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No. 85556-1

SUPREME COURT  
OF THE STATE OF WASHINGTON

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TESORO REFINING AND MARKETING COMPANY,

Respondent

v.

STATE OF WASHINGTON,  
DEPARTMENT OF REVENUE,

Petitioner

---

ON PETITION FOR REVIEW FROM DIVISION II  
OF THE COURT OF APPEALS

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**RESPONDENT'S SECOND STATEMENT OF  
ADDITIONAL AUTHORITIES**

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Under RAP 10.8, Respondent Tesoro Refining and Marketing Company (Tesoro) submits the following additional authorities:

1. The measure of the Manufacturing B&O tax. Regarding the contention of Petitioner Department of Revenue (DOR), during rebuttal argument on October 11, 2011, that the measure of tax for manufacturing is the value of the products but that does not equate with the selling price, Tesoro submits the following additional authority:

- **WAC 458-20-112, Value of products.**

The term "value of products" . . . herein, shall be determined by "gross proceeds of sales" whether such sales are at wholesale or at retail . . . . **In the case of bona fide sales of products.** The law provides (RCW 82.04.450), that under the . . . manufacturing classification[] of the business and occupation tax the value of products . . . manufactured shall be determined by the gross proceeds of sales *in every instance in which a bona fide sale of such products is made, and whether sold at wholesale or at retail.* [bold in original; emphasis in italics added]

2. How taxpayers engaged in multiple activities are required to report. Regarding the contention of DOR, during rebuttal argument on October 11, 2011, that WAC 458-20-19301 is a procedural rule that cannot create a manufacturing deduction that the statute (RCW 82.04.433) does not otherwise allow, Tesoro submits the following additional authorities:

- **WAC 458-20-136, Manufacturing, processing for hire, fabricating.**

(4) **Tax-reporting responsibilities for income received by manufacturers** . . . . Persons who manufacture products in this state are subject to the manufacturing B&O tax upon the value of the products; . . . (see also WAC 458-20-112 regarding "value of products") . . . . (a) Manufacturers who sell their products at retail

or wholesale in this state are also subject to either the retailing or wholesaling B&O tax, as the case may be. In such cases, the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) classifications of the B&O tax, and claim a multiple activities tax credit (MATC). *See also WAC 458-20-19301 for a more detailed explanation of the MATC reporting requirements.*  
[bold in original; emphasis in italics added]

• **WAC 458-20-19301, Multiple activities tax credits.**

(6) Deductions in combination with MATC. Effective August 12, 1987, with the enactment of the MATC system, the liability for actual payment of tax by persons who . . . manufacture, and sell products in this state was shifted from the selling activity (wholesaling or retailing) to the production activity (. . . manufacturing). . . . [T]he payment of the production taxes may now be credited against the liability for selling taxes on the same products. However, the deductions from tax provided by chapter 82.04 RCW (business and occupation tax deductions) may still be taken before tax credits are computed and used, with noted exceptions. *In order for the MATC system to result in the correct computation of tax liabilities and credit applications, the tax deductions which may apply for any reporting period must be taken equally against both levels of tax liability reported, i.e., at both the production and selling levels. Failure to report tax deductions in this manner will result in overreporting tax due and may result in overpayment of tax.*  
[bold in original; emphasis in italics added]

Copies of the cited authorities are attached for the Court's convenience.

RESPECTFULLY SUBMITTED this 13<sup>th</sup> day of October, 2011.



George C. Mastrodonato

WSBA No. 7483

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WSBA No. 14405

*Attorneys for Respondent*

*Tesoro Refining and Marketing Company*

## DECLARATION OF SERVICE

I certify that I served a copy of the foregoing *Respondent's Second Statement of Additional Authorities* on the date set forth below by electronic mail (email) and by U.S. Mail, postage prepaid, on the Appellant's counsel of record, as follows:

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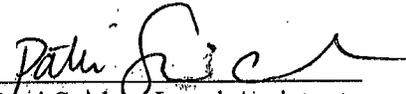
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I certify under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

DATED this 13<sup>th</sup> day of October, 2011 at Seattle, Washington.

  
Patti Saiden, Legal Assistant

DECLARATION OF SERVICE



# WASHINGTON STATE LEGISLATURE

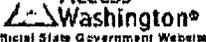
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## WAC 458-20-112

No agency filings affecting this section since 2003

### Value of products.

The term "value of products" includes the value of by-products, and except as provided herein, shall be determined by "gross proceeds of sales" whether such sales are at wholesale or at retail, to which shall be added all subsidies and bonuses received with respect to the extraction, manufacture, or sale thereof.

"The term 'gross proceeds of sales' means the value proceeding or accruing from the sale of tangible personal property . . . without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses." (RCW [82.04.070](#).)

**In the case of bona fide sales of products.** The law provides (RCW [82.04.450](#)), that under the extracting and manufacturing classifications of the business and occupation tax the value of products extracted or manufactured shall be determined by the gross proceeds of sales in every instance in which a bona fide sale of such products is made, and whether sold at wholesale or at retail.

