Cite as Det. No. 00-124ER, 22 WTD 115 (2003)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON[1]

In the Matter of the Petition For Correction of Refund of	)	FINAL EXECUTIVE LEVEL DETERMINATION
	)	No. 00-124ER[2]
. . .	)	Registration No. . . .
	)	Docket No. . . .
	)	FY . . . /Audit No. . . .
	)	FY . . . /Audit No. . . .

[1] RULE 112; RCW 82.04.070, RCW 82.04.270: B&O TAX -- MEASURE OF TAX ON EXCHANGE AGREEMENTS -- GROSS PROCEEDS OF SALE. When a manufacturer exchanges similar products with a competitor by delivering product to the competitor at one location and receiving similar products from the competitor at a different location and the agreement does not specify a selling price for the quantities exchanged, then there is no stated gross proceeds of sale.

[2] RULE 112; RCW 82.04.070, RCW 82.04.270: B&O TAX -- MEASURE OF TAX ON EXCHANGE AGREEMENTS -- GROSS PROCEEDS OF SALE. When there is no stated gross proceeds of sale, the measure of the tax is determined by reference to comparable sales.

[3] RULE 112; RCW 82.04.070, RCW 82.04.270: B&O TAX -- MEASURE OF TAX ON EXCHANGE AGREEMENTS -- GROSS PROCEEDS OF SALE -- PLATTS AND OPIS. Industry publications reporting the prices at which similar products are sold, such as Platts Oilgram and OPIS, provide data to be used to determine comparable sales prices.

[4] RULE 112; RCW 82.04.070, RCW 82.04.270: B&O TAX -- MEASURE OF TAX ON EXCHANGE AGREEMENTS -- GROSS PROCEEDS OF SALE -- INVENTORY VALUE. Inventory value of products (costs) exchanged may not

[1] NON PRECEDENTIAL PORTIONS OF THIS DETERMINATION HAVE BEEN DELETED.
[2] The original determination, Det. No. 00-124, is published at 22 WTD 103 (2003).

be used to measure the B&O tax on exchanges of said products, unless there is an absence of comparable sales. Further, the use of inventory value is unreliable when the starting point (interdivisional transfer prices) are determined by means that may be manipulated.

[5] RULE 112; RCW 82.04.070, 82.04.090: B&O TAX -- MEASURE OF TAX ON EXCHANGE AGREEMENTS -- IMPUTING INCOME. The use of Platts Oilgram or OPIS to determine the measure of tax on an exchange of products does not impute income. Rather, the consideration received by the taxpayer is being measured.

[6] RULE 110; RCW 82.04.070: B&O TAX -- MEASURE OF TAX ON EXCHANGE AGREEMENTS -- HANDLING FEES. When a taxpayer charges its customer a handling fee when it sells (exchanges) products, the handling fee is part of the measure of the selling price and taxed under the same B&O tax classification as the product sale (wholesaling or retailing).

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: Susan Y. Price[3]

NATURE OF ACTION:

The taxpayer, a refiner of petroleum products, seeks executive level reconsideration of Det. No. 00-124 in which we sustained the Department's partial denial of the taxpayer's refund request of Business and Occupation Tax, Petroleum Products Tax, and Hazardous Substance Tax. The taxpayer's refund claim is based on the taxpayer's valuation of products transferred to exchange partners. The taxpayer challenges the value ascribed to the products, which we said for purposes of determining the measure of the taxes, is the bulk market price at the place of receipt of the product less cash paid to the exchange partner or plus cash paid to the taxpayer. The taxpayer restates its original position that the correct measure, for purposes of determining the measure of the taxes, is its internally generated inventory value. [4]

PROCEDURAL HISTORY:

Coffman, A.L.J. -- The taxpayer requested a refund of business and occupation (B&O) tax, Petroleum Products Tax (PPT), and Hazardous Substance Tax (HST) paid on products exchanged with its exchange partners for the period January 1, 1991 through December 31, 1996.[5] The Audit Division of the Department of Revenue (Department) considered the taxpayer's request and granted a portion of the amount requested. The taxpayer then filed an

[3] Susan Y. Price, Assistant Director, Appeals Division, replaced Stephen P. Zagelow, former Appeals Review Manager, as the Director's Designee.
[4] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[5] The taxpayer and Department agree that the measure of the B&O tax, PPT, and HST is the same.

appeal with the Department's Appeals Division. The Appeals Division issued Det. No. 00-124 denying the taxpayer's request to value the products at its inventory cost and remanded the matter to the Audit Division. The taxpayer then filed a request for executive level reconsideration. The Appeals Division agreed to hear this matter as an executive level reconsideration. The Appeals Division issued a proposed determination on November 20, 2001. The taxpayer filed objections to the proposed determination on December 20, 2001 (Taxpayer Objections 12-20-2001). The taxpayer also filed supplemental objections to the proposed Determination on February 27, 2002 (Taxpayer Objections 2-27-2002). This determination addresses the arguments taxpayer specifically raised in its petition for executive level reconsideration and the taxpayer's objections to the proposed determination.

FACTUAL BACKGROUND:

We restate the following pertinent facts from Det. No. 00-124, pages 1-2:

> The taxpayer refined crude oil in the state of Washington. The taxpayer entered into exchange agreements with other refiners (exchange partners) who do not have refineries in the state of Washington to deliver products to the exchange partners in exchange for similar products delivered by the exchange partner to the taxpayer at locations where the taxpayer does not maintain a refinery. The exchanges made under these agreements are sales subject to business and occupation (B&O) tax, petroleum products tax (PPT), and hazardous substance tax (HST).[6] The taxpayer does not dispute the taxability of these exchanges.
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> The taxpayer provided us copies of two sample exchange agreements.
>
> Exchange Agreement No. 1.
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> The first exchange agreement provided for a "barter exchange." The terms of the exchange were identified in the exhibits to the agreement. Exhibit A provided that the taxpayer will deliver to the exchange partner . . . barrels per month of identified petroleum products plus amounts of other petroleum products "as agrd." The delivery point for all the products delivered to the exchange partner was the taxpayer's refinery. With one exception, all deliveries by the taxpayer were "into transport trucks." In all such cases, the taxpayer charged the exchange partner a handling fee of either $ . . . or $ . . . per barrel. The agreement also provided for an "as agrd." volume of product to be transferred "by book transfer." There was no handling charge for the "book transfer" deliveries.
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> Exhibit A also provided the taxpayer would receive . . . barrels of petroleum products per month plus amounts of other petroleum products "as agrd." The only situations requiring the taxpayer [to] pay the exchange partner [were] when delivery was made "into

[6] Time Oil v. State of Washington, 79 Wn.2d 143, 483 P.2d 628 (1971).

> pipeline" and "from pipeline to storage." In these cases, the taxpayer paid the exchange partner $ . . . per barrel as a location fee.
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> Exchange Agreement No. 2.
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> Exchange Agreement No. 2 is also a "barter agreement." While Exchange Agreement No. 1 involved the delivery and receipt of product exclusively within Washington state, Exchange Agreement No. 2 involves the delivery by the taxpayer of products in Washington and the receipt of products both within and without the state of Washington. The number of products subject to the terms of Exchange Agreement No. 2 is extensive. The taxpayer's handling fee is $ . . . per barrel for products delivered into barges and $ . . . or $ . . . per barrel when delivered into transportation trucks. Additionally, the taxpayer pays $ . . . per barrel delivered into transportation trucks at one location in Hawaii.
>
> Location fees vary significantly. When the taxpayer takes receipt of products from pipeline to storage or into the pipeline in Hawaii, the location fee it pays is $ . . . per barrel. When the taxpayer takes receipt of product into a barge in Hawaii, the location fee is either $ . . . or $ . . . per barrel. The location fee for delivery into transportation trucks in Hawaii varies from $ . . . to $ . . . per barrel. The taxpayer received a location fee (either $ . . . or $ . . . per barrel) for products it delivered at two points in Washington.

