Cite as Det. No. 04-0232, 24 WTD 230 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition For Correction of Assessment and Refund of	)	D E T E R M I N A T I O N
	)	No. 04-0232
. . .	)	Registration No. . . .
	)	Document. No. . . .
	)	Partial Audit No. . . .
	)	Docket No. . . .

[1] RULE 193C: B&O TAX – WHOLESALING -- IMPORTS – FEDERAL TRADE ZONE ("FTZ") – FEDERAL TRADE ZONES ACT -- FEDERAL PREEMPTION. A B&O selling tax imposed by this state on a foreign company's sales into this state from an FTZ does not subvert the intent of, diminish the advantages conferred by, or impede the purposes of the Federal Trade Zones Act.

[2] RULE 193C: B&O TAX – WHOLESALING – IMPORT-EXPORT CLAUSE -- IMPORTS FROM FTZ. Because imported goods are no longer considered to be "in transit" when they enter their state of destination under *Michelin*, the assessment of B&O tax on a seller who delivers goods manufactured in an FTZ from foreign ingredients to its Washington customers is not constitutionally prohibited.

[3] RULE 193C: B&O TAX – WHOLESALING – IMPORTS – FTZ -- DELIVERY TO WASHINGTON BUYER FROM FTZ. *Coast Pacific Trading* does not permit Rule 193C to be interpreted as authorizing a deduction from a seller's B&O tax when the seller delivers goods to Washington buyers from an out-of-state FTZ.

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.

Bauer, A.L.J. – . . . (Taxpayer), a [foreign] company, manufactured products in a Foreign Trade Zone ("FTZ") located in [State A]. From there it sold and delivered products directly to its wholesaling customers in Washington. Taxpayer protests the imposition of business and occupation (B&O) tax on these sales, arguing that Washington's B&O tax on goods coming from an FTZ is not only constitutionally prohibited, but is prohibited by the Department's own rule. We deny Taxpayer's petition.[1]

ISSUES:

1. Was Washington's wholesaling B&O tax preempted by the federal Foreign Trade Zones Act of 1934, when a foreign Taxpayer with Washington nexus assembled its products in a [State A] FTZ from primarily imported ingredients, and then shipped these products directly from the FTZ to its Washington customers?

2. Did the Import-Export Clause prohibit the imposition of the wholesaling B&O tax when a foreign Taxpayer with Washington nexus assembled its products in a [State A] FTZ from primarily imported ingredients, and then shipped these products directly from the FTZ to its Washington customers?

3. Did WAC 458-20-193C (Rule 193C) authorize a deduction from the wholesaling B&O tax when a foreign Taxpayer with Washington nexus assembled its products in a [State A] FTZ from primarily imported ingredients, and then shipped these products directly from the FTZ to its Washington customers?

FINDINGS OF FACT:

Bauer, A.L.J – . . . Taxpayer requested a refund on December 27, 2000 from the Audit Division (Audit) of the Department of Revenue (Department) for B&O taxes paid on sales it made to Washington buyers, claiming these sales to be imports eligible for deduction under Washington's Revenue Act. In response to this request, Audit conducted a partial audit of Taxpayer's business records for the period January 1, 1996 through December 31, 2000 (audit period) and issued an assessment on June 3, 2003. The assessment resulted in neither taxes owed nor refund due. Taxpayer timely petitioned for refund and correction of this assessment to the Department's Appeals Division (Appeals) on July 1, 2003.

On [date], the Federal Foreign Trade Zone Board Order No. . . . approved the establishment of a foreign trade zone -- Subzone [A] -- in [State A] for Taxpayer pursuant to the Federal Foreign Trade Zones Act of 1934, as amended (FTZ Act). Subzone [A] encompassed the facilities used to manufacture [Taxpayer's product B].

On [date], Order No. . . . expanded Subzone [A] to include facilities used for the production of [Taxpayer's product C].

