BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition	)	F I N A L
For Hazardous Substance Tax Ruling of	)	D E T E R M I N A T I O N
	)	
	)	No. 88-329
	)	
. . .	)	Registration No. . . .
	)	
	)	

[1] **RCW 82.22.040 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- EXEMPTION -- CERTIFICATES -- PARTIAL EXPORTATION. The export exemption certificate of subsection (4)(c)(iv) under Rule 252 may be used even though not all of the hazardous substance covered by the certificate will be exported. F.I.D.

[2] **RCW 82.22.040 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- EXEMPTION -- CERTIFICATES -- EXPORTED FUEL. Purchasers of fuel products for use outside this state may give their suppliers tax exemption export certifications but must report and pay hazardous substance tax themselves upon any substances not actually exported and not used by them as fuel in this state. Ultimate use of such substances as fuel by another person in this state does not entitle the in-state refiner to any tax exemption. F.I.D.

[3] **RCW 82.22.040 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- EXEMPTION -- EXPORT FUEL SALES OR USES -- "CUTTERS" -- "BLENDING STOCK" -- "FEEDSTOCK." "Cutters" and "blending stock" are generally used as fuels and are thus entitled to hazardous substance tax exemption when exported for sale or use outside this state. "Feed" and "feedstock" are not fuels or generally used as fuels and are not entitled to the statutory export exemption. F.I.D.

[4] **RCW 82.22.030 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- PETROLEUM PRODUCTS -- FUNGIBLES -- COMMINGLING TAXED AND UNTAXED PETROLEUM PRODUCTS -- PRESUMPTION OF LIMITED LIABILITY. Under rare circumstances when untaxed fungible petroleum products are mixed with the same kind of products which have been previously taxed, and export sales are made from the commingled supply, it will be presumed that the seller will minimize its tax liability by exporting the previously untaxed portion first. F.I.D.

[5] **RCW 82.22.020 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- WHOLESALE VALUE -- DEDUCTIONS -- OTHER TAXES DEDUCTIBLE. Other taxes collected by the seller merely as collecting agent, from the buyer of hazardous substances are not part of the "wholesale value" tax measure. Such other taxes which are primarily imposed upon the buyer, and which may be deducted from the hazardous substance tax measure, include federal and state taxes on gasoline, diesel, special fuels, aircraft fuel, and the state retail sales tax and use tax. The federal taxes on underground storage tanks, federal excise on lubricating oils, and the federal environmental tax ("superfund") are not deductible from the state hazardous substance tax measure. F.I.D.

[6] **RCW 82.22.040 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- EXEMPTION -- FUEL USED IN PROCESSING PETROLEUM. Only persons who actually use fuel as a consumer in the process of refining petroleum products are entitled to the exemption for such fuel used in this state. This exemption is limited to the fuel user's possession and is not applicable for a refiner's possession simply because the fuel may be used by the refiner's buyer in an exempt way. F.I.D.

[7] **RULE 136:** B&O TAX -- MANUFACTURING -- INTERMEDIATE SUBSTANCES -- END PRODUCT MANUFACTURED. The manufacturing B&O tax does not apply to the value of each intermediate substance produced during the manufacturing process which then becomes a component of the end product being made for sale. Only if such intermediate substances are withdrawn from the process are their possessions taxable. F.I.D.

[8] **RCW 82.22.050 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- HAZARDOUS INGREDIENTS -- INTERNAL CREDITS. The hazardous substance tax applies to ingredients or components purchased and used in manufacturing other hazardous end products. The purchaser/user may not pay the seller's

tax liability and then claim credit against its own tax liability on the finished end product. F.I.D.

[9] **RCW 82.22.020 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- PETROLEUM PRODUCTS DEFINED -- PETROLEUM DERIVATIVES -- TAXABILITY -- VACUUM BOTTOMS -- SULPHUR. Non-fuel type refined oil derivatives, including vacuum bottoms, asphalt base, sulphur compounds, and sulphur are petroleum products. Petroleum products include oil refining byproducts other than just fuel and lubricants. Such byproducts are taxable hazardous substances once they are removed from the oil refining process. Only further manufactured end products are excluded from the "petroleum products" definition for tax purposes. F.I.D.

[10] **RCW 82.22.040 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- EXPORT FUEL EXEMPTION -- PETROLEUM PRODUCTS USED OR SOLD AS FUEL ITEMIZED. Fuels which may be exported and exempted of hazardous substance tax do not include feedstock or vacuum gas oils in raw or treated form. ETB 540.22.252 itemizes the petroleum products usable as fuel which may qualify for exemption. F.I.D.

[11] **RCW 82.22.020 AND RULE 252:** HAZARDOUS SUBSTANCE TAX -- "WHOLESALE VALUE" DEFINED -- SELLING PRICE -- IMPUTED VOLUME DISCOUNT. The "wholesale value" for measuring the hazardous substance tax is the actual manufacturer's/refiner's selling price, not a calculated price which imputes a hypothetical purchase volume discount when no such discount is actually given. F.I.D.