. . .

The taxpayer argues that the measure of the B&O tax, PPT, and HST should be its internally generated inventory value. We rejected that argument in Det. No. 00-124 and held that the proper measure of the tax is the bulk market price at the place of receipt less cash paid to the exchange partner or plus cash paid to the taxpayer. We said that because of the administrative difficulties of determining the value of the products in numerous locations, we would allow the use of the wholesale bulk price of the products in Washington as the measure of the tax.

The taxpayer petitioned for reconsideration claiming we erred . . . . First, the taxpayer claims we erred in relying on two published determinations, Det. No. 91-341, 12 WTD 327 (1991) and Det. No. 93-118, 13 WTD 262 (1993), in which we rejected the use of inventory values as the proper measure of the taxes at issue in those cases. . . .

TAXPAYER'S OBJECTIONS:

The taxpayer objected to our characterization of its argument contained in the proposed determination. Specifically, the taxpayer stated:

> [The taxpayer's] objection: This is not and has never been the taxpayer's argument. [The taxpayer's] argument is that the "value proceeding or accruing" definition under RCW 82.04.090 (as the term is used in the "gross income of the business" definition under RCW 82.04.080 and the "gross proceeds of sale" definition under RCW 82.04.070) means "money, credits, rights, or other property expressed in terms of money, *actually*

> *received or accrued.*" The "other property expressed in terms of money, actually received", [the taxpayer] argued, is the inventory value. . . .
>
> Inventory value, by its common meaning and understanding, means the cost of goods sold *before* any markup. It is in this context that [the taxpayer] uses and used the term "inventory value." Any other construction of what the taxpayer argued is not supported by anything [the taxpayer] argued to the Department.

Taxpayer's Objections 12-20-2001, page 1 (emphasis in original).

The taxpayer argued extensively that the inventory value it calculates is the value of the products received. The taxpayer calculates the inventory value by using inter-divisional transfer prices from its refining division to its marketing division and then reducing that price by margin percentages. . . . The numerator of the fraction used to calculate the margin percentage is the inter-divisional transfer price less costs (profit) and the denominator is the interdivisional transfer price. Thus, our characterization of the taxpayer's argument is accurate.

Additionally, the taxpayer apparently misconstrued our finding that the bulk sales price should be used to measure the taxes. The taxpayer discusses the effect of selling the acquired products to different types of buyers and how that results in different measures of tax. See Taxpayer's Objections 2-27-2002, pages 2 and 3. We did not hold that the subsequent sale was to be used to determine the measure of the tax on the exchanges.

ISSUE:

What is the correct measure of the tax? Specifically,

1. Is inventory value of products delivered to exchange partners the value of the property received from the exchange partners?
2. . . .
3. . . .

DISCUSSION:

1. Use of Inventory Value.

In its petition for reconsideration, the taxpayer states:

> The Department and the oil industry for years have used comparable selling price as a surrogate to determine the measure for the B&O and hazardous substance taxes. The parties operated under the presumption that there was no selling price when the oil companies exchanged their products. . . . Historically, the parties relied upon Rule 112 [WAC 458-20-112]. The Department has routinely rejected inventory cost because the Department does not consider inventory cost as a “comparable” price under Rule 112.

Thus, the taxpayer acknowledges that the Department and the petroleum industry have used Platts and OPIS to determine the value of the products exchanged and that they have used comparable sales to determine the measure of the taxes under exchange agreements. However, now the taxpayer claims that the proper measure is its inventory value.[7] Accordingly,

> [the taxpayer], however, chose a different theory in its petition for refund. It challenged the presumption that there was no selling price. In other words, the taxpayer contended that there is no need for a surrogate measure because there was in fact a selling price.