Taxpayer operates out of additional FTZs in the United States, but Subzone [A] in [State A] is the only one from which products are delivered to Washington customers. Taxpayer uses that FTZ for the purposes intended and authorized by Congress, as expressed in the FTZ Act. U.S. workers are

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

employed in the manufacture of finished products from imported ingredients within the FTZ.

During the audit period, Taxpayer manufactured [product B and product C] both within and outside the United States. During the audit and refund claim periods, Taxpayer manufactured its products primarily from foreign-sourced ingredients in its FTZ facility located in [State A]. It shipped the finished products directly from its [State A] manufacturing facility to wholesale customers in various locations, including the State of Washington.

It is uncontested that Taxpayer has nexus with the State of Washington.

ANALYSIS:

Taxpayer contends that the wholesaling B&O tax, as applied to the sales at issue, constituted (1) a tax that was preempted by the federal FTZ Act, (2) a tax prohibited by the Import-Export Clause of the United States Constitution, or (3) a tax violating the Department's own Rule 193C. We find that Taxpayer's arguments are without merit and deny Taxpayer's petition for refund.

Purposes of the FTZ Act

FTZs were first authorized by the Federal Trade Zones Act of 1934, 19 U.S.C. 81a, *et. seq*. Generally, FTZs are designated geographical areas that, for purposes of customs and tariff laws, are treated as being outside of the United States. Businesses engaged in the import of foreign goods, or the remanufacture of foreign-made goods, may use FTZs to realize substantial tax and duty benefits including deferral or elimination of duties, inverted tariffs, and exemption from state and local property tax.[2] As stated in *Ocean Garden, Inc. v. Marktrade Co.*, 953 F2d 500 (9th Cir., 1991), Congress created FTZs to stimulate foreign commerce and to encourage domestic commerce and jobs:

> Through these zones, "United States citizens could be involved in and, consequently financially profit from the breaking down, repacking and relabeling of the goods." *A.T. Cross, [v. Sunil Trading Corp., 467 F. Supp. 47, 50 (1979)]*. "The Act stimulated foreign commerce by allowing goods in transit in foreign commerce to remain in secure storage, duty free, until they resumed their journey in export." *Xerox [Corp. v. Harris County, 459 U.S. 145, 150 (1982)]*.

Under the FTZ Act, foreign merchandise may be brought into an FTZ without being subject to the customs duties of the United States. While located in an FTZ, merchandise may be stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated or manufactured. Goods may then be exported without ever being subject to U.S. customs duties. Goods admitted into the customs territory of the United States benefit from deferral of duties until such time as the goods are

[2] Weitzner, Steven P., and Gregory Marques, Consider Foreign Trade Zones For a Variety of Tax and Other Benefits, 11-NOV J. Multistate Tax'n 20, 2001 WL 1491159 (W.G.&.L.).

admitted, and may be eligible for reduced duty rates.

The FTZ Act was further amended in 1984 to provide that states could not impose ad valorem taxation on foreign goods in the FTZ held for eventual import or export, or on domestic goods held for export. 19 U.S.C. 81o(e).

[1] **1. Federal Preemption.** The Federal Preemption doctrine derives from the Supremacy Clause of the Constitution, which states:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the contrary notwithstanding.

U.S. Const. art. VI, Paragraph 2. Under the Supremacy Clause, one must follow federal law in the face of conflicting state law. State law is void to the extent that it actually conflicts with a valid federal statute, and a conflict will be found either where compliance with both federal and state law is impossible or where the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. *Edgar v. Mite Corp*., 457 U.S. 624, 631 (1982).

The FTZ Act provides in pertinent part:

> Tangible personal property imported from outside the United States and held in a zone for the purpose of storage, sale, exhibition, repackaging, assembly, distribution, sorting, grading, cleaning, mixing, display, manufacturing, or processing, and tangible personal property produced in the United States and held in a zone for exportation, either in its original form or as altered by any of the above processes, shall be exempt from State and local ad valorem taxation.

19 U.S.C. 81o(e) (emphasis added). This section is the only statutory provision in the FTZ Act that expressly preempts states from assessing tax in an FTZ. It is clear the preemption is limited to state and local *ad valorem* taxes.

