

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

In the Matter of the Petition) D E T E R M I N A T I O
N
For Correction of Assessment of)
) No. 89-326
))
. . .) Registration No. . . .
) . . .
)

- [1] RULE 112: B&O TAX -- MANUFACTURING -- "VALUE OF PRODUCTS" -- INTERNAL PRICING. "Value of products" will be based on the sales price when finally sold by a taxpayer. Internal pricing between a taxpayer's divisions or locations will therefore not be a basis for establishing a product's value for manufacturing tax purposes - only the final sales price to another person.
- [2] RULE 112: B&O TAX -- MANUFACTURING -- "VALUE OF PRODUCTS" -- SHIPMENT OF PRESOLD GOODS TO OUT-OF-STATE DIVISION/LOCATION. When goods which have been presold by an out-of-state division/location are shipped to that division/location, the products' values must be determined by subtracting costs of transportation from their actual sales prices.
- [3] RULE 112: B&O TAX -- MANUFACTURING -- "VALUE OF PRODUCTS" -- SHIPMENT OF GOODS TO OUT-OF-STATE DIVISION/LOCATION FOR SALE. When goods which have not been presold are shipped to out-of-state locations for sale, their values for manufacturing tax purposes must be determined by comparable sales of similar products to comparable purchasers at comparable locations in this state.

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: April 2, 1986

NATURE OF ACTION:

Petition concerning internal pricing valuations of sales to out-of-state branches for the purpose of the manufacturing tax.

FACTS:

Bauer, A.L.J. -- The taxpayer's business records were examined for the period January 1, 1981 through June 30, 1985. As a result, the above-referenced tax assessment was originally issued on December 3, 1985 in the total amount of \$ A post-audit adjustment was issued on June 10, 1986, reducing the total tax and interest due to \$ The taxpayer has made a \$. . . payment on the assessment.

The taxpayer manufactures and sells windows and doors at wholesale. In this industry, it is common to establish a "list price" for these products. This list price is generally a starting hypothetical price which almost no one ever pays.

The actual price paid by customers is generally a percentage of the list price; this percentage is called an "on-factor." This term is common to the industry of building materials.

The taxpayer's customers fall largely into three groups:

1. Small customers, who pay the highest on-factor of 39% or 40%. These customers are mostly small contractors or those who perform specialty jobs.
2. Large established customers, who pay a 28% to 32% on-factor. These are large established customers who are developers of multi-family units. These customers have a high volume, are competitive, and generally order nothing fancy.
3. Dealers, who purchase at about a 30% on-factor, and will sell at a 38%-40% on-factor.

The taxpayer has six different locations: [Three in state, and three out-of-state]. There was another [out-of-state] location . . . until 1984.

The taxpayer is operated on a decentralized basis. Each location has a location manager responsible for the profit performance of his location. All locations (except [one]) manufacture some products. Many products are still shipped to all locations from [its major Washington location], which is where most of the manufacturing takes place. The taxpayer is working towards each location manufacturing its own products.

Each location is sensitive to the prices paid for its products, since each location is evaluated on its "profits." So that locations can calculate their "profits," an internal pricing schedule has been worked out. According to the taxpayer, this internal pricing schedule is an average on-factor of 29.45%.

The auditor assessed manufacturing tax on those products manufactured in Washington and shipped to the taxpayer's out-of-state locations for sale. In calculating the "value of [these] products," he used an on-factor of 39%, reasoning that that value appeared to correspond most nearly to the eventual gross proceeds of like sales under comparable conditions by the taxpayer. Audit staff further concluded that this on-factor was justified because some 40% of orders shipped out-of-state were customer orders that had been presold by the out-of-state locations.

The taxpayer strenuously objects to the imposition of a 39% on-factor, and argues that 30% would be reasonable. In support of this percentage, the taxpayer has not only submitted invoices supporting its own average internal pricing 29.45% on-factor, it has submitted that those values are what a comparable competitor would charge a dealer.

