Cite as 10 WTD 406 (1990).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 91-051
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] RULE 170: CONTRACTOR--PERFORMANCE BOND--GROSS CONTRACT PRICE--PAID BY OWNER. Where the owner pays the performance bond for a construction contract, and the contract states a gross contract price that does not include the bond, the payment is not subject to the sales or use tax and is not part of the construction contract.

[2] RULE 113: RCW 82.04.050(1) -- SALES OR USE TAX -- EXEMPTION -- INGREDIENT. Chemicals are only entitled to the exemption for ingredients used in producing a new substance if some proportion of the chemical remains as a necessary ingredient in the final product.

[3] RULE 106: USE TAX--TRANSFERS OF ASSETS--NON-WHOLLY-OWNED SUBSIDIARIES. The use tax is due on all transfers of assets from one company to another where no sales tax has been paid on the transaction, unless an exemption applies. When an asset is transferred from a non-wholly owned subsidiary for consideration, no exemption applies.

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.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

Taxpayer protests the assessment of use tax on the purchase of a performance bond; the transfer of an asset from one division to another; and on the purchase of . . . antifoam.

FACTS AND ISSUES:

Hesselholt, Chief A.L.J. -- The business activities of the [taxpayer] were audited for the period January 1, 1984 through December 31, 1986. An assessment was issued and later adjustments resulted in a credit to taxpayer. Taxpayer appeals three items in the audit.

The first item is the assessment of use tax on the purchase of a performance bond on a contracting project. Taxpayer paid the bond itself. It claims that the bond was never a part of the contract price and as such, is not subject to use tax under WAC 458-20-170.

The second item protested is the assessment of use tax on the purchases of . . . antifoam from [the chemical co.]. Taxpayer argues that the antifoam is a required additive in the pulping process and approximately one percent remains in the finished product. According to information provided by taxpayer, the antifoamer is a defoamer which minimized foam bubble formation in the pulp slurry and helps to form a uniform, clean sheet devoid of foam spots.

The third item protested by taxpayer is use tax on the transfer of a . . . blower with a transfer value of $5,000. Taxpayer argues that the blower was originally acquired in November, 1971, for use at its operation in [a County in Washington] . It has been transferred twice, once to the [affiliate in Washington], and then later to this taxpayer. Taxpayer admits that purchase invoice documents going back to 1971 have been destroyed, but argues that any deficiency in sales or use tax "must be deemed to have been satisfied via audit."

DISCUSSION:

WAC 458-20-170 (Rule 170) provides as follows:

> [3] (a) Prime contractors are taxable under the retailing classification, and subcontractors under the wholesaling classification upon the gross contract price.

> (b) Where no gross contract price is stated in any contract or agreement between the builder and the property owner, then the measure of business and occupation tax is the total amount of construction costs, including any charges for licenses, fees, permits, etc., required for the construction and paid by the builder.
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> [(4)(a)] Prime contractors are required to collect from consumers the retail sales tax measured by the full contract price. Where no gross contract price is stated, the measure of sales tax is the total amount of construction costs including any charges for licenses, fees, permits, etc., required for construction and paid by the builder.

[1] In this case, the bond was not included in the gross contract price. It was paid by the taxpayer. It is not a purchase generally subject to sales or use tax outside of a construction contract. Because the taxpayer paid this cost directly, and because taxpayer and its contractor had a set contract price and were not operating on a cost-plus basis, we find that this amount is not subject to use tax.

[2] The taxpayer has relied on Van Dyk v. Department of Revenue, 41 Wn. App. 71 (1985) to support its position that the antifoam is not taxable.

The Department's position is that an additive that is necessary for the manufacturing process is not necessarily an exempt "ingredient" even though some of it remains in the final product. Only additives which are necessary or intended in the finished product meet the "ingredient" exemption. WAC 458-20-113(3). See also, Det. 87-48, 2 WTD 239 (1986) and Det. 87-15, 2 WTD 139 (1986).

The Department relies on case law in support of this position. In one case, Weyerhaeuser v. Department of Rev., 16 Wn.App. 112 (1976), the court found the purchase of calcium chloride was exempt. The court found that calcium chloride was used only once in the process, stating:

> It is added as an ingredient of the material from which corrugating medium is manufactured to change the character of the fiber in the slurry. It is the change in character which makes the use of calcium

> chloride beneficial to plaintiff's process. The purpose for its use can be accomplished only by making it an ingredient of the slurry, and it is used once for the single purpose of becoming an ingredient.

16 Wn.App. at 118.

In Van Dyk v. Department of Rev., the court granted a refund of use taxes paid on coke used in the manufacture of iron products from scrap iron, coke, and other ingredients. The coke was about 92% carbon. Although most of the carbon was burned in the manufacturing process, a portion of the carbon became a "necessary" ingredient of final products. 41 Wn.App. at 72. The court noted that "[b]y applying a primary purpose test to any chemical, even though intended as an ingredient, the ingredient exemption would be destroyed altogether." Id. at 76-77. The language, although dicta, infers that the chemical must be intended as an ingredient. As noted above, the Court stated that chemicals which are exhausted in processing and do not directly contribute to the finished product are taxable.

We do not agree that the antifoam is exempt as an "ingredient" merely because a small portion remains with the final product. The substance only serves a useful purpose during the manufacturing process. Simply because the product is necessary in the manufacturing process, however, does not make it a necessary ingredient in the final product. If the chemicals are not necessary ingredients in the final product, we do not find they meet the "ingredient" exemption. The fact that a portion of the chemical remains in the final product is not dispositive.

Finally, the taxpayer argues that the transfer of an asset from one division to another should not be subject to use tax because tax has clearly been paid on it at some previous time.

[3] The use tax is due on every transfer of tangible personal property on which the retail sales tax has not been paid. RCW 82.12.020, 010. The fact that the item may have been subject to sales tax or use tax at some previous time does not alter the tax liability of subsequent transactions. The Audit report recognizes this, stating at page 5:

> These were transfers of equipment from a subsidiary that is not wholly-owned. The transfers did not fall in the categories of exempt transfers listed in

> WAC 458-20-106. . . Although [affiliate] paid sales tax or use on these items when they purchased them, [taxpayer] would owe tax on the acquisition because [affiliate] is a separate entity that received consideration for the transfer.

Transfers of assets between wholly-owned subsidiaries or between a corporation and its a wholly-owned subsidiary, or where the transfer is accomplished by an adjustment in the beneficial interest are not taxable. WAC 458-20-106. In this case, none of these exceptions apply. Therefore, the transfer of the asset for consideration is fully taxable.

DECISION AND DISPOSITION:

Taxpayer's petition is denied in part and granted in part.

DATED this 26th day of February 1991.