**Sales to points outside the state.** In determining the value of products delivered to points outside the state there may be deducted from the gross proceeds of sales so much thereof as the taxpayer can show to be actual transportation costs from the point at which the shipment originates in this state to the point of delivery outside the state.

**All other cases.** The law provides that where products extracted or manufactured are

(1) For commercial or industrial use (by the extractor or manufacturer -- see WAC [458-20-134](#)); or

(2) Transported out of the state, or to another person without prior sale; or

(3) Sold 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.

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.

Revised June 1, 1970.

[Order ET 70-3, § 458-20-112 (Rule 112), filed 5/29/70, effective 7/1/70.]



# WASHINGTON STATE LEGISLATURE

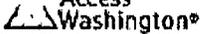
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## WAC 458-20-136

[Agency filings affecting this section](#)

### Manufacturing, processing for hire, fabricating.

(1) **Introduction.** This section explains the application of the business and occupation (B&O), retail sales, and use taxes to manufacturers. It identifies the special tax classifications and rates that apply to specific manufacturing activities. The law provides a retail sales and use tax exemption for certain machinery and equipment used by manufacturers. Refer to RCW [82.08.02565](#), [82.12.02565](#), and WAC [458-20-13601](#) (Manufacturers and processors for hire--Sales and use tax exemption for machinery and equipment) for more information regarding this exemption. Persons engaging in both extracting and manufacturing activities should also refer to WAC [458-20-135](#) (Extracting natural products) and [458-20-13501](#) (Timber harvest operations).

(2) **Manufacturing activities.** RCW [82.04.120](#) explains that the phrase "to manufacture" embraces all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different, or useful substance or articles of tangible personal property is produced for sale or commercial or industrial use. The phrase includes the production or fabrication of special-made or custom-made articles.

(a) "To manufacture" includes, but is not limited to:

(i) The production or fabrication of dental appliances, devices, restorations, substitutes, or other dental laboratory products by a dental laboratory or dental technician;

(ii) The cutting, delimiting, and measuring of felled, cut, or taken trees;

(iii) The crushing and/or blending of rock, sand, stone, gravel, or ore; and

(iv) The cleaning (removal of the head, fins, or viscera) of fish.

(b) "To manufacture" does not include:

(i) The conditioning of seed for use in planting;

(ii) The cubing of hay or alfalfa;

(iii) The growing, harvesting, or producing of agricultural products;

(iv) The cutting, grading, or ice glazing of seafood which has been cooked, frozen, or canned outside this state;

(v) The packing of agricultural products, including sorting, washing, rinsing, grading, waxing, treating with fungicide, packaging, chilling, or placing in controlled atmospheric storage; and

(vi) The repairing and reconditioning of tangible personal property for others.

(3) **Manufacturers and processors for hire.** RCW [82.04.110](#) defines "manufacturer" to mean every person who, either directly or by contracting with others for the necessary labor or mechanical services, manufactures for sale or for commercial or industrial use from his or her own materials or ingredients any articles, substances, or commodities. However, a nonresident of the state of Washington who is the owner of materials processed for it in this state by a processor for hire is not deemed to be a manufacturer in this state because of that processing. Additionally, any owner of materials from which a nuclear fuel assembly is fabricated in this state by a processor for hire is also not deemed to be a manufacturer

because of such processing.

(a) The term "processor for hire" means a person who performs labor and mechanical services upon property belonging to others so that as a result a new, different, or useful article of tangible personal property is produced for sale or commercial or industrial use. Thus, a processor for hire is any person who would be a manufacturer if that person were performing the labor and mechanical services upon his or her own materials.

(b) If a particular activity is excluded from the definition of "to manufacture," a person performing the labor and mechanical services upon materials owned by another is not a processor for hire. For example, the cutting, grading, or ice glazing of seafood that has been cooked, frozen, or canned outside this state is excluded from the definition of "to manufacture." Because of this exclusion, a person who performs these activities on seafood belonging to others is not a "processor for hire."

(c) A person who produces aluminum master alloys, regardless of the portion of the aluminum provided by that person's customer, is considered a "processor for hire." RCW 82.04.110. For the purpose of this specific provision, the term "aluminum master alloy" means an alloy registered with the Aluminum Association as a grain refiner or a hardener alloy using the American National Standards Institute designating system H35.3.

(d) In some instances, a person furnishing the labor and mechanical services undertakes to produce an article, substance, or commodity from materials or ingredients furnished in part by the person and in part by the customer. Depending on the circumstances, this person will either be considered a manufacturer or a processor for hire.

(i) If the person furnishing the labor and mechanical services furnishes materials constituting less than twenty percent of the value of all of the materials or ingredients which become a part of the produced product, that person will be presumed to be processing for hire.

(ii) The person furnishing the labor and mechanical services will be presumed to be a manufacturer if the value of the materials or ingredients furnished by the person is equal to or greater than twenty percent of the total value of all materials or ingredients which become a part of the produced product.

