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

In the Matter of the Petition For Correction of Assessments of	)	S U P P L E M E N T A L D E T E R M I N A T I O N
	)	No. 86-295A
. . .	)	Registration No. . . .
	)	Tax Assessment Nos. . . .

[1] **RULE 136, RCW 82.04.110, RCW 82.04.240, AND RCW 82.04.280(3):** B&O TAX -- MANUFACTURER -- PROCESSOR FOR HIRE -- FUNGIBLE GOODS COMMINGLING. Person who produces finished products from materials supplied by customer is a processor for hire, notwithstanding that materials or finished products, due to their fungible nature, are commingled with other materials or finished products in the person's possession.

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:

A Determination was issued in response to taxpayer's petition for correction of assessment. The taxpayer requests a modification of the Determination based on newly-acquired evidence.

FACTS AND ISSUES:

Rosenbloom, A.L.J. -- In its petition for correction of the above-referenced tax assessments and at the hearing held in response thereto, the taxpayer took the position that sales of alumina originating out of state and delivered to . . . ("customer" herein) in this state were dissociated from the taxpayer's local business and were interstate in nature. It was represented at the hearing

that the customer agreed to ship bauxite to the taxpayer's facilityin Texas in exchange for alumina needed in the customer's manufacturing operation in Washington. The taxpayer also stated that the alumina was at first shipped to the taxpayer's . . . , Washington manufacturing facility, and from there to the customer's Washington plant. Later shipments were sent directly from a point outside this state to the customer's plant, according to the taxpayer.

The Department issued a Determination which held that sales of alumina shipped via the taxpayer's [Washington] plant were subject to tax, but that sales of alumina shipped directly to the customer from a point outside this state were dissociated. The Determination directed the Audit Section to delete the proceeds of any sales of the latter type from the measure of the tax.

While attempting to determine the amount of proceeds of sales qualifying for dissociation under the Determination, the taxpayer discovered that the deliveries of alumina to the customer were not pursuant to a contract of sale. They were pursuant to an agreement ("Agreement" herein) whereby the taxpayer was to produce alumina for the customer from bauxite supplied by the customer.

The taxpayer's letter of March 30, 1987 explains.

> Our investigation showed that the (customer/taxpayer) Agreement did not involve a sale of alumina from (the taxpayer) to (the customer) or an exchange of bauxite for alumina. Rather the tolling agreement provided that (the customer) delivered their bauxite to (the taxpayer's) Texas facility. (The taxpayer) then tolled the (customer's) bauxite into (the customer's) alumina. That is, through a manufacturing process known as tolling, (the taxpayer) converted the (customer's) bauxite into (the customer's) alumina. The revenue listed in the destination sales report reflects primarily the tolling charge.

The taxpayer supplied a copy of the Agreement with its March 30, 1987 letter. We have reviewed this Agreement and we find that it does in fact provide that the taxpayer for a charge shall produce alumina for the customer from bauxite supplied by customer. The Agreement recites the parties' intent that all bauxite delivered by the customer shall be converted to alumina and that deliveries shall be planned so that the taxpayer will have no such bauxite on hand at the expiration of the term of the Agreement. Due to the fungible nature of both bauxite and alumina, the Agreement allows the taxpayer to commingle bauxite delivered by the customer with other bauxite in the taxpayer's possession, and to substitute other alumina for alumina theretofore belonging to the customer.

The issue is whether the transaction should be characterized as a sale of goods (i.e., a sale of alumina in exchange for bauxite and cash) or as processing for hire. If it is characterized as the latter, then it is beyond the taxing jurisdiction of this state since the processing activity occurred in Texas.

DISCUSSION:

Rule 136 provides the following definition:

> The term "processing for hire" means the performance of labor and mechanical services upon materials belonging to others so that as a result a new, different or useful article of tangible personal property is produced. Thus, a processor for hire is any person who would be a manufacturer if he were performing the labor and mechanical services upon his own materials.

A processor for hire, by definition, does not make sales of goods because the goods already belong to the customer. The narrow question presented in this appeal is whether by commingling the materials or the finished product a processor for hire becomes a manufacturer.

[1] Though the question is an interesting one, it is not a novel one. In a prior Determination issued to this taxpayer (. . .) the Department ruled that a toll conversion contract whereby the taxpayer produced ingots from scrap metal supplied by its customers constituted processing for hire rather than manufacturing; even though the scrap metal was commingled with the scrap metal of other customers, and even though the ingot was possibly delivered from a different plant than the one to which the scrap metal was delivered.

We agree with this characterization. Scrap metal and ingots are fungibles. There is no business purpose for segregating them, other than by alloy content. It would have been an elevation of form over substance for the Department to have required physical segregation of the goods by customers in order for the processing for hire classification to apply.

Likewise, bauxite and alumina are fungibles. The taxpayer's status as a processor for hire should not depend upon the narrow technicality of whether these substances have been commingled. Under the terms of the Agreement presented for our review, we are satisfied that the taxpayer was a processor for hire. Since the processing activity took place in Texas, it is not subject to Washington B&O tax.

DECISION AND DISPOSITION:

The Audit Section will issue amended assessments consistent with Determination No. 86-295, as amended by this Supplemental Determination advising the taxpayer of any balance due or credit.

DATED this 29th day of July 1987.