Taxpayer argues that Congress's purpose in enacting the FTZ Act was to encourage U.S. jobs, and that imposing a B&O tax would not only penalize Taxpayer from using the FTZ in order to take advantage of its federal benefits, but would also reduce those benefits.

In analyzing whether a state law impedes the purposes of Congress, the Court in *RJ Reynolds Tobacco Co. v. Durham County,* 479 U.S. 130, 140 (1986), explained:

> In undertaking this analysis, however, we must be mindful of the principle that "federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons--either that the nature of the regulated subject

> matter permits no other conclusion, or that the Congress has unmistakably so ordained."

(Citations omitted.) Federal preemption may exist in three circumstances.

> First, in enacting the federal law, Congress may explicitly define the extent to which it intends to pre-empt state law. Second, even in the absence of express pre-emptive language, Congress may indicate an intent to occupy an entire field of regulation, in which case the States must leave all regulatory activity in that area to the Federal Government. Finally, if Congress has not displaced state regulation entirely, it may nonetheless pre-empt state law to the extent that the state law actually conflicts with federal law. Such a conflict arises when compliance with both state and federal law is impossible, or when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."

Michigan Canners & Freezers Assn., Inc., v. Agricultural Marketing & Bargaining Bd., 467 U.S. 461, 469 (1984) (citations omitted). Our first inquiry under *Michigan*, then, is whether Congress, in the FTZ Act, explicitly defined the extent to which it intended to preempt state law. As set forth above, Congress explicitly preempted only the imposition of state *ad valorem* taxes on goods held in FTZs. Washington's B&O tax is not an *ad valorem* tax. Det. No. 99-070, 22 WTD 144 (1999). The FTZ Act, therefore, does not explicitly preempt the Washington B&O tax.

The second inquiry under *Michigan* requires that we determine whether Congress intended to occupy an entire field of regulation by the FTZ Act. The FTZ Act did not reserve all regulatory functions in foreign trade zones to the federal government, but contemplated federal preemption of state regulations only in discrete areas:

> The Board shall cooperate with the State, subdivision, and municipality in which the zone is located in the exercise of their police, sanitary, and other powers in connection with the free zone.

9 U.S.C. 81i. Congress, by the very wording of the quoted section of the statute above, demonstrated that it did not intend the FTZ Act to govern and control all activities in FTZs. If Congress had intended to occupy all powers of taxation in FTZs, it would have done so. However, because Congress only preempted state and local taxation with respect to certain property or goods within an FTZ, and disallowed only *ad valorem* state taxes on those goods, it is evident Congress did not foreclose the application of other state taxing provisions and clearly contemplated that some types of state and local taxes might be imposed. *See, e.g., Department of Rev. of Oregon v. ACF Indus.*, 510 U.S. 332, 345 (1994); *Tyler Pipe Industries, Inc. v. Department of Rev.*, 105 Wn.2d 318, 327, 715 P.2d 123 (1986). We therefore conclude that the FTZ Act does not preclude the imposition of Washington's excise taxes on the activities of a taxpayer operating in an FTZ, wherever that FTZ might be located, as long as that taxpayer has established nexus with Washington.

Finally, the third inquiry under *Michigan* concerns whether Congress, having not displaced state regulation entirely, nonetheless preempted state law to the extent that Washington's B&O tax actually conflicts with federal law. With regard to whether there is an actual conflict between the FTZ Act and Washington's B&O tax, we conclude there is none. We see no reason that the imposition of a B&O tax on Taxpayer's activity of selling to Washington customers could constitute an obstacle to the purposes of Congress.

As described above, the intent of the FTZ Act was to stimulate foreign commerce, to encourage domestic commerce, and to increase jobs in this country. As an incentive, certain benefits were conferred to FTZs. A B&O selling tax imposed by this state on foreign companies' sales into this state does not subvert those intents, nor does it diminish the advantages conferred by the FTZ Act. We conclude that a nondiscriminatory tax on the business of wholesaling in Washington does not impede the purposes of the federal legislation.

