sale of that processed product qualifies for the special tax classification and rate unless the end product is a "perishable meat product" under RCW 82.04.260(7). As we explained, a "perishable meat product" cannot be combined and sold with other food items.

The last issue is whether Audit used a valid statistical method in making its tax assessment. The audit report and correspondence reveal that the auditor and the taxpayer had difficulty in interpreting many of the taxpayer's product codes. Audit admits that the test it used was in lieu of actual records. Audit also states that some adjustments may be necessary "when the terminology used to describe the products can be deciphered" and "if additional records can be provided." We note that taxpayers have the responsibility to "keep accurate and complete business records." RCW 82.32A.030. See also RCW 82.32.070, which provides:

(1)(a) Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be

necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue. Any person who fails to comply with the requirements of this section shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

Thus, the taxpayer has the duty to provide accurate and complete business records for the Department to review. According to Audit, the taxpayer's records were not decipherable. Unless the taxpayer timely provides suitable, accurate, and complete records to the Department, the assessment stands.

**DECISION AND DISPOSITION:**

The taxpayer's petition is denied.

Dated this 30<sup>th</sup> day of October, 1998.