Cite as Det. No. 99-070, 22 WTD 144 (2003)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 99-070
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .

RCW 82.04.220; 82.12.020: SERVICE B&O TAX – USE TAX - FOREIGN TRADE ZONE. Washington's B&O tax is not an ad valorem tax, and federal law does not pre-empt Washington from assessing its B&O tax on gross income earned by the taxpayer's activities associated with operating its foreign trade zone. Likewise, Washington is not barred from assessing use tax on tangible personal property used by the taxpayer to operate its foreign trade zone.

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:

An operator (the taxpayer) of a foreign trade zone protests the assessment of business and occupation (B&O) tax and use tax.[1]

FACTS:

De Luca, A.L.J. – The taxpayer is a corporation that operates a foreign trade zone in Washington. The taxpayer's business activities occur only in Washington. Foreign trade zones are areas within the United States where goods may be stored, sold, exhibited, broken-up, repacked, assembled, distributed, sorted, and mixed without being subject to customs laws. Foreign trade zones are intended to stimulate foreign commerce by allowing goods in transit in

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

foreign commerce to be kept in secure storage, duty free, until they resume their journey in export by land, water, or air. The taxpayer leases the real estate for its foreign trade zone from a port district.

The taxpayer provides warehousing, inventory, distribution, and shipping services in relation to its foreign trade zone. The taxpayer also offers postal services, including post office box rentals. Additionally, the taxpayer offers business services including incorporation, trademark registration, secretarial services, insurance consultation, work permits and loan/grant applications.

The Department of Revenue (the Department) reviewed what was available of the taxpayer's books and records for the period January 1, 1993 through October 31, 1997, and assessed $ . . . in service B&O tax, use tax, and interest. Document No. FY . . . . In making the service B&O tax assessment, the Department credited the taxpayer for taxes it reported under the stevedoring, international freight forwarders, etc. B&O tax classification. The Department's Audit Division acknowledged that some of the taxpayer's income may have come from these types of activities, but, due to a lack of records, the detail documentation necessary to support such a B&O tax classification was not available to the Department. Consequently, the Audit Division reclassified all of the taxpayer's gross income to the service B&O tax classification. The Audit Division recognizes that some future adjustments to the assessment may be required if additional records are provided. Indeed, the Audit Division and the taxpayer have agreed that if we determine that the taxpayer's activities are taxable, the taxpayer will attempt to locate more records to help determine the proper tax classifications and amounts due.

TAXPAYER'S EXCEPTIONS:

The taxpayer contests the entire assessment. As noted, the taxpayer had reported some gross income for B&O tax purposes. However, the taxpayer now argues that federal law preempts the state of Washington from taxing any of its gross income or property it purchased for use in the foreign trade zone. The taxpayer cites the Foreign Trade Zones Act, 19 U.S.C. Sections 81a-81u in support of its argument. The taxpayer explains that the U.S. Foreign Trade Zone Board regulates all functions occurring within any foreign trade zone. Arbor Foods, Inc. v. United States, 885 F.Supp. 281, 287-88 (1995). That board also has the jurisdiction to regulate the admission of merchandise and operation in a zone for the public's interest, health, or safety. 15 C.F.R. Section 400.43(a). In light of these powers, the taxpayer cites 3M Health Care, Ltd. v. Grant, 908 F.2d 918 (11th Cir. 1990) to support its argument that the state of Washington is preempted from assessing its taxes. The taxpayer also cites Xerox Corp. v. County of Harris, 459 U.S. 145, 154 (1982) for the holding that any merchandise brought into a foreign trade zone is not "imported" into the United States and is not subject to United States' customs laws.

Finally, the taxpayer argues the B&O tax is an ad valorem tax that is specifically prohibited by 19 U.S.C. Section 81o(e).

ISSUES:

Is Washington's B&O tax an ad valorem tax?

Is the state of Washington preempted by federal law, in particular the Foreign Trade Zones Act, from assessing its B&O tax and use tax on the taxpayer's activities associated with its foreign trade zone?

DISCUSSION:

Contrary to the taxpayer's argument, Washington has not asserted an ad valorem tax on goods in foreign commerce. Instead, it has assessed excise taxes, but not on goods in foreign commerce. The Department assessed B&O tax on the taxpayer's gross income for services rendered in Washington. It also assessed use tax on the taxpayer's privilege of using tangible personal property in the state. An ad valorem tax is "a tax imposed on the value of property." Black's Law Dictionary 51 (6th ed. 1990). The more common ad valorem tax is that imposed by states, counties, and cities on real estate. However, ad valorem taxes can be imposed on personal property. Id. By comparison, an "excise tax" is "imposed on the performance of an act, the engaging in an occupation, or the enjoyment of a privilege." Ibid. at 563. Consistent with these definitions the service B&O tax is imposed "(2) Upon every person engaging within this state in any business activity. . . ." RCW 82.04.290.[2]

