Cite as Det. No. 99-298, 20 WTD 197 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Letter Ruling of	)	D E T E R M I N A T I O N
	)	No. 99-298
. . .	)	Registration No. . . .
	)	TI&E Ruling

[1] RULE 193; RULE 103; RCW 82.04.240: WHOLESALING B&O TAX -- PLACE OF SALE -- RECEIPT OF GOODS -- UCC DEFINITIONS OF DELIVERY. Sales take place in Washington where an out-of-state manufacturer sells products to a Washington buyer under a contract which provides that the goods will be sent f.o.b. the taxpayer's out-of-state manufacturing plant and that the products are subject to final inspection and acceptance by the buyer at the destination in Washington. Transfer of title is not dispositive for B&O tax purposes. Rule 193 cannot be read to permit transactions to escape taxation that the Supreme Court has specifically construed the B&O statute to include. Out-of-state delivery of a product by a seller to a common carrier does not constitute out-of-state receipt by a purchaser. Uniform Commercial Code definitions of delivery are not controlling for B&O tax purposes. Instead, a Washington sale takes place when the goods are received by the buyer or its agent in this state. Accord: Det. No. 99-216E, 18 WTD 264 (1999)

[2] RULE 193; RULE 103; RCW 82.04.040: WHOLESALING B&O TAX -- PLACE OF SALE -- RECEIPT OF GOODS -- QUALITY ASSURANCE PROGRAMS DISTINGUISHED FROM ACCEPTANCE. Where taxpayer's personnel inspect goods at the taxpayer's out of state facilities on behalf of the buyer to satisfy governmental regulations regarding quality assurance, such inspection and subsequent shipment of goods do not constitute the acceptance of goods by the buyer's agent out of state so as to make such sales out-of-state sales.

[3] RULE 193; INTERSTATE SALES -- ACCEPTANCE IN WASHINGTON -- CONTRACT LANGUAGE. Goods are accepted in Washington if the contract between the buyer and the out-of-state seller expressly states that products shall be subject to final inspection and acceptance by the buyer at the buyer's Washington facility . . ., notwithstanding any payment or prior inspection out-of state. Accord: Det. No. 99-216E, 18 WTD 377 (1999).

NATURE OF ACTION:

Taxpayer appeals a letter ruling from Taxpayer Information and Education's (TI&E) that sales to a Washington manufacturer were Washington sales subject to the wholesaling Business and Occupation (B&O) tax where [products were] inspected and approved at an out-of-state location by a quality assurance team made up of taxpayer's employees acting on behalf of the Washington manufacturer.[1]

HISTORY OF CASE

Bianchi, A.L.J. – . . . (the Taxpayer) manufactures [products] at an out-of-state facility, ands sells [them] to a Washington customer. On May 23, 1997, the Taxpayer wrote to TI&E of the Washington Department of Revenue asking whether sales of its [product] to a Washington manufacturer were subject to wholesaling B&O tax. The taxpayer made two arguments. The taxpayer first argued that goods shipped F.O.B out-of-state plant to Washington should be considered out-of-state sales. Second it contended that the Washington buyer's quality assurance program at the taxpayer's out-of-state factory should constitute acceptance by the buyer out-of-state, rendering the sales out-of-state sales and, therefore, not taxable.

TI&E responded on June 10, 1997, concluding that goods shipped F.O.B. origin plant were not out-of-state sales and advising that employees of the out-of-state taxpayer would not be deemed to act as agents of the buyer for purposes of inspection and final acceptance of goods. TI&E reasoned that no substantive distinction could be made between the seller as manufacturer and the seller as inspector and, therefore, for acceptance to occur out-of-state, someone other than an employee of the seller must do the inspection and acceptance on behalf of the buyer.

The taxpayer appealed this advice to the Appeals Division on July 14, 1997.

DESCRIPTION OF QUALITY ASSURANCE PROGRAM

The taxpayer contended that the goods were accepted out-of-state by an employee of the taxpayer who was specifically approved by the buyer to conduct quality assurance inspections. The contract between the buyer and seller required the seller's quality assurance representative to be specifically approved by the buyer, trained according to the buyer's specifications, and supervised, occasionally, by the buyer's employees. The buyer's purchase orders were coded with the notation "[Quality]." Taxpayer asserted that this code meant that the seller must provide evidence of acceptance and that one of seller's quality assurance employees would provide such evidence.[2]

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

[2] The actual language of note [Quality], however, said:

> Seller must provide evidence of acceptance by its quality assurance department on all shipments. (A) Certified physical and . . . test reports where required by controlling specifications, or (b) a signed, dated

The inspection of the [products] had to be done as it was being developed. Such inspection could not be done after completion because the testing would damage or destroy the integrity of the
[products]. Inspection involved a continuous process of examining the manufacturing documents and testing [products] as they were installed . . . . Furthermore, the inspection required specialized equipment that was available only at the seller's plant. None of this could be done at the buyer's plant.

