BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund	)	D E T E R M I N A T I O N
	)	
	)	No. 98-056
. . .	)	Registration No. . . .
	)	
	)	

[1] RULE 178; RCW 82.12.010, 020: -- CONSTRUCTIVE DELIVERY; USE TAX. Use tax is due if there is constructive delivery. Constructive delivery is deemed to have occurred when a product is held by the seller on behalf of the buyer, pending a buyer's instructions for future delivery of the product. But, if the buyer notifies a seller that it will no longer require production and delivery of a product and the seller does not deliver the product but continues to invoice the buyer and the buyer continues to pay the seller as if the product were produced and delivered, the payments are not subject to use tax because there is no use.

[2] RULE 103; RCW 82.04.040; 82.04.050: -- Retail sales tax is due upon the sale of tangible personal property. If a buyer does not pay retail sales tax at the time of purchase, the Department will assess "deferred retail sales tax." If, however, a buyer cancels a contract for the production and delivery of tangible personal property but the seller continues to invoice the buyer for the delivery of the goods and the buyer chooses to continue to pay the invoices rather than pay the liquidated damages for breach of the contract, the payments are not subject to deferred retail sales tax. This is because there has been no sale of tangible personal property. The payments are compensatory in nature and the seller is required to pay B&O tax upon such receipts.

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.

NATURE OF ACTION:

Taxpayer petitions for refund of use tax.[1]

FACTS:

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

Danyo, A.L.J. -- Taxpayer manufactures glass. In 1986, Taxpayer contracted with a Washington company (seller) to supply all the oxygen and nitrogen it needed to make glass at one of its plants located in this state. At its own expense, the seller built an oxygen and nitrogen generating facility on a site near Taxpayer's plant. The seller agreed to "fabricate, and operate" the generating facility to produce and deliver all Taxpayer's "requirements of Oxygen and Nitrogen gas at [its] Plant within the limits of the Facility Capability." The gases were to be delivered monthly by pipeline from the facility to Taxpayer's plant.

The seller contracted to furnish all Taxpayer's needs for oxygen and nitrogen for 180 months, which was broken down into "supply periods" of five-year intervals. The first supply period was 1986 through 1991, beginning sometime in July or August 1986. The Taxpayer agreed to pay a "monthly fee of . . . for any quantity of Oxygen and Nitrogen gas delivered" during the supply period. Taxpayer agreed to pay the monthly charge "irrespective of the amount of Oxygen and Nitrogen gas [Taxpayer] actually took during the particular month to which such charge pertained." The contract provided that there would be no reduction in the monthly charge during the first supply period if Taxpayer "curtailed or suspended" its requirement for either oxygen or nitrogen.

Section 18.4 of the contract addressed the Taxpayer's ability to cancel its contract with the seller, if it no longer required oxygen and nitrogen, after the first five-year supply period. It reads:

> If, due to technological changes, Buyer [Taxpayer] no longer requires Oxygen and Nitrogen at Buyer's Plant and gives Seller twelve (12) months' prior written notice thereof, Buyer may terminate this Agreement; provided, however, that Buyer pays to seller a termination charge equal to one-hundred twenty-five percent (125%) of the net book value of the Facility as of the effective date of termination, net of Facility salvage value.

According to Taxpayer, it stopped making glass at its plant in 1990, but continued to pay the monthly charge to the seller rather than pay the 125% termination charge. Taxpayer also continued to report use tax on the monthly amount paid to the seller. Taxpayer requested a refund of this tax.

Taxpayer's books and records were examined by the Department of Revenue for the audit period, January 1, 1989 through December 31, 1993. The audit report confirmed that Taxpayer's plant was not operational after 1990 and that Taxpayer did not use any oxygen and nitrogen from the facility after that period. However, when taxpayer requested a refund of the use tax it reported and paid on its monthly excise tax returns for the period January 1, 1991 through December 31, 1993, the Department denied its request based on its conclusion that a sale occurred when the seller received payment for the oxygen and nitrogen. The Audit Division relied on Det. No. 91-174, 11 WTD 353 (1991), to find that a retail sale had occurred in this state. The Audit Division explained:

> While technically use tax is not due, [Taxpayer] still owes the deferred sales tax on the retail sales of nitrogen and hydrogen (sic). . . .

> For the purpose of determining tax liability, a sale takes place in this state when the goods sold are delivered to the buyer in this state. In this case, [Taxpayer] has requested the seller retain the goods pending [Taxpayer's] future disposition of the plant. [Taxpayer] was invoiced for the goods and made payment.
>
> Where the seller sells and invoices for the goods sold, and then stores the goods for lengthy period of time pending disposition by the buyer, there has been constructive delivery to the buyer with the seller deemed as agent of the buyer to provide storage. . . .
>
> Since a retail sale took place, deferred sales tax is due even though [Taxpayer] gave a valid resale certificate. The items in questions were not for resale.

According to the Audit Division, the seller continued to invoice Taxpayer as if it delivered the gases, and Taxpayer paid for the products.

Taxpayer appealed. According to Taxpayer's petition:

> The refund is for use tax paid on the legal obligation clause of a take or pay contract with [the seller] during the period when Taxpayer closed the plant and it remained closed. . . . Therefore, no tax should have been paid because there was neither a transfer of tangible personal property or a taxable service provided.