Accordingly, we conclude that the federal FTZ Act does not preempt Washington's B&O tax under the Supremacy Clause of the U.S. Constitution.[3] Taxpayer's petition as to federal preemption is denied.

[2] **2. <u>Import-Export Clause.</u>** The Import-Export Clause of the United States Constitution states:

> No state shall, without the consent of the congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws.

U.S. Const. art. 1, §10. Historically, the Supreme Court interpreted the Import-Export Clause to prohibit any tax that fell on an import or export. Prior to 1976, the Supreme Court looked to whether the imported goods had lost their character as imports and become incorporated into the mass of property in the destination state.

However, the Supreme Court initiated a change of course in *Michelin Tire Co. v. Wages*, 427 U.S. 276 (1976), which upheld the assessment of a nondiscriminatory property tax on imported tires and tubes included in the importer's inventory at its wholesale distribution warehouse. In analyzing whether the tax was a prohibited impost or duty under the Import-Export Clause, the court looked beyond the question of whether the goods were imports to the original purpose of the clause:

> The Framers of the Constitution thus sought to alleviate three main concerns by committing sole power to lay imposts and duties on imports in the Federal Government, with no concurrent state power: the Federal Government must speak with one voice when regulating commercial relations with foreign governments, and tariffs, which might affect foreign relations, could not be implemented by the States consistently with that exclusive power; import revenues were to be the major source of revenue of the Federal Government and should not be diverted to the States; and harmony among the States

[3] *See also*, Det. No. 99-070, 22 WTD 144 (2003).

> might be disturbed unless seaboard States, with their crucial ports of entry, were prohibited from levying taxes on citizens of other States by taxing goods merely flowing through their ports to the other States not situated as favorably geographically.

427 U.S. at 285-86 (footnotes omitted). The Court found that the *ad valorem* tax at issue offended none of these policies. With regard to the first concern, the Court determined that the tax did not impinge on the federal government's exclusive regulation of foreign commerce. This is because the nondiscriminatory tax did not fall on imports because of their place of origin. The tax could not be used to create protective tariffs on domestic goods, and the tax could not be applied selectively to encourage or discourage importation in a manner inconsistent with federal law.

With regard to the second concern, the court found that the tax did not divert import revenues from the federal government. The tax was not a tax on "the commercial privilege of bringing goods into a county." Instead, the tax was the means by which the state pays for services such as police and fire protection from which the importer benefited.

Finally, the Court held that the tax did not interfere with the free flow of imported goods amongst the states. In comparison to exactions by states under the articles of confederation directed solely at imported goods, the Court noted that the exaction at issue there was merely to compensate the state for benefits conferred, noting, "there is no reason why local taxpayers should subsidize the services used by the importer." Finding the tax offended none of the policies behind the Import-Export Clause, the Court held that the tax was not a prohibited impost or duty.

In *Department of Rev. of Wash. v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734 (1978), the Supreme Court applied the *Michelin* policy analysis to Washington's B&O tax with respect to stevedoring income and found that the B&O tax threatened no Import-Export Clause policy. First, the tax did not prevent the federal government from speaking with one voice with regard to foreign policy. The tax applies only to business conducted within Washington. Further, the tax applies to virtually all business in the state, so it could not be used to create special protective tariffs. Second, the tax merely compensates the state for services extended to all businesses in the state. Finally, the court found that the tax did not interfere with the free flow of goods amongst the states. The court recognized that this third prong of the Import-Export Clause analysis is essentially the same inquiry as the commerce clause:

> The third Import-Export Clause policy, therefore, is vindicated if the tax falls upon a taxpayer with reasonable nexus to the State, is properly apportioned, does not discriminate, and relates reasonably to services provided by the State."

435 U.S. at 754-55. The Court sustained the tax, finding it was not a prohibited impost or duty.

In the present case, Taxpayer argues that, if it had manufactured its products overseas, the Import-Export Clause would prevent the B&O tax on the sales of goods to Washington customers. We disagree. Under the *Michelin* analysis, we find that imposing Washington's B&O tax on the sale of imported goods to Washington customers does not offend any of the Import-Export purposes.