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: . . .
. . .

DEPARTMENT REPRESENTED BY DIRECTOR'S DESIGNEES:
Edward L. Faker, Sr. Administrative Law Judge

DATE AND PLACE OF HEARING: April 8, 1988; Olympia, Washington

NATURE OF ACTION:

The taxpayer seeks prospective tax rulings concerning the taxability and deductions or exemptions of possessions of hazardous substances under the provisions of chapter 82.22 RCW, the Hazardous Substance Tax.

FACTS AND ISSUES:

Faker, Sr. A.L.J. -- The taxpayer has raised eight separate but related issues regarding the application of hazardous substance tax to its possessions of hazardous substances used or produced in the oil refining process. Some of the issues raise compound questions. The taxpayer has provided proposed solutions to each such question and seeks the Department's confirmation of its understandings of the law and its solutions to the problems posed.

Because the taxpayer seeks prospective rulings, there are no actual facts from which any tax assessments or deficiencies have arisen. Appropriately, the projected facts or information surrounding each kind of transaction or each possession of substances are explained in a summary of the problems submitted by the taxpayer. The summary consists of eight parts which are incorporated in this Final Determination, verbatim. For purposes of clarity, our discussion and rulings are contained herein immediately following each separate request.

REVENUE RULING REQUEST #1

Background: WAC 458-20-252(4)(c)(iv) provides that "the exemption for... petroleum products for export... may be taken by any person within the chain of distribution...." Moreover, the regulation provides an exemption certificate for a party exporting 100% of its purchased products.

Problem A: . . . sells petroleum products to Boeing and other registered taxpayers. . . . has reason to believe that some portion of the products purchased by these registered taxpayers will be consumed and/or resold in Washington--although . . . does not know what use is precisely made of the particular products it sells to these registered taxpayers. . . . , therefore, cannot take in good faith an exemption certificate from these customers which indicates that they export 100% of the products purchased.

Solution A: . . . request written confirmation that the following blanket exemption certificates will relieve . . . of any hazardous substance tax payment obligation in regards to fuel covered by such certificates.

Certificate of Tax Exempt Petroleum Products

We hereby certify that the petroleum products purchased by or transferred to the undersigned from . . . Refining Co. are principally exported for use or sale outside Washington State as fuel. To the extent any such products are consumed in Washington, we will become liable for and pay any hazardous

> substance tax directly to the State. This certificate is given with full knowledge of, and subject to the legally prescribed penalties for fraud and tax evasion and is effective until revoked in writing by the undersigned.
>
> Registration No._____
> Registered Name _____
> Firm Name (if different)_____
> Type of Business_____
> Authorized Signature_____
> Printed Name_____
> Title_____
> Date_____

DISCUSSION - Request #1 (Problem A)

[1] The sample export exemption certificate contained in Rule 252, Part (4-c-iv) is not contemplated for use only by buyers who will be exporting 100% of the purchased petroleum products as the taxpayer asserts. Clearly, if 100% exportation were necessary it would be internally contradictory for this certification form to provide, as it does, that the buyer will directly become liable for and pay the tax due upon the portion of product which is not exported. The certificate may be given even if the buyer will not be exporting 100% of the product purchased.

The blanket certificate format proposed by the taxpayer is acceptable for use and will relieve the taxpayer of hazardous substance tax liability in regard to fuel covered by such certificates.

> Problem B: . . . also purchases various petroleum products (such as cutters, feed and other blending stocks) which are subsequently blended with other petroleum products or otherwise further manufactured into fuels. The blending and/or further manufacturing may occur in or outside of Washington--although 90+% of the petroleum products purchased by . . . will ultimately be consumed outside Washington as an ingredient of a fuel blended and/or manufactured by . . . or others. Some portion of the purchased petroleum products, however, will ultimately be consumed in Washington. . . . therefore cannot provide -in good faith- exemption certificates which indicate that 100% of the products it purchases will be exported.
>
> Solution B: . . . requests written confirmation that its provision of the following certificate to its vendors will relieve its vendors of any hazardous substance tax payment obligation as to the petroleum products covered

by such certificates and that . . . is not liable for any hazardous substance tax on its purchase of products covered by such certificates which are subsequently consumed outside the state as fuel or as an ingredient of fuel.

Certificate of Tax Exempt Petroleum Products

. . . Refining Co. hereby certifies that the principal use of cutter, feed and other blending stocks purchased by or transferred to the undersigned, from _____, are for export for use or sale outside the state as fuel. . . . will become liable for and pay any hazardous substance tax due upon all or any part of said products which are ultimately consumed within the State of Washington. This certificate is given with full knowledge of, and subject to the legally prescribed penalties for fraud and tax evasion and is valid until revoked in writing by . . . Refining Co.

