

Cite as Det. No. 13 WTD 18 (1993)

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

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| In the Matter of the Request |) | <u>D E T E R M I N A T I O N</u> |
| For Ruling of |) | |
| |) | No. 91-020 |
| |) | |
| ... |) | Registration No. ... |
| |) | |
| |) | |

- [1] RULE 136: B&O TAX - MANUFACTURING - NONRESIDENT CORPORATION - MATERIALS PROCESSED FOR HIRE IN WASHINGTON. A foreign nonresident company will not be taxable as a manufacturer when it contracts to have materials processed for hire in this state.

- [2] RULES 193B and 137: B&O TAX - SELLING - OUT-OF-STATE MANUFACTURE - INSTALLATION BY SUBCONTRACTOR IN WASHINGTON. A foreign company will be taxable as a seller when it contracts with a Washington taxpayer to have its product - manufactured out of state - installed in this state.

- [3] RULE 136: B&O TAX - PROCESSING FOR HIRE - MATERIALS SUPPLIED IN LARGE BY CUSTOMER. A taxpayer will be taxable as a processor for hire when it completes the assembly of manufactured galley systems shipped in from [Europe] by a foreign affiliate, using materials furnished by the foreign affiliate and supplying only the incidental fastening materials to complete the assembly, so that the value of material provided by it is less than 5% of the overall sales price for any one galley.

- [4] RULE 173: B&O TAX - WHOLESALING - INSTALLATION IN WASHINGTON - FOR OUT-OF-STATE MANUFACTURER. A Washington taxpayer is taxable as a wholesaler when it is hired and paid by a foreign manufacturer to assist in installing galleys in customers' aircraft.

- [5] RULE 19301: B&O TAX - MANUFACTURING AND SELLING IN WASHINGTON - MATC. A Washington taxpayer manufacturing and selling the

same in Washington will be liable for both the manufacturing and appropriate selling tax (retailing or wholesaling), with an entitlement for the Multiple Activities Tax Credit (MATC).

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: . . .

NATURE OF ACTION:

Request for ruling on the tax liability of a Washington corporation which will assist in the final assembly and installation of aircraft galleys manufactured by its European affiliate, and a request for clarification on the tax liability of the European affiliate by virtue of the taxpayer's activities on its behalf.

FACTS:

Bauer, A.L.J. -- The Washington taxpayer's [European] affiliate is engaged in the business of designing, manufacturing, installing, and selling aircraft galleys to a number of international air carriers. All of its activities, including sales negotiations, are conducted outside the United States.

The taxpayer is a Washington corporation that will at first assist in the final assembly of its [European] affiliate's aircraft galleys and work as a liaison . . . to make sure that the galleys are properly installed on the aircraft.

The taxpayer's [European] affiliate has negotiated directly with foreign air carriers for the sale and installation of its galley systems in new planes being built

In the near future the taxpayer will provide the following services:

Activity #1: The taxpayer will complete the assembly of manufactured galley systems that are shipped in from its affiliate in [Europe]. Depending upon the plane and its configuration, the galley systems will be 60% to 80% complete at the time of arrival in the United States. The necessary pieces to complete assembly will also be provided by the taxpayer's [European] affiliate. The taxpayer will provide the necessary labor and any incidental fastening materials to complete the assembly. The first galley sale will occur in the fourth quarter of 1990. Although final costs have not yet been computed, it appears that the value of labor and material services provided by the taxpayer to its [European] affiliate will be less than 5% of the overall sales price for any one galley. Currently, the [European] affiliate intends to compensate the taxpayer for its services.

Activity #2: The taxpayer will provide an employee who will alternate between the company's facilities and the [manufacturer in Washington]. This employee will assist [the airplane

manufacturer] in the final installation of the galley into the airplane. This employee will do any necessary touch up work and other installation items such as mirrors.

Activity #3. The taxpayer's long-term goal is to engage in more substantial manufacturing activities of galleys.

ISSUES AND TAXPAYER'S ANALYSIS:

The taxpayer has requested a ruling on the following issues:

Issue #1: Will a foreign company be taxable as a manufacturer when it contracts to have materials processed for hire in this state?

The taxpayer believes that its [foreign] affiliate would not be classified as a manufacturer within Washington in accordance with WAC 458-20-136(3) by virtue of having [its affiliated Washington taxpayer] complete (process for hire) the galleys in this state.

Issue #2: Will a foreign company be taxable as a seller when it contracts with [its Washington affiliate (the taxpayer)] to have its manufactured product installed in this state?

The taxpayer reasons that the taxpayer's [foreign] affiliate will pay no tax to the state of Washington.

Issue #3: Will a Washington taxpayer be taxable as a processor for hire when it completes the assembly of manufactured galley systems (60% to 80% complete at the time of arrival) shipped in from [its] foreign affiliate, using materials furnished by the foreign affiliate and supplying only the incidental fastening materials to complete the assembly, so that the value of material provided by it is less than 5% of the overall sales price for any one galley?