Petition for Reconsideration, pages 3-4.

The taxpayer specifically claims that our affirmation of the use of Platts or OPIS to determine the measure of the taxes was wrong because:

1. We allegedly failed to address the taxpayer's claim "that it actually received the inventory value, expressed in terms of money; it did not receive any profit." Petition for Reconsideration, page 4.
2. Use of Platts or OPIS results in imputing income when none existed; and
3. We should not have relied on Det. No. 91-341, 12 WTD 327 (1991) and Det. No. 93-118, 13 WTD 262 (1994).

Alleged Failure to Address the Taxpayer's Argument that Inventory Value is the Appropriate Measure of its Receipts in the Exchange Transactions.

We disagree with the taxpayer's claim that we did not address its arguments. In reaching our original decision, we quoted extensively from Det. No. 91-341, supra, and Det. No. 93-118, supra, and concluded that the reasoning used in those determinations was correct and applicable to the taxpayer's facts. As in our original decision, we again reject the taxpayer's claim that there is a stated selling price for the quantities it received in the exchange transactions. We have reviewed the taxpayer's exchange agreements and other documents provided to us and find that these documents do not specify a selling price for the quantities delivered. Rather, to arrive at the selling price the taxpayer proposes the use of the inventory value less a profit margin, which requires the use of internally generated surrogate values. This proposition, the use of surrogate values, conflicts with the taxpayer's principal objection to the use of Platts and OPIS, which is that an actual selling price exists thus the use of a surrogate value is unnecessary. Actually, the taxpayer is urging that we merely substitute one surrogate value for another.[8]

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[7] The taxpayer objected to our use of the term "inventory value less a profit margin." While we believe this characterization of the taxpayer's method of calculating the measure of the taxes in fact is accurate, our decision does not rest on this characterization. See Taxpayer's Objections, infra.

[8] The taxpayer objects to our characterization of the inventory value as a surrogate value claiming that "inventory value is the actual value that is on the books and records of" the taxpayer. Taxpayer's Objections 12-20-2001, page 1-2. The taxpayer claims, when it engaged in exchanges, it does not adjust the inventory value on its books and records, in part because, for federal income tax purposes the taxpayer does not treat the exchanges as sales. We do not comment on the taxpayer's federal income tax treatment of the exchanges. However, for Washington B&O tax purposes, the exchanges are sales. *Time Oil v. State*, 79 Wn.2d 143, 483 P.2d 628 (1971).

The taxpayer analyzed its argument as follows:

1. An exchange of petroleum products is a wholesale sale. RCW 82.04.270.
2. The "gross proceeds of sale" is the measure of the wholesaling tax. *Id.*
3. The "gross proceeds of sale" means "the value proceeding or accruing from the sale of tangible personal property." RCW 82.04.070.
4. The " value proceeding or accruing" means "the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued." RCW 82.04.090 (emphasis supplied).
5. In this case, the consideration received is inventory of petroleum products.
6. The inventory value is expressed in terms of money on [the taxpayer's] regularly kept books and records.
7. Therefore, the inventory value is the gross proceeds of sale.

Taxpayer's Objections 12-20-2001, page 2.

We agree with the taxpayer on the first 5 steps in its argument. The taxpayer's argument, however, fails in the 6th step.

The exchange agreements are barter agreements. As such, the value proceeding or accruing from an exchange is the value of the product received plus or minus a differential because this is the consideration the taxpayer receives from the transaction. The question we must answer, for the purposes of determining the correct measure of the tax, is: What is the value of the product received?

[1] In Det. No. 98-133, 18 WTD 153 (1999), we said the measure of tax on a barter agreement is "the amount of consideration 'actually received or accrued' [which] includes the value of the property or services a taxpayer receives in lieu of any monetary payment for such services or property." Id. at 160. The value of the property received is defined in WAC 458-20-112 (Rule 112). Rule 112 states:

> [W]here products extracted or manufactured are . . . [s]old under circumstances such that the stated gross proceeds from the sale are not indicative of the true value of the subject matter of the sale; the 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. (Emphasis added.)