Reg. No. _____C278 034 377_____
Reg. Name __ . . . Refining Co._____
Firm Name (if different) _____ . . . _____
Type of Business _____refinery_____
Authorized signature _____
Printed Name _____
Title _____
Date_____

DISCUSSION - Request #1 (Problem B)

The Department has weighed extrinsic evidence which convinces us that "cutters" and "blending stocks" are usable and are used as fuel in the refining of petroleum products. Such evidence also convinces us that "feed" and "feedstock" are not used or usable as fuel. This has been the independent testimony of refinery members of the Western States Association, made up of major oil refineries. It has resulted in the issuance of Excise Tax Bulletin No. 450.22.252 which is being published contemporaneous with this Final Determination.

The law does not contemplate any hazardous substance tax exemption for petroleum products used in this state or exported from this state other than "fuels." There are only two exemption provisions under chapter 82.22 RCW which could apply for such fuel substances. They are implemented in Rule 252 at part (4)(c)(ii) and (iii). They are:

(ii) Liquid fuel or fuel gas used in processing petroleum; and,

(iii) Petroleum products that are exported for use or sale outside this state as fuel. (Emphasis supplied.)

[2] Because the taxpayer regularly exports for out-of-state use the bulk of the cutters and other blending stocks it purchases from other refiners, it may provide a certificate of exemption for all such substances. These substances are "fuels," or are generally used as "fuel." For purposes of the export fuel exemption it is immaterial whether these fuels are burned as a source of energy or are simply blended as an ingredient of other petroleum products outside this state. They are exported fuels. This is not true, however, with regard to "feed" and "feedstock." They are not fuel and they do not qualify for any exemption whatever under the law. Moreover, even cutters and blending stock which are purchased by the taxpayer for use as ingredients in this state are entitled to no statutory exemption. In order to be exempt they must be first possessed by the user of such substances who burns them as fuel in this state in processing petroleum. The certification proposed for use by the taxpayer is approved for use only if the internal references to "feed" is deleted. Also, the taxpayer is not exempt of hazardous substance tax upon its possessions of any cutters, feed, or blending stock which it ends up using in this state as ingredients or components of other petroleum products it processes.

According to the taxpayer's own petition the cutters, feed, and blending stocks will not be used in this state as "fuel" in processing petroleum. More importantly, the taxpayer will not use these substances as a consumer at all. Rather, its possession of these substances is for resale to others. Accordingly, the taxpayer does not qualify for the first of the two exemptions. This is true regardless of the nature of the use to which the taxpayer's instate buyers put these substances. It is the Department's position that only the "user" of the fuel in processing petroleum is qualified to claim this exemption.

[3] The second exemption for export sale or use as fuel, is never available for substances which are not usable as "fuel." Thus, it is not applicable for "feed" or "feedstock." Again, see ETB 450.22.252. However, because "cutters" and "blending stock" are "fuels," all such substances which are exported for sale or use outside this state are entitled to the export exemption.

The taxpayer's requested ruling for tax exempt treatment of exported cutters and blending stocks through using the proposed certification is hereby granted. The request for exempt treatment of feed and feedstock is denied.

REVENUE RULING REQUEST #2: COMMINGLING

Background: The legislature has exempted from the hazardous substance tax previously taxed substances and petroleum products exported outside the state. The Department's rule recognizes that taxpayers may be unable to accurately track fungible products so as to maximize their entitlement to the statutory exemptions. See WAC 458-20-252(13) (providing for formulary reporting and special rulings by the Department).

Problem A: Assume that . . . purchases 1,000 units of butane a year on which hazardous substance tax has been paid by . . . 's vendor. During the year, but not necessarily over the same reporting periods, . . . produces 5,000 units of butane. Thus, during a year, . . . possesses 6,000 units of butane. Of that 6,000 units, . . . sells 2,000 units and consumes 4,000 units in the course of petroleum processing.

Solution A: We understand that . . . should pay tax on 1,000 units of butane (because it is deemed to have resold 1,000 units of purchased, tax-paid butane, 1,000 units of self-produced butane and consumed 4,000 units of self-produced exempt product).

Problem B: Assume that . . . buys 25 units of tax-paid gasoline, manufactures 100 units of gasoline and sells 120 units of gasoline outside the state and 5 units in Washington.

Solution B: We understand that . . . would be required to pay no tax on the gasoline. The five units sold in Washington would be deemed to be product . . . purchased tax-paid. All of the product exported would qualify for an exemption.

Problem C: . . . sells 80 units of gasoline outside the state and 45 units in-state, while purchasing 25 units of tax-paid gasoline and manufacturing 100 units.

Solution C: . . . would be obligated to pay tax on 20 units. It would be deemed to export 80 units of self-produced gasoline and sell in-state 20 units of self-produced gasoline and 25 units of purchased, tax-paid gasoline).

Generalization Governing Products Possessed By . . . :
. . . will be deemed to have acted in the manner which would have reduced the total hazardous substance tax on fungible products possessed by . . . if . . . had the ability to track such products.