Issue #4: Is a Washington taxpayer taxable as a seller when it is hired and paid by a foreign manufacturer of galley systems to help install them in the customer's aircraft?

The taxpayer believes that its activities in the foreseeable future will render it taxable only as a processor for hire, the tax measure being its billings for services rendered in accordance with WAC 458-20-136(12)(b).

Issue #5: What will be the Washington taxpayer's tax liability if it should expand its activities to the manufacture, sale, and installation of galleys in this state?

Should more substantial manufacturing activities be engaged in by the Washington taxpayer in the future - so that the taxpayer will then provide more than 20% of the materials and labor in manufacturing the galleys - the taxpayer reasons that it will then be deemed to be the manufacturer of the entire galley system and will be subject to the manufacturing B&O tax on the entire sales price (value) of its galleys.

APPLICABLE REGULATIONS:

WAC 458-20-136 ("Rule 136") provides in pertinent part as follows:

(2) The word "manufacturer" means every person who, from the person's own materials or ingredients manufactures for sale, or for commercial or industrial use any articles, substance or commodity either directly, or by contracting with others for the necessary labor or mechanical services.

(3) . . . a nonresident of the state of Washington who owns materials processed for hire in this state is not deemed to be a manufacturer because of such processing.

. . .

(5) The term "processing for hire" means the performance of labor and mechanical services upon materials belonging to others so that as a result a new, different or useful article of tangible personal property is produced for sale or commercial or industrial use. Thus, a processor for hire is any person who would be a manufacturer if that person were performing the labor and mechanical services upon that person's own materials.

. . .

(12) Processing for hire. Persons processing for hire for consumers or for persons other than consumers are taxable under the processing for hire classification upon the total charge made therefor.

(13) Materials furnished in part by customer. In some instances, the persons furnishing the labor and mechanical services undertakes to produce a new article, substance, or commodity from materials or ingredients furnished in part by them and in part by the customer. In such instances, tax liability is as follows:

(a) The persons furnishing the labor and mechanical services will be presumed to be the manufacturer if the value of the materials or ingredients furnished by them is equal to or exceeds 20% of the total value of all materials or ingredients which become a part of the finished product.

(b) If the person furnishing the labor and mechanical services furnishes materials constituting less than 20% of the value of all of the materials which become a part of the finished product, such person will be presumed to be processing for hire. The

person for whom the work is performed is the manufacturer in that situation, and will be taxable as such.

(14) Retail sales tax. Persons taxable as engaging in the business of manufacturing and selling at retail any of the products manufactured and persons manufacturing, fabricating, or processing for hire tangible personal property for consumers shall collect the retail sales tax upon the total charge made to their customers.

(Emphasis added.)

WAC 458-20-137 (Rule 137) provides in pertinent part as follows:

Persons who manufacture articles outside this state and install the same for consumers in this state are taxable under the retailing classification upon the total charge made therefor, irrespective of whether or not a segregation is made between the charge for the article manufactured and the charge for installing the same.

...

The retail sales tax applies upon both the sale and installation of such articles when made to or for consumers.

(Emphasis added.)

WAC 458-20-193B (Rule 193B) provides in pertinent part as follows:

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.

...

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.

Applying the foregoing principles to sales of property shipped from a point outside this state to the purchaser in this state, the following activities are examples of sufficient local nexus for application of the business and occupation tax:

...

(5) Where an out-of-state seller, either directly or by an agent or other representative, performs significant services in relation to establishment or maintenance of sales into the state, the business tax is applicable, even though (a) the seller may not have formal sales offices in Washington or (b) the agent or representative may not be formally characterized as a "salesman."

(6) Where an out-of-state seller either directly or by an agent or other representative in this state installs its products in this state as a condition of the sale, the installation services shall be deemed significant services for establishing or maintaining a market in this state for such installed products and the gross proceeds from the sale and installation are subject to business tax.

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.

SALES AND USE TAX:

Retail sales tax must be collected and accounted for in every case where business and occupation tax is due as outlined above.

The following sets forth the conditions under which out-of-state vendors are required to collect and remit the retail sales tax or use tax on deliveries to customers in this state. It conforms to the recommended jurisdiction standards of the multistate tax commission.

JURISDICTION STANDARD. A vendor is required to pay or collect and remit the tax imposed by chapter 82.08 or 82.12 RCW if within this state he directly or by any agent or other representative:

...

All vendors who are registered with the department of revenue are required to collect use tax or sales tax from all persons to whom goods are sold for use in this state irrespective of the absence of local activity on any given sale.

(Emphasis added.)

WAC 458-20-173 (Rule 173) provides in pertinent part as follows:

RETAILING. Persons installing . . . tangible personal property of consumers or for consumers are taxable under the retailing classification upon the gross proceeds received from . . . the rendition of services.

WHOLESALE. Persons who . . . render any of the above services for others than consumers, are taxable under the wholesaling classification upon the gross proceeds of sales received therefrom.

