Cite as Det. No. 98-133, 18 WTD 153 (1999)

BEFORE THE 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. 98-133
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 113; RCW 82.04.050; RCW 82.04.190: RETAIL SALES TAX -- INGREDIENT -- BYPRODUCT. A fruit juice producer did not owe retail sales tax on a byproduct of fruit juice, rice hulls, a necessary and intended ingredient of pomace produced in the juicing process, which had a market value.

[2] RULE 103; RULE 254; RCW 82.04.080: B&O TAX -- SALE -- VALUE PROCEEDING OR ACCRUING -- CONSIDERATION -- BARTER. The transfer of goods for valuable services constitutes a sale of the goods measured by the value of the services.

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 producer of fruit juice protests the assessment of use tax on rice hulls spent in juice production.[1]

FACTS:

M. Pree, A.L.J. (Successor to Breen, A.L.J.)[2]. . . The business records of (taxpayer) were examined by the Department of Revenue (Department) for the period January 1, 1992, through March 31, 1996. On August 16, 1996, an audit assessment was issued for a total of $ . . . in tax and interest. The full amount of the assessment remains owing. At issue is the assessment of use tax on rice hulls used in producing fruit juice. The taxpayer did not pay retail sales tax when

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] A.L.J. Breen heard the appeal in this case and drafted this determination

purchasing the hulls. The Taxpayer previously received a determination, . . . , when it was doing business as . . . that granted its petition on, essentially, the same issue that is in dispute in this current appeal.

Rice hulls do not become part of the finished fruit juice product. Instead, the spent hulls are mixed with other materials to make pomace. Pomace is the pulpy matter remaining after the juice has been pressed from the fruit. The pomace is transferred to third parties, who then sell it for inclusion in cattle feed and fertilizer. The consideration for the transfer is a central issue and will be described more fully below.

In order to produce fruit juice, the fruit is typically first chopped into smaller pieces. The next stage of producing juice involves a number of processes, the intent of which is to extract as much of the juice and color as possible from the fruit. Rice hulls and enzymes are added at this point to aid in the extraction process. The hulls assist in maximizing the amount of extracted juice. The rice hulls are added as a press aid to give more body and to even the pressure on the fruit when pressed. The hulls retain their form even when subjected to a great amount of pressure. The various enzymes assist in maximizing the amount of extracted juice by acting to break down the cell walls of the fruit. The enzymes may also either remove or breakdown cellulose, starch, and pectin that is present in the fruit. The rice hulls and other materials are then removed. The amalgamation of the removed materials is known as pomace, which is made up of the rice hulls and the cores, skins, and seeds of the fruit used in making the juice. Later in the juice production process the main concern is to remove solids from the solution to achieve the greatest clarity possible. At this point, various filter aids or fining agents are used. These fine particles attach to insoluble solids suspended in the juice to achieve a much higher degree of clarity.

As noted above, we granted the taxpayer's petition in . . . for a prior audit period. We observed:

> It seems clear that in recent years pomace has become a salable product so that the taxpayer can now purchase the ingredients or components of that product exempt from payment of sales and use tax.

In the present audit period, the taxpayer did not sell the product in a typical sale transaction wherein the buyer tenders pecuniary consideration to the seller in exchange for the product. Instead, the present transactions were conducted in more of a barter arrangement. During the audit period the taxpayer had an arrangement to supply pomace first with . . . (January 1, 1992 through September 1994) and then with . . . . (October 5, 1994 through the remainder of the audit period). The first customer desired the pomace for purposes of inclusion in cattle feed. The second customer desired the pomace as an amendment to planting mix, i.e., fertilizer.