[2,3] Because the exchange agreements do not specify a stated gross proceeds of sale the stated gross proceeds of sale is zero. Therefore, comparable sales must be used. Platts and OPIS

provide the data to be used to determine a comparable sale price, which is the "value of the products" and thus the measure of the B&O tax, PPT, and HST the taxpayer is required to pay.[9]

Essentially, the taxpayer is asking that its costs of producing its products be used to determine the measure of the taxes – Inventory value less a profit factor. However, Rule 112 states:

> 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.

(Emphasis added.)

[4] Platts and OPIS provide evidence of similar sales. Therefore, a precondition to the use of costs does not exist and costs may not be used to measure the tax.

The taxpayer claims that using Platts and OPIS to measure the value of the products it received per the exchange agreements has the effect of attributing the same value to the cost of purchasing inventory as to selling it. The taxpayer states: "no business buys inventory and sells it at the same price." Petition for Reconsideration, page 4. Specifically, the taxpayer claims because Platts and OPIS show wholesale prices and are used to measure its receipts, when the taxpayer sells the products it received, it allegedly would appear to be selling them for the same price -- their cost.

We do not agree with the taxpayer's conclusion. The taxpayer's argument is incongruous. . . . On one hand, the taxpayer, focusing on the second transaction, claims using Platts or OPIS is the same as buying inventory and selling it at the same price. The taxpayer claims no business does this. On the other hand, looking at the exchange only, the taxpayer argues the measure of the tax should be its inventory cost. The inventory cost is the price the taxpayer pays for the inventory it manufactured. Thus, the taxpayer argues it is buying inventory and selling it at the same price, which the taxpayer claims no business does.[10]

Further, we share the Audit Division's concerns regarding the use of inventory cost as the measure because there are uncertainties regarding how the taxpayer calculated the inventory cost. The taxpayer's starting point is "interdivisional transfer prices," and then the taxpayer deducted some costs (but not all costs) to determine a profit margin. The taxpayer then deducted the profit margin from the interdivisional transfer price to determine the inventory cost. We are concerned about how the interdivisional transfer price was determined. Further, there appears to

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[9] The taxpayer's objection to the use of Platt's or OPIS to determine the value of the products received (Taxpayer's Objections 12-20-2001, pages 3-4) hinges on the erroneous assumption that the exchange agreements have a stated gross proceeds of sale.

[10] The taxpayer also argues that the Department is measuring the gross proceeds of sale from the exchange agreements by the measure of its subsequent sale of the product to distributors and consumers (ie., Platts and OPIS values.) This could be true only if the taxpayer sells the newly acquired products at the bulk rate. However, we note that the taxpayer sells the product to consumers at its gas stations. These sales are **not** at the bulk rate.

be little justification for the omission of certain costs in determining the "profit margin." Thus, we are concerned about the possibility that interdivisional prices can be manipulated. As we said in Det. No. 91-341, supra:

> 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. In the oil industry it is not uncommon for products to be obtained from international affiliates. We cannot accept those transactions as reflecting arms-length fair market value. Estimates offered by other divisions of the company itself are also suspect. Indirect overhead costs of these conglomerates would be extremely difficult to determine. In light of these problems, absent actual sales, the Department will accept values prepared by organizations independent of the oil industry (such as Platts or OPIS) before considering any cost figures offered by an interested taxpayer.

We believe that the use of Platts or OPIS results in predictable audit findings, avoids costly calculations of inventory costs, avoids the costs associated with disputed inventory valuations, and, therefore, is beneficial to taxpayers when viewed in its totality. We find that we fully addressed the taxpayer's argument in our original determination and hereby affirm our conclusions as stated in that determination.