First, the tax does not prevent the federal government from speaking with one voice. The tax applies to all wholesale and retail sales occurring in the state and does not create special protective tariffs. Furthermore, the tax does not divert revenues from the Federal government because it merely compensates the state for services extended to the business. It is not a tax on the commercial privilege of bringing goods into the country. Finally, the tax does not violate any of the Commerce Clause concerns. We note that the taxpayer does not dispute nexus to Washington. The Commerce Clause concerns are satisfied. *See, e.g.,* Det. No. 99-216E, 18 WTD 264 (1999). Therefore, the tax does not offend any of the Framers' concerns and is not a prohibited impost or duty. Accordingly, we conclude that, under *Michelin*, there is no constitutional restriction on taxing goods sold to Washington customers, irrespective of the origin of the goods.

Because the *Michelin* court qualified its holding with the finding that the goods at issue were "no longer in transit," Taxpayer argues that its analysis does not apply. Taxpayer asserts that the B&O tax in this case falls directly on goods "in transit."

We first note that the wholesaling B&O tax is not a tax on property. Instead it is a tax on the privilege of engaging in the business of selling at wholesale in Washington. *C.f., Stevedoring,* 435 U.S. at 746*; Itel Containers Int'l Co. v. Commissioner of Rev. of Tennessee,* 507 U.S. 60, 64 (1993); *The Bradford Exchange v. Illinois Department of Rev*., 155 Ill.App.3d 674, 681, 508 N.E.2d 316 (1987).

Second, we conclude that goods shipped from the FTZ for delivery into the State of Washington, the destination state, were not "in transit." Washington's wholesaling B&O tax is not imposed until the goods are delivered to the buyer here. A reading of *Michelin* allows a clear understanding of the meaning of "in transit." In explaining why the tax did not interfere with the free flow of goods amongst the states, the Court stated:

> An evil to be prevented by the Import-Export Clause was the levying of taxes which could only be imposed because of the peculiar geographical situation of certain States that enabled them to single out goods destined for other States. In effect the Clause was fashioned to prevent the imposition of exactions which were no more than transit fees on the privilege of moving through a State. A nondiscriminatory *ad valorem* property tax obviously stands on a different footing, and to the extent there is any conflict whatsoever with the purpose of the clause, <u>it may be secured merely by prohibiting the assessment of even nondiscriminatory property taxes on goods which are merely in transit through the State when the tax is assessed.</u>

427 U.S. at 289-90 (emphasis added). The *Michelin* court then suggested that if the goods were "merely in transit through the State," even a nondiscriminatory property tax might be prohibited.

But because the goods in *Michelin* had come to rest in the distribution warehouse, the court was not concerned with goods "in transit."

We [conclude] that the tax at issue here does not concern goods that are "in transit" under the Import-Export Clause. Based on the principles enunciated in *Michelin*, goods in the process of entering the state of their destination cannot be characterized as "in transit." *See, e.g., Bradford Exchange v. Illinois Dep't of Rev*., 155 Ill. App. 3d 697, 681, 508 N.E.2d 316 (1987). Further, in *Neuces County Appraisal Dist. v. Diamond Shamrock Refining & Marketing, Co.*, 853 S.W.2d 212, 216 (1995), the court stated:

> We conclude that once the purposes of the Import-Export Clauses of the United States Constitution have been satisfied . . . the concept of "in transit" loses any rational meaning.

Because the "in transit" limitation is to prohibit a state from assessing a tax as the property is merely passing through en route to another state, the state of Washington is not exploiting its location by taxing an item merely passing through. It is taxing a business transaction occurring in this state, where the goods are delivered to the customer. The B&O tax imposed in this case is on the business activity of selling to a buyer in Washington when delivery of the goods is made to the buyer here. The tax is not imposed until the sale is completed by delivery to the Washington buyer.

