

Cite as Det. No. 18-0194, 38 WTD 261 (2019)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 18-0194
)	
...)	Registration No. . . .
)	

RCW 82.04.260(11)(a); RCW 82.32.550(2); ETA 3210.2018 – B&O TAX – AEROSPACE MANUFACTURING – MANUFACTURERS OR SELLERS OF COMMERCIAL AIRPLANE COMPONENTS MANUFACTURED BY THE SELLER – FEDERAL AVIATION ADMINISTRATION – FAA – PROOF OF FAA CERTIFICATION – PRODUCTION CERTIFICATE – TYPE CERTIFICATE – SUPPLEMENTAL TYPE CERTIFICATE. Taxpayers that manufacture commercial airline components, as defined in RCW 82.32.550, or those who sell such components they manufacture themselves, may qualify for the B&O tax rate in RCW 82.04.260(11)(a,) so long as the components are certified by the FAA and are sold for installation into a commercial airplane. Taxpayers must adequately document their activities to substantiate qualification for the preferential rate. Examples of acceptable documentation include purchase orders, sales invoices, or other records that identify the production certificate, type certificate, or supplemental type certificate issued to the commercial airplane manufacturer. Where manufacturers or sellers do not receive a separate FAA certification for the components, such components are deemed “FAA certified” when the manufacturer or seller can document that the components are for use under the FAA certification issued to the airplane manufacturer, and that they are sold for installation into the new commercial airplane.

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.

LaMarche, T.R.O. – A Washington-based aerospace manufacturing business (Taxpayer) argues that it has shown that certain activities qualify for the business and occupation (B&O) tax classification applicable to manufacturers or sellers of commercial airplane components manufactured by the seller. We remand the petition for an adjustment based upon Taxpayer’s timely submission of proof to the operating division which substantiates its qualification for the aerospace manufacturing B&O tax rate on the disputed transactions, consistent with the holding in this determination.¹

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

ISSUE

Has Taxpayer shown that certain parts it manufactures and sells are FAA-certified “components” as defined in RCW 82.32.550(2), thereby entitling Taxpayer to the B&O tax rate for aerospace manufacturers in RCW 82.04.260(11)(a)?

FINDINGS OF FACT

. . . (Taxpayer) operates a machine shop in . . . WA that specializes in custom gear and spline cutting,² Computer Numerical Control (CNC)³ turning, and CNC milling for items of tangible personal property designed to be installed into aircraft. Taxpayer contracts with vendors to manufacture parts to design specifications provided by their vendor’s customers, who are certain aircraft manufacturers. Taxpayer generally sells the custom parts to the vendors, who in turn sell the parts directly to the aircraft manufacturers.

The Department of Revenue’s (Department) Audit Division (Audit) audited Taxpayer’s business activities for the period from January 1, 2013, through June 30, 2016 (Audit Period). Taxpayer reported certain income under the B&O tax classification for “manufacturers and processors for hire of commercial airplanes or component parts of commercial airplanes” (“Aerospace Manufacturing” B&O tax classification). Audit noted that Taxpayer had properly filled out and submitted the annual surveys and reports required to report under the Aerospace Manufacturing B&O tax classification.

However, Audit found that Taxpayer failed to show that the parts it manufactured were certified by the Federal Aviation Administration (FAA), and thereby did not meet the definition of commercial airplane “components” under RCW 82.32.550(2). On that basis, Audit reclassified the disputed income to the general manufacturing B&O classification, which resulted in additional tax due.

The Department issued an assessment on June 16, 2017, Document No. . . . , totaling \$. . . , which consisted of \$. . . in wholesaling B&O tax; \$. . . in use tax and/or deferred sales tax; \$. . . in manufacturing B&O tax, a MATC credit (line code 07) of \$. . . ; an adjustment of \$. . . in Aerospace Manufacturing B&O tax; a \$. . . MATC credit (line code 195); an adjustment of \$. . .