(iii) If the person furnishing the labor and mechanical services supplies, sells, or furnishes to the customer, before processing, twenty percent or more in value of the materials or ingredients from which the product is produced, the person furnishing the labor and mechanical services will be deemed to be the owner of the materials and considered a manufacturer.

(e) There are occasions where a manufacturing facility and ingredients used in the manufacturing process are owned by one person, while another person performs the actual manufacturing activity. The person operating the facility and performing the manufacturing activity is a processor for hire. The owner of the facility and ingredients is the manufacturer.

**(4) Tax-reporting responsibilities for income received by manufacturers and processors for hire.** Persons who manufacture products in this state are subject to the manufacturing B&O tax upon the value of the products, including by-products (see also WAC 458-20-112 regarding "value of products"), unless the activity qualifies for one of the special tax rates discussed in subsection (5) of this section. See also WAC 458-20-193 (inbound and outbound interstate sales of tangible personal property).

For example, Corporation A stains door panels that it purchases. Corporation A also affixes hinges, guide wheels, and pivots to unstained door panels. Corporation B shears steel sheets to dimension, and slits steel coils to customer's requirements. The resulting products are sold and delivered to out-of-state customers. Corporation A and Corporation B are subject to the manufacturing B&O tax upon the value of these manufactured products. These manufacturing activities take place in Washington, even though the manufactured product is delivered out-of-state. A credit may be available if a gross receipts tax is paid on the selling activity to another state. (See also WAC 458-20-19301 on multiple activities tax credits.)

(a) Manufacturers who sell their products at retail or wholesale in this state are also subject to either the retailing or wholesaling B&O tax, as the case may be. In such cases, the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) classifications of the B&O tax, and claim a multiple activities tax credit (MATC). See also WAC 458-20-19301 for a more detailed explanation of

the MATC reporting requirements.

For example, Incorporated purchases raw fish that it fillets and/or steaks. The resulting product is then sold at wholesale in its raw form to customers located in Washington. Incorporated is subject to both the manufacturing raw seafood B&O tax upon the value of the manufactured product, and the wholesaling B&O tax upon the gross proceeds of sale. Incorporated is entitled to claim a MATC.

(b) Processors for hire are subject to the processing for hire B&O tax upon the total charge made to those services, including any charge for materials furnished by the processor. The B&O tax applies whether the resulting product is delivered to the customer within or outside this state.

(c) The measure of tax for manufacturers and processors for hire with respect to "cost-plus" or "time and material" contracts includes the amount of profit or fee above cost received, plus the reimbursements or prepayments received on account of materials and supplies, labor costs, taxes paid, payments made to subcontractors, and all other costs and expenses incurred by the manufacturer or processor for hire.

(d) A manufacturing B&O tax exemption is available for the cleaning of fish, if the cleaning activities are limited to the removal of the head, fins, or viscera from fresh fish without further processing other than freezing. RCW 82.04.2403. Processors for hire performing these cleaning activities remain subject to the processing for hire B&O tax.

(e) Amounts received by hop growers or dealers for hops shipped outside the state of Washington for first use, even though the hops have been processed into extract, pellets, or powder in this state are exempt from the B&O tax. RCW 82.04.337. However, a processor for hire with respect to hops is not exempt on amounts charged for processing these products.

(f) Manufacturers and processors for hire making retail sales must collect and remit retail sales tax on all sales to consumers, unless the sale is exempt by law (e.g., see WAC 458-20-244 regarding sales of certain food products). A manufacturer or processor for hire making wholesale sales must obtain resale certificates for sales made before January 1, 2010, or reseller permits for sales made on or after January 1, 2010, from the customers to document the wholesale nature of any sale as provided in WAC 458-20-102A (Resale certificates) and WAC 458-20-102 (Reseller permits). Even though resale certificates are no longer used after December 31, 2009, they must be kept on file by the seller for five years from the date of last use or December 31, 2014.

**(5) Manufacturing--Special tax rates/classifications.** RCW 82.04.260 provides several special B&O tax rates/classifications for manufacturers engaging in certain manufacturing activities. In all such cases the principles set forth in subsection (4) of this section concerning multiple activities and the resulting credit provisions are also applicable.

Special tax classifications/rates are provided for the activities of:

- (a) Manufacturing wheat into flour, barley into pearl barley, soybeans into soybean oil, canola into canola oil, meal, or canola by-products, or sunflower seeds into sunflower oil;
- (b) Splitting or processing dried peas;
- (c) Manufacturing seafood products, which remain in a raw, raw frozen, or raw salted state;
- (d) Manufacturing by canning, preserving, freezing, processing, or dehydrating fresh fruits and vegetables;
- (e) Slaughtering, breaking, and/or processing perishable meat products and/or selling the same at wholesale and not at retail; and
- (f) Manufacturing nuclear fuel assemblies.