DISCUSSION - Request #2

The problems posed by the taxpayer appear to result not so much from a commingling of fuel products as from a commingling of tax exemptions. The statutory exemption for previously taxed hazardous substances and for petroleum products for sale or use outside this state are intended to stand alone, separately, and are never intended to apply to the same fuel. Moreover, in cases of doubtful applications of tax exemptions, the statutory exemption provisions are to be strictly construed against the person claiming entitlement to exemption. Group Health Coop. of Puget Sound, Inc. v. State Tax Comm., 72 Wn.2d 422 (1967).

Here, the taxpayer has posed hypothetical factual situations which bring to bear the application of distinct and separate exemption provisions. These are rare, if not unique hypotheticals. They could only occur if the taxpayer were to purchase fuel from some supplier other than another oil refinery. Only then would the fuel product have already been subjected to the hazardous substance tax. Conversely, if the taxpayer purchases the product from another refinery, it should merely provide its seller with a blanket export exemption certificate so that its seller does not incur the tax liability upstream. Then, the taxpayer simply reports and pays hazardous substance tax upon the volume of its product on hand, whether purchased from another or manufactured by the taxpayer, which is used or sold for consumption in this state. There is no need to claim any exemption for previously taxed substances.

[4] It may be, in rare cases, that the taxpayer will purchase fuel product which, for some reason, has already had the hazardous substance tax paid. If such fuel product is commingled with product manufactured by the taxpayer upon which the tax has not been paid, and then the taxpayer both sells locally and exports portions of this same fuel supply, then and only then could the proposed hypothetical situations arise.

In such rare cases the Department is willing to accept the taxpayer's premise that it would minimize its own hazardous substance tax liability by exporting previously untaxed fuel first and only secondarily exporting any previously taxed fuel from commingled supplies. Thus, in such cases, the taxpayer will be liable for hazardous substance tax only upon that portion of commingled supplies of fuel products which represents its own manufactured product sold within this state in excess of the volume of commingled product which has been purchased from another with the tax previously paid. The taxpayer must retain all pertinent purchase and production records, including certifications of previously taxed hazardous substances, so that audit confirmation of its tax liability under this ruling may be made. (RCW 82.32.070).

As qualified above, the taxpayer's special ruling request covering commingled products is granted.

REVENUE RULING REQUEST #3: DEDUCTIBILITY OF MISCELLANEOUS TAXES

Background: The hazardous substance tax is measured by a product's wholesale value, which is "the price paid to a manufacturer. . ."

Problem: Certain taxes are typically included in a refinery's price for petroleum products. WAC 458-20-195 and WAC 458-20-129 provide a deduction from the measure of the business and occupation tax for certain of these taxes. WAC 458-20-252 does not contain similar guidance for deducting miscellaneous taxes included in a product's price from the measure of the hazardous substance tax.

Solution: . . . requests written confirmation that taxes imposed on the sale, the refinery's customer or otherwise after the refinery's initial possession of a petroleum product are deductible from the measure of the hazardous substance tax and that -in order to qualify for the deduction- the other taxes may or may not be separately itemized on the refinery customer's invoice. . . . further requests that the Department confirm that the following specific taxes are deductible: (a) the federal excise taxes on gasoline, diesel, and aircraft fuels imposed by 26 U.S.C. § 4081 et seq.; (b) the motor vehicle, special and aircraft fuel taxes imposed by RCW 82.36; 82.38 and 82.42; (c) the federal leaking underground storage tank tax imposed by 26 U.S.C. § 4101 et seq. and (d) the sales and use taxes imposed by RCW 82.08 and 82.12. . . . also requests the Department's opinion on the deductibility of the federal environmental tax on petroleum products imposed by 26 U.S.C. § 4611 et seq. and the federal excise tax on lubricating oils imposed by 26 U.S.C. § 4091 et seq.

DISCUSSION - Request #3

Under the provisions of WAC 458-20-129 and 458 20-195, the only taxes which are deductible from the gross receipts tax measure of the B&O tax are those for which the economic burden falls primarily upon a person other than the seller. In other words, the seller is deemed to be a mere collecting agent for these taxes and they are not deemed to be part of the seller's cost of doing business.

[5] The hazardous substances tax is a privileges tax the incidence of which is the possession of hazardous substances in this state. In all possible respects it is administered, under WAC 458-20-252, in the same manner as the B&O taxes of chapter 82.04 RCW. Accordingly, only the taxes which constitute costs of doing

business of the refiner or manufacturer are considered to be part of the "wholesale value," which is the statutory tax measure. Other taxes, which are deemed to be collected by the seller as agent for the government, are not part of the wholesale value selling price for hazardous substance tax purposes. This is true whether or not such other taxes are included in a lump-sum selling price or separately itemized on customers' billings. Such deductible "other taxes" include only the federal and state taxes on gasoline, diesel, special fuels, and aircraft fuel, and the state retail sales tax and use tax.

