Cite as 2 WTD 11 (1986)

BEFORE THE INTERPRETATION AND APPEALS SECTION
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. 86-295
. . .	)	Registration No. . . .
	)	Tax Assessment Nos. . . .

[1] **RULE 193B and RCW 82.04.4286:** DISSOCIATION - ORIGIN OF GOODS - DESTINATION OF GOODS. Sales may be dissociated only where goods are shipped directly from a point outside this state. When goods are shipped first to the out-of-state seller's instate facilities prior to ultimate delivery to the buyer in this state, delivery of the goods is made from a local stock of goods of the seller in this state. Furthermore, it cannot be said that there has been no participation whatever in this state by the seller's local place of business.

[2] **RULE 193B, RCW 82.04.4286 and ETB 506:** NEXUS - DISSOCIATION - MULTIPLE SALES. When out-of-state seller makes multiple sales to a buyer in this state and business and occupation (B & O) tax is assessed on the first sale because there is sufficient nexus the Department will presume that subsequent sales to the same buyer are sufficiently related to the first sale and tax them as well; however, the presumption is rebutted upon showing that subsequent sales are totally unrelated (i.e. dissociated) from the initial sale.

[3] **RULE 103 and RCW 82.04.4286:** DELIVERY - TIME OF SALE - PLACE OF SALE - TITLE - RISK OF LOSS. Physical or constructive delivery of goods determines the time and place of sale and not such matters as where title to the goods or risk of loss passes.

[4] **RULE 179 and RCW 82.04.010(10):** WATER DISTRIBUTION BUSINESS - INCIDENTAL SALES - REGULATED UTILITIES. Taxpayer primarily engaged in business as a manufacturer but making incidental sales of water from a well which it owns and operates is taxable under public utility tax as a Water Distribution Business, even though it sells only a relatively small amount

of water to a single buyer and is not a "public utility" in the sense that it is subject to state regulatory authority.

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.

TAXPAYER REPRESENTED BY: . . .
. . .

DATE OF HEARING: May 22, 1986

NATURE OF ACTION:

An examination of the taxpayer's account resulted in issuance of the above - captioned tax assessments in which additional tax and interest are asserted. The taxpayer protests the following items:

I. The assessment of Wholesaling B & O tax on certain sales of goods originating in other states to persons in Washington, which sales, according to the taxpayer, are dissociated from the taxpayer's local business and interstate in nature.

II. The assessment of Manufacturing B & O tax on a quantity of aluminum ingot, which, according to the taxpayer, was not manufactured and sold, but merely invoiced to and the following day repurchased from an out-of-state buyer.

III. The assessment of Water Distribution Business public utility tax on charges made for water supplied by the taxpayer to its wholly-owned subsidiary.

FACTS AND ISSUES:

Rosenbloom, A.L.J. --

I. The taxpayer, a leading producer of aluminum products, has manufacturing facilities and sales offices both within and without this state, but is incorporated and headquartered out of state. During the audit, the taxpayer took the position that certain sales of goods originating in other states to persons in Washington are dissociated from the taxpayer's local business and interstate in nature. The auditor initially asserted Wholesaling B & O tax on all such sales. On the basis of additional information provided by the taxpayer, the auditor allowed some sales to be dissociated, disallowing others. In almost all instances, the Audit Section and taxpayer were able to reach concurrence as to which sales are dissociable and which are not.

The transactions which remain in dispute are sales of goods originating in other states to . . . a buyer headquartered out of

state with facilities in Washington. This buyer also purchases goods produced at one of the taxpayer's Washington manufacturing facilities. The auditor apparently concluded that all sales to this buyer, including sales of goods originating in other states, were tainted by the business relationship which existed between the taxpayer's in-state manufacturing facility and the buyer.