**(6) Repairing and/or refurbishing distinguished from manufacturing.** The term "to manufacture" does not include the repair or refurbishing of tangible personal property. To be considered "manufacturing," the application of labor or skill to materials must result in a "new, different, or useful article." If the activity merely restores an existing article of tangible personal property to its original utility, the activity is considered a repair or refurbishing of that property. (See WAC 458-20-173 for tax-reporting information on repairs.)

(a) In making a determination whether an activity is manufacturing as opposed to a repair or reconditioning activity, consideration is given to a variety of factors including, but not limited to:

- (i) Whether the activity merely restores or prolongs the useful life of the article;
- (ii) Whether the activity significantly enhances the article's basic qualities, properties, or functional nature; and
- (iii) Whether the activity is so extensive that a new, different, or useful article results.

(b) The following example illustrates the distinction between a manufacturing activity resulting in a new, different, or useful article, and the mere repair or refurbishment of an existing article. This example should only be used as a general guide. The tax results of other situations must be determined after a review of all the facts and circumstances. In cases of uncertainty, persons should contact the department for a ruling.

(i) Corporation rebuilds engine cores. When received, each core is assigned an individual identification number and disassembled. The cylinder head, connecting rods, crankshaft, valves, springs, nuts, and bolts are all removed and retained for reassembly into the same engine core. Unusable components are discarded. The block is then baked to burn off dirt and impurities, then blasted to remove any residue. The cylinder walls are rebored because of wear and tear. The retained components are cleaned, and if needed straightened and/or reground. Corporation then reassembles the cores, replacing the pistons, gaskets, timing gears, crankshaft bearings, and oil pumps with new parts. The components retained from the original engine core are incorporated only into that same core.

(ii) Corporation is under these circumstances not engaging in a manufacturing activity. The engine cores are restored to their original condition, albeit with a slightly larger displacement because of wear and tear. The cores have retained their original functional nature as they run with approximately the same efficiency and horsepower. The rebuilding of these cores is not so extensive as to result in a new, different, or useful article. Each engine core has retained its identity because all reusable components of the original core are reassembled in the same core. Corporation has taken an existing article and extended its useful life.

**(7) Combining and/or assembly of products to achieve a special purpose as manufacturing.** The physical assembly of products from various components is manufacturing because it results in a "new, different, or useful" product, even if the cost of the assembly activity is minimal when compared with the cost of the components. For example, the bolting of a motor to a pump, whether bolted directly or by using a coupling, is a manufacturing activity. Once physically joined, the resulting product is capable of performing a pumping function that the separate components cannot.

(a) In some cases the assembly may consist solely of combining parts from various suppliers to create an entirely different product that is sold as a kit for assembly by the purchaser. In these situations, the manufacturing B&O tax applies even if the person combining the parts does not completely assemble the components, but sells them as a package. For example, a person who purchases component parts from various suppliers to create a wheelbarrow, which will be sold in a "kit" or "knock-down" condition with some assembly required by purchaser, is a manufacturer. The purchaser of the wheelbarrow kit is not a manufacturer, however, even though the purchaser must attach the handles and wheel.

(b) The department considers various factors in determining if a person combining various items into a single package is engaged in a manufacturing activity. Any single one of the following factors is not considered conclusive evidence of a manufacturing activity, though the presence of one or more of these factors raises a presumption that a manufacturing activity is being performed:

- (i) The ingredients are purchased from various suppliers;
- (ii) The person combining the ingredients attaches his or her own label to the resulting product;
- (iii) The ingredients are purchased in bulk and broken down to smaller sizes;
- (iv) The combined product is marketed at a substantially different value from the selling

price of the individual components; and

(v) The person combining the items does not sell the individual items except within the package.

(c) The following examples should be used only as a general guide. The specific facts and circumstances of each situation must be carefully examined to determine if the combining of ingredients is a manufacturing activity or merely a packaging or marketing activity. In cases of uncertainty, persons combining items into special purpose packages should contact the department for a ruling.

(i) Combining prepackaged food products and gift items into a wicker basket for sale as a gift basket is not a manufacturing activity when:

(A) The products combined in the basket retain their original packaging;

(B) The person does not attach his or her own labels to the components or the combined basket;

(C) The person maintains an inventory for sale of the individual components and does sell these items in this manner as well as the combined baskets.

(ii) Combining bulk food products and gift items into a wicker basket for sale as a gift basket is a manufacturing activity when:

(A) The bulk food products purchased by the taxpayer are broken into smaller quantities; and

(B) The taxpayer attaches its own labels to the combined basket.

(iii) Combining components into a kit for sale is not a manufacturing activity when:

(A) All components are conceived, designed, and specifically manufactured by and at the person's direction to be used with each other;

(B) The person's label is attached to or imprinted upon the components by supplier;

(C) The person packages the components with no further assembly, connection, reconfiguration, change, or processing.

**(8) Tax liability with respect to purchases of equipment or supplies and property manufactured for commercial or industrial use.** The retail sales tax applies to purchases of tangible personal property by manufacturers and processors for hire unless the property becomes an ingredient or component part of a new article produced for sale, or is a chemical used in the processing of an article for sale. If the seller fails to collect the appropriate retail sales tax, the buyer is required to remit the retail sales tax (commonly referred to as "deferred retail sales tax") or use tax directly to the department. Refer to WAC [458-20-113](#) for additional information about what qualifies as an ingredient or component or a chemical used in processing.