Neither the federal underground storage tank tax, the federal environmental ("superfund") tax on petroleum products, nor the federal excise tax on lubrication oils are deductible from the state hazardous substances tax measure. These nondeductible taxes are primarily imposed upon the seller of such substances.

It is not necessary to separately itemize any deductible tax on customers' invoices. It must be noted, however, that if the hazardous substance tax is recovered from customers and is separately line itemized on customer billings, it may not be recovered in an amount greater than the tax actually reported and paid by the seller, that is, after applicable deductions for the other taxes which are deductible under this ruling. See also, ETB 540.22.252.

REVENUE RULING REQUEST #4: SALE OF LIQUID FUELS

> Background: WAC 458-20-252(4)(iii) (sic) exempts from the hazardous substance tax "liquid fuel used in processing petroleum." WAC 458-20-252 (2) (i) defines fuel as including "all combustible gases and liquids suitable for the generation of energy." Petroleum processing is defined by the same section to mean "all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to crude oil or any byproduct of crude oil so that as a result thereof a fuel or lubricant is produced . . .." "Used" is defined by RCW 82.12.010(2) to have its "ordinary meaning, and shall mean the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer), and include(s) . . . any other act preparatory to subsequent actual use or consumption within this state" (emphasis added).
>
> . . . sells cutter and feed stocks to other refineries in Washington. Those other refineries use the cutterstocks as an ingredient of fuels which those refineries produce. Cutterstock is itself suitable for the generation of energy.

> Request: . . . requests written confirmation that the cutter and feed stocks it sells to other refineries is exempt from hazardous substance tax.

On April 26, 1988 the taxpayer submitted a post-hearing memorandum which contained further arguments and support for this requested ruling, as follows:

> At the April 8 conference, you asserted that . . . would not be entitled to the exemption because it is not the party that uses the cutter, feed and blending stocks in processing petroleum. You tacitly agreed that the refinery which purchases . . . 's products does qualify for the exemption.
>
> . . . respectfully requests that the Department reconsider this position. The statute exempts "any possession of . . . liquid fuel . . . used in petroleum processing," not just the single possession where the liquid fuel is so used. Moreover, it will always be true that the first possession of such fuel will occur prior to the fuel being used in petroleum processing, and the first possession is a taxable incident. Therefore, the basis asserted for denying . . . the benefit of the exemption could be used to deny all possessors the benefit of the exemption. The asserted position also runs counter to public policy. To grant the purchaser an exemption, but not . . . , will lead to out-of-state refineries having a competitive advantage over . . . when they market cutters to local refineries. Neither the out-of-state refinery, nor the local purchaser will be subject to the tax.

DISCUSSION - Request #4

[6] The possession of cutter and feed stocks for sale to other refineries for those buyers' use as ingredients or components of fuel products does not qualify for exemption from the hazardous substance tax. Feed stocks are not "liquid fuel or fuel gas." Thus, they do not qualify for the exemption of "liquid fuel or fuel gas used in processing petroleum" under Rule 252(4)(c)(ii). Moreover, even if these substances were considered to be liquid fuels or fuel gases, they are not used by the taxpayer in processing petroleum under the factual hypothetical in question here. Rather, the taxpayer sells these substances to others for the buyer's use as components or ingredients of petroleum products. In order to qualify for the exemption in question it must be the person who first possesses these substances for the exempt purpose of processing petroleum. It is the Department's position, under the law, that the ultimate use by some other person cannot retrospectively qualify a previous person's possession for exemption.

Tax exemptions must be strictly construed against the person claiming exemption. Group Health Coop., supra. Under this rule of statutory construction the applicability of the exemption is not controlled by the useability of a substance for the exempt purpose. Rather, it is the actual use of the substances for the exempt purpose by the person claiming the exemption which controls.

The taxpayer's requested ruling for exemption of its possessions of cutter and feed stock sold to other refiners in this state for use as components of petroleum products produced by the buyers is denied.

Whether the taxpayer's purchasers' uses of these substances could qualify for tax exemption is not a question before us here.

REVENUE RULING REQUEST #5: FINISHED INGREDIENTS

Background: Part of the process of manufacturing gasoline and other fuels typically includes the blending of butane, naphtha, cutterstocks and/or other ingredients. Generally, most of the ingredients blended into the fuels are produced on-site by the refinery in the refining process. At times, however, depending on the type and quality of the crude oil being refined, a refinery will have to purchase additional quantities of butane, naphtha, cutter stocks or other ingredients in order to manufacture the appropriate finished product.

SINGLE REFINERY

Problem: When a single refinery manufactures the intermediate products which are blended together or otherwise further manufactured as part of the process of manufacturing a finished product, what are the consequent B&O and hazardous substance tax consequences?

Solution: . . . requests written confirmation that when a single refinery produces all the intermediate products which get blended into the finished product, the refinery is not subject to the hazardous substance or business and occupation taxes on the production of the intermediate products (e.g., raw gasoline, naphtha and butane). The possession of intermediate products manufactured as part of the process of manufacturing a finished product is not a taxable possession for hazardous substance tax purposes. Intermediate products are likewise not used for commercial or industrial purposes when they are used in further processing, and therefore, no business and occupation tax is imposed on their manufacture.

