Cite as Det. No. 20-0315, 41 WTD 235 (2022)

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

In the Matter of the Petition for Correction of Assessments of	)	D E T E R M I N A T I O N
	)	No. 20-0315
. . .	)	Registration No. . . .

WAC 458-20-193; RCW 82.32.730: B&O TAX – SOURCING – RECEIPT OF TANGIBLE PERSONAL PROPERTY. The purchaser did not exercise dominion and control outside of Washington over products it purchased, and was therefore unable to establish that it received those products outside of Washington by taking constructive possession of them outside of Washington.

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.

Sattelberg, T.R.O. – An out-of-state valve manufacturer protests the Department's assessment of wholesaling business and occupation ("B&O") tax. The manufacturer argues that its valves were received outside of Washington, and therefore are not subject to Washington's B&O tax. We deny the petition.[1]

ISSUE

Whether a valve manufacturer's products were received outside of Washington, under RCW 82.32.730 and WAC 458-20-193, when acceptance of the valves contractually occurred outside of Washington.

FINDINGS OF FACT

. . . ("Taxpayer") designs and manufactures custom and commercial valves, largely for the aerospace industry, from its facility [outside of Washington]. Taxpayer had a large customer, . . . ("Customer A"), . . . with headquarters [outside of Washington]. Customer A has locations across the United States, [including] Washington. Taxpayer delivers its products to whichever location it is directed to deliver to by Customer A.

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

Taxpayer and Customer A entered into an Agreement that contained the following provisions:

> Acceptance and Rejection
> a. Final Acceptance shall take place at [Taxpayer's] facility upon completion of agreed upon Final Acceptance test procedures as set forth in any specifications previously agreed to by the parties [ ]. The [Acceptance test procedures] results shall be verified by a representative of [Customer A] in accordance with the applicable specifications related to any Purchase Order. Prior to the [Acceptance test procedures], [Taxpayer] shall notify [Customer A] that the Goods are ready for [Acceptance test procedures] and if so requested by [Customer A], shall submit any data package as required by any applicable deliverable requirement previously agreed upon by the parties. Upon execution of the [Taxpayer] Facility Non-Disclosure Agreement required for admittance to the [Taxpayer's] facility, [Customer A] shall be permitted, but is not required, to attend the [Acceptance test procedures] to certify the successful compliance of the Goods with the [Acceptance test procedures]. *Upon a showing of compliance to the specifications for the Goods as evidenced by the Goods' successful passage of the [Acceptance test procedures], whether witnessed by [Customer A] or otherwise, the Goods shall be deemed accepted by [Customer A] ("Final Acceptance"). Title to the Goods and risk of loss for the Goods shall pass to Buyer upon Final Acceptance of the Goods*. [Customer A] will not be obligated to accept substitutions, untimely deliveries, deliveries in quantities other than those ordered by [Customer A], or deliveries of Work failing to conform to [Customer A's] specifications or Seller's warranties described in the Contract.
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> b. If [Taxpayer] delivers non-conforming Work, [Customer A] may, after providing written notice to [Taxpayer], (i) accept all or part of such Work; (ii) return the Work for credit or refund; or (iii) require [Taxpayer] to correct or replace the Work. [Customer A] shall be entitled to an Equitable Adjustment for all costs, expenses, and loss of value incurred resulting from inspection, return, correction or replacement of non-conforming Work.
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> c. [Taxpayer] shall not redeliver corrected or rejected Work without disclosing the corrective action taken.

[Customer A] Negotiated General Provisions with [Taxpayer] . . . (emphasis added.)

Between July 2017 and August 2019, Taxpayer delivered valves to Customer A's Washington location during almost every month or quarter. Taxpayer filed excise tax returns with Washington reporting income under the preferential wholesaling of commercial airplanes, components, or aerospace tooling B&O tax classification.