(a) RCW [82.08.02565](#) and [82.12.02565](#) provide a retail sales and use tax exemption for certain machinery and equipment used by manufacturers and/or processors for hire. Refer to WAC [458-20-13601](#) for additional information regarding how these exemptions apply.

(b) Persons manufacturing tangible personal property for commercial or industrial use are subject to both the manufacturing B&O and use taxes upon the value of the property manufactured, unless a specific exemption applies. (See also WAC [458-20-134](#) on commercial or industrial use.) Persons who also extract the product used as an ingredient in a manufacturing process should refer to WAC [458-20-135](#) for additional information regarding their tax-reporting responsibilities.

[Statutory Authority: RCW [82.32.300](#), [82.01.060\(2\)](#), chapters [82.04](#), [82.08](#), [82.12](#) and [82.32](#) RCW, 10-06-069, § 458-20-136, filed 2/25/10, effective 3/28/10. Statutory Authority: RCW [82.32.300](#), 00-11-096, § 458-20-136, filed 5/17/00, effective 6/17/00; 88-21-014 (Order 88-7), § 458-20-136, filed 10/7/88; 86-20-027 (Order 86-17), § 458-20-136, filed 9/23/86; 83-07-032 (Order ET 83-15), § 458-20-136, filed 3/15/83. Statutory Authority: RCW [82.01.060\(2\)](#) and [82.32.300](#), 78-07-045 (Order ET 78-4), § 458-20-136, filed 6/27/78; Order ET 71-1, §

458-20-136, filed 7/22/71; Order ET 70-3, § 458-20-136 (Rule 136), filed 5/29/70, effective 7/1/70.]



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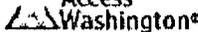
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## WAC 458-20-19301

No agency filings affecting this section since 2003

### Multiple activities tax credits.

(1) Introduction. Under the provisions of RCW [82.04.440](#) as amended effective August 12, 1987, Washington state's business and occupation taxes imposed under chapter [82.04](#) RCW were adjusted to achieve constitutional equality in the tax treatment of persons engaged in intrastate commerce (within this state only) and interstate commerce (between Washington and other states). The business and occupation tax system taxes the privilege of engaging in specified business activities based upon "gross proceeds of sales" (RCW [82.04.070](#)) and the "value of products" (RCW [82.04.450](#)) produced in this state. In order to maintain the integrity of this taxing system, to eliminate the possibility of discrimination between taxpayers, and to provide equal and uniform treatment of persons engaged in extracting, manufacturing, and/or selling activities regardless of where performed, a statutory system of internal and external tax credits was adopted, effective August 12, 1987. This tax credits system replaces the multiple activities exemption which, formerly, assured that the gross receipts tax would be paid only once by persons engaged in more than one taxable activity in this state in connection with the same end products. Unlike the multiple activities exemption which only prevented multiple taxation from within this state, the credits of the new system apply for gross receipts taxes paid to other taxing jurisdictions outside this state as well.

(2) Definitions. For purposes of this section the following terms will apply.

(a) "Credits" means the multiple activities tax credit(s) authorized under this statutory system also referred to as MATC.

(b) "Gross receipts tax" means a tax:

(i) Which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which the deductions allowed would not constitute the tax an income tax or value added tax; and

(ii) Which is not, pursuant to law or custom, separately stated from the selling price.

(c) "Extracting tax" means a gross receipts tax imposed on the act or privilege of engaging in business as an extractor, and includes the tax imposed by RCW [82.04.230](#) (tax on extractors) and similar gross receipts taxes paid to other states.

(d) "Manufacturing tax" means a gross receipts tax imposed on the act or privilege of engaging in business as a manufacturer, and includes:

(i) The taxes imposed in RCW [82.04.240](#) (tax on manufacturers) and subsections (2) through (5) and (7) of RCW [82.04.260](#) (tax on special manufacturing activities) and

(ii) Similar gross receipts taxes paid to other states.

The term "manufacturing tax," by nature, includes a gross receipts tax upon the combination of printing and publishing activities when performed by the same person.

(e) "Selling tax" means a gross receipts tax imposed on the act or privilege of engaging in business as a wholesaler or retailer of tangible personal property in this state or any other state. The term "selling" has its common and ordinary meaning and includes the acts of making either wholesale sales or retail sales or both.

(f) "State" means:

(i) The state of Washington,

(ii) A state of the United States other than Washington or any political subdivision of such other state,

(iii) The District of Columbia,

(iv) Territories and possessions of the United States, and

(v) Any foreign country or political subdivision thereof.

(g) "Taxes paid" means taxes legally imposed and actually paid in terms of money, credits, or other emoluments to a taxing authority of any "state." The term does not include taxes for which liability for payment has accrued but for which payment has not actually been made. This term also includes business and occupation taxes being paid to Washington state together with the same combined excise tax return upon which MATC are taken.