DUAL REFINERIES

> Problem: When refinery A sells an ingredient, which is subsequently blended or otherwise further manufactured to produce a finished product, to refinery B, what are the consequent B&O and hazardous substance tax consequences?

BUSINESS AND OCCUPATION TAX

> The purchaser of the butane, naptha, cutter stocks and other ingredients that are blended or otherwise manufactured into a finished product owes business and occupation tax only on its finished products. It owes no tax on its self-produced intermediate products that are blended or otherwise manufactured into the finished product along with the purchased products. The vendor of the ingredients is, however, subject to B&O tax on its sale of the butane, naphtha, cutter stocks and other ingredients.

Regarding the application of hazardous substance tax the memorandum of April 26, 1988 expands the taxpayer's presentation as follows:

> Where . . . purchases the butane, naphtha and other ingredients to blend with the raw gasoline, . . . is uncertain as to the appropriate hazardous substance tax treatment of the butane, naphtha, other purchased ingredients, the raw self-produced gasoline and the finished gasoline. We perceive three possible views as to the hazardous substance tax consequences and seek the Department's written opinion as to which view is correct.
>
> (i) Hazardous substance tax is imposed only on the standard grade gasoline ultimately produced by . . . . No tax purchased by . . . or on the raw gasoline produced by . . . into which the purchased products ar blended. The rationale for this approach is that the raw gasoline is an intermediary which per WAC 458-20-252(7)(b) is not possessed in a taxable manner. The purchased products are exempt per WAC 458-20-252(4)(c)(ii) which exempts liquid fuel or fuel gas used in processing petroleum. (Butane, naphtha and the other ingredients blended into raw gasoline to make standard grade gasoline are liquid fuels.)
>
> (ii) Hazardous substance tax is imposed on the raw gasoline and the products purchased. No tax is imposed on the finished product. The rationale for this result is that the raw gasoline as well as the products purchased are all hazardous substances. The finished gasoline is therefore manufactured by the blending of two or more hazardous substances and is itself not a hazardous product. WAC 458-20-252(2)(c). Nevertheless,

> no B&O tax is due on the self-produced intermediate product because it is produced as part of the process of making finished grade gasoline.
>
> (iii) The ingredients purchased by . . . are taxed and the standard grade gasoline produced by . . . is also taxed. Self-produced intermediate products (such as raw gasoline produced by . . .) are not taxed. This result may be appropriate if the exemption for liquid fuel used in petroleum processing does not extend to ingredients.

If the Department considers this third view correct, . . . would consider entering into agreements with its in-state vendors whereby it becomes contractually obligated to pay the hazardous substance tax on the ingredients it purchases. . . . seeks written confirmation that such agreements will allow . . . to take a credit for the amount of tax it pays on the purchased ingredients against the amount of tax it owes on the finished standard grade gasoline. Moreover, . . . seeks a private ruling that if its contracts shift the tax payment obligation, the first possessor will be relieved from its tax payment obligation if a downstream possessor actually pays the tax or is exempt from tax.

If . . . is not allowed to pay the tax directly to the state (and take a credit for the tax paid) on the ingredients it purchases in-state, then . . . will consider purchasing the ingredients from non-Washington vendors and importing the ingredients into the state. Where . . . is the importer it will be able to claim credit for the tax paid on the ingredients. See WAC 458-20-252(5)(a).

DISCUSSION - Request #5

[7] B&O Tax. It is the Department's position that the manufacturing B&O tax does not apply to 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. We concur with, and confirm the taxpayer's understanding of the B&O tax application.

[8] Hazardous Substance Tax. Rule 252, Part (7) provides that the law intends the hazardous substance tax to apply only once upon any hazardous substance possessed in this state. When taxable substances or products are refined or manufactured, the tax applies

upon possession of that finished product. For this very reason, Part (7)(b) of the rule, in essence, provides that "intermediate possession" of hazardous components, ingredients, byproducts, or other on-line substances which are produced and temporarily possessed while end products are being manufactured, processed, or refined do not, themselves, constitute taxable possessions. This is true so long as the intermediate possession is contained within the manufacturing, processing, or refining plant or environment, "on-line," so to speak. If and when any such substances are withdrawn from the manufacturing or refining process for some other use or sale, then a taxable first possession occurs. See Rule 252, Part (7)(b)(i).

Also, purchases of hazardous substances which are incorporated as components or ingredients of any newly manufactured or refined end-product result in taxable possessions of the hazardous component or ingredient. The system of internal tax credits provided in Part (5)(a) of Rule 252 prevents the double taxation of any hazardous ingredients or components. Clearly, however, the law contemplates that all hazardous substances possessed in this state should be subject to tax upon their first possession unless expressly tax exempt. Thus, possessions of hazardous ingredients and components are taxable as is the possession of any hazardous end product, with credits in place so that the tax does not compound.