In both situations, the taxpayer agreed to make available to the other party all the pomace generated from its processing operations, however, the taxpayer made no warranty as to the amount of pomace that would be available. The agreements called for the customer to take

delivery of the pomace F.O.B. taxpayer's plant. The following two provisions of the agreement with . . . [3] are particularly pertinent:

> **3. Delivery - Pickup.** [Customer] understands the absolute necessity of timely pickups of pomace so as to accommodate the needs of [Taxpayer]. [Customer] agrees, through a common contract carrier (*currently* . . .), to have trucks or vehicles available to pick up loads of pomace from [Taxpayer] on such schedules as are established from time to time by [Taxpayer] for all shifts the [Taxpayer] plant operates. All costs of transportation from [Taxpayer]'s plant and all risk of loss with respect to the transporting of the pomace and all liability with respect to said transportation shall be borne by [Customer].
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> . . .
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> **6. Default.** [Customer] understands that if it does not perform its obligations relating to the timely pickup of pomace from [Taxpayer], [Taxpayer] will suffer damages and may be required to shut down its processing operations. For this reason, it is understood that if [Customer] fails to timely pick up pomace generated by [Taxpayer] . . . [Customer] shall be responsible for reimbursing [Taxpayer] for its reasonable costs in disposing of the pomace, including transportation costs. . . .

. . . , a representative from the current contract carrier . . ., testified that [Customer] aggressively bid for this contract to secure what he refers to as a valuable "commodity." Different juice producers produce different quality of pomace. In other words, all pomace is not the same, just as all wood is not the same. Just as there is oak vs. pine in the world of timber, so exists varying degrees of the quality of different types of pomace. Apparently, the quality of the taxpayer's pomace results in a 10 ton load providing the same quantum of fertilizer value as would 30 tons from another similar juice processor. The taxpayer and . . . further argue that the quality of [Taxpayer]'s pomace is verified by the fact that the contract enabling [Customer] to secure this commodity places such a high duty of diligence in timely removal at the risk of default . . . states that the actual transportation costs to [Customer] for . . . to provide its contractual duties equates to approximately $8.25 per ton.

In a letter dated July 18, 1996, the taxpayer claimed they had received a prior determination on the issues in which its petition was granted. Although, the taxpayer changed its name since the prior determination, it still argued that the prior decision was binding. In a letter dated July 29, 1996, the Department conceded the prior decision, but maintained that it was only binding as long as the underlying facts had not changed. Here, however, the Department contended the facts had changed. In short, the Department concluded that in the prior decision determining whether or not a sale of the pomace occurred was a "close case." The Hearings Examiner in the prior case gave the benefit of the doubt to the taxpayer. In the present situation, however, the

[3] The same provisions were present in the agreement with . . . although stated in different language.

Department argued that no "sale" of the pomace had occurred. The Department's reasoning was as follows:

> [We] can find no accounting basis for treating the reduction of a potential expense the same as income. Either a sale of the waste or byproduct pomace has been made or not made. The income is credited in the accounting records or no consideration has been received. While the net effect of reducing potential expense by requiring parties receiving pomace to haul it away may roughly equate to what formerly was received when delivering it to the buyers, this is not the same. Also note that the [prior] determination refers to extrusion and filter aids as becoming secondarily a component of a "salable" product. We cannot ignore the simple accounting fact that no income was realized in at least most of the audit period from pomace given to cattle feeders and landscape companies.
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> The auditor also stated that in his review of accounting records at least some of the material was neither sold or given away but rather disposed of at dump sites.
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> I agree that for any pomace "sold" in the audit period we are bound by [the prior determination] to remove from taxable purchases the spent press or filter aids. Even though this appears to be an incorrect application of the administrative rule we are estopped from asserting any tax if the fact pattern is the same.

The taxpayer protests the assessment of use tax on the rice hulls. It contends that rice hulls meet the criteria for exemption as ingredients or components of a manufactured product because they are an intended and beneficial ingredient of the byproduct, pomace, that is conveyed to third parties in exchange for valuable consideration (albeit in the form of services instead of money that is recorded in an income ledger).

ISSUES:

1) Whether the use of rice hulls may be exempt from use tax when they are not traceable in the primary product, but become ingredients or components of a byproduct.

2) Whether a contract for removing the pomace provides valuable consideration for the pomace to be considered "produced for sale."

DISCUSSION:

1) Ingredient or Component Issue

This state's use tax law, ch. 82.12 RCW, imposes a tax "for the privilege of using within this state as a consumer any article of tangible personal property purchased at retail." RCW 82.12.020. It complements the sales tax by imposing a tax generally equal to the sales tax on an item of tangible personal property used in this state in cases where the retail sales tax was not paid. WAC 458-20-

178. "Use" is defined under RCW 82.12.010(2) as "the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property. . . ." Thus, as a preliminary matter, the assessment of use tax is appropriate unless the use of the rice hulls is otherwise exempt.