In 2019, the Department's Taxpayer Account Administration Division ("TAA") reviewed Taxpayer's filings for eligibility for the preferential rate Taxpayer had been claiming. Through communication with Taxpayer, TAA learned that Taxpayer's sales of valves were for spacecraft, not for aircraft. Based on this information, TAA reclassified Taxpayer's income to the general

wholesaling B&O tax classification from the wholesaling of commercial airplanes, components, or aerospace tooling B&O tax classification. On March 6, 2020, TAA issued several assessments to Taxpayer totaling $. . . .

Taxpayer did not pay any of the additional amounts due in the assessments, and timely petitioned for their correction. Taxpayer does not argue that TAA erroneously reclassified its income from the preferential B&O tax classification to the wholesaling B&O tax classification. Instead, Taxpayer argues that all of its valves were received [outside of Washington], and therefore there was nothing to tax in Washington at all. Thus, Taxpayer also seeks a refund of B&O tax previously paid.

Taxpayer states that it removes accepted valves from its inventory system by generating a packing list after final acceptance. Taxpayer claims that its terms of sale with Customer A placed Customer A in constructive possession of the valves at its [out-of-state] facility. Taxpayer claims that by doing this, Customer A obtained ownership and dominion and control over the products [outside of Washington]. Taxpayer claims that this ownership and dominion and control was manifested by the instances when Customer A would direct Taxpayer to ship accepted valves to third parties that Taxpayer had no contractual relationship with.

In support of its position, Taxpayer provided a Packing List showing that certain valves were billed to Customer A, but were shipped to another entity at Customer A's direction. Taxpayer also provided documentation showing that valves were shipped FOB origin at Taxpayer's location, and Taxpayer states that this reinforces that Customer A was in constructive possession of the valves while they were in [Customer A's out-of-state facility]. Taxpayer states it is an industry standard that FOB indicates that title and possession have transferred prior to shipment.

Taxpayer provided its . . . certificate, which indicates that it is a registered parts supplier under the requirements of the Society of Automotive Engineers for aviation, space, and defense organizations.[2] Taxpayer also provided its internal policy regarding inventory transfers, which states:

> Customer owned property may include any material, detail hardware, sub-assemblies, fixtures or finished goods that have been procured or manufactured by [Taxpayer]. This property is then shipped out of [Taxpayer's] inventory and title transferred immediately to customer. Any of the items previously listed will be considered customer owned property. If said property remains at [Taxpayer's] facility it will be stored in a physical cabinet located at [Taxpayer's] Facility (locked) and labeled "Customer Owned Property Cabinet" for a determined period, negotiated by buyer/[Taxpayer] and/or until further direction from the customer. Access to the cabinet is limited to those in Production Control and Top-Level Management of the company. There is a possibility that a storage fee and insurance may be charged, if the product remains in the cabinet long term, to be determined by Management.

[2] https://www.sae.org/standards/content/as9100d/ (last visited August 19, 2020).

> Identification of the customer owned property shall be maintained until customer or [Taxpayer's] personnel are given direction to take physical possession. There will be a . . . Customer Owned Property Tag, FORM 189 (see Appendix A) with the hardware at all times. Customer owned property Tag shall contain the part number, customer name quantity and date of title transfer. A copy of the Packing Slip will remain with the product.
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> There will be a current list of all Customer Owned Property that is being stored and it will reside with Production Control.

Taxpayer's Customer Owned Property policy, . . . effective February 5, 2020.

In conjunction with the internal policy, Taxpayer provided a copy of its . . . Customer Owned Product tag. The tag has lines for all of the information listed in the policy, plus additional lines for "[Taxpayer] Packing List #" and "P/L # - Lot # - Job #." Appendix A – Sample Product ID Tags. The tag is labeled "[Taxpayer] Document Number . . . Effective Date ." *Id.*

ANALYSIS

Washington imposes a B&O tax on "every person that has a substantial nexus" with Washington "for the act or privilege of engaging in business" in this state. RCW 82.04.220(1). Washington's B&O tax is "extremely broad." *ARUP Laboratories, Inc. v. Dep't of Revenue*, 12 Wn. App. 2d 269, 457 P.3d 492 (2020) (quoting *Steven Klein, Inc. v. Dep't of Revenue*, 183 Wn.2d 889, 896, 357 P.3d 59 (2015)). The B&O tax is "extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State." *Analytical Methods, Inc. v. Dep't of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep't of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). "Business" is defined broadly to include "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140.

