Cite as Det. No. 16-0016, 35 WTD 515 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 16-0016
. . .	)	Registration No. . . .

Rule 244; RCW 82.08.0293: RETAIL SALES TAX EXEMPTION FOR FOOD AND FOOD INGREDIENTS - EXCEPTION FOR PREPARED FOOD – 75% RULE. Bagged chips, otherwise treated as a non-prepared food exempt from retail sales tax as a food or food ingredient, are treated as a prepared food not exempt from retail sales tax when 75% or more total sales are non-exempt prepared foods. Therefore, a restaurant or deli that prepares more than 75% of its food must charge retail sales tax on bagged chips.

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.

Gabriella Herkert, A.L.J. – Owner of several sandwich franchise locations (Taxpayer), which sell bagged chips both individually and as part of single price meal options with other prepared foods, challenges an assessment of retail sales tax on the sale of bagged chips. We deny the petition.[1]

ISSUE

1. Are bagged chips exempt from retail sales tax under RCW 82.08.0293?

2. Does [WAC 458-20-244] ("Rule 244") erroneously interpret "prepared foods" under RCW 82.08.0293 when it treats non-prepared foods as prepared foods when 75% of the sales of a business are prepared foods by definition?

3. Is the Department of Revenue (Department) estopped from assessing [retail sales tax on bagged chips] if taxpayer failed to receive previous audit instructions [the Department sent] specifically addressing [the 75% standard in Rule 244]?

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FINDINGS OF FACT

Taxpayer owns and operates several sandwich food franchises. At Taxpayer's location, sandwiches are made to order for customers using multiple ingredients. Some sandwiches and other items are heated before sale. Taxpayer also sells bottled and concession water and soda, baked goods, and bagged chips. Sometimes the sandwiches are sold in combination with other items at a single price. Sometimes the non-sandwich items are sold individually.

In August 2011, an audit was issued for the period January 1, 2007 through June 30, 2010, resulting in no assessment. Subsequently, the Department's Audit Division (Audit) sent taxpayer specific written instructions regarding the seventy-five percent rule, which states if a retailer's sales of prepared foods exceed seventy-five percent of gross food sales, all sales of food and food ingredients are taxable. According to the Department's records, the audit instructions were sent by United States Post Office regular mail on August 16, 2011. Taxpayer denies it received written instructions at that time although copies of the instructions were provided by the Department during appeal.

The Department subsequently audited Taxpayer for the period January 1, 2011 through March 31, 2014, and issued an assessment for $ . . . [2] with a due date of August 27, 2015. Taxpayer was granted an extension of the time to file an appeal and did file timely. Prior to February 2014, Taxpayer treated sales of bagged chips as exempt. After the implementation of a new accounting system in February 2014, Taxpayer began collecting and remitting retail sales tax on sales of bagged chips. At the time of the appeal, Taxpayer had aggregate balance due assessments of $ . . . , for a prior period (Document Nos. . . . through . . .)[3] that, due to similar underlying issues, were included in the consideration of this appeal.

ANALYSIS

1. Exemption under RCW 82.08.0293 and Rule 244

The retail sales tax is imposed on every retail sale occurring in the State of Washington. RCW 82.08.020(1). A "sale" includes "the furnishing of food, drink, or meals for compensation whether consumed upon the premises or not." RCW 82.04.040. A "retail sale" is "every sale of tangible personal property . . . to all persons irrespective of the nature of their business . . . ." RCW 82.04.050(1). The definitions of "sale" are incorporated by reference for retail sales tax purposes by RCW 82.08.010(6).

The tax levied by RCW 82.08.020 does not apply to sales of food and food ingredients, which are defined as "substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value." RCW 82.08.0293. *See also* . . . Rule 244(2)(a).

[2] The assessment consisted of $ . . . in uncollected retail sales tax on sales of soda and bagged chips, and $ . . . in interest.

[3] Doc. No. . . . in the amount of $ . . . ; Doc. No. . . . in the amount of $ . . . ; Doc. No. . . . in the amount of $ . . . ; Doc. No. . . . in the amount of $ . . . ; Doc. No. . . . in the amount of $ . . . ; Doc. No. . . . in the amount of $ . . . .

Bagged chips are sold for human consumption. They are, therefore, a "food or food ingredient" under RCW 82.08.0293.

The exemption of "food and food ingredients" does not apply to prepared food, soft drinks, or dietary supplements. RCW 82.08.0293(2).

RCW 82.08.0293(2)(b)(i) defines "prepared food" as:

> (A) Food sold in a heated state or heated by the seller;
>
> (B) Food sold with eating utensils provided by the seller, including plates, knives, forks, spoons, glasses, cups, napkins, or straws. A plate does not include a container or packaging used to transport the food; or
>
> (C) Two or more food ingredients mixed or combined by the seller for sale as a single item, . . .

[WAC] 458-20-244(4)(c)(iii) provides a "seventy-five percent test" to determine whether sales of food and food ingredients are subject to retail sales tax as "prepared foods" when "sold with utensils provided by the seller":

> **More than seventy-five percent prepared food sales with utensils available.** All food [and food ingredients] . . . sold at an establishment . . . are "sold with utensils provided by the seller" if the seller makes utensils available to its customers and the seller's gross sales of prepared food under . . . this subsection equal more than seventy-five percent of the seller's gross sales of all food and food ingredients, including prepared food, soft drinks . . . .