Further evidence that the B&O tax is an excise tax and not an ad valorem tax that does not conflict with the federal government's regulation of foreign commerce is found in Department of Rev. v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978). The U.S. Supreme Court ruled Washington's B&O tax on stevedoring activities did not violate either the Commerce Clause or the Import-Export Clause of the Federal Constitution. In reference to the Import-Export Clause, the Supreme Court declared at 754:

> A similar approach demonstrates that the application of the Washington business and occupation tax to stevedoring threatens no Import-Export Clause policy. First, the tax does not restrain the ability of the Federal Government to conduct foreign policy. As a general business tax that applies to virtually all businesses in the State, it has not created any special protective tariff. The assessments in this case are only upon business conducted entirely within Washington. No foreign business or vessel is taxed. Respondents, therefore, have demonstrated no impediment posed by the tax upon the regulation of foreign trade by the United States.
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> Second, the effect of the Washington tax on federal import revenues is identical to the effect in Michelin. The tax merely compensates the State for services and protections extended by Washington to the stevedoring business. Any indirect effect on the demand for imported

[2] Similarly, the use tax is imposed on every person in this state "for the privilege of using within this state as a consumer any article of tangible personal property purchased at retail . . . ." RCW 82.12.020.

> goods because of the tax on the value of loading and unloading them from their ships is even less substantial than the effect of the direct ad valorem property tax on the imported goods themselves.

The Supreme Court continued at 755:

> First, the activity taxed here occurs while imports and exports are in transit. Second, however the tax does not fall on the goods themselves. The levy reaches only the business of loading and unloading ships or, in other words, the business of transporting cargo within the State of Washington. Despite the existence of the first distinction, the presence of the second leads to the conclusion that the Washington tax is not a prohibited "Impost or Duty" when it violates none of the policies.

Moreover, the Supreme Court compared Washington's B&O tax in Stevedoring with another gross receipts tax case, Canton R. Co. v. Rogan, 340 U.S. 511 (1951), by stating at 435 U.S. at 757:

> The transportation services in both settings are necessary to the import-export process. Taxation in neither setting relates to the value of the goods, and therefore in neither can it be considered taxation upon the goods themselves.

Thus, it is clear Washington's B&O tax is not an ad valorem tax and does not conflict with the Constitution's Import-Export Clause by impeding the regulation of foreign trade.

Previously, the taxpayer filed an application, dated September 25, 1996, with the Department seeking exemptions from property tax and leasehold excise tax for its foreign trade zone operations. The taxpayer in its application made nearly identical arguments to the ones it makes in the present matter i.e., the state of Washington is preempted by the Foreign Trade Zones Act, 19 U.S.C. Sections 81a-81u, from taxing the taxpayer. The Department denied the exemption request by determining that federal law did not preempt Washington from imposing such taxes. The Department's reasons for denying the application were based in large part on a November 12, 1996 memorandum the Department prepared in response to the taxpayer's application. The Department provided a copy of that memorandum to the taxpayer.

We believe the Department's reasoning in its 1996 memorandum is applicable to the taxpayer's petition before us whether the Department has assessed leasehold excise tax, property tax, B&O tax, or use tax. We agree with the memorandum that federal law preempts only state and local ad valorem taxes. We will quote, in part, and then summarize the Department's memorandum because we find it persuasive:

> An analysis of this [federal preemption] doctrine "starts with the basic assumption that Congress did not intend to displace state law." Building & Constr. Trades Council v. Associated Builders & Contractors, 507 U.S. 218 (1993) . . . . Furthermore, there is a strong presumption against preemption and "state laws are not superseded by federal law

> unless that is the clear and manifest purpose of Congress." Id. at 265 . . . . The goal in a preemption analysis is to determine congressional intent. Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992). Congress' intent may be "explicitly stated in the statute's language or implicitly contained in its structure and purpose." Id. at 516 . . . .
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> Preemption may occur in any of three ways: (1) Congress passes a statute that expressly preempts state law; (2) Congress occupies the entire field of regulation; or (3) state law conflicts with federal law, making compliance with both an impossibility or state law presents an obstacle to the accomplishment of the federal purposes. Stevedoring Services of America, Inc. v. Eggert, 129 Wn. 2d 17, at 23 (1996); See also 3M Health Care, Ltd., v. Grant, 908 F. 2d 918 at 920 (11th Cir. 1990).

In its memorandum, the Department determined none of the three types or ways of federal preemption applied. To begin, the Foreign Trade Zones Act provides in pertinent part:

> Tangible personal property imported from outside the United States and held in a zone for the purpose of storage, sale, exhibition, repackaging, assembly, distribution, sorting, grading, cleaning, mixing, display, manufacturing, or processing, and tangible personal property produced in the United States and held in a zone for exportation, either in its original form or as altered by any of the above processes, shall be exempt from State and local ad valorem taxation. (Underlining ours).