The B&O tax measure and rate are determined by the type or nature of the business activity in which a person is engaged. Chapter 82.04 RCW. The measure of the B&O tax is the application of rates against the "value of products, gross proceeds of sales, or gross income of the business, as the case may be." RCW 82.04.220(1). The wholesaling B&O tax rate applies to gross proceeds of sales of persons making "sales at wholesale" in Washington. RCW 82.04.270. "Sale at wholesale" is defined as any sale of tangible personal property that is not a retail sale. RCW 82.04.060(1)(a). There is no dispute here that Taxpayer is selling tangible personal property, and there is also no dispute that these sales are not retail sales.

With respect to the time and place of sale generally, RCW 82.04.040(1) explains that "sale" includes "any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a 'sale at retail' or 'retail sale' under RCW 82.04.050." WAC 458-20-193 ("Rule 193") further explains that the Department may tax the sale of tangible personal property into Washington when "the seller has nexus with Washington and the sale occurs in Washington." Rule 193(2). Persons making wholesale sales of tangible personal property into Washington are subject to the state's economic nexus thresholds for sales made on

September 1, 2015, or later, when the sales are sourced to Washington. Rule 193(104), (105)(b). The economic nexus threshold for wholesale sales sourced to Washington for the periods at issue here was $267,000.00 of receipts from sales per calendar year. RCW 82.04.067(1)(c)(iii); Rule 193(104). Taxpayer met that threshold for each year at issue, so it meets the nexus element of Rule 193(2) if its sales are sourced to Washington.

A sale of tangible personal property is sourced to the business location of the seller when the "tangible personal property is received by the purchaser" at the seller's business location. Rule 193(203)(a). "Receipt" and "receive" mean "the purchaser first either taking physical possession of, or having dominion and control over, tangible personal property."[3] Rule 193(202)(a). Thus, Rule 193 covers both actual possession and constructive possession. "Actual possession means that the goods are in the personal custody of the person . . . ; whereas, constructive possession means that the goods are not in actual, physical possession, but that the person . . . has dominion and control over the goods." *State v. Callahan*, 77 Wn.2d 27, 29, 459 P.2d 400 (1969) (citing *State v. Walcott*, 72 Wn.2d 959, 435 P.2d 994 (1967)).[4]

Because the items are shipped via common carrier, Customer A did not take physical possession of the items outside of Washington. Since physical possession is not at issue, the only issue is whether Customer A took constructive possession of the items outside of Washington.

Black's Law Dictionary contains the following relevant definitions of "constructive possession," "control," and "dominion":

> **Constructive possession**. Control or dominion over a property without actual possession or custody of it.
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> **Control,** *n.* The direct or indirect power to govern the management and policies of a person or entity, whether through ownership of voting securities, by contract, or otherwise; the power or authority to manage, direct, or oversee.
>
> **Dominion**. Control, possession.

Black's Law Dictionary (11th ed. 2019).

We have addressed the issue of the constructive possession of tangible personal property in the interstate sales context before. In Det. No. 14-0157, 33 WTD 539 (2014), an out-of-state nutritional

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[3] Rule 193(2)(b)(i) defines terms regarding receipt by a shipping company, and includes this additional definition:

> "Receive" and "receipt" do not include possession by a shipping company on behalf of the purchaser, regardless of whether the shipping company has the authority to accept and inspect the goods on behalf of the purchaser.

Rule 193(2)(b)(ii) goes on to define "shipping company" as a "separate legal entity." We note that Taxpayer has not made an argument regarding the third-party shipping company having authority to accept and inspect the valves, nor has it presented any facts to support such an argument.