The taxpayer's requested hazardous substance tax ruling covering intermediate possessions of purchased or manufactured components and ingredients mixes and confuses three different tax treatments. It hypothetically includes:

a) possession of hazardous ingredients and components purchased from other in-state refiners, and,

b) possessions of on-line, self-manufactured hazardous ingredients and components,

c) some of all of which are fuels further used in processing petroleum products and some of which are not.

Unscrambling this mix may itself be confusing. Suffice to say that we concur with the third of the taxpayer's views about hazardous substance tax treatment, listed as (iii) above. The exemption for liquid fuel or fuel gas used in processing petroleum applies only when such substances themselves are used as fuel in the refining process at the plant. The exemption does not apply when such fuel substances are merely added as ingredients or components of end-petroleum-products.

Of course, when these fuel substances are themselves produced during the refining process they are merely intermediate substances, the temporary possession of which is not taxable anyway. Thus, no exemption is needed. It is only when these fuels

are purchased from another in-state refiner that the tax applies. Even then, it is the first-level refiner who sells such fuel substances to the taxpayer who owes the tax, not the taxpayer/purchaser. In such cases there is no tax exemption or credit under the law which is intended to apply. There is no basis or support for any ruling by the Department, private or general, which would avoid the intended tax liability. The taxpayer's requested "private" ruling would simply give credence to a ruse through which the taxpayer could voluntarily and contractually assume its supplier's tax liability so that it could then use it as a credit which would not otherwise be available. Such a machination is not necessary for the administration of the hazardous substance tax law and it would be, in our view, beyond the discretion or authority of the Department. Persons may not contractually avoid their legal tax liabilities. The Department refuses to recognize the validity of such contractual tax avoidance provisions.

The taxpayer may purchase the ingredients and components for its petroleum products from whomever, wherever it chooses. If by doing so it qualifies for credit taking under the law and rule, so be it.

We concur with the taxpayer's "third view" of the B&O tax and hazardous substance tax applications explained above. We deny the taxpayer's requested ruling which would avoid the tax application upon purchased ingredients and components.

REVENUE RULING REQUEST #6: REFINED OIL DERIVATIVES

Legal Background:

The hazardous substance tax is imposed on petroleum products. WAC 458-20-252(d) defines "petroleum products" as including every product derived from the refining of crude oil. The term "derived from the refining of crude oil" is further defined to mean "produced because of and during petroleum processing." "Petroleum processing" is further defined to include all activities which result in a fuel or lubricant being produced for sale or use. Thus, in order to be a petroleum product, the item must be a fuel or a lubricant. All other products resulting from refining crude oil are known as "refined oil derivatives" which are not subject to tax. WAC 458-20-252(2)(d)(i).

"Fuel" includes all combustible gases and liquids suitable for the generation of energy. It does not include materials which are solid, nor does it include refined oil derivatives such as petroleum jellies, cleaning solvents and asphalt paving.--Id. Although such items might be flammable, they are not commercially suitable for the generation of energy.

> Factual Background
> In the course of refining crude oil, . . . obtains certain substances which are neither fuels nor lubricants, including certain vacuum bottoms, sulphur compounds and sulphur. . . . sells some of these products and manufactures additional products (see accompanying chart) from others.
>
> Request: . . . requests written confirmation that the sale or possession of these refined oil derivatives and the products manufactured from them are not subject to the hazardous substance tax.

The taxpayer's April 26, 1988 memorandum includes the following:

> At the April 8 conference, we presented the chart reproduced below and samples of some of these products. The samples demonstrated that many of the products are solids. The chart illustrates that the products highlighted in green are not produced in the course of making fuels or lubricants. Therefore, the green highlighted products are not derived from refining crude oil. We emphasized that such a conclusion is not only mandated from the definitions contained in WAC 458-20-252, but also that such definitions are necessary in order to tax all fuels produced by chemical manufacturers and at the same time not tax food preservatives produced from the same raw material by the same manufacturers. Moreover, we perceive no relevant difference between . . . 's further manufacturing processes with the "asphalt base"/vacuum bottoms and asphalt paving manufacturers processes.
>
> The chart also was intended to focus attention on the possibility that the products highlighted in orange are not petroleum products. These products are not themselves fuels or lubricants, though the link in the manufacturing chain during which they are produced also produce fuels. Therefore, we concluded at the conference that those substances -- if sold as a final product -- were subject to tax. When those same substances are further manufactured, however, they are nontaxable intermediate products. In the case of sulfur, we suggested that perhaps the taxpayer should have the burden of demonstrating that the sulfur was not obtained from petroleum processing.

DISCUSSION - Request #6

[9] We do not agree with the taxpayer's conclusion that, "in order to be a petroleum product, the item must be a fuel or lubricant."