Id. (brackets added.) Thus, in accordance with Rule 244(4)(c)(iii), when more than 75% of a seller's sales are sales of prepared foods as described in the rule, then 100% of the seller's sales will be considered to be "sold with utensils provided by the seller" [and subject to retail sales tax.]

We conclude that the entirety of Taxpayer's sales, including the sale of bagged chips, was correctly treated as retail sales.

2. Statutory Interpretation

Taxpayer argues that, to the extent WAC 458-20-244 imposes retail sales tax on bagged chips when the Taxpayer's . . . sales of prepared foods exceed 75% of its total sales, the rule runs counter to clear legislative intent and is *ultra vires* and, therefore, invalid. Taxpayer asserts that there is no language in the statutes treating an otherwise exempt food as a prepared food when certain sales thresholds are met. If such had been intended, the legislature could have said so. Taxpayer contends that, correctly construed, bagged chips are always exempt from retail sales tax under RCW 82.08.0293. We disagree.

RCW 82.08.0293 provides a retail sales tax exemption for food and food ingredients. RCW 82.08.0293 also provides an exception to the exemption for [certain] food items, such as soft drinks, dietary supplements, and prepared foods. In order to comply with the Streamlined Sales and Use Tax Agreement (SSUTA), the Legislature amended this exemption statute by . . .Laws of 2003, ch.168, sec. 301, effective July 1, 2004.[4]

The fundamental purpose of the SSUTA is to create uniformity of major base definitions. STREAMLINED SALES AND USE TAX AGREEMENT § 102(C) (2002)[5]. Consequently, the retail sales tax exemption for the sales of certain "food and food ingredients" contained in RCW 82.08.0293 now mirrors the SSUTA. The SSUTA Governing Board, in an interpretative opinion, clarified that for purposes of the SSUTA, the definition of "prepared food" includes the 75% threshold test applicable in the context of the phrase "provided by the seller" with respect to utensils. The interpretative opinion is numbered as Interpretation 2006-04 (2006) available at http://www.streamlinedsalestax.org. It is the "intent of the legislature that the provisions of this [Title 82 RCW] relating to the administration and collection of state and local sales and use taxes be interpreted and applied consistently with the agreement [SSUTA]." RCW 82.02.210; *See also* Det. No. 13-0048, 32 WTD 276 (2013); *North Central Washington Respiratory Care Services, Inc. v. Dep't of Revenue*, 165 Wn. App. 616, 641-44, 268 P.3d 972 (2011).

. . . RCW 34.05.230, which encourages agencies to turn interpretive statements into rules, . . . provides sufficient authority for an agency to express an interpretation by means of an agency rule. *Ass'n of Wash. Bus. v. Dep't of Revenue*, 155 Wn.2d 2d 430, 442-43 (2005). Agency rules are de facto authoritative for the public until the public challenges them in court and the court agrees. *Id.* [at 448.]

The Department had the authority to create a rule expressing the interpretation put forth by the SSUTA's Governor's Board. The rule is consistent with the legislative intent expressed in RCW 82.02.210. Rule 244 is not ultra vires. Agency rules are de facto authoritative until a court agrees otherwise. Therefore, we deny taxpayer's petition with respect to statutory interpretation.

3. Effect of Prior Audit . . .

Taxpayers have the responsibility to file accurate returns and pay taxes in a timely manner. RCW 82.32A.030(4). Failure of the taxpayer to receive notices or orders, whether served, mailed, or provided electronically, shall not release the taxpayer from any tax or any increases or penalties thereon under RCW 82.32.130. Taxpayer had a responsibility to accurately file returns and pay taxes which was not relieved by its stated failure to receive the audit instructions mailed by the Department.

Taxpayer contends that having undergone a previous audit, which resulted in no adjustment, and not receiving audit instructions that would have put him on notice that previous reporting was inaccurate, are circumstances under which the Department should be estopped from assessing tax on periods before actual notice of the 75% rule was received and imposing penalties during that period. We disagree.

[4] Washington became a Member State of the SSUTA on July 1, 2008.
[5] The SSUTA was adopted on November 12, 2002 and amended through October 8, 2014.

Taxpayers have the right to rely on specific, official written advice and written tax reporting instructions from the Department to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment. RCW 82.32A.020(2).

We find the taxpayer has not established all the required elements of RCW 82.32A.020(2). The Department issued audit instructions and sent them via regular mail on August 16, 2011. While taxpayer claims he did not receive those instructions, they were sent and consistent with the assessment that underlies this petition. Taxpayer did not, therefore, rely to his detriment on specific, official written reporting instructions. The only instructions available, which taxpayer himself asserts he never saw, could not be detrimentally relied on [because] they correctly advised taxpayer that the 75% rule applied to his business.

. . . [T]he taxpayer has not met all the required elements of RCW 82.32A.020. . . . Consequently, the taxpayer has no basis under . . . RCW 82.32A.020 . . . for waiver of the assessment, interest, or penalties.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 15th day of January, 2016.