Taxpayer asserts that it had no requirements for any oxygen and nitrogen the seller may have produced at the plant after it informed the seller that the plant was closing. Taxpayer stated during the hearing that the seller had the option to discontinue operation of the facility completely or to continue to produce the oxygen and nitrogen and sell to others. Taxpayer believes that the seller sold to others any oxygen and nitrogen it produced at the facility after 1990.

Taxpayer contends that its monthly payments to the seller were nothing more than the equivalent of its termination penalty under the contract. The Audit Division acknowledged that when Taxpayer "closed the glass plant in Washington, [Taxpayer] continued to make payment to their supplier as required under the contract."

ISSUE:

Did Taxpayer's payments to the seller constitute a sale of products subject to deferred retail sales tax?

DISCUSSION:

Revised Code of Washington (RCW) 82.04.040 defines a "sale" as

> any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a "sale at retail" or "retail sale" under

> RCW 82.04.050. It includes renting or leasing, conditional sale contracts, leases with option to purchase, and any contract under which possession of the property is given to the purchaser but title is retained by the vendor as security for the payment of the purchase price. . . .

RCW 82.04.050 defines a sale at retail as:

> every sale of tangible personal property (including articles produced, fabricated, or imprinted) to all persons irrespective of the nature of their business . . . other than a sale to a person who presents a resale certificate under RCW 82.04.470 and who:
>
> (a) Purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person; or . . .

The administrative rule that provides guidance on the taxability of sales made in this state, WAC 458-20-103 (Rule 103) explains that

> For the purpose of determining tax liability of persons selling tangible personal property, a sale takes place in this state when the goods sold are delivered to the buyer in this state, irrespective of whether title to the goods passes to the buyer at a point within or without this state.

[1] Taxpayer did not use or receive any oxygen and nitrogen produced by the seller after 1990. There seems to be no dispute on this fact. The Audit Division confirmed that Taxpayer did not operate its plant after 1990. Use tax is imposed for "the privilege of using within this state as a consumer any article of tangible personal property" acquired by certain means. RCW 82.12.020. RCW 82.12.010 provides that "use" shall have its " ordinary meaning" and shall mean "the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer)." "Use" also includes any "act preparatory to subsequent actual use or consumption within this state." Id.; see also WAC 458-20-178 (Rule 178). Thus, taxpayer is correct in stating that because it never possessed the oxygen and nitrogen it is not subject to use tax.

Alternatively, the Audit Division found that Taxpayer was not entitled to a refund of the use tax, but owed "deferred sales tax" on the monthly payments it made to the seller. We disagree.

The Audit Division relied on 11 WTD 353, supra., to find a retail sale in accordance with Rule 103. In that determination, we said:

> where a taxpayer/seller provides storage of the goods sold at is own Washington facility at the request of the buyer pending the buyer's future disposition of the goods, the taxpayer in accepting the responsibility for the storage is acting as an agent for the buyer and constructive delivery thus takes place in this state. [citation omitted].

[2] Rule 103 requires both a transfer of title and delivery of tangible personal property. In this case, the sole basis for finding a retail sale was Taxpayer's monthly payments to the seller. The Audit Division construed these as Taxpayer's payments for products that the seller was holding for Taxpayer as its agent. But, the Audit Division had no basis for determining that the seller was holding any product for future delivery to Taxpayer. To the contrary, the facts show that Taxpayer stopped operating its plant. By the terms of the contract, the seller produced oxygen and nitrogen to fill all Taxpayer's requirements for oxygen and nitrogen on a monthly basis. Taxpayer had no requirements. Taxpayer notified the seller that it would not require any nitrogen or oxygen in the immediate future. Taxpayer's plant did not take delivery of the oxygen and nitrogen after 1990.

But, Taxpayer continued to pay seller as if it did rather than pay the lump sum of 125% of the facility's market value, as stated in the default clause of the contract. In 11 WTD 353, supra., we found constructive delivery because the buyer asked the seller to hold and store the goods until it decided what the buyer would do with the goods and the seller accepted responsibility for the goods. There is no evidence Taxpayer asked the seller to store any products produced after it notified the seller that it had no future requirements for the gases. There is no evidence the seller "accepted responsibility for storing" oxygen and nitrogen as Taxpayer's agent after the plant stopped taking delivery of the gases. There is no evidence that the product was delivered to Taxpayer at any other location.

In conclusion, we find the facts simply do not support the Department's conclusion that there was "constructive delivery" of the gases to Taxpayer. Therefore, we find that Taxpayer's monthly payments to seller were not for products "constructively delivered," but were compensatory damages to the seller for Taxpayer's default on its contract. While these monthly payments constituted income to the seller, they do not constitute retail sales on which Taxpayer became liable for retail sales tax.

Generally, there must be transfer of ownership, title, or possession to constitute a sale for sales tax purposes. See, RCW 82.04.040, 82.08.020. Because there was no transfer of ownership, title, or possession of the oxygen and nitrogen to Taxpayer, the monthly payments Taxpayer made to seller were not subject to deferred sales tax.

DECISION AND DISPOSITION:

Taxpayer's petition for refund is granted.

DATED this 31st day of March 1998