RCW 82.04.050 defines the term "retail sale." Excluded from the definition is a sale of tangible personal property to a person who:

> Purchases for the purpose of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component or is a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale. . . .

RCW 82.04.050(1)(c). Along similar lines, the term "consumer" is defined, in part, as:

> Any person who purchases . . . or uses any article of tangible personal property . . . other than for the purpose . . . (c) of consuming such property in producing for sale a new article of tangible personal property or a new substance, of which such property becomes an ingredient or component or as a chemical used in processing, when the primary purpose of such chemical is to create a chemical reaction directly through contact with an ingredient of a new article being produced for sale. . . .

RCW 82.04.190(1). This provision creates two distinct exemptions, the ingredients exemption and the chemicals used in processing exemption. Van Dyk v. Department of Revenue, 41 Wn. App. 71, 702 P.2d 472 (1985). Since it is conceded that rice hulls do not chemically react with any ingredient of the final product, the later exemption is not applicable. See Van Dyk, 41 Wn. App. at 73; Northwest Steel Rolling Mills, Inc. v. Department of Revenue, 40 Wn. App. 237, 240, 698 P.2d 100 (1985), cert. denied, 104 Wn.2d 1006 (1985). Therefore, our inquiry will focus on the ingredients exemption.

The ingredients exemption is implemented by WAC 458-20-113 (Rule 113). The rule, in part, states:

> (2) Ingredients or components. The sale of articles of tangible personal property which physically enter into and form a part of a new article or substance produced for sale does not constitute a retail sale. This does not exempt from the retail sales tax the sale of articles consumed in a manufacturing process which do not enter into and become a physical part of the new article produced for sale, such as fuel used for heating purposes, oil for machinery, sandpaper, etc.
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> (3) Also, the definition of retail sale does not exclude consumables purchased for use in manufacturing, refining, or processing new articles for sale merely because some constituents of the consumables may also be traceable in the finished product, which are impurities or undesirable or unnecessary constituents of the finished product.

> (4) For articles to qualify for sales and use tax exemption as ingredients or components of products produced for sale, such articles or their constituents must be traceable in the finished product and identifiable as having been directly provided by the article claimed for exemption.

In order to resolve the present issue, Rule 113 requires us to answer two questions: (1) did the rice hulls "physically enter into and form a part of a new article or substance produced for sale;" and (2) assuming rice hulls were traceable in the produced product, were they "impurities or undesirable or unnecessary constituents of the finished product."

The Department concedes that rice hulls enter into and form a part of the pomace, but argue that the pomace is not the finished product and even if it is a "product," it is waste and, thereby, not produced for sale. Det. No. 92-161, 13 WTD 75 (1993) involved a taxpayer who manufactured and sold steel and additionally sold slag, a byproduct of the steel making process. In producing the steel, limestone was employed as a flux in the furnace where it played a major role in the chain of chemical reactions through which impurities were removed from the melt. The limestone did not remain in the final finished product, i.e., steel. Based on the holding in Northwest Steel Rolling Mills, supra, we concluded that the limestone was not exempt under the chemicals used in processing exemption. However, we determined that the limestone was exempt under the ingredients exemption because:

> [T]he limestone became a necessary and intended final ingredient of the slag, which was sold by the taxpayer on a regular basis. The limestone . . . therefore constituted property consumed in producing for sale a new article of tangible personal property. (Emphasis added.)

This is exactly the case here. The rice hulls are a traceable final ingredient of the pomace. The rice hulls are consumed in producing a new article of tangible personal property, i.e., pomace, which is then conveyed to third parties on a regular basis. We find no support under the law, the pertinent rule, or our precedential published determinations to find that the ingredient exemption is inapplicable merely because the property is eventually traceable in a byproduct instead of the primary product.

This raises the question of whether pomace is a "byproduct." RCW 82.04.210 defines this term as:

> [A]ny additional product, other than the principal or intended product, which results from extracting or manufacturing activities and which has a market value, without regard to whether or not such additional product was an expected or intended result of the extracting or manufacturing activities. (Emphasis added.)

