BEFORE THE INTERPRETATION AND APPEALS DIVISION
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. 89-349
)
. . .) Registration No. . . .
) . . . /Audit No. . . .
)

[1] RULE 203: CORPORATIONS -- DOING BUSINESS AS TWO SEPARATE CORPORATIONS -- REQUIREMENTS -- SEPARATE BOOKS AND RECORDS. Because the taxpayer maintained one set of books and records, filed one federal income tax return, had one federal identification number, and supplied no evidence to substantiate its assertion that it was operating as two separate corporations, the taxpayer was found to be one corporation.

[2]RULE 193B: B&O & RETAIL SALES TAX -- SALES MADE TO WASHINGTON RESIDENTS -- AFFIDAVIT OF OUT-OF-STATE DELIVERY. Where the taxpayer's sales office was located in Oregon, and all deliveries were made from that location, taxpayer's affidavits of out-of-state delivery were accepted, as sufficient documentation for the interstate nature of its sales for this audit period only.

[3] RULE 102: RETAIL SALES TAX -- RESALE CERTIFICATE -- FAILURE TO OBTAIN -- BURDEN OF PROOF. Where a seller fails to secure a resale certificate at the time of sale, it has the burden of proving that the property was purchased for resale and that the purchaser was eligible to give a bona fide resale certificate. Where the purchaser gives an invalid registration number, or was not registered at the time of the sale, the seller has not sustained that burden.

[4] RULE 134 and RULE 178: USE TAX -- MANUFACTURING FOR OWN USE -- BONA FIDE SALE -- RETAIL SELLING PRICE -- ARMS LENGTH TRANSACTION -- VALUATION. Where the taxpayer manufactures molds for industrial use, a bona fide sale of the molds has not been made to the user of the item manufactured. Therefore use tax is computed at the retail selling price of similar products of like quality and character provided that such sales price results from an arms length transaction which is separately and independently negotiated. Where it is not possible to obtain the selling price of similar products of like quality and character, cost may be used.

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 TELEPHONE CONFERENCE: April 6, 1989

NATURE OF ACTION:

The taxpayer protests the imposition of additional taxes assessed in an audit report.

FACTS & ISSUES:

Okimoto, A.L.J. -- . . . (taxpayer) books and records were examined by a Department of Revenue (Department) auditor for the period January 1, 1984 through December 31, 1987. An audit resulted in additional taxes and interest owing in the amount of $ . . . and Document No. . . . was issued in that amount on November 29, 1988. The taxpayer has protested the above assessment and it remains due.

The taxpayer is a Washington corporation which operates a manufacturing plant in . . . , Washington which manufactures wax castings solely for its sales and production location in . . . , Oregon.

The normal scenario of events whereby the taxpayer manufactures bronze castings is as follows:

The Oregon location negotiates the sales price and signs the contract with the customer at its Oregon location. The Oregon location then accepts the artwork from its customer which is

sent to the Washington manufacturing plant. Sometimes, the taxpayer must make an enlargement of the statue to enable it to construct the mold. Once the enlargement is completed, the next step is to manufacture a detailed mold the actual size of the statue. After the mold is created, wax is poured into the mold to manufacture the required number of wax castings. After the wax castings are made, they are transferred to the Oregon location while the mold and enlargements remain at the . . . plant. Once the wax castings are received in Oregon, workers pour molten bronze over the wax castings and when the bronze cools, the wax is melted, creating a hollow bronze statue. At this time, the taxpayer separately bills the artist/customer for the bronze statues (including the cost of the wax castings), the molds and the enlargements. Sometimes the customer takes delivery of the statues at the Oregon location, and sometimes the taxpayer ships the statues by common carrier to the customer at its place of business or some other specified location.

Taxpayer's Exceptions

Schedule III: Unreported Retail Sales Tax

The taxpayer argues that the two locations are separate corporations of the same name, . . . The Oregon corporation does the billing and invoicing and merely subcontracts the production work to the Washington corporation.

The taxpayer stated at the telephone conference that each corporation has its own set of articles of incorporation, bylaws and officers, but also admits that there is only one federal identification number, only one consolidated federal income tax return, and only one set of corporate books and records. . . . is separately registered with both the States of Oregon and Washington for the purposes of unemployment and industrial insurance.

Basing its analysis on this corporate structure, the taxpayer argues that the sales of the bronze statues are made entirely by the Oregon location. Since the Washington plant is a separate corporation, then the Oregon location has no nexus with Washington, and therefore is not required to collect sales tax on sales made to Washington residents.

In the event that the Department finds that there is only one entity, the taxpayer objects to the auditor's assumption that if the purchaser had a Washington address, then the sale was

delivered to the purchaser at that address. The taxpayer states in its petition:

> A majority of the items sold to Washington addressed purchasers were picked up by purchasers (the artists) at the . . . , Oregon workplace. In fact, the artists frequently participate in the finishing touches. In other cases, items were sent from the Oregon workplace to the final consumer located in a state other than Washington. Pursuant to WAC 458-20-103, "a sale takes place in this state when goods sold are delivered to the buyer in this state." Therefore, sales picked up or delivered outside of Washington are not subject to Washington's retail sales tax.

