

Cite as Det No. 10-0027, 29 WTD 53 (2010)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	<u>D E T E R M I N A T I O N</u>
	)	
	)	No. 10-0027
...	)	
	)	Registration No. . . .
	)	Document No. . . ./Audit No. . . .
	)	
	)	Docket No. . . .

[1] RULE 252; RCW 82.21.020; RCW 82.23A.010: HAZARDOUS SUBSTANCE TAX - PETROLEUM PRODUCTS TAX – DEFINITION OF “HAZARDOUS SUBSTANCE.” Denatured ethanol is not a hazardous substance under RCW 82.21.020 and WAC 458-20-252 because it is mostly commonly denatured with natural gasoline, which is not “derived from the refining of crude oil” under WAC 458-20-252(2)(b)(i).

[2] RULE 252; RCW 82.21.020; RCW 82.23A.010: HAZARDOUS SUBSTANCE TAX - PETROLEUM PRODUCTS TAX – DEFINITION OF “HAZARDOUS SUBSTANCE.” Oxygenated gasoline, which is a combination of denatured ethanol and petroleum based gasoline, is a hazardous substance under RCW 82.21.020 and WAC 458-20-252 because it contains a “petroleum product,” as defined in RCW 82.21.020(2) and RCW 82.23A.010(1).

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.

Jensen, A.L.J. – A seller of petroleum products protests an assessment of Petroleum Products Tax (PPT), and Hazardous Substance Tax (HST) on its production of oxygenated gasoline in this state claiming that denatured ethanol is a hazardous substance subject to PPT and HST, and, therefore, that the subsequent blending of denatured ethanol with gasoline to create oxygenated gasoline is not a hazardous substance subject to PPT and HST. We hold that denatured ethanol is not a hazardous substance, whereas oxygenated gasoline is a hazardous substance.<sup>1</sup>

<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

## ISSUES

1. Whether denatured ethanol is a “hazardous substance” within the meaning of WAC 458-20-252?
2. Whether the blending of gasoline with denatured ethanol creates a “hazardous substance” within the meaning of WAC 458-20-252?
3. ...

## FINDINGS OF FACT

[Taxpayer] sells petroleum products in Washington through terminals owned by third parties. Taxpayer does not own a refinery in this state and does not bring gasoline into this state, but acquires gasoline from local refineries. Taxpayer acquires denatured ethanol from suppliers in and outside of Washington. Taxpayer blends the denatured ethanol with the gasoline to create oxygenated gasoline. Taxpayer claims that, during the relevant time period, the blending occurred [in] Washington. Taxpayer then sold the oxygenated gasoline to Washington customers. . . .

“Ethanol,” or “grain alcohol,” is “a biofuel produced from food crops such as corn and sugar cane.” *Id.* Ethanol is an active ingredient in alcoholic beverages. The fuel industry blends ethanol with small amounts of additives to create denatured ethanol. This process renders the ethanol undrinkable to avoid federal beverage taxes. Ethanol can be denatured by using products such as natural gasoline or petroleum based gasoline. According to various sources, natural gasoline is the most common denaturant of ethanol. *See* Ron Kotrba, *Denaturant Pricing Movement Affects Blend Volume*, Ethanol Producer Magazine (March 2008); Richard E. Shockey, *Optimal Ethanol Blend-Level Investigation Final Report*, Energy & Environmental Research Center, University of North Dakota (November 2007).<sup>2</sup> “Natural gasoline” is “[a] mixture of liquids extracted from natural gas and suitable for blending with ordinary oil-derived gasoline.” <http://www.consumerenergycenter.org/glossary/n.html>.

The Department of Revenue (Department) audited Taxpayer’s records for the period of January 1, 1992, through December 31, 1994. In that audit, Taxpayer was assessed HST on denatured ethanol. Taxpayer then reported and paid HST and PPT on denatured ethanol. After that audit, the Department issued Washington Tax Determination (WTD) 03-0224E, 24 WTD 36 (2005). In that determination, the Department held that denatured ethanol is not a hazardous substance subject to HST and PPT, whereas oxygenated gasoline is a hazardous substance. *Id.* at 60.

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<sup>2</sup> The US Environmental Protection Agency’s website also contains a question and answer format. One of the questions provided indicates that “the predominant denaturant used [to denature ethanol] is natural gasoline.” [http://fuelsprograms.custhelp.com/cgi-bin/fuelsprograms.cfg/php/enduser/std\\_adp.php?p\\_faqid=4898](http://fuelsprograms.custhelp.com/cgi-bin/fuelsprograms.cfg/php/enduser/std_adp.php?p_faqid=4898).

The Department's Audit Division (Audit) audited Taxpayer's records for the period of January 1, 2001, through December 31, 2004. Audit made various adjustments resulting in a net tax refund of \$. . . . The audit adjustments included \$. . . in assessed PPT, and \$. . . in assessed HST on the blending of denatured ethanol with gasoline. Taxpayer protests these adjustments and asks for a refund of the taxes . . . .