WAC 458-20-19301 (Rule 19301 - concerning the multiple activities tax credit) provides in pertinent part as follows:

(3) Scope of credits. This integrated tax credits system is intended to assure that gross receipts from sales or the value of products determined by such gross receipts are taxed only one time, whether the activities occur entirely within this state or both within and outside this state. . . . Internal tax credits arise from multiple business activities performed entirely within this state, all of which are now subject to tax, but with the integrated credits offsetting the liabilities so that tax is only paid once on gross receipts. Under this system Washington extractors and manufacturers who sell their products in this state at wholesale and/or retail must report the value of products or gross receipts under each applicable tax classification. Credits may then be taken in the amount of the extracting and/or manufacturing tax paid to offset the selling taxes due. There are three ways in which credits may arise because of taxes paid exclusively in this state.

...

(h) Products manufactured in Washington are sold in Washington. Again, the payment of the manufacturing tax reported may be credited against the selling tax (wholesaling and/or retailing business and occupation tax) reported.

(Emphasis added.)

RULING:

Based on the facts and regulations given above, the issues are correctly analyzed as follows:

[1] Issue #1: A foreign nonresident company will not be taxable as a manufacturer when it contracts to have materials processed for hire in this state. The taxpayer's [foreign] affiliate - by virtue of its owning materials processed for hire by the taxpayer within this state - will thus not be considered to be a manufacturer under the Washington business and occupation tax. See WAC 458-20-136(3).

[2] However, a foreign company will be taxable as a seller when it contracts with a Washington taxpayer to have its product - manufactured out of state - installed in this state. Because the taxpayer's [foreign] affiliate will hire the taxpayer to assist [the manufacturer] in the installation of its galleys for customers, the [foreign] affiliate will be indirectly performing a service "significantly associated with [its] ability to establish or maintain a market in this state" under WAC 458-20-193B. Thus its sales will be fully taxable. This same result is likewise dictated by WAC 458-20-137. The [foreign] affiliate will be fully subject to the B&O selling tax because it manufactures articles outside of this state but installs them inside this state - even though the installation might actually be performed by a subcontractor (the taxpayer), and even though the installation charges might be separately billed. The taxpayer's [foreign] affiliate will thus be taxable as a seller in accordance with both WAC 458-20-137 and WAC 458-20-193B.

Accordingly, the taxpayer's [foreign] affiliate will be required to register, and the appropriate business and occupation selling tax (retailing, since its sales are apparently directly to consumers) paid. Retail sales tax must normally be collected and paid unless the exemption for sales to private and common carriers applies (see WAC 458-20-175).

[3] The taxpayer will be taxable as a processor for hire when it completes the assembly of manufactured galley systems (60% to 80% complete at the time of arrival) shipped in from [its foreign affiliate], using materials furnished by the foreign affiliate and supplying only the incidental fastening materials to complete the assembly, so that the value of material provided by it is less than 5% of the overall sales price for any one galley. The taxpayer's activity of completing the manufacturing of the galleys will be that of a processor for hire, since it will provide less than 20% of the materials in the finished product. The correct tax measure will be the amount it receives from its [foreign] affiliate for this activity, reportable under the processing for hire classification. WAC 458-20-136(5) and (12). Because it will be completing the manufacture of the galleys for its [foreign] affiliate who will in turn sell the galleys to its own customers, it will be a sale for resale, and retail sales tax need not be collected.

[4] The Washington taxpayer will be taxable as a wholesaler when it is hired and paid by a foreign manufacturer to assist in installing the manufactured property for customers. Thus, the taxpayer's second projected activity - the service of assisting [the manufacturer's] personnel install the galleys in the airplanes sold to consumers and completing final installation of small items - will be a wholesale sale under WAC 458-20-173. The tax measure will be the gross proceeds received for this service.

[5] A Washington taxpayer manufacturing (supplying over 20% of the materials - excluding labor - in the finished product) and selling the same in Washington will be liable for both the manufacturing tax and appropriate selling tax (retailing or wholesaling), with an entitlement for the Multiple Activities Tax Credit (MATC). Thus, if the taxpayer extends its activities to that of manufacturing, installing, and selling aircraft galleys, it will be taxable both as a manufacturer and a seller. The provisions of WAC 458-20-19301 will then apply, and payment of the manufacturing tax reported may be credited against the selling tax (wholesaling and/or retailing business and occupation tax)

reported.

This legal opinion may be relied upon for reporting purposes and as support of the reporting method in the event of an audit. This ruling is issued pursuant to WAC 458-20-100(18) and is based upon only the facts that were disclosed by the taxpayer. In this regard, the department has no obligation to ascertain whether the taxpayer has revealed all of the relevant facts or whether the facts disclosed are actually true. This legal opinion shall bind this taxpayer and the department to these facts. However, it shall not be binding if there are relevant facts which are in existence but have not been disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes. This opinion may be rescinded or revoked in the future; however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

DATED this 23rd day of January 1991.