(h) "Business," "manufacturer," "extractor," and other terms expressly defined in RCW 82.04.020 through 82.04.212 have the meanings given in those statutory sections regardless of how the terms may be used for other states' taxing purposes.

(3) Scope of credits. This integrated tax credits system is intended to assure that gross receipts from sales or the value of products determined by such gross receipts are taxed only one time, whether the activities occur entirely within this state or both within and outside this state. External tax credits arise when activities are taxed in this state and similar activities with respect to the same products produced and sold are also subject to similar taxes outside this state. There are five ways in which external tax credits may arise because of taxes paid in other states.

(a) Products or ingredients are extracted (taken from the ground) in this state and are manufactured or sold and delivered in another state which imposes a gross receipts tax on the latter activity(s). The credit created by payment of the other state's tax may be used to offset the Washington extracting tax liability.

(b) Products are manufactured, in whole or in part, in this state and sold and delivered in another state which imposes a gross receipts tax on the selling activity. Again, payment of the other state's tax may be taken as a credit against the Washington manufacturing tax liability.

(c) Conversely, products or ingredients are extracted outside this state upon which a gross receipts tax is paid in the state of extracting, and which are sold and delivered to buyers here. The other state tax payment may be taken as a credit against Washington's selling taxes.

(d) Similarly, products are manufactured, in whole or in part, outside this state and sold and delivered to buyers here. Any other state's gross receipts tax on manufacturing may be taken as a credit against Washington's selling tax.

(e) Products are partly manufactured in this state and partly in another state and are sold and delivered here or in another state. The combination of all other states' gross receipts taxes paid may be taken as credits against Washington's manufacturing and/or selling taxes.

Thus, the external tax credits may arise in the flow of commerce, either upstream or downstream from the taxable activity in this state, or both. Products extracted in another state, manufactured in Washington state, and sold and delivered in a third state may derive credits for taxes paid on both of the out-of-state activities.

Internal tax credits arise from multiple business activities performed entirely within this state, all of which are now subject to tax, but with the integrated credits offsetting the liabilities so that tax is only paid once on gross receipts. Under this system Washington extractors and manufacturers who sell their products in this state at wholesale and/or retail must report the value of products or gross receipts under each applicable tax classification. Credits may then be taken in the amount of the extracting and/or manufacturing tax paid to offset the selling taxes due. There are three ways in which credits may arise because of taxes paid exclusively in this state.

(f) Products are extracted in Washington and directly sold in Washington. Extracting business and occupation tax and selling business and occupation tax must both be reported but the payment of the former is a credit against the latter.

(g) Similarly, ingredients are extracted in Washington and manufactured into new products in this state. The extracting business and occupation tax reported and paid may be taken as a credit against manufacturing tax reported.

(h) Products manufactured in Washington are sold in Washington. Again, the payment of the manufacturing tax reported may be credited against the selling tax (wholesaling and/or retailing business and occupation tax) reported.

All of the external and internal tax credits derived from any flow of commerce may be used, repeatedly if necessary, to offset other tax liabilities related to the production and sale of the same products.

(4) Eligibility for taking credits. Statutory law places the following eligibility requirements and limitations upon the MATC system.

(a) The amount of the credit(s), however derived, may not exceed the Washington tax liability against which the credit(s) may be used. Any excess of credit(s) over liability may not be carried over or used for any purpose.

(b) The person claiming the credit(s) must be the same person who is legally obligated to pay both the taxes which give rise to the credit(s) and the taxes against which the credit is claimed. The MATC is not assignable.

(c) The taxes which give rise to the credit(s) must be actually paid before credit may be claimed against any other tax liability. Tax liability merely accrued is not creditable.

(d) The business activity subject to tax, and against which credit(s) is claimed, must involve the same ingredients or product upon which the tax giving rise to the credit(s) was paid. The credits must be product-specific.

(e) The effective date for developing and claiming credit(s) for products manufactured in Washington state and sold and delivered in other states which impose gross receipts selling taxes is June 1, 1987.

(f) The effective date for developing and claiming all credits other than those explained in subsection (e) above, is August 12, 1987.

(g) Persons who are engaged only in making wholesale or retail sales of tangible personal property which they have not extracted or manufactured are not entitled to claim MATC. Also, persons engaged in rendering services in this state are not so entitled, even if such services have been defined as "retail sales" under RCW 82.04.050. (See WAC 458-20-194 for rules governing apportionment of gross receipts from interstate services.)

(5) Other states' qualifying taxes. The law defines "gross receipts tax" paid to other states to exclude income taxes, value added taxes, retail sales taxes, use taxes, or other taxes which are generally stated separately from the selling price of products sold. Only those taxes imposed by other states which include gross receipts of a business activity within their measure or base are qualified for these credit(s). The burden rests with the person claiming any MATC for other states' taxes paid to show that the other states' tax was a tax on gross receipts as defined herein. Gross receipts taxes generally include:

(a) Business and occupation privileges taxes upon extracting, manufacturing, and selling activities which are similar to those imposed in Washington state in that the tax measure or base is not reduced by any allocation, apportionment, or other formulary method resulting in a downward adjustment of the tax base. If costs of doing business may be generally or routinely deducted from the tax base, the tax is not one which is similar to Washington state's gross receipts tax.