It is clear that the byproduct need not be an expected or intended result of producing the primary product. Thus, the fact that pomace was not an intended result of the juice making process is not determinative. The crucial inquiry is whether the pomace has a market value.

The definition of "byproduct" speaks to the resulting additional product having a "market value." This term is not defined in the Revenue Act. A basic tenet of statutory construction is that when a term is used but not defined in a statute or regulation, it must be given its usual and ordinary meaning usually ascertained from dictionaries. Marino Property v. Port of Seattle, 88 Wn.2d 822, 567 P.2d 1125 (1977); Sellen Construction v. Dept. of Revenue, 87 Wn.2d 878, 558 P.2d 1342 (1976). "Market value" is generally defined as "[t]he amount that a seller may expect to receive in the open market for merchandise, services, or securities." See WEBSTER'S II NEW RIVERSIDE UNIVERSITY DICTIONARY 728 (1988). Something with "market value" is said to have "worth." Id. at 1329. On the other hand, the term "waste" is defined as a worthless or useless byproduct. Id. at 1303. Something devoid of worth is said to be "worthless." Id. at 1329. In the context of waste collection, the Department defines the term "waste" as garbage, trash, rubbish, or other material discarded as worthless or not economically viable for further use. WAC 458-20-250.

Thus, for purposes of this case, the resulting pomace is either "worth" something and thereby has "market value" or it is devoid of worth, i.e., worthless, and is deemed "waste." In Det. No. 92-035, 12 WTD 85 (1993), we addressed the issue of whether sludge was a waste product subject to the refuse collection tax. The sludge was applied to various tracts of land as a fertilizer in order to increase the level of nitrogen in the soil. In concluding that the resulting sludge was, in fact, "economically viable for further use," we said:

> Sludge in this case is collected primarily for recycling or salvage. If it was "discarded as worthless", it would be dumped at a landfill . . . or [elsewhere], as it was formerly. As stated previously all of the taxpayer's sludge is distributed over land as a soil amendment or fertilizer. Moreover, we are convinced, based on the considerable information contributed by the taxpayer and other participants in this matter, that sludge has significant utility as a soil fertilizer. This information unequivocally suggests that trees, grass, or most any kind of plant life will flourish on a diet of this nutrient-packed substance. Additionally, sludge is valuable in reducing the effects of erosion.
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> Consequently, we conclude that sludge is "economically viable for further use". Therefore, . . . it is not "waste".

12 WTD at 89. We find this decision instructive in resolving the present case. The pomace clearly is not "worthless," thus, it has market value. The taxpayer has produced evidence of and our own investigations have confirmed the development of a relatively large, ongoing market for pomace for use in cattle feed and/or fertilizer. As for whether the spent rice hulls are impurities or undesirable or unnecessary constituents of the pomace, there is no argument to refute the importance of the hulls in the pomace. In fact, the spent hulls are a chief ingredient. It follows that the hulls are, therefore, not mere impurities, undesirable, or unnecessary constituents.

2) Barter Issue

Concluding that the pomace has market value begs the question - what is the value of the pomace in terms of dollars? The state imposes the B&O tax on the gross income of a business. RCW 82.04.220. The gross income of a business includes the "value proceeding or accruing by reason of the transaction of the business." RCW 82.04.080.

The "value proceeding or accruing" to a business means the consideration paid to the business, whether in the form of money or other property. RCW 82.04.090. Thus, the amount of consideration "actually received or accrued" includes the value of the property or services a taxpayer receives in lieu of any monetary payment for such services or property. A transaction where goods or services are exchanged without the use of money is commonly identified as a "barter" transaction.

The word "sale" means any transfer of the ownership of, title to, or possession of, property for a valuable consideration, and includes the sale or charge made for performing certain services. RCW 82.04.040; WAC 458-20-103. The definition does not require specific accounting entries it solely requires that there be consideration supporting the exchange. The term consideration is not defined in the Revenue Act. As previously stated, a basic tenet of statutory construction is that when a term is used but not defined in a statute or regulation, it must be given its usual and ordinary meaning usually ascertained from dictionaries. Marino Property, supra; Sellen Construction, supra. The term "consideration" is generally defined as:

> Some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other.