### ANALYSIS

[1] Washington law imposes a hazardous substance tax (HST), on "the privilege of possession of hazardous substances in this state." RCW 82.21.030. Additionally, Washington imposes a petroleum products tax (PPT) on "the privilege of possession of petroleum products in this state." RCW 82.23A.020. Both HST and PPT are imposed on the first possession of hazardous substances or petroleum products in this state; however, the Department can collect both taxes from any person who has taxable possession of the product if the tax has not been paid. WAC 458-20-252(1)(c) (Rule 252). The amount of tax paid is then considered "a debt owed by the first person having had taxable possession to the person who pays the tax." *Id.*

Washington law defines "hazardous substance" as:

- (a) Any substance that, on March 1, 1989, is a hazardous substance under section 101(14) of the federal comprehensive environmental response, compensation, and liability act of 1980, 42 U.S.C. Sec. 9601(14), as amended by Public Law 99-499 . . . .
- (b) Petroleum products;
- (c) Any pesticide product required to be registered under section 136a of the federal insecticide, fungicide and rodenticide act, 7 U.S.C. Sec. 136 et seq., as amended by Public Law 104-170 on August 3, 1996; and
- (d) Any other substance, category of substance, and any product or category of product determined by the director of ecology by rule to present a threat to human health or the environment if released into the environment. The director of ecology shall not add or delete substances from this definition more often than twice during each calendar year. For tax purposes, changes in this definition shall take effect on the first day of the next month that is at least thirty days after the effective date of the rule. The word "product" or "products" as used in this paragraph (d) means an item or items containing both: (i) One or more substances that are hazardous substances under (a), (b), or (c) of this subsection or that are substances or categories of substances determined under this paragraph (d) to present a threat to human health or the environment if released into the environment; and (ii) one or more substances that are not hazardous substances.

RCW 82.21.020(1).

In this case, Taxpayer argues that denatured ethanol is a hazardous substance. Denatured ethanol is not designated as a hazardous substance in either of the federal acts mentioned in the above

definition, or by the Washington State Department of Ecology. If denatured ethanol is a hazardous substance it must therefore meet the definition of “petroleum product.”

“Petroleum product” is defined as any “plant condensate, lubricating oil, gasoline, aviation fuel, kerosene, diesel motor fuel, benzol, fuel oil, residual oil, liquefied or liquefiable gases such as butane, ethane, and propane, and *every other product derived from the refining of crude oil*, but the term does not include crude oil.” RCW 82.21.020(2)<sup>3</sup> (Emphasis added). “Product(s),” for petroleum product purposes, includes “any item(s) containing a combination of ingredients, some of which are hazardous substances and some of which are not hazardous substances.” Rule 252(2)(c). Denatured ethanol is not specifically listed as a petroleum product. However, it is nonetheless a hazardous substance if it is “derived from the refining of crude oil.”

Rule 252 provides the following definition for “derived from the refining of crude oil:”

The term "derived from the refining of crude oil" as used herein, means *produced because of and during petroleum processing*. "Petroleum processing" includes 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 for sale or commercial or industrial use. "Fuel" includes all combustible gases and liquids suitable for the generation of energy. The term "derived from the refining of crude oil" does not mean petroleum products which are manufactured from refined oil derivatives, such as petroleum jellies, cleaning solvents, asphalt paving, etc. Such further manufactured products become hazardous substances only when expressly so designated by the director of ecology.

Rule 252(2)(b)(i) (emphasis added).

Taxpayer’s main argument is that because ethanol is denatured by a hazardous substance, gasoline, it becomes a “petroleum product.” The main problem with Taxpayer’s argument is that it assumes that a hazardous substance is used to denature the ethanol it acquires from third parties. Ethanol is most commonly denatured by natural gasoline, which is not a “petroleum product” under the above definition. Natural gasoline is not a product that was “derived from the refining of crude oil.” It is a product that is extracted from natural gas.<sup>4</sup> Therefore, we deny Taxpayer petition with respect to this issue.<sup>5</sup>

[2] In the alternative, Taxpayer argues that if denatured ethanol is not a hazardous substance, then oxygenated gasoline is also not a hazardous substance. 24 WTD 36 addresses this question. That determination provides: “...when the taxpayer uses denatured ethanol to create a new petroleum product, the new product is a hazardous substance. In its operations, the taxpayer

<sup>3</sup> RCW 82.23A.010 provides an almost identical definition of “petroleum product” for purposes of the PPT. . . .

<sup>4</sup> [http://www.eia.doe.gov/glossary/glossary\\_n.htm](http://www.eia.doe.gov/glossary/glossary_n.htm).

<sup>5</sup> Taxpayer must produce substantiating documentation to demonstrate that the denatured ethanol that it acquires is denatured with a petroleum product, other than natural gasoline. RCW 82.32.070; RCW 82.32A.030(3); and WAC 458-20-254.

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combines a hazardous substance, gasoline, with a non-hazardous substance, denatured ethanol, to produce a new petroleum product, oxygenated gasoline.” *Id.* at 60.

What makes oxygenated gasoline a hazardous substance, as opposed to denatured ethanol, is that oxygenated gasoline contains petroleum based gasoline, which is a “petroleum product,” as defined in RCW 82.21.020(2). To conclude that oxygenated gasoline is not a hazardous substance would be contrary to that term’s definition in RCW 82.21.020(1), which specifically includes petroleum products.

#### DECISION AND DISPOSITION

Taxpayer’s refund petition is denied.

Dated this 28th day of January 2010.