(b) Severance taxes measured by the selling price of the ingredients or products severed (oil, logs, minerals, natural products, etc.) rather than measured by costs of production, stumpage values, the volume or number of units produced, or some other formulary tax base.

(c) Business franchise or licensing taxes measured by the gross volume of business in terms of gross receipts or other financial terms rather than units of production or the volume of units sold.

Other states' tax payments claimed for MATC must be identifiable with the same ingredients or products which incurred tax liability in Washington state, i.e., they must be product specific.

(d) The department will periodically publish an excise tax bulletin listing current taxes in other jurisdictions which are either qualified or disqualified for credit under the MATC system.

(6) Deductions in combination with MATC. Effective August 12, 1987, with the enactment of the MATC system, the liability for actual payment of tax by persons who extract, manufacture, and sell products in this state was shifted from the selling activity (wholesaling or retailing) to the production activity (extracting and/or manufacturing). As explained, the payment of the production taxes may now be credited against the liability for selling taxes on the same products. However, the deductions from tax provided by chapter 82.04 RCW (business and occupation tax deductions) may still be taken before tax credits are computed and used, with noted exceptions. In order for the MATC system to result in the correct computation of tax liabilities and credit applications, the tax deductions which may apply for any reporting period must be taken equally against both levels of tax liability reported, i.e., at both the production and selling levels. Failure to report tax deductions in this manner will result in overreporting tax due and may result in overpayment of tax. Thus, with the exceptions noted below, tax deductions formerly reported only against selling activities should now be reported against production activities as well. All such deductions, the result of which is to reduce the measure of tax reported, should be taken against both the production taxes (extracting or manufacturing) and the selling taxes (wholesaling and/or retailing) equally.

(a) Example:

(i) A company manufactures products in Washington which it also sells at wholesale for \$5,000 and delivers to a buyer in this state. The buyer defaults on part of the payment and the seller incurs a \$2,000 credit loss which it writes off as a bad debt during the tax reporting period. The bad debt deduction provided by RCW 82.04.4284 must be shown on both the manufacturing-other line and the wholesaling-other line of the combined excise tax return. Taking the deduction on only one of those activities results in overreported tax liability on the \$2,000 loss.

(b) Exceptions. The deductions generally provided by RCW 82.04.4286, for interstate or foreign sales (where goods are sold and delivered outside this state) may not be taken against tax reported at the production level (extracting or manufacturing). This is because the MATC system itself provides for tax credits instead of tax deductions on gross receipts from transactions involving goods produced in this state and sold in interstate or foreign commerce. Thus, deductions which eliminate transactions from tax reporting may be taken only against selling taxes.

(c) Applicable deductions should be shown on the front of the combined excise tax return (Column #3) on each applicable tax classification line and detailed on the back side of the return, as usual, before MATC is taken.

(d) It is not the intent of the MATC law to invalidate or nullify the business and occupation tax exemption for taxable amounts below minimum (see WAC 458-20-104). Thus any person whose gross receipts or value of products reported under any single tax classification with respect to the production and sale of any product is less than the minimum taxable amount will not incur tax liability merely because of the requirement to report those gross receipts or value of products on the same product under other tax classifications as well.

(i) Example: A person both manufactures and sells at wholesale \$2,000 worth of widgets in the first quarter of a tax year. The requirement to report the \$2,000 tax measure under both the manufacturing-other classification and the wholesaling-other classification gives the false appearance of \$4,000 in gross receipts during this quarter. However, only the amount reported under the manufacturing-other classification need be considered to determine eligibility for the amount-below-minimum exemption.

(7) How and when to take MATC. The credits available under the MATC system are all to be taken on the combined excise tax return beginning in August, 1987 and thereafter. The return form has been modified to accommodate these credits. Each tax return upon which MATC has been taken must be accompanied by a completed Schedule C. This schedule details the business activities and credits computations. The line by line instructions insure that no more or no less credits are claimed than are authorized under the law.

(8) Consolidation of tax liabilities and credits. Under the MATC system a person's Washington tax liability for all activities involved in that person's production and sale of the same ingredients or products (extracting, and/or manufacturing, and/or selling) is to be reported only at the time of the sale of such products or at the time of that person's own use of such products for commercial or industrial consumption. All of the taxable activities are to be reported on that same periodic excise tax return. Also, all external and internal tax credits derived from the payment of any gross receipts taxes on any of these activities are to be taken at that time. Thus, the taxable activities and the tax credits are procedurally consolidated for reporting. This consolidation generally overcomes any need to track ingredients or products from their extraction to their sale. It also overcomes any need to report and pay Washington tax liability during one reporting period and to take credits against that tax liability in a different reporting period. Thus, except as noted below, there can be no credit carryovers or carrybacks under this system.