Taxpayer further contends that goods in an FTZ are by definition "in transit" under the federal FTZ Act. Taxpayer relies on *Xerox Co. v. County of Harris, Texas*, 459 U.S. 145 (1982). In *Xerox*, the Supreme Court analyzed the assessment of state *ad valorem* taxation of foreign goods held in a U.S. customs bonded warehouse for export. The Court found that federal law preempted states from imposing a state property tax on the goods because the goods were "in transit," and held that a state *ad valorem* tax was preempted where the foreign goods were held in a U.S. Customs bonded warehouse for eventual import.

In 1986, four years after *Xerox***,** the Court in *Reynolds***,** *supra*, found that the Import-Export Clause did not present a barrier to taxation, and we find its reasoning persuasive here:

> Reynolds contends that because goods stored in customs-bonded warehouses are by definition "in transit," this case does not fall within the scope of *Michelin's* holding. This reasoning, however, is unpersuasive. The imported tobacco here, we repeat, has nothing transitory about it: It has reached its State—indeed its county—of destination and only the payment of the customs duty, after the appropriate aging, separates it from entrance into the domestic market.

479 U.S. at 154-55. Further, in footnote 24, the *Reynolds* Court noted that *Xerox* did not reach the Import-Export Clause issue and was concerned only with the possible preemption of state taxes in the limited context of goods destined to reenter the export stream. Therefore, we conclude that *Xerox's* description of the goods as "in transit" is not relevant to our Import-Export

Clause analysis.

We conclude that, even if we were to find, contrary to *Reynolds*, that the goods in the [State A] FTZ were “in transit,” the goods were no longer “in transit” when they left the FTZ to enter their state of destination, Washington. Because the B&O tax is not a property tax on goods “in transit,” we conclude that the *Michelin* analysis applies. Accordingly, we find that the United States Constitution does not bar the Department from assessing wholesaling B&O tax with respect to sales of imported goods to Washington customers.

Taxpayer’s petition as to the Import-Export Clause is denied.

[3] **3. <u>Rule 193C.</u>** Washington’s B&O tax is a tax on the privilege of engaging in business in this state. RCW 82.04.220. The rate and the measure of the tax depend on the type of business activity being taxed. *Id*. With regard to wholesaling activities, the tax is calculated by multiplying a rate times the gross proceeds from sales in this state. RCW 82.04.270. Taxable sales take place in this state if the goods are delivered to the purchaser in this state and the seller has nexus. WAC 458-20-103, WAC 458-20-193.

No provision in either Title 82 RCW or Chapter 458-20 WAC specifically addresses the applicability of Washington’s excise taxes when a company with Washington nexus engages in business activities in an FTZ. Taxpayer argues that the Department’s own WAC 458-20-193C (Rule 193C) authorizes a deduction from the measure of the B&O tax for the sale of imported goods. Relying on this rule, Taxpayer reasons that goods manufactured within the FTZ from imported ingredients, and then sold and delivered directly to Washington buyers from that FTZ, should be exempt from B&O tax as imports under Rule 193C.

RCW 82.04.4286 provides a deduction from tax for amounts protected from state taxation by the United States and Washington Constitutions:

> In computing [B&O] tax there may be deducted from the measure of tax amounts derived from business, which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States.

(Bracketed material added.) Rule 193C, which implements the RCW 82.04.4286 deduction, specifically concerns the B&O taxation of import and export sales. As to the B&O taxation of the sales of imports, it provides:

> Foreign commerce means that commerce which involves the purchase, sale or exchange of property and its transportation from a state or territory of the United States to a foreign country, or from a foreign country to a state or territory of the United States.
>
> IMPORTS. An import is an article which comes from a foreign country (not from a state, territory or possession of the United States) for the first time into the taxing jurisdiction of a state.