Conversely, during the refining of crude oil into fuels and lubricants some petroleum products are derived which are not themselves fuels or lubricants; viz: asphalt base or sulphur. These products are taxable petroleum products even though they are not used or usable as fuel. This is also true of certain petroleum intermediate products generally referred to as feedstock and vacuum bottoms. Such substances, once removed from the oil refining process, are not entitled to any tax exemption under the law.

Under Rule 252(2)(d)(i) it is only the end products which may be further manufactured from oil derivatives which are not considered as taxable hazardous substances until so designated by Department of Ecology rule. Such end products include things like WD-40, asphalt paving, petroleum gels, cleaning solvents, etc. Conversely, other products which are directly derived from refining crude oil, whether or not they are "fuels," are taxable hazardous substances when removed from the processing line.

The taxpayer's request for confirmation that certain non-fuel, refined oil derivatives including vacuum bottoms, sulphur compounds, and sulphur are not subject to the hazardous substance tax is denied. See also, ETB 540.22.252.

The taxpayer's request for confirmation that end products, further manufactured from refined oil derivatives are not subject to the tax is granted and hereby confirmed.

REVENUE RULING REQUEST #7: EXPORTED PETROLEUM PRODUCTS

Background: WAC 458-20-252(4) exempts exported petroleum products from the hazardous substance tax. . . . produces the following products, all of which are fuels, i.e., suitable for the generation of energy.

Butane
Gasoline
Gasohol
Jet A
JP-5
Cutterstock
#6 Fuel Oil
PS-300
Bunker C
Stove Oil
Fuel Oil #2
Light Industrial Distillates
Marine Gas Oil
Marine Diesel Oil
FCC Feedstock & Raw Vacuum Gas Oil-
R.V.G.O.
HydroTreated FCC Feedstock - Treated
Vacuum Gas Oil - T.V.G.O.
Industrial Fuel Oils - IFOs

Request: We request written confirmation that when . . . or its customers exports any of these products outside

the state of Washington that no hazardous substance tax is due on . . . , . . .'s vendor or customer, if any, on their sale of possession of the product.

DISCUSSION - Request #7

[10] FCC feedstock, raw vacuum gas oil (RVGO), hydrotreated FCC feedstock, and treated vacuum gas oil are not generally sold or used as fuels. They are, at best, components or ingredients of further manufactured or processed end products. As such, possessions of these substances off the petroleum processing line are taxable possessions for which no exemption exists under the law or rule.

All of the other substances listed in ruling request #7 are generally considered to be fuels and are used or sold for that purpose. Possessions of these substances are entitled to tax exemption when they are used as fuel in the processing of petroleum or exported for sale or use outside this state. See also, ETB 540.22.252.

The taxpayer's requested ruling is hereby granted with exception of the few feedstocks and vacuum gas oils differentiated above.

REVENUE RULING REQUEST #8: VALUATION

Background: . . . is the first possessor of approximately 900,000 barrels of petroleum products each month. If . . . were to purchase its entire inventory outside the state or if . . . had one customer willing to purchase all of its inventory in Washington, the hazardous substance tax would be measured by the true wholesale value of the quantity and quality of products . . . possesses each month (either . . . 's acquisition cost of the price which would be paid by a single buyer of the products . . . possesses). No such purchaser exists, and . . . purchases exempt crude oil, not refined products. Therefore, . . . sells its products in piecemeal and at higher prices than it would be willing to sell to a single, volume purchaser.

Request: We understand that it is the price a volume purchaser would pay which should be the measure of . . . 's tax obligation. WAC 458-20-112 provides that in determining the value of products "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." Therefore, . . . requests written confirmation that it should report hazardous substance tax based on the amount a purchaser would pay

> for products of like qualities and quantities to what . . . possesses each month.

DISCUSSION - Request #8

Under the statutory law the measure of the hazardous substance tax is "wholesale value," defined as the price paid by a wholesaler or retailer to a manufacturer. Oil refiners are manufacturers. See RCW 82.04.110. The tax measure is the manufacturer's actual selling price, not some contrived amount calculated to equate to a price which would include some hypothetical purchase volume discount. The taxpayer here knows what it sells petroleum products for. Under Rule 252(8)(c) there are special provisions for manufacturers and refiners which allow the tax to be reported and paid when the products are removed from storage for sale or other use. There is no reason that the taxpayer will not know its actual "wholesale value" of products when it reports and pays the tax.

The taxpayer's requested ruling is denied.

This legal opinion may be relied upon for reporting purposes and as support of the reporting method in the event of an audit. This ruling is issued pursuant to WAC 458-20-100(18) and is based upon only the facts that were disclosed by the taxpayer. In this regard, the department has no obligation to ascertain whether the taxpayer has revealed all of the relevant facts or whether the facts disclosed are actually true. This legal opinion shall bind this taxpayer and the department upon these facts. However, it shall not be binding if there are relevant facts which are in existence but have not been disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes. This opinion may be rescinded or revoked in the future, however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

DATED this 23rd day of August 1988.