Cite as Det. No. 91-020E, 13 WTD 33 (1993)

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Prospective Ruling of	)	E X E C U T I V E D E T E R M I N A T I O N
	)	No. 91-020E[1]
. . .	)	Registration No. . . .
	)	Executive Level Reconsideration of Det. Nos. 91-020 and 91-020R

RULE 193C -- EXPORTS-- DEDUCTION -- COMMENCEMENT OF EXPORT. Process of exportation must have begun for export deduction to apply. When a Washington seller/manufacturer delivers a component part to another manufacturer for inclusion in a product which will be exported when finished, export deduction does not apply.

This headnote is provided as a convenience for the reader and is not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

FACTS:

Bauer, A.L.J. -- [A foreign company] manufactures and sells airplane galleys which are to be installed in aircraft which will leave the United States upon completion. [The company's] Washington affiliate takes delivery of the galleys' components and assembles them before ultimate delivery to [the Washington airplane manufacturer], which receives the galleys on behalf of [foreign buyers].

Det. No. 91-020 was issued on January 23, 1991, and Det. No. 91-020R was issued on December 31, 1991. These determinations, which set forth the facts in greater detail, denied the taxpayer's arguments that certain of its business activities would be exempt under WAC 458-20-193B and 458-20-193C. The taxpayer then requested executive level reconsideration of these determinations, stating that the Administrative Law Judge's decision

[1] The original determination, Det. No. 91-020, is published at 13 WTD 18 (1993). The reconsideration determination, Det. No. 91-020R, is published at 13 WTD 27.

> . . . assumes incorrectly that foreign airline carriers may use the finished aircraft for intrastate travel after taking delivery of the finished aircraft in the state of Washington. Foreign airline carriers may not land in another port in the United States after taking delivery of the aircraft in the state of Washington unless they have received special permission to do so. It is our understanding that [the foreign buyers] do not have such special permission when they take delivery of aircraft in the State of Washington.

ISSUES/TAXPAYER EXCEPTIONS:

The specific portion of the ruling to which the taxpayer objects in its petition dated [January 1992] reads as follows:

> Although it has been argued that the [foreign] manufacturer should be exempt under the export immunity portion of Rule 193C, we likewise disagree. Although the foreign buyers are contractually committed to take delivery of the finished aircraft with the expectation that they will remove the aircraft from Washington for use in interstate or foreign commerce, this is only an expectation at the time the galleys are delivered to [the manufacturer]. At this time the process of exportation will not have actually begun, and thus delivery has not been directly into the export stream.

[Det. No. 91-020R, p. 6]

The issue to be resolved, therefore, is whether the taxpayer is exempt from B&O tax under the Export Clause of the United States Constitution when it delivers airplane galleys to a Washington airplane manufacturer for installation in an airplane under construction for a foreign buyer, and the airplane will not be used by the buyer in the United States.

DISCUSSION:

After a careful and thorough review of the facts and issues in this case, we conclude that the Administrative Law Judge's handling of them in Determinations No. 91-020 and 91-020R was a correct and constitutional application of Washington's tax law.

The basis for her ruling on the Export Clause issue was WAC 458-20-193C (Rule 193C), which states:

> A deduction is allowed with respect to export sales when as a necessary incident to the contract of sale the seller agrees to, and does deliver the goods ... or (3) to the buyer at shipside or aboard the buyer's vessel or other vehicle of transportation under circumstances where it is clear that <u>the process of exportation of the goods has begun</u>, and such exportation will not necessarily be deemed to have begun if the goods are merely in storage awaiting shipment, even though there is reasonable certainty that the goods will be exported. The intention to export, as evidenced for example, by financial and contractual relationships does not indicate "certainty of

> export" if the goods have not commenced their journey abroad; there must be an actual entrance of the goods into the export stream.
>
> In all circumstances there must be (a) a certainty of export and (b) the process of export must have started.
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> It is of no importance that title and/or possession of the goods pass in this state so long as delivery is made directly into the export channel. To be tax exempt upon export sales, the seller must document the fact that he placed the goods into the export process. That may be shown by the seller obtaining and keeping in his files any one of the following documentary evidence: . . .
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> . . . Thus, where the seller actually delivers the goods into the export stream and retains such records as above set forth, the tax does not apply. It is not sufficient to show that the goods ultimately reached a foreign destination; but rather, the seller must show that he was required to, and did put the goods into the export process.

(Emphasis added.)