The taxpayer counters that there is absolutely no relationship between the local sales to this buyer and the sales of goods originating in other states. This particular buyer is not a buyer in the normal sense because it is a competitor of the taxpayer. For this reason, the taxpayer's sales personnel do not call on this buyer. The sales of goods originating in other states were actually exchange agreements negotiated by upper level corporate executives of the taxpayer and the buyer, all of whom were located out of state. The buyer agreed to ship boxite to the taxpayer's facility in Texas in exchange for alumina needed in the buyer's manufacturing operation in Washington. The alumina, which originated in Australia, was first shipped to the taxpayer's . . . Washington manufacturing facility, and from there to the buyer's Washington plant. Later shipments were sent directly to the buyer.

These sales were not solicited or facilitated by the taxpayer's Washington- based sales personnel, and they had no contact with this buyer with respect to these shipments. Further, no contact was made between the taxpayer's out- of-state sales office and the buyer's Washington facilities. The problem, at least as far as the auditor was concerned, is that the taxpayer also sells goods produced at its . . . Washington manufacturing facility to the buyer. The taxpayer's . . . Washington plant produces ramming paste for its own use and for sale. Some of this ramming paste is sold to the buyer and shipped to its Washington facility. The taxpayer does not actively solicit orders for these sales and is not certain exactly when or how the practice began. The taxpayer's representative stated that the taxpayer has been selling ramming paste to this buyer for thirty years. Sales of ramming paste account for only four to five percent of the taxpayer's total sales to this buyer.

II. On January 1, 1983 the taxpayer entered a sales order for the sale of a quantity of aluminum ingot at a stated price per pound to an out-of-state buyer. The sales order included recitations that the total quantity would be invoiced to the buyer on March 31, 1983, and that title and risk of loss would pass to the buyer upon invoicing.

By a purchase order dated March 21, 1983, the taxpayer repurchased the same quantity of aluminum ingot at the same price. The purchase order included the instruction "Do not ship - material already received. This purchase order is for invoicing purposes only."

On March 31, 1983, the taxpayer invoiced the buyer for the goods. The invoice indicated that the goods were to be shipped "FOB Destination prepaid From . . ., WA." The following day, on April 1, 1983, the buyer issued its invoice to the taxpayer in the same amount.

No goods were actually shipped as a result of the foregoing. Instead, the parties replaced the original sales agreement with a new agreement under which the taxpayer was to sell the same quantity of aluminum ingots at the same price in five equal installments. Shipments pursuant to this replacement agreement began in October 1983 and continued through May 1984. The goods were shipped from various locations, both within and without the state, and the taxpayer asserts that Manufacturing B & O tax was paid on those goods which were shipped from its Washington manufacturing facilities.

III. Public utility tax was imposed on the sale of water by the taxpayer's . . . Washington manufacturing facility to its wholly-owned subsidiary. The subsidiary occupies a building at [that] site and obtains its water from a well owned and operated by the taxpayer.

TAXPAYER'S EXCEPTIONS:

I. The taxpayer protests the assessment of Wholesaling B & O tax on sales of goods originating in other states to [buyer's] Washington facilities. The taxpayer asserts that these sales are dissociated from its local business and interstate in nature, and thus exempt from Washington tax by reason of RCW 82.04.4286 and the Commerce Clause of the Constitution of the United States.

II. The taxpayer protests the assessment of Manufacturing B & O tax on the value of aluminum ingot invoiced to an out-of-state buyer. The taxpayer asserts that the tax only applies upon the manufacturing of goods within this state and not upon the mere invoicing of goods.

III. The taxpayer protests the assessment of Water Distribution Business public utility tax on sales of water to its wholly-owned subsidiary. The taxpayer asserts that it is not in the business of operating a plant for the distribution of water; rather it is in the business of manufacturing aluminum. Furthermore, the taxpayer sells a relatively small amount of water and only to its subsidiary; it sells water to no other entity. Therefore, the taxpayer argues it is not a public utility and should not be taxed as such.

DISCUSSION:

I. Specific federal legislation establishes limits on the states' ability to impose a net income tax on interstate businesses. There

is no comparable legislation pertaining to gross proceeds taxes such as Washington's. Instead, we are guided by the provisions of the Constitution of the United States and the case law that has arisen thereunder. It is widely recognized that both the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article 1, § 8 require that there be some minimum connection or "nexus" between the interstate activities and the taxing state. Chicago Bridge and Iron Company v. Department of Revenue, 98 W.2d 814 (1983).