Imputing Income.

[5] The taxpayer claims that using Platts and OPIS imputes income to the taxpayer when none existed. The taxpayer relies on Weyerhaeuser v. the Department of Rev., 106 Wn.2d 557, 723 P.2d 1141 (1986). We disagree. When the taxpayer makes an exchange, it is engaged in a wholesale transaction. Time Oil v. State of Washington, 79 Wn.2d 143, 483 P.2d 628 (1971). The taxpayer did not specify a reasonable price for the products sold to its competitors in the exchange agreements. Rather, it specified that certain goods would be received in exchange for similar goods. Under RCW 82.04.070 and .090 and Rule 112, the Department is simply determining the value the taxpayer received as a result of such transactions based on the consideration the taxpayer received. No income is being imputed. The consideration the taxpayer received is the wholesale value of similar quantities of the product. Rule 112.

Reliance on Det. Nos. 91-341 and 93-118.

We disagree with the taxpayer's claim that these determinations did not address the taxpayer's argument that inventory cost is the appropriate measure and that we erred in relying on them. If there were a reasonable stated selling price, we would agree that the selling price is generally the appropriate measure. See RCW 82.04.090. Further, the alleged selling price (inventory value) is not stated in the exchange agreements. According to the taxpayer, the selling price is the inventory value less a profit margin. But that figure only exists on the taxpayer's internal books and records. As stated above, those records are not reliable.

Further, if we were to rely on the taxpayer's internal books and records, then the exchange partner's internal books and records would be used to calculate the measure of exchange

partner's tax. But the exchange partner's internal cost calculations are unlikely to be the same as the taxpayer's internal cost calculations. This would raise a serious problem for the Department. When two taxpayers exchange identical goods in a single transaction, the measure of the tax for each of the taxpayers would be different. For example, assume no price differentials are in effect and the taxpayer delivers 10,000 barrels of gasoline to Exchange Partner A and vice versa. Further assume that the taxpayer's cost for the 10,000 barrels is $286,000, while Exchange Partner A's cost is $226,000. If we accepted the taxpayer's theory, it would pay more taxes than Exchange Partner A on identical transactions because the measure of the taxpayer's tax would be $286,000 (the value of consideration received, i.e., the taxpayer's inventory cost for the 10,000 barrels) while the measure of Exchange Partner A's tax would be $226,000 (Exchange Partner A's inventory cost for the 10,000 barrels). We decline to adopt a measure that is contrary to Rule 112's requirement to use comparable sales to measure the tax and would lead to inconsistent and inequitable results.

Finally, we note that use of Platts and OPIS is consistent with the decision in Shell Oil Co. v. State of Washington, Dept. of Rev., Board of Tax Appeals, Docket No. 93-28 (1997).[11]

In short, we find that both Det. No. 91-341, supra, and Det. No. 93-118, supra, adequately state the Department's position against the use of inventory value to measure the tax on exchange agreements, and we reaffirm our acceptance of their analysis.

. . .

Handling fees.

[6] The taxpayer correctly argues:

> Charges for handling one's own merchandise prior to delivery or for delivery itself are considered part of the selling price and subject to tax under the same classification as the sale of the product -- in this case wholesaling. WAC 458-20-110.

Reconsideration Petition page 6.

We agree that we erred when we said the handling fees were subject to B&O tax under the service and other activities classification.

. . .

DECISION AND DISPOSITION:

The taxpayer's petition is denied as to the use of inventory value. The taxpayer's petition is granted as to the treatment of handling fees. Handling fees shall be treated in the same manner

[11] We note that both the Department and Shell appealed the Board of Tax Appeals (BTA) decision and settled the matter. . . .

as other differentials. The file is remanded to the Audit Division for the purpose of recalculating the refund in a manner consistent with Determination No. 00-124 as clarified by this determination.

Dated this 9th day of May 2002.