Although not explained at length in the Administrative Law Judge's determinations, the basis for the state of Washington's position in WAC 458-20-193C is firmly grounded in federal and state case law. The Washington Supreme Court's decision in Coast Pacific v. Department of Rev., 105 Wn.2d 912, 719 P.2d 541 (1986), which case involved the export of logs by a taxpayer to Japanese buyers, articulately sets forth the rationale of this position:

> . . . [I]n this case the taxable transaction -- the sale of the logs -- was completed before the logs were towed from storage to be loaded aboard ship for their final journey overseas. . . .
>
> We understand [the taxpayer] Coast Pacific's argument that these logs were reasonably certain to be exported and that their "final movement" overseas had begun before the logs reached the F.O.B. delivery point. However, courts repeatedly have rejected these grounds for tax immunity. The Sumitomo court specifically responded that "[c]ertainty of export evidenced by financial and contractual relationships does not by itself render goods 'exports' before the commencement of their journey abroad." 504 F.2d at 608. The [United States Supreme Court] in Coe v. Errol, supra, . . . explained the matter well:
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> > The point of time when State jurisdiction over the commodities of commerce begins and ends is not an easy matter to designate or define, and yet it is highly important . . .
> >
> > . . . It seems to us untenable to hold that a crop or a herd is exempt from taxation merely because it is, by its owner, intended for exportation. If such were the rule in many States there would be

> nothing but the lands and real estate to bear the taxes. . . . Certainly, as long as . . . products are on the lands which produce them, they are part of the general property of the State. And so we think they continue to be until they have entered upon their final journey for leaving the State and going into another State.

Coe, 116 U.S. at 526.

In effect, Coast Pacific asks for blanket tax immunity for any business that buys or manufactures goods for shipment overseas. The import-export clause does not require such a broad immunity. The framers of the import-export clause intended to allow the states to impose sufficient taxes to defray the expenses of providing local services to the importers and exporters of goods. Abramson, State Taxation of Exports: The Stream of Constitutionality, 54 N.C. L. Rev. 59, 61-62 (1975). In 1949, Justice Frankfurther wrote in Joy Oil Co. v. State Tax Comm'n, 337 U.S. 286, 93 L. Ed. 1366, 69 S. Ct. 1075 (1949) that "[t]he Export-Import Clause was meant to confer immunity from local taxation upon property being exported, not to relieve property eventually to be exported from its share of the cost of local services." 337 U.S. at 288. Justice Hale of this court agreed:

> The billions of dollars worth of goods piled on the docks of the nation's ports, or within nearby warehouses and storage depots, can hardly be said to be exports at that state of the journey, even though documented for overseas shipment and ultimate delivery. They and the business activities connected with them are at that point still drawing all of the beneficial and protective services of the state and municipality in which they are kept, including those provided by police, firemen, inspectors and all of their equipment and paraphernalia. They have the use of the public streets, highways, utilities and port. . . . The goods and the transactions affecting them should, therefore, bear their fair share of the taxes imposed upon them or the businesses connected with them to support the state and local services precisely as do all other goods and businesses so taxed within the state.

Carrington Co. v. Department of Rev., 84 Wn.2d at 466-67 (Hale, C.J., dissenting).

Coast Pacific, supra, at 919-921.

In the case here at issue, the taxpayer ships unassembled galleys into the state of Washington for assembly by its Washington affiliate. The galleys are then delivered to the [airplane manufacturer] for installation into aircraft which, once their manufacture is completed, are to be delivered to European air carriers for use outside the United States. Under these circumstances, and even assuming that the foreign air carriers do take delivery as scheduled, it is clear that the process of exportation has not actually begun when the taxpayer delivers the galleys to its Washington affiliate

for assembly, or even when they are then delivered to the [airplane manufacturer] for installation. The taxpayer is therefore not entitled to deduct these sales from its business and occupation tax measure.

Accordingly, we conclude that the rulings of the Administrative Law Judge in the above-cited determinations were lawful and correct.

RULING:

The rulings contained in Det. Nos. 91-020 and 91-020R are sustained.

This letter constitutes the final action by the Department of Revenue. However, remedies are not at this point exhausted. If the taxpayer remains convinced that the Department is incorrect in its opinion about its liability, it may pay the tax and petition for a refund in Thurston County Superior Court in accordance with RCW 82.32.180. The Thurston County Superior Court is the only court in the state that has original jurisdiction to hear excise tax matters and where venue is proper.

In the alternative, the taxpayer may wish to file a petition with the Board of Tax Appeals [PO Box 40915, Olympia 98504-0915] pursuant to RCW 82.03.190. If this alternative is chosen, the petition must be filed with the Board within thirty days of this denial. Filing a petition with the Board does not stop the Department's Compliance division from pursuing collection of any outstanding assessment. In order to stay collection, a taxpayer must either enter into a payment agreement or post a bond as provided by RCW 82.32.200.

DATED this 29th day of January 1993.