There is no dispute that the taxpayer has established nexus in Washington by virtue of its extensive manufacturing and sales activities in this state. Even where threshold nexus exists, however, a taxpayer is entitled to a deduction for purely interstate transactions. But the burden of proving entitlement to the deduction falls upon the taxpayer. The following portion of Norton Co. v. Illinois, 419 U.S. 570 (1975), states the rule succinctly,

> But when, as here, the corporation has gone into the State to do local business by state permission and has submitted itself to the taxing power of the State, it can avoid taxation on some Illinois sales only by showing that particular transactions are dissociated from the local business and interstate in nature. The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption.

And it is a heavy burden indeed. In the Norton case, certain sales were found to be dissociated because, "(p)etitioner has not established that such services as were rendered by the Chicago office were not decisive factors in establishing and holding this market." It is never easy to prove a negative, but that is nevertheless the standard imposed by the Norton case. The court did observe, however, that "(o)n this record, no other source of the buyer relationship is shown." This clearly implies that such a showing might help to establish that local activities were not decisive factors in establishing and holding the market.

The Department interprets the Norton case as requiring the taxpayer to show an exclusively independent source of the buyer relationship, or otherwise establish that its local activity is not a decisive factor in establishing or maintaining its market for the sales in question. Dissociation will not be allowed where there is or there has been any degree of local participation in the transaction. Thus, WAC 458-20-193B provides in part:

BUSINESS AND OCCUPATION TAX

> RETAILING, WHOLESALING. Sales to persons in this state are taxable when the property is shipped from points

> outside this state to the buyer in this state and the seller carries on or has carried on in this state any local activity which is significantly associated with the seller's ability to establish or maintain a market in this state for the sales. If a person carries on significant activity in this state and conducts no other business in this state except the business of making sales, this person has the distinct burden of establishing that the instate activities are not significantly associated in any way with the sales into this state. The characterization or nature of the activity performed in this state is immaterial so long as it is significantly associated in any way with the seller's ability to establish or maintain a market for its products in this state. The essential question is whether the instate services enable the seller to make the sales.
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> . . .
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> Under the foregoing principles, sales transactions in which the property is shipped directly from a point outside the state to the purchaser in this state are exempt only if there is and there has been no participation whatsoever in this state by the seller's branch office, local outlet, or other local place of business, or by an agent or other representative of the seller. . . . (Emphasis supplied.)

[1] Sales in which the goods were first shipped to the taxpayer's . . . Washington manufacturing facility are not dissociated. The goods must be "shipped directly from a point outside the state." WAC 458-20-193B. Where, as here, goods are shipped first to the taxpayer's instate manufacturing facility prior to ultimate delivery to the buyer in this state, "delivery of the goods is made . . . from a local stock of goods of the seller in this state." Id. Furthermore, it cannot be said that "there has been no participation whatever in this state by the seller's . . . local place of business." Id. We conclude that sales of alumina to a buyer in this state are not dissociated where the goods are first shipped to the taxpayer's in-state manufacturing facility for further shipment to the buyer.

At some point, the taxpayer asserts that it began shipping the alumina directly to the buyer from a point outside this state. As to these transactions, it is appropriate to inquire whether they are dissociated from the taxpayer's local business and interstate in nature.

[2] The question then is whether all sales to this buyer were tainted by sales of ramming paste produced at one of the taxpayer's Washington manufacturing facilities. When an out-of-state seller

makes multiple sales to buyers in this state and B & O tax is assessed on the first sale because there is sufficient nexus, the Department will presume that a subsequent sale to the same buyer is sufficiently related to the first sale and tax it as well. It is possible, however, to rebut this presumption. ETB 506.04.193B.

That ETB describes a determination in which a taxpayer who sold books at retail in Washington was allowed to dissociate subsequent sales of book supplements to the same buyers. The Department determined that "the taxpayer rebutted the factual presumption (that subsequent sales are subject to tax) by showing that the subsequent sales were totally unrelated to the initial sales by establishing the absence of a sales commission or consumer contact with the salesman. ETB 506.04.193B (parenthetical inclusion ours).