² **Gear and spline cutting** refers to the machining process of creating gears and splines. Splines are ridges or teeth on a drive shaft that mesh with grooves in a mating piece and transfer torque to it, maintaining the angular correspondence between them. *Spline (mechanical)*, Wikipedia.org, [https://en.wikipedia.org/wiki/Spline_\(mechanical\)](https://en.wikipedia.org/wiki/Spline_(mechanical)) (last accessed June 6, 2018). Splines are required in aircraft engines to transmit torque between shafts that are lined along the length of the engine. *Aircraft Engine Bearings and Splines*, Schaubhut, Suomi, Espinosa, Department of Mechanical & Industrial Engineering, Northeastern University, Fall 2009, [http://www1.coe.neu.edu/~smuftu/docs/2009/ME5656_Term_Project_Aircraft%20Engine%20Bearings%20and%20Splines%20\(Schaubhut%20Suomi%20Espinosa\).pdf](http://www1.coe.neu.edu/~smuftu/docs/2009/ME5656_Term_Project_Aircraft%20Engine%20Bearings%20and%20Splines%20(Schaubhut%20Suomi%20Espinosa).pdf) (last accessed June 6, 2018). Taxpayer’s custom gears and splines generally are made to specific designs, for use solely in particular aircraft. The designs and information about the parts are proprietary and generally cannot be disclosed to third parties other than the vendor and manufacturer. *See, e.g.*, Price List. Thus, such parts are rarely, if ever, sold for purposes other than installation in the aircraft for which they are designed.

³ **Computer numerical control (CNC)** refers to the automation of machine tools by means of computers executing pre-programmed sequences of machine control commands. This is in contrast to machines that are manually controlled. *Numerical Control*, Wikipedia.org, https://en.wikipedia.org/wiki/Numerical_control (last accessed June 6, 2018).

in wholesaling Aerospace Manufacturing B&O tax; and \$. . . in interest. Taxpayer did not pay the assessment, but timely filed a petition for review of the assessment.

After filing the petition, Taxpayer provided two documents for the first time. The first is a document with the heading . . . (Parts List) that refers to a specific component Taxpayer manufactures, part number The Parts List indicates that the part is specifically designed for the . . . commercial airplane. Audit reviewed the document and found that the part number appeared to correspond to a substantial portion of the gross receipts in dispute, which Taxpayer reported in its profit and loss detail.

The second document is entitled . . . (Purchase Document), which states in part:

. . . - QUALITY ASSURANCE:

This procurement is under . . . Federal Aviation Administration (FAA) issued Production Certificate . . . quality system supplier control program.

Unless explicit direction is given to the contrary, no articles (or constituent parts thereof) ordered by . . . shall contain any Federal Aviation Administration-Parts Manufacturer Approval (FAA-PMA) markings, the articles shall not be certified under an FAA-PMA approval, and the accompanying paperwork (e.g., packages, shippers, etc.) shall not contain any FAA-PMA markings.

FOR ALL SHIPMENTS OF ARTICLES INTENDED FOR USE ON . . . COMMERCIAL AIRCRAFT, THE SELLER WILL PLACE THE FOLLOWING STATEMENT ON THE SHIPPING DOCUMENTATION:

“Seller hereby acknowledges that the parts and/or materials being shipped under this order are intended for use under . . . Federal Aviation Administration (FAA) issued Production Certificate”

Taxpayer indicates that it places the latter statement on all shipments of parts in compliance with the terms of the Purchase Document.

Audit reviewed the Purchase Document and indicated that if Taxpayer can substantiate the connection between the . . . parts and disputed income, this would likely serve as a basis for additional adjustments. Taxpayer indicated that it could provide additional records, including invoices and other documents that would connect disputed revenue to the sale of parts that were manufactured to specifications for use solely in certain commercial airplanes. Based on the Parts List, Purchase Document, and Taxpayer’s statements that it could provide additional proof, Audit agreed to a remand to make possible adjustments and to allow Taxpayer the opportunity to provide additional records, subject to Audit’s verification.

ANALYSIS

Washington imposes a B&O tax “for the act or privilege of engaging in business activities” in this state. RCW 82.04.220. The measure of the B&O tax is the appropriate tax rate multiplied by the “value of products, gross proceeds of sales, or gross income of the business, as the case may be.” *Id.* The specific tax rate is determined by the nature of the business activity in which a taxpayer is engaged. See generally Chapter 82.04 RCW.