In addition, the taxpayer has submitted sample invoices reflecting its sales to certain Washington customers - mostly developers - which closely parallel the claimed 30% on-factor.

ISSUE:

The taxpayer, in its original petition, raised two issues. One issue, which involved the imposition of a selling tax on goods on which the manufacturing tax had been previously

imposed, has been since resolved by the audit staff and will not be further addressed herein.

The sole remaining issue for resolution is whether the auditor correctly calculated the value on goods shipped to a Washington taxpayer's out-of-state sales locations for manufacturing tax purposes by (a) estimating the eventual selling price of the goods when they have not yet been sold when shipment occurs, and (b) using actual sales prices when goods have already been presold by the out-of-state locations when shipment occurs, or whether he should have used the internal pricing used by the taxpayer.

DISCUSSION:

WAC 458-20-112 (Rule 112), which concerns the "value of products," provides in pertinent part as follows:

The term "value of products" includes the value of by-products, and except as provided herein, shall be determined by "gross proceeds of sales" whether such sales are at wholesale or at retail, to which shall be added all subsidies and bonuses received with respect to the extraction, manufacture, or sale thereof.

"The term 'gross proceeds of sales' means the value proceeding or accruing from the sale of tangible personal property . . . without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses." (RCW 82.04.070.)

IN THE CASE OF BONA FIDE SALES OF PRODUCTS. The law provides (RCW 82.04.450), that under the extracting and manufacturing classifications of the business and occupation tax the value of products extracted or manufactured shall be determined by the gross proceeds of sales in every instance in which a bona fide sale of such products is made, and whether sold at wholesale or at retail.

SALES TO POINTS OUTSIDE THE STATE. In determining the value of products delivered to points outside the state there may be deducted from the gross proceeds of sales so much thereof as the taxpayer can show to be actual transportation costs from the point at which the shipment originates in this state to the point of delivery outside the state.

ALL OTHER CASES. The law provides that where products extracted or manufactured are

1. For commercial or industrial use (by the extractor or manufacturer -- see WAC 458-20-134); or

2. Transported out of the state, or to another person without prior sale; or

3. Sold under circumstances such that the stated gross proceeds from the sale are not indicative of the true value of the subject matter of the sale; the value shall correspond as nearly as possible to the gross proceeds from other sales at comparable locations in this state of similar products of like quality and character, in similar quantities, under comparable conditions of sale, to comparable purchasers, and shall include subsidies and bonuses.

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. (Emphasis added.)

[1] In accordance with Rule 112 then, the "value of products" will be based on the sales price when finally sold by a taxpayer. Thus, internal pricing between a taxpayer's divisions or locations will not be a basis for establishing a product's value for manufacturing tax purposes - only the final sales price to another person.

Accordingly, the taxpayer's evidence regarding the internal pricing of these products between its various locations, or testimony that competitors would have sold to the taxpayer for those prices, will not be dispositive of the establishment of values for manufacturing tax purposes.

[2] When goods which have been presold by an out-of-state division/location are shipped to that division/location or its customer's location, their values must be determined by subtracting costs of transportation to the out-of-state location from the actual sales prices.

In this case, the "value of products" which had been pre-sold at the time of shipment will be based on their actual sales

prices minus the costs of transportation to the out-of-state location.

[3] Finally, when goods which have not been presold are shipped to out-of-state locations for sale, their values must be determined by comparable sales of similar products to comparable purchasers at comparable locations in this state.

Thus, the taxpayer's goods which had not been presold when shipped from this state to a taxpayer's out-of-state location/division will be valued as if they had been sold by a Washington location/division to a similar customer in this state.

DECISION AND DISPOSITION:

The taxpayer's petition is denied in part. The file will be referred to the Audit Division for possible adjustment in accordance with this Determination. An amended assessment will then be issued, payment of which will be due on the date indicated thereon.

DATED this 23rd day of June 1989.