[4] Although the cited cases involve the application of law to the crime of possession, they are nonetheless instructive with respect to how constructive possession works in this context.

supplement manufacturer and wholesaler manufactured a beverage in bulk quantities and sold it to a buyer. 33 WTD at 540. The buyer then authorized the wholesaler to deliver the purchased beverage to a third-party packager, also located out-of-state. *Id.* at 541. Upon delivery, the third-party packager removed the beverage from large bulk drums, repackaged it into smaller units, and then delivered the repackaged products to the buyer in Washington. *Id.* The wholesaler had no contract with the third-party packager, and had no further involvement with any aspect of the beverage after delivery to the third-party packager. *Id.* We held that these facts supported the buyer's "power to manage, direct, and oversee the Beverage," and that this was consistent with the buyer having constructive possession. *Id*. at 544. Because the buyer had constructive possession as evidenced by directing the beverage to a third-party packager outside of Washington, we concluded the buyer did not have receipt in Washington, and therefore that Washington could not tax the transactions. *Id.*

In another constructive possession case, Det. No. 15-0279, 35 WTD 27 (2016), a commercial vehicle chassis wholesaler sold chassis to vehicle dealers in Washington for subsequent resale. 35 WTD at 29. The chassis would be delivered to a third-party carrier for storage and subsequent delivery to an out-of-state, third-party body shop. *Id*. at 30. Once delivered to an out-of-state, third-party body, the body shop would add the components necessary for the vehicle to be driven on public roads. *Id.* at 31. The body shop then delivered the completed vehicle to the purchasing dealer in Washington. *Id*. We held these facts, like those in 33 WTD 539, supported a holding of constructive possession by the buyer. *Id*. at 33.

Here, the facts are unlike those of 33 WTD 539 or 35 WTD 27. There is no third-party modification of the valves between the time the common carrier picks them up from Taxpayer, the manufacturer and wholesaler, and when the carrier delivers them to Customer A, the purchaser of the valves. Instead, Taxpayer ships the valves directly to Customer A in Washington via common carrier.

In a case involving delivery and receipt, Det. No. 17-0243, 37 WTD 112 (2018), an out-of-state carrot grower shipped carrots to retail customers in Washington via third-party carriers. 37 WTD at 113. Title to the carrots passed when the third-party carrier picked up the carrots from the grower's location outside of Washington, and the carrots were shipped "FOB," or free on board. *Id*. at 114. The grower argued that receipt occurred outside of Washington, but the Department rejected that argument. *Id*. at 118. As part of its reasoning, the Department looked at these two examples from Rule 193(203)(a):

> **Example 3.** An out-of-state purchaser sends its own trucks to Washington to receive goods at a Washington-based seller and to immediately transport the goods to the purchaser's out-of-state location. The sale occurs in Washington because the purchaser receives the goods in Washington. The sale is subject to B&O and retail sales tax.
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> **Example 4.** The same purchaser in Example 3 uses a wholly owned affiliated shipping company (a legal entity separate from the purchaser) to pick up the goods in Washington to deliver them to the purchaser's out-of-state location. Because "receive" and "receipt" do not include possession by the shipping company, the purchaser receives the goods when the goods arrive at the purchaser's out-of-state

> location and not when the shipping company takes possession of the goods in Washington. The sale is not subject to B&O and retail sales tax.

Since the third-party carrier in 37 WTD 112 was similar to the facts in Example 4, we reasoned that it was that example that applied. *Id*. The taxpayer also argued that where title passed was where receipt occurred, but we denied that argument based on Rule 193, quoted above. *Id*. The taxpayer finally argued that the right to acceptance in the bills of lading controlled where receipt occurred, but we denied that argument because that claim was based on an older version of Rule 193 that had since been amended to remove that provision. *Id*.