The seller's employees, approved by buyer, followed a checklist approved by buyer prior to acceptance. The checklist contained technical items such as physical specifications that could be objectively measured and/or tested. After inspecting the goods, the quality assurance representative stamped on the shipping documents: "This Shipment Accepted by [Buyer] Quality Assurance Delegate." The quality assurance representative was further required to place his or her signature on a Certification of Conformance on the shipping documents: "This certifies that products supplied herewith conform to the specification(s), drawing(s), and order(s) that are referenced hereon. Records that document the inspection and test of these products are maintained on file."

The taxpayer testified that the quality assurance representatives understood that they worked for the buyer, not the taxpayer, when they performed the quality tests and they signed a document prepared by the buyer, to this effect. A buyer's employee came to the plant frequently, and may or may not have conducted some of the tests himself or herself. But for the signature on the certification, the buyer had no way of knowing whether its own employee or the taxpayer/seller's employee had inspected any given shipment. After the quality assurance representative finally inspected and accepted the product, the buyer then arranged for the carrier and controlled the destination of the shipment.

The buyer and the taxpayer signed a General Terms Agreement to cover the sale of the [products] in 1994. Despite the procedures described above, the General Terms Agreement, stated at Paragraph 8.2: "Products shall be ***subject to final inspection and acceptance by Buyer at destination***, notwithstanding any payment or prior inspection. Final inspection of a Product will be made within a reasonable time after receipt of such Product." [Emphasis added.]

The Agreement further stated that "passage of title on delivery does not constitute Buyer's acceptance of Products." Paragraph 3.0. Finally, the purchase orders used stated that "[*s]ubject to final acceptance at destination,* [buyer] source inspection is required and authorized." [Emphasis added]

> statement on the packing sheet certifying <u>its</u> quality assurance department has inspected the [products] and they adhere to all applicable drawings and /or specifications.

{Emphasis added.] The document refers only to acceptance by the quality assurance program of the quality of the goods, not receipt of the goods by the buyer.

Despite such language in the contract, the taxpayer argued that any inspection done after the product's arrival in Washington State was only for the purpose of finding damage in shipping, not for acceptance of the goods. Only after a product is installed and doesn't work properly might the buyer itself discover a problem and return the product to the taxpayer. Because the buyer conducted no inspection similar to the one described above, the taxpayer contended that the taxpayer/seller's agent actually accepted the goods at its plant, on behalf of the buyer. Because the buyer accepts the product out-of-state in this manner, the taxpayer asserts the product is delivered out-of-state. As a result, the taxpayer contends such sales are out-of-state sales, not taxable by Washington.

ISSUES:

1. Are sales that are made FOB out-of-state plant Washington sales?

2. Is the taxpayer's quality assurance program the functional equivalent of acceptance out-of-state by the Washington buyer so that such sales are not subject to wholesaling B&O tax?

DISCUSSION:

[1] 1. Sales designated FOB out-of-state plant are Washington sales if the goods are delivered in Washington and accepted here.

Whether sales delivered "FOB out-of-state plant" are Washington sales has recently been decided in Det. No. 99-216E, 18 WTD 264 (1999), a copy of which is enclosed. Det. No. 99-216E rejected arguments identical to those made by this taxpayer that F.O.B. out-of-state plant sales were not Washington sales for tax purposes. For the reasons stated in that determination and because, under RCW 82.32.410, it is precedential, we hold that the goods at issue in the appeal were delivered to the customer in Washington, were received by the customer in Washington and constitute Washington sales.

[2] 2. A quality assurance program does not constitute acceptance out-of-state.

In deciding that quality assurance programs could not be considered a surrogate for delivery or acceptance of possession out-of-state, TI&E determined that the taxpayer's employee could not serve as the agent for the buyer to accept goods. TI&E relied on *Pressed Steel Car Co, Inc. v. Lyons*, 129 N.E.2d 765, 7 Ill.2d 95 (1955). That case held that where the same railroad was both the buyer of goods and the carrier of the same goods, the carrier was not acting as the agent of the seller when it received goods in Illinois prior to transporting them to its corporate headquarters in Indiana. The goods were taxable in Illinois because they were accepted by the railroad in that state. The court held that substance would be sacrificed to form to hold that the carrier was acting on behalf of the seller rather than the buyer. The court pointed out that as soon as the carrier obtained the product, it could have redirected the destination of the goods, even within Illinois, at the request of the buyer, without suffering any economic consequences. The seller would not have cared what happened to the goods because the buyer would not have

complained. Further, the buyer's authorization of the diversion would have shifted any risk of loss away from the seller for not delivering the goods as agreed. The sales therefore were not functionally different from an Illinois sale to an Illinois recipient who intended to ship the product out-of-state. TI&E reasoned that to consider the taxpayer/seller as acting on behalf of the Washington buyer when it inspected and accepted the goods would be to sacrifice substance to form.