In support of this position the taxpayer has presented affidavits signed by the purchaser stating that a particular sale was consummated and delivered to the customer at the Oregon plant and/or sales office. In virtually all cases, the invoice does not specify whether the sale was "will call" or shipped to Washington.

The taxpayer also objects to the auditor's failure to accept certain resale certificates. It states:

> Pursuant to WAC 458-20-102, when a vendor takes, in good faith, a resale certificate from a purchaser, the vendor is relieved of liability for resale sales tax with respect to the transaction. Therefore, the auditors have no authority to reject the certificates presented....

Schedule V: Use Tax on Consumable Supplies

The taxpayer objects to the assertion of use and/or deferred sales tax on approximately 50% of its purchases of lumber . The taxpayer stated at the telephone conference that all of the lumber purchased is included in the value of the enlargements and molds upon which the auditor assessed use tax in Schedule VI. The taxpayer stated that no lumber or particle board was used during the audit period for shelving, or any other capital projects.

The taxpayer also objects to the assertion of use and/or deferred sales tax on wax used to make the wax castings and shipped to the Oregon location to produce the bronze statues contending that such items are for resale to its Oregon corporation.

VI: Use tax on Enlargements and Molds

The taxpayer objects to the auditor's valuations of the molds and enlargements based on the price billed by the taxpayer to its customer upon completion of the entire order. The taxpayer argues that this selling price is not indicative of the true value of the molds and enlargements at the time of production for the following reasons:

> The sales price charged for production of the molds and enlargements is purely arbitrary. To compete, the Company will often bid lower on the bronzing process and try to partially recover by charging a high amount for the mold and enlargement.
>
> Charges for molds and enlargements, although billed separately, become part of the total charges for the art products; therefore, the value of molds and enlargements is absorbed in the total value of the sale.
>
> Customers attach value only to the art itself as evidenced by the fact that molds and enlargements are often not delivered.
>
> A recent cost analysis (necessitated by the audit) shows that molds and enlargements have been sold at a large profit offset by the cost of producing wax patterns and lower than expected margins on the sale of the final bronze products.
>
> There is practically no market for unique molds or enlargements sold separately. They are produced to the specifications required by each artist.

DISCUSSION:

Schedule III: Unreported Retail Sales Tax

[1] Although the taxpayer may have originally intended to set up two separate corporations, the facts fail to substantiate that it has actually implemented that intent. On the contrary, the above facts are entirely consistent with the existence of one ongoing corporation and one inactive shell corporation. We have asked the taxpayer to produce evidence to substantiate its assertion that it is operating as two separate corporations, but it has failed to do so. Absent evidence to the contrary, we find that the taxpayer is

operating as a single corporation doing business in both Washington and Oregon.

Since we find only one corporation and that corporation has a manufacturing facility within the state, it clearly has satisfied the jurisdictional requirement of "nexus" with the State of Washington.

[2] WAC 458-20-103 (Rule 103) states:

> For the purpose of determining the tax liability of persons selling tangible personal property, a sale takes place when the goods sold are delivered to the buyer in this state.

Therefore, under Rule 103, a sale takes place in this state when the goods sold are delivered in this state. Conversely, if delivery to the buyer takes place outside this state, there is no sale in this state. WAC 458-20-193A, (Rule 193A) describes the documentation requirements needed to substantiate an interstate sale. It requires the seller to (1) have an agreement to deliver the goods to the buyer outside the state, either with his own transportation equipment or by common carrier, and (2) retain documentary proof that establishes both the agreement and that the delivery was in fact made to the purchaser outside the state at the risk and expense of the seller.

In this case, however, since the taxpayer's sales office was located in Oregon, and all deliveries were made from that location, coupled with the fact that the taxpayer was unfamiliar with this state's tax laws, and documentation requirements, we believe a reasonable attitude toward documentation is appropriate. Accordingly, absent evidence to the contrary, we will accept the taxpayer's affidavits of out-of-state delivery as sufficient documentation to substantiate the interstate nature of its sales for this audit period only. The taxpayer should be aware that future interstate transactions must be documented in accordance with WAC 458-20-193 A&B.

[3] As to the auditor's disallowance of resale certificates acquired after the actual transaction took place, we believe that the taxpayer misconstrues the meaning of WAC 458-20-102 (Rule 102). Rule 102 states:

> . . . Except as hereinafter noted, all sales are deemed to be retail sales unless the seller takes

> from the buyer a resale certificate signed by and bearing the registration number and address of the buyer, to the effect that the property purchased is:
>
> (1) For resale in the regular course of business without intervening use, or
>
> (2) To be used as an ingredient or component part of a new article of tangible personal property to be produced for sale, or
>
> (3) A chemical to be used in processing an article to be produced for sale. (See WAC 458-20-113.)
>
> When a vendor receives and accepts in good faith from a purchaser a resale certificate as described in this rule, the vendor is relieved of liability for retail sales tax with respect to the transaction. When a vendor has not secured such a resale certificate he is personally liable for the tax due unless he can sustain the burden of proving (1) that the property was sold for one of the three purposes set forth above and (2) that the purchaser was eligible to give a bona fide resale certificate under the provisions of this rule. (Emphasis ours.)