In a similar case, Det. No. 99-216E, 18 WTD 264 (1999), an out-of-state manufacturer manufactured parts that would be incorporated into products manufactured by separate, Washington manufacturers. 18 WTD at 265. The out-of-state manufacturer's contracts with Washington buyers stated that its parts would be delivered FOB "carrier's transport" at its out-of-state manufacturing plant. *Id*. at 266. The contracts passed title and risk of loss upon delivery to the common carrier, "except for loss or damage resulting from the [out-of-state manufacturer's] fault or negligence or failure to comply with the terms of the contract." *Id*. Under the contracts, the manufactured parts were "subject to final inspection and acceptance" by the Washington buyers at their Washington destinations. *Id*. The out-of-state manufacturer conceded that the Washington buyers did not have an employee or agent at the out-of-state manufacturing plant who inspected the parts and either accepted or rejected them on behalf of the Washington buyers prior to shipment. *Id*. In denying the out-of-state manufacturer's argument about receipt being out-of-state, we cited to *B.F. Goodrich v. State,* 38 Wn.2d 663, 231 P.2d 325 (1951) and *General Motors Corp. v. State*, 60 Wn.2d 862, 376 P.2d 843 (1962), which both held that B&O tax was due on shipments made FOB the out-of-state location.

Here, we have a third-party carrier picking up products out of state, and title passing out of state as well. Taxpayer recognizes that this is insufficient to prove receipt out of state, as we held in 37 WTD 112 and 18 WTD 264. Taxpayer also recognizes that it does not have evidence of the manifestation of constructive possession similar to what is found in 33 WTD 539 or 35 WTD 27. Taxpayer, however, argues that we need not have the manifestation of constructive possession like in 33 WTD 539 or 35 WTD 27, because that manifestation is only the exercise of dominion and control that the buyers must have legally had prior to exercising it.

Taxpayer claims the crucial fact here, that neither taxpayer had in 37 WTD 112 and 18 WTD 264, is contractual acceptance out of state, and this contractual acceptance is what confers [Customer A's] legal authority to direct the valves while still [outside the state]. This amounts to control, Taxpayer argues, and therefore [Customer A] has constructive possession out of state. We disagree.

Rule 193 contains only one example that addresses constructive possession, example 10, and that example is based on 33 WTD 539, the juice rebottling case discussed above. Example 10 states:

> An out-of-state manufacturer/seller of a bulk good with nexus in Washington sells the good to a Washington-based purchaser in the business of selling small quantities of the good under its own label in its own packaging. The purchaser directs the

> seller to deliver the goods to a third-party packaging plant located out-of-state for repackaging of the goods in the purchaser's own packaging. The purchaser then has a third-party shipping company pick up the goods at the packaging plant. The Washington purchaser takes constructive possession of the goods outside of Washington *because it has exercised dominion and control* over the goods by having them repackaged at an out-of-state packaging facility before shipment to Washington. The sale is not subject to B&O and retail sales tax in this state because the purchaser received the goods outside of Washington.

(Emphasis added.)

As mentioned above, 33 WTD 539 and 35 WTD 27 both hold that the buyer had constructive possession out of state based on the evidence presented in both cases. What these WTDs and Rule 193's example 10 point to as being crucial for dominion and control is some affirmative act by or on behalf of the buyer. This can also be seen in 18 WTD 264, which concludes its section on dominion and control as follows:

> The parties concede that [Manufacturer] did not have its employees or agents accepting or rejecting the parts following inspection at the taxpayer's out-of-state plants. Lastly, the common carriers that transported the parts to Washington did not have express written authority to accept or reject the goods for [Manufacturer] with the right of inspection.

18 WTD 264 also looks for an affirmative act by or on behalf of the buyer when examining whether the buyer has dominion and control. Finding none, 18 WTD 264 concludes the buyer does not have dominion and control. As we do not have such an act here, only contractual terms, we conclude that Taxpayer has not shown that [Customer A] exercised any direct authority, any dominion and control, over the valves outside of Washington. Without this, [Customer A] cannot have constructive possession, and [Taxpayer] has therefore not shown that receipt occurred outside Washington. Accordingly, we deny Taxpayer's petition.

DECISION AND DISPOSITION

We deny Taxpayer's petition.

Dated this 20th day of November 2020.