[The] Pressed Steel case is somewhat problematic. Dual agency, provided it is disclosed to both principals and agreed upon by both principals, is permissible. *Restatement of Agency, 2d*, §§ 24, 392 (1958), and cases cited therein, and *see Callahan v. Aetna Indemnity Co*., 33 Wash. 583, 74 Pac. 693 (1903). In *Pressed Steel* dual agency was rejected as form over substance based on the real possibility of diversion by the agent on behalf of the buyer and the lack of economic consequences to either the seller or buyer for such diversion. We recognize that these factors were not present in the instant case.

Nevertheless, form would be exalted over substance were we to hold that the quality assurance delegate actually receives the goods on behalf of the Washington buyer at the out-of-state location. The quality assurance representative inspects the goods for adherence to quality standards, then authorizes their shipment. Nothing about the program suggests that the representative has either the purpose or the authority to accept possession of the goods on behalf of the Washington buyer. This is clear if one compares the purpose of a quality assurance program with the B&O tax's statutory requirement that a sale occurs when the goods are delivered to the buyer who accepts them in Washington. RCW 82.04.040; WAC 458-20-103, 193 (Rule 103 and Rule 193).

Quality assurance programs are required by federal safety regulations. Regulations of the [Agency] require prime manufacturers of certain [products], like the Washington buyer, to submit to the [Agency] for approval: "a description of inspection procedures used to ensure acceptable quality . . . that cannot be completely inspected for conformity and quality when delivered to the manufacturer's plant." . . .

The description required by the [Agency] of the buyer's procedures for such source inspection is contained in . . . and . . . . These documents were submitted to and approved by the [Agency]. The buyer imposed the procedures outlined in these documents on the taxpayer-seller through . . ., which is attached to the General Terms Agreement between the parties. The seller's instructions to its employees regarding the buyer's requirements were set out in ". . .," Document Number . . . .

The purpose of the inspection program described by the seller in this hearing and in Document . . . is to satisfy federal regulations relating to . . . safety, not to designate where products are accepted for purposes of determining where a sale occurs. Thus, the fact that inspection is performed out-of-state at the production plant does not automatically mean that the goods are delivered to the buyer out-of-state. It merely means that the buyer is compelled to have a quality assurance program that meets the [Agency] requirement that components that cannot be

satisfactorily inspected at their destination be rigorously inspected where they are made. A quality assurance program such as the one described here would be required by [Agency] even if a buyer sent one of its own employees to the seller's plant to finally inspect and accept the goods on its behalf, an act which would constitute final acceptance out-of-state under Rule 193 (11)(k). Therefore, a buyer's use of a quality assurance program cannot be considered acceptance out-of-state by the buyer.

B. Taxpayer cites an unpublished determination. Taxpayer characterizes the determination as supporting its position that quality assurance programs constitute acceptance out-of-state for tax purposes. Neither a taxpayer nor the Department can rely or comment upon an unpublished determination in a tax dispute in which the taxpayer is not a party. Such determination has no precedential value. *See* RCW 82.32.410.

[3] C. Finally, where the General Terms Agreement between the buyer and seller on its face reserves final inspection and acceptance in Washington, and inspection actually occurs in Washington[3], we do not find that acceptance occurs out-of-state.

The General Terms Agreement controls the transaction at issue. Paragraph . . . specifically addresses other inspections, such as the one performed by the quality assurance inspectors: "Products shall be subject to final inspection and acceptance by Buyer at destination, ***notwithstanding*** *any payment* ***or prior inspection.***" [Emphasis added.] The sale is subject to final inspection, which occurs in Washington. The buyer accepts in Washington. Delivery occurs in Washington. The sale is in Washington. Washington taxes the sale in Washington. *See* Rule 193(7).

We recently addressed this question in Det. No. 97-202ER, 18 WTD 377 (1999), a copy of which is attached hereto. Det. No. 97-202ER has been designated as precedent, and controls the outcome before us. In the instant case the General Terms Agreement contains such a reservation and the taxpayer admits that some inspection occurs in Washington. Accordingly, we find that these sales are not out-of-state sales. Delivery to the buyer does not occur out-of-state merely as a result of the inspection and acceptance of the goods by a quality assurance employee of the taxpayer-seller acting as a surrogate for the buyer where final acceptance in Washington is reserved by the General Terms Agreement. Therefore, the taxpayer is subject to wholesaling B&O tax on the sale of its components to the Washington buyer.

DECISION AND DISPOSITION:

We uphold TI&E's ruling denying that taxpayer's sales are out-of-state sales.

Dated this 29th day of October, 1999.

[3] [In the instant case the taxpayer admits that some inspection actually occured in this state. Although present in this case, inspection in this state is not required for final acceptance to occur here.]