

Cite as Det. No. 94-015, 14 WTD 180 (1995).

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

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment of)	
)	No. 94-015
)	
. . .)	Registration No. . . .
)	FY. . ./Audit No. . . .

RULES 136 AND 112: MANUFACTURING B&O TAX -- VALUE OF PRODUCT -- GROSS PROCEEDS OF SALE. Engineering drawings incorporated into the manufacture of circuit boards are materials or ingredients of the final product whose value is measured by the gross proceeds of sale of the circuit boards and not by the cost basis of the engineering itself.

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.

NATURE OF ACTION:

The taxpayer protests how the Department of Revenue (Department) determined the value of products for manufacturing business and occupation (B&O) tax. The taxpayer further protests reclassifying wholesale sales to retail ones.¹

FACTS:

De Luca, A.L.J. -- The Department audited the taxpayer for the period January 1, 1989 through September 30, 1992. The Department assessed the taxpayer taxes and interest. Although the entire assessment remains unpaid, the taxpayer protests only Schedules II and IV for manufacturing B&O tax and retail sales tax.

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

The taxpayer is a corporation with headquarters outside Washington. It has an office in Washington where it employs numerous engineers and support staff. The engineers design circuit boards which the taxpayer sells. The engineers send their drawings to a third party contractor in Washington who constructs the boards and prepares related manuals. The contractor then packages the boards and manuals and ships them to the taxpayer's customers. The taxpayer states that its administrative, sales, customer billing and collection activities take place at its out-of-state headquarters without involving the Washington office. The taxpayer estimates that the engineering activity within Washington accounts for about 20% of its total costs.

Schedule II assessed manufacturing B&O tax based on the value of the circuit boards made in Washington as determined by the prices charged to the customers. In Schedule IV, the Department also reclassified sales from wholesaling B&O tax to retailing and assessed retail sale tax where it found the taxpayer failed to obtain completed resale certificates from buyers per WAC 458-20-102 (Rule 102).

ISSUES:

Was it proper to assess the manufacturing B&O tax based on the selling prices of the circuit boards? Alternatively, should it have been based only on the value of the engineering drawings exclusive of the other costs, as the taxpayer asserts?

DISCUSSION:

RCW 82.04.110 defines a "manufacturer" in pertinent part as:

. . . every person who, either directly or by contracting with others for the necessary labor or mechanical services, manufactures for sale or for commercial or industrial use from his own materials or ingredients any articles, substances or commodities.

RCW 82.04.120 defines "to manufacture" as follows:

. . . embraces all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use, and shall include the production or fabrication of special made or custom made articles.

RCW 82.04.240 imposes the B&O tax on manufacturers:

The measure of the tax is the value of the products, including byproducts, so manufactured regardless of the place of sale or the fact that deliveries may be made to points outside the state.

WAC 458-20-136 (Rule 136) is the rule implementing these statutes.

Thus, the tax is imposed on "the value of the products." The auditor assessed the tax upon the value of the products as determined by the sales prices paid by the taxpayer's customers.

The taxpayer cites RCW 82.04.450 and WAC 458-20-112 (Rule 112). The rule reads in relevant parts:

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 law (RCW 82.04.450), provides 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.

. . .

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.)

The taxpayer contends the value of the products transported to another person without prior sale (i.e., the transfer of the engineering drawings to the taxpayer's contractor) is to be determined by the gross proceeds of sale of similar products. It further argues where such products are customarily sold "value of products" is determined on a cost basis under the statute and Rule 112. Thus, it concludes the value of its manufacturing activities in Washington should be determined on the cost basis of the engineering activities only and not on the selling price of finished products sold from outside of Washington.

We respectfully disagree. The taxpayer is not manufacturing the engineering drawings; it is manufacturing circuit boards. The engineering activity, standing alone, would have been a professional service governed by WAC 458-20-224 (Rule 224) and subject to the service and other business activities B&O tax. Therefore, when the taxpayer sends the drawings to the contractor, it is not transporting "a manufactured product" to another person without prior sale. It is merely sending its drawings to facilitate the manufacturing of the circuit boards. The drawings, while an important step in manufacturing the boards, are not manufactured products themselves. See Det. No. 90-342, 10 WTD 123 (1990).

Rule 112 clearly indicates a preference that the value of the products is determined by the "gross proceeds of sales", which is the sales price when sold by the taxpayer to its customers. Det. No. 89-326, 8 WTD 39 (1989). Only when the gross proceeds of sale are not indicative of the product's true value, first, may comparable sales be used and, second, if not available, may the cost basis be used. There is no evidence that the gross proceeds of sales were not indicative of the circuit boards' true values. The auditor was correct in using the selling prices as the basis for the assessment.

The next issue is merely a factual one. The taxpayer's petition states it is developing further information about the resale certificates. Thus far, no new evidence has been presented to show the auditor erred in reclassifying the sales to retail. If the taxpayer can demonstrate to the auditor in the time allowed by RCW 82.32.060 that it properly made sales for resale, it can seek a refund of taxes assessed and paid.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 28th day of January, 1994.