The section to which the taxpayer refers, applies only in the event that the seller (taxpayer) has "in good faith" secured a resale certificate prior to or at the time of the sale. If the seller has failed to secure such certificate, however, then the above underlined language is controlling. In that case, the seller has the burden of proving that the property was both purchased for resale and that the purchaser was eligible to give a bona fide resale certificate. Where the purchaser gives an invalid registration number, or was not registered at the time of the sale, the seller has not sustained that burden.

This issue will be referred to the audit section for resolution of the factual issues consistent with this determination.

Schedule V: Use Tax on Consumable Supplies

LUMBER: The taxpayer objects to the assertion of use and/or deferred sales tax on approximately 50% of its purchases of lumber. The taxpayer acknowledges that these purchases are subject to use tax, but argues that all lumber (component

parts or stands) is included as direct materials in the value of the enlargements and molds, which have been subjected to use tax in Schedule VI. We have examined the pictures illustrating the manufacturing operation of the . . . plant which were supplied by the taxpayer and included in the audit report. These pictures show that the plywood is incorporated into the stands of the enlargements, and should be considered a component of the enlargements. The purchases of plywood shall be deleted. The particle board is not, however, and is correctly included in the consumable supplies schedule.

WAX: The taxpayer also objects to the assertion of use and/or deferred sales tax on wax used to make the wax castings which are shipped to the Oregon location and used to produce the statues.
Since we have previously found that there is only one entity, then it follows that the wax castings are not for resale but are used by the taxpayer as a consumer at its Oregon location to produce the bronze statues. Because the wax castings are not resold in the regular course of business, the purchase of the wax is subject to deferred sales tax. The taxpayer's petition is denied on this point.

VI: Use tax on Enlargements and Molds

[4] RCW 82.12.020 imposes a use tax ". . . for the privilege of using within this state as a consumer any article of tangible personal property purchased at retail, . . . or manufactured by the person so using the same, ... The tax shall be levied and collected in an amount equal to the value of the article used by the taxpayer . . . ."

RCW 82.12.010 defines `value of the article used' to mean:

> . . . the consideration, . . ., paid or given or contracted to be paid or given by the purchaser to the seller for the article of tangible personal property, the use of which is taxable under this chapter. . . . In case the article used is . . . manufactured by the person using the same or is sold under conditions wherein the purchase price does not represent the true value thereof, the value of the article used shall be determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character under such rules and regulations as the department of revenue may prescribe.

Because the taxpayer manufactured the molds itself, bona fide sales to the consumer of that product have not been made. The auditor based her valuation of the molds and enlargements on the subsequent billing prices made by the taxpayer to its customer. To establish a retail selling price at the place of use of similar products of like quality and character, we believe the statute contemplates an arms length transaction whereby the sales price of the item to be used for comparison, is separately and independently negotiated. The billings relied upon by the auditor fail to meet this requirement. Quite frankly, we doubt that used molds and enlargements with virtually no market value or future utility to the buyer could be sold at any price absent the fact that they are sold in conjunction with a final saleable product. This conclusion is supported by the fact that often the molds and enlargements are not in fact delivered to the customer. Therefore, we find the charges made for the molds and enlargements by the taxpayer to its customer are primarily a part of the total charges for the art products and that they do not reflect the true retail value of such items.

The Washington Supreme Court has interpreted the definition of a retail sale under RCW 82.04.080 to mean "a sale to an ultimate consumer" Standard Oil Co. v. State, 57 W2d. 56, (1960). Purchases of molds or patterns by manufacturers are purchases for consumption and are therefore retail sales. WAC 458-20-225. The taxpayer has submitted ten sample bids obtained from two separate custom mold manufacturers relative to the estimated selling price of the sample molds. The sample results indicate that the production of the molds could be sub-contracted out to a custom mold manufacturer for approximately 35% of the sales price charged by the taxpayer to its customer and significantly below taxpayer's own cost figures. Because of the small test sample, the variable nature of the mold charges, and the fact that the bids do not constitute actual sales, we believe (and the taxpayer agrees) that there is substantial room for error. Therefore, we find that the accuracy of the sample bids are suspect and therefore, by themselves, are insufficient to establish the retail selling price of the molds and enlargements.

Where the manufactured items are unique, and an accurate retail selling price is not determinable, Rule 112 provides:

> In the absence of sales of similar products as a guide to value, such value may be determined upon a cost basis. In such cases, there shall be included every item of cost attributable to the particular

> article or article extracted or manufactured, including direct and indirect overhead costs.

The taxpayer's petition is remanded to the audit section so that it may recompute the valuation of the molds and enlargements on a cost basis.

DECISION AND DISPOSITION:

The taxpayer's petition for correction is denied in part and granted in part. The taxpayer's file shall be referred to the Audit Section so that the appropriate adjustments consistent with this Determination can be made.

DATED this 7th day of July 1989.