This taxpayer has likewise demonstrated that sales of alumina are unrelated to the sales of ramming paste. The taxpayer testified that its Washington sales personnel have no contact with the buyer with respect to sales of alumina, and there is no evidence to the contrary on record. Furthermore, sales of books and sales of updating supplements are, if anything, more closely related by the very nature of the goods than are sales of ramming paste and sales of alumina. Thus, making sales of an unrelated product such as ramming paste cannot be construed as a decisive factor in establishing or maintaining a market for sales of alumina pursuant to exchange agreements negotiated by upper-level corporate executives of the taxpayer and the buyer, all of whom are located out of state.

We conclude that sales of alumina shipped directly to the buyer from a point outside this state, involving no local activity, are dissociated from the taxpayer's local business and interstate in nature. The Audit Section will delete the proceeds of any such sales that may have occurred during the audit period from the measure of the tax.

II. The Manufacturing B & O tax is measured by the value of the products. RCW 82.04.240. The value of products manufactured is determined by the gross proceeds derived from the sale thereof. RCW 82.04.450. The auditor examined the documents relating to the sale/repurchase of aluminum ingot and concluded that a sale took place when the buyer was invoiced. We disagree.

WAC 458-20-103 provides in part:

> 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.

[3] The rule is not strictly applicable since it addresses sales of goods originating in other states to persons in this state, and not vice versa. However, the rule can be read for the broader proposition that physical or constructive delivery of goods determines the time and place of sale and not such matters as where title to the goods or risk of loss passes, i.e. that the substance of a transaction prevails over its form.

Turning to the facts of this case, the parties' sales agreement provided that title and risk of loss would pass to the buyer upon invoicing. However, the goods were never physically or constructively delivered to the buyer pursuant to this invoice, but were repurchased the following day. In substance no sale occurred.

Even if there had been a sale, selling goods is not the taxable incidence of the Manufacturing B & O tax. While the tax may be measured by the selling price, it is the manufacturing of goods in this state upon which the tax is imposed.

The taxpayer's petition for correction is granted as to this issue.

III. A single taxpayer engaging in multiple business activities may be subject to both the B & O tax imposed by chapter 82.04 RCW and the public utility tax imposed by chapter 82.16 RCW. This is clearly implicit in RCW 82.16.060 which provides:

> Nothing herein shall be construed to exempt persons taxable under the provisions of this chapter from tax under any other chapter of this title with respect to activities other than those specifically within the provisions of this chapter.

Thus, while the taxpayer may be primarily engaged in manufacturing and subject to the B & O tax, it is also subject to public utility tax if it engages in any business activity within the purview of chapter 82.16 RCW. Of course, amounts derived from such activities would not also be subject to B & O tax. RCW 82.04.310 provides a B & O tax exemption for "business activity with respect to which tax liability is specifically imposed under the provisions of 82.16 RCW."

RCW 82.16.020 imposes a public utility tax on every person engaging within this state in various businesses including the water distribution business. RCW 82.16.010(4) provides this definition:

> "Water distribution business" means the business of operating a plant or system for the distribution of water for hire or sale.

[4] The taxpayer owns and operates a well from which water is drawn for distribution and use throughout its . . . Washington

manufacturing facility. A portion of that water is sold to the taxpayer's wholly-owned subsidiary. Thus, the taxpayer falls squarely within the statutory definition. The taxpayer is therefore subject to the Water Distribution Business public utility tax, even though it is primarily engaged in business as a manufacturer. It does not matter that the taxpayer sells only a relatively small amount of water to a single buyer. Nor is it relevant whether the taxpayer is a "public utility" in the sense that it is subject to state regulatory authority. The definition is not limited to regulated utilities making sales of water to the public at large.

The taxpayer's petition for correction is denied as to this issue.

DECISION AND DISPOSITION:

The taxpayer's petition for correction is granted in part and denied in part. The Audit Section will issue amended assessments advising the taxpayer of any balance due or credit.

DATED this 21st day of November 1986.