19 U.S.C. Sec. 81o(e). This section is the only statutory provision in the Foreign Trade Zones Act that expressly preempts states from assessing tax in a foreign trade zone. It is clear the preemption is limited to state and local ad valorem taxes. Indeed, the U.S. Supreme Court in R. J. Reynolds Tobacco Co. v. Durham County, 479 U.S. 130, 151 (1986) declared that the Foreign Trade Zones Act provided "a statutory exemption from state and local property taxes for goods held in a foreign trade zone."[3] The Supreme Court in R. J. Reynolds explained that congressional legislators from Texas sought to preempt state taxation of goods in foreign trade zones because Texas, alone among the states, permitted this taxation, thus discouraging business from locating such zones in that state. Therefore, the first type of preemption is not applicable to the present matter because, as explained above, the Department did not impose an ad valorem tax on export goods in the zone.

[3] The taxpayer cited Xerox, supra, for the principle that goods brought into a foreign trade zone are not imported into the U.S. and are not subject to U.S. customs law. The taxpayer is correct up to a point. The Supreme Court in Xerox ruled that state property tax on goods stored under bond in a customs warehouse is pre-empted by Congress' comprehensive regulation of customs duties. 459 U.S. at 154. However, the goods, as in Xerox, must be exported to avoid duties and state and local taxation. R. J. Reynolds followed Xerox, and the Supreme Court ruled in R. J. Reynolds that a state may impose a nondiscriminatory ad valorem property tax on imported goods stored in a customs-bonded warehouse and destined for domestic manufacture and sale. 479 U.S. at 152. In either case, the ruling in Xerox is not applicable because Washington is not imposing its taxes on goods stored in either a customs-bonded warehouse or in a foreign trade zone.

Second, it is obvious that Congress did not intend to occupy the entire field of taxation or regulation because, as noted, the Foreign Trade Zones Act prohibits state and local governments from imposing only ad valorem taxes on tangible personal property held in the trade zones for future export. Thus, tangible personal property in the zones that has not been either imported and held there for export, or manufactured in the U.S. and held there for export, can be subject to ad valorem taxes and other state and local taxation. For example, the Foreign Trade Zones Act does not apply to equipment and machinery used to process the imports or exports. See 19 U.S.C. § 81c(e) (production equipment, or parts thereof, admitted to a Foreign Trade Zone for use in the Foreign Trade Zone is subject to customs duties when it is placed in operation.) See also 19 U.S.C. § 81i which states, in part: "The Board shall cooperate with the State, subdivision, and municipality in which the zone is located in the exercise of their police, sanitary, and other powers in and in connection with the free zone."

Likewise, the third type of federal preemption is not applicable to this matter. That way requires a showing that state law conflicts with federal law making compliance with both an impossibility, or state law presents an obstacle to accomplishing the federal purpose. We note there is no direct conflict with federal law because federal law does not prohibit state taxation, except for ad valorem taxes, as discussed above. A taxpayer may comply with both state law and federal law without conflict when the taxpayer pays B&O tax on its gross income for services rendered, and use tax on its tangible personal property that is not held in the zone for export.

The assessment of B&O tax and use tax also is not an obstacle to accomplishing the federal purpose in establishing foreign trade zones. The Court of Appeals in 3M Health Care, supra, declared that this federal purpose is to "regulate how goods can flow through special zones to avoid the customs duties of the United States." 908 F.2d at 921. The Court of Appeals decided that Florida was preempted from regulating 3M's activities within a foreign trade zone regarding the manufacture, processing, storage, handling, marking, packaging, and shipment of pharmaceuticals even though such activities violated Florida law. The Court stated that Florida could not seek to regulate foreign goods in a place set aside by Congress for ease and economy. The Court declared the goal of the Foreign Trade Zones Act is to facilitate the use of U.S. ports for the transshipment of goods in foreign commerce.

In contrast to the state of Florida in 3m Health Care, the state of Washington is not attempting to regulate the goods in foreign commerce in any way. Washington is merely taxing the taxpayer's gross income earned from services the taxpayer provided. Stevedoring, supra. Washington also is assessing use tax on tangible personal property not in foreign commerce that the taxpayer used. Neither tax is an obstacle to accomplishing the purpose of the Foreign Trade Zone Act.

The Department correctly noted in its prior memorandum that there is a clear distinction between property in a zone that is held for export and property that is used by the taxpayer to operate its business. There is also a clear distinction between taxing tangible personal property held for export in a free trade zone and taxing gross income from services rendered in relation to that zone.

In conclusion, the assessment of Washington's B&O tax on services provided by the taxpayer and use tax on tangible personal property not intended for export that was used by the taxpayer is not preempted by federal law.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

Dated this 30th day of March 1999.