BLACK'S LAW DICTIONARY 306 (6th ed. 1990); see, also, 1 Williston, Contracts, 425 § 122 (1937). Stated differently, consideration is any act, forbearance, creation, modification, or destruction of a legal relationship, or return promise given in exchange. King v. Riveland, 125 Wn.2d 500, 505, 886 P.2d 160 (1994).

In ETB 64.04.208[4], we addressed the issue of whether intercompany loans of gasoline, oil, and similar products were subject to the business and occupation tax as sales. Major petroleum distributors were making exchanges of stock on a regular and continuing basis to cover shortages occurring because of a lack of storage or production facilities and to effect savings in transportation costs. The transfers were carried as loans on the books of account and did not include the products so acquired as part of the regular inventory. The loans were generally repaid in kind or with a substitute product and no monetary consideration was involved. The petroleum producers argued that these were not sales because, inter alia, the transfers did not involve money.

The Tax Commission, now the Department, held that these transactions constituted "sales" since there was a transfer of the ownership of, title to, or possession of property for a valuable consideration. The Commission noted that "expressed in terms of money" as used in RCW 82.04.090 means that when consideration is something other than money (credits, rights, or other

[4] Now ETA 64.04.208

property), the value shall be converted to money terms for determination of the measure of tax. Similarly, the services rendered by [the transport company and the customer] clearly provide the requisite consideration to support a sale in the current case.

In evaluating a barter transaction, we must identify both what the taxpayer exchanged and the value of what was exchanged. Det. No. 94-272, 15 WTD 78 (1995). Here, the taxpayer elected to convey its pomace in exchange for a contractual commitment to remove all pomace on a timely basis. The taxpayer in most, if not all cases, did not simply pay someone to cart away the pomace and dump it.[5] In fact, the opposite is true. [Customer], via [the transport company], incurred the cost of removal in exchange for being *allowed* access to the pomace. If the removal was not timely, [Customer] would be in default of its legal obligation and would be liable for damages. This is clearly a legally binding relationship with real duties and real commitments flowing from the relationship. See Det. No. 94-272, 15 WTD 78 (1995). The taxpayer exchanged goods (pomace) for services (diligent and timely removal of the pomace) without the use of money. There is adequate consideration flowing from both parties to conclude that this is a "sale" for purposes of the Revenue Act.

The taxpayer has requested us to treat its barter transaction as a sale and we will do so under the unique facts of this case. However, in granting this request the taxpayer becomes liable for B&O tax on the gross receipts from these sales of pomace. RCW 82.04.220, 82.04.080. The taxpayer is liable for B&O tax at the wholesaling rate, assuming it obtains valid resale certificates from [the transport company/customer], or at the retailing rate absent valid certificates.

The remaining issue is valuing the services received by the taxpayer in exchange for the pomace. Or, in the alternative, valuing the pomace. Under WAC 458-20-254 (Rule 254), a taxpayer is required to maintain books and records regarding the "amount of gross receipts and sales from all sources, however derived, including barter or exchange transactions,. . . ." The best available evidence for valuing the taxpayer's sales of pomace during the audit period is the cost incurred by the transportation carrier and subsequently billed [Customer]. Thus, we find that the amount of $8.25 per ton to be the best available evidence of the price paid for the pomace. The taxpayer has the burden of demonstrating records substantiating the number of tons removed or, in lieu of adequate documentation, the Department's Audit Division shall extrapolate the number of tons based on a mutually agreed upon test period.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in regards to the exemption from use tax on the use of the rice hulls. On the other hand, we find that the taxpayer owes B&O tax in relation to the sales supporting the above use tax exemption. We find that the amount of $8.25 per ton to be the best available evidence of the price paid for the pomace. The taxpayer has the burden of

[5] Although the Department has stated that occasionally some of the pomace was dumped, the fact remains that at all times during the audit period the taxpayer had the legal obligation to make all pomace available to . . . or [Customer] for their pickup.

demonstrating records substantiating the number of tons removed or, in lieu of adequate documentation, the Audit Division shall extrapolate the number of tons based on a mutually agreed upon test period. The amount of the use tax exemption shall be offset against the imputed B&O tax. We remand this matter to the Audit Division to make the appropriate adjustments.

Dated this 22nd day of July 1998.