> Taxation of such goods is impermissible while the goods are still in the process of importation, i.e., while they are still in import transportation. Further, such goods are not subject to taxation if the imports are merely flowing through this state on their way to a destination in some other state.
>
> * * *
>
> IMPORTS. Sales of imports by an importer or his agent are not taxable and a deduction will be allowed with respect to the sales of such goods, if at the time of sale such goods are still in the process of import transportation. Immunity from tax does not extend: (1) To the sale of imports to Washington customers by the importer thereof or by any person after completion of importation whether or not the goods are in the original unbroken package or container; nor (2) to the sale of imports subsequent to the time they have been placed in use in this state for the purpose for which they were imported; nor (3) to sales of products which, although imports, have been processed or handled within this state or its territorial waters.

At the time of the audit, both Taxpayer and Audit, relying on the above-quoted portions of Rule 193C, believed that sales of imports to Washington customers during the process of importation could not be taxed under Rule 193C. Audit, however, concluded that the process of importation had ended when Taxpayer's goods were processed in the FTZ, and the sales to Washington customers were properly B&O taxable. Taxpayer took the position that the process of importation continued when the product[s were] in the FTZ, and did not end until they reached their destination in the State of Washington.

Although Rule 193C was intended to deal with the constitutional limitations on Washington's taxation of imports and exports, it has not yet been amended to reflect current Import-Export Clause jurisprudence. In 1986, the Washington Supreme Court, in *Coast Pacific Trading, Inc. v. Department of Rev*., 105 Wn.2d 912, 917-18, 719 P.2d 541(1986), held that Rule 193C cannot provide tax immunity greater than what is required by the Import-Export Clause:

> The Department of Revenue cannot use Rule 193C to expand the tax immunity of exporters beyond the exemptions provided by statute or required by the constitution. . . . The Department cannot contradict a substantive legislative enactment by administrative regulation.
>
> > [T]he Department is without authority to amend the statute by regulation. It cannot properly carve out an exemption . . . when the statute makes no such exemption.
>
> *Budget Rent-A-Car of Washington-Oregon, Inc. v. Department of Rev*., 81 Wn2d 171, 176, 500 P.2d 764 (1972). This court has ruled repeatedly that when the Legislature enacted the business and occupation tax the Legislature intended "to tax all business

> activities not expressly excluded." *Rena-Ware Distribs., Inc. v. State*, 77 Wn.2d 514, 517, 463 P.2d 622 (1970). In the case of imports and exports, the Legislature has provided that a deduction is available only for tax amounts "which the state is prohibited from taxing under the Constitution . . . of the United States." RCW 82.04.4286. Arguably, the *Michelin* and *Stevedoring* decisions have reduced the scope of the constitutional prohibition of export and import taxes. We reject Coast Pacific's arguments that Rule 193C increases the deduction available to exporters.

(Footnotes omitted.) Taxpayer bases its argument that its Washington sales are not taxable on its interpretation of Rule 193C -- that sales of imports are deductible from B&O tax. Based on this interpretation, Taxpayer reasons that sales of imported goods from an FTZ must likewise be deductible. To the extent Audit or Taxpayer may understand Rule 193C to permit immunity from tax greater than required by the Import-Export Clause, or case law construing it, this is error. *Coast Pacific Trading* does not allow such an interpretation. Under *Michelin*, the Import-Export Clause does not constitutionally bar this state from imposing the B&O tax on sellers who deliver imported goods to Washington buyers. Such sellers may not rely on Rule 193C for a deduction.

We conclude that Taxpayer's argument -- that its sales of goods from an FTZ to its Washington customers were properly deductible from Washington's wholesaling B&O tax -- must fail, and the tax assessed must stand. This is because Taxpayer's suggested reading of Rule 193C would grant tax immunity greater than that required by the Import-Export Clause and, therefore, RCW 82.04.4286. Taxpayer, having conceded Washington nexus, was not entitled to an import deduction from its wholesaling B&O tax when it manufactured goods in an out-of-state FTZ using imported ingredients, and sold and shipped those finished goods directly from the FTZ to its Washington customers. Taxpayer's petition as to this issue is denied.

DECISION AND DISPOSITION:

Taxpayer's petition for correction of assessment and refund is denied.

DATED this 15th day of October 2004.