(a) Exception. Where different tax reporting periods are assigned by Washington state and another state to a company doing business both within and outside Washington state, the other state's gross receipts tax on the same products may not yet have been paid when the Washington tax is due for reporting and payment. In such cases the Washington tax due must be timely reported and paid during the period in which the sale is made. The external credit arising later, when the other state's tax is paid, may be taken as a credit against any Washington business and occupation tax reported during that later period. Thus, the limitation that the MATC must be product-specific by being limited to the amount of Washington tax paid on the same products does not mean that the credit(s) can only be used against precisely those same Washington taxes paid.

(i) In the situation described in subsection (a) above, if there is not sufficient Washington business and occupation tax due for payment in the later period, when the external tax credit arises, to allow for utilization of the entire credit, the amount of any overage may be carried forward and taken against Washington taxes reported in subsequent reporting periods until fully used.

When filing such exception returns, the full amount of any credits should be claimed, even though that credit amount will exceed the amount of tax liability reported for that period. The department of revenue itself will make the necessary adjustments and will perform the carrying over of any excess credits into future reporting periods.

(ii) In the same situation, if the person entitled to claim such credit overage is no longer engaged in taxable business in this state or for any other reason does not incur sufficient Washington business and occupation tax liability to fully utilize the perfected credit overage, a tax refund will be issued.

(iii) No tax refunds, MATC carryovers, or MATC carrybacks will be allowed under any circumstances other than those explained above.

(b) Special circumstances may arise where it is not possible to specifically identify ingredients or products as they move from production to sale (e.g., fungible commodities from various sources stored in a common warehouse). In such cases the taxpayer should seek advance approval from the department, in writing, for tax reporting and credit taking on a test period, formulary, or volume percentage basis, subject to audit verification.

(9) Recordkeeping requirements. Persons claiming the MATC must keep and preserve such records and documents as may be necessary to prove their entitlement to any credits taken under this system (RCW 82.32.070). It is not required to submit copies of such proofs when credits are claimed or together with the Schedule C detail. Rather, such records must be kept for a period no less than five years from the date of the tax return upon which the related tax credits are claimed. Such records are fully subject to audit for confirmation of the validity and amounts of credits taken. Records which must be preserved by persons claiming external tax credits include:

(a) Copies of sales contracts, or other written or memorialized evidence of any sales agreements, including purchase and billing invoices showing the origin state and destination state of products sold.

(b) Copies of shipping or other delivery documents identifying the products sold and delivered, reconcilable with the selling documents of subsection (a) above, if appropriate.

(c) Copies of production reports, transfer orders, and similar such documents which will reflect the intercompany or interdepartmental movement of extracted ingredients or

manufactured products where no sale has occurred.

(d) Copies of tax returns or reports filed with other states' taxing authorities showing the kinds and amounts of taxes paid to such other states for which MATC is claimed.

(e) Copies of cancelled checks or other proofs of actual tax payment to the other state(s) giving rise to the MATC claimed.

(f) Copies of any other state(s) taxing statutes, laws, ordinances, and other appropriate legal authorities necessary to establish the nature of the other states' tax as a gross receipts tax, as defined in this section.

(g) Failure to keep and preserve proofs of entitlement to the MATC will result in the denial of credits claimed and the assessment of all taxes offset or reduced by such credits as well as the additional assessment of interest and penalties as required by law. (See RCW 82.32.050.)

(10) MATC in combination with other credits. The tax credits authorized under this system may be taken in combination with other tax credits available under Washington law. Such other credit programs, however, authorize credit carryovers from reporting period to period until the credits are fully utilized. Thus, the MATC must be computed and used to offset business and occupation tax liabilities during any tax reporting period before any other program credits to which a claimant may be entitled are claimed or applied. Failure to compute and take the MATC before applying other available credits may result in the loss of the other credit benefits.

(11) Superseding provisions. The MATC provisions of this section supersede and control the provisions of other sections of chapter 458-20 WAC (other tax rules) relating to intrastate, interstate, and foreign transactions to the extent that such provisions are or appear to be contrary or conflicting.

(12) Unique or special credit situations -- Appeals. The provisions of this section generally explain the nature of the MATC system and the tax credit qualifications, limitations, and claiming procedures. The complexity of the integrated tax reporting and credit taking procedures may develop situations or questions which are not addressed herein. Such matters and requests for specialized rulings should be submitted to the department of revenue for prior determination before credits are claimed. Generally, prior determinations will be provided within sixty days after the department receives the information necessary to make such a ruling. Adverse rulings, tax credit denials, or tax assessments resulting from audits or other examinations of returns upon which the MATC is claimed may be administratively appealed under the provisions of chapter 82.32 RCW and WAC 458-20-100.

[Statutory Authority: RCW 82.32.300, 87-23-008 (Order 87-8), § 458-20-19301, filed 11/6/87.]