Beginning July 1, 2008, RCW 82.04.260(11)(b) provides for a B&O tax rate of 0.2904 percent for persons “engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller.” (Emphasis provided.)⁴

The definitions of the terms “commercial airplane” and “component” are incorporated into RCW 82.4.260 by reference to RCW 82.32.550. RCW 82.32.550(1) defines “commercial airplane” as “an airplane certified by the [FAA] for transporting persons or property, and any military derivative of such an airplane.” RCW 82.32.550(2) defines “component” as “a part or system certified by the [FAA] for installation or assembly into a commercial airplane.” There is no dispute that Taxpayer is a manufacturer of the parts it sells.

Here, Taxpayer did not initially provide proof showing that the parts it manufactured and sold during the Audit Period were FAA certified for installation or assembly into an airplane certified by the FAA for transporting persons or property, or a military derivative of such an airplane, pursuant to RCW 82.04.260(11)(b) and RCW 82.32.550(1).

On June 28, 2018, while this case was pending, the Department issued Excise Tax Advisory (ETA) 3210.2018, Manufacturing Airplane Materials or Components and Eligibility for the Preferential Aerospace B&O tax rate, <http://taxpedia.dor.wa.gov/documents/current%20eta/3210.pdf> (last accessed July 9, 2018). The Department found that many stakeholders in the aerospace manufacturing industry were uncertain about application of the provisions of RCW 82.32.550(2) and RCW 82.04.260(11). ETA 3210.2018 gives examples of the types of proof taxpayers can provide to show qualification, in relevant part here, for the preferential aerospace manufacturing B&O tax rate. Such proof includes including blanket production certificates, such as . . . FAA-issued Production Certificate

After filing its petition for correction of the assessment, Taxpayer provided new documents, the first of which is the Parts List, which shows that the part described is manufactured specifically for use in a certain commercial airplane, the The part number listed is the same as that in Taxpayer’s accounting records for many of the sales in dispute. We note that the Parts List only refers to the part itself and is not an invoice or purchase order that lists Taxpayer or any of its vendors. However, Audit indicated that this information, once verified, in conjunction with Taxpayer’s records, should be sufficient to show that the part qualifies as a “component” under RCW 82.32.550(1).

⁴ RCW 82.04.260(11)(d) also provides: “In addition to all other requirements under this title, a person reporting under the tax rate provided in this subsection (11) must file a complete annual report with the department under RCW 82.32.534.” Audit indicates that Taxpayer complied with these reporting requirements during the Audit Period.

Our review of the second submission, the Purchase Document, shows that the . . . parts are manufactured pursuant to an FAA-issued production certificate, . . . Production Certificate We note that the FAA certifies both commercial aircraft and aircraft parts, and an aircraft manufacturer may receive the following certificates: 1) Type Certificate, for the airworthiness of an aircraft design; 2) Production Certificate, to allow for production of duplicate models of the aircraft for which the aircraft manufacturer has previously received a Type Certificate; and 3) Supplemental Type Certificate for modification or repair to aircraft for which a Type Certificate was previously issued.⁵

We find that the Purchase Document refers to a valid FAA-issued production certificate specific to a commercial airplane. However, there is no mention of Taxpayer or its vendor on the Purchase Document, or other way to connect Taxpayer to the manufacture and sale of parts with the . . . designation. Taxpayer states, however, that it will be able to connect such parts to specific invoices and other documents that will show that the part is FAA certified.

Audit agrees that Taxpayer has shown a basis for adjustments, so long as Taxpayer can timely provide proof by which Audit can verify that the parts meet the requirements of RCW 82.04.260(11) and RCW 82.32.550(1). Accordingly, we conditionally grant the petition and remand to the Audit Division for possible adjustments to the assessment.

DECISION AND DISPOSITION

We [conditionally grant the petition and] remand the case to the Audit Division (Operating Division) for possible adjustment to the assessment.

Dated this 10th day of July 2018.

⁵ See United States Department of Transportation, Federal Aviation Administration, Aircraft Certification, https://www.faa.gov/aircraft/air_cert/ (accessed June 29, 2018).