BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	F I N A L
	)	E X E C U T I V E L E V E L
	)	D E T E R M I N A T I O N
	)	
	)	No. 97-202ER
	)	
	)	Registration No.
	)	Petition for Refund
	)	

[1] RULE 193; RCW 82.04.4286: INTERSTATE SALES – ACCEPTANCE IN WASHINGTON – CONTRACT LANGUAGE. Goods are accepted in Washington where the contract between the buyer and the out-of-state seller expressly states that products shall be subject to final inspection and acceptance by the buyer at the buyer's Washington facility and inspection or acceptance in Washington actually occurs, notwithstanding any payment or prior inspection out-of state.

[2] RULE 193; RCW 82.04.4286: INTERSTATE SALES – QUALITY CONTROL DISTINGUISHED FROM ACCEPTANCE. An out-of-state inspection of goods for quality and even acknowledgement that the goods are acceptable are not the same as final acceptance and first possession of the goods themselves.

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 out-of-state corporation seeks reconsideration of Det. No. 97-202, in which we denied a refund request for business and occupation (B&O) taxes paid on gross receipts derived from wholesales of tangible personal property sold to a Washington buyer.[1]

FACTS:

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

Bianchi, Operations & Policy Manager, and Gray, A.L.J. -- The taxpayer petitions for reconsideration of Det. No. 97-202, in which we denied a refund request of B&O tax in the amount of . . . for the period January 1, 1992 through April 30, 1993.

The facts presented below are drawn from Det. No. 97-202 and the facts presented to us by the taxpayer on reconsideration.

The Audit Division denied the taxpayer's refund request based upon language in a contract between the taxpayer and the Washington customer:

> Products shall be subject to final inspection and acceptance by Buyer at destination, notwithstanding any payment or prior inspection.

The taxpayer manufactures tangible personal property outside of Washington and sells the same tangible personal property to a Washington customer. The taxpayer's Washington customer buys the taxpayer's products that are manufactured at the taxpayer's facilities outside Washington. The taxpayer argues that the Washington customer takes delivery of the tangible personal property in the state of manufacture, and that the actual acceptance of the tangible personal property occurs in that state after inspection occurs.

The taxpayer argues that the Washington customer designates some of the taxpayer's employees as the customer's agents for purposes of inspecting and accepting the taxpayer's products manufactured outside of Washington and shipped to the customer in Washington. The Washington customer designates the intended agents on a form, together with a "final inspection stamp" for each of the designated employees/agents. The stamps belong to the taxpayer, but are "approved and registered by" the Washington customer, according to the taxpayer.

At the hearing on reconsideration, the taxpayer presented affidavits from two of its employees with first-hand knowledge of the quality control program. One affidavit, from M.M., described the quality control program. It occurs in several steps. The first step is the production process itself, generating a paper trail of "build documentation." The second step is laboratory testing, simulating actual use of the product. The third step is the taxpayer's final inspection of the product, checking for "external configuration," reviewing all paper work in the "trail," serial numbers, etc. The "final inspection" is done by the "source inspectors;" who are different employees of the taxpayer acting on behalf of the Washington customer. The Washington customer designates certain of the taxpayer's employees who have "inspection" and "acceptance" authority. The "source inspectors" review all laboratory test results and certifications, review all of the taxpayer's quality assurance documentation, compare the products to the Washington customer's purchase order, and conduct numerous physical examinations of the product to verify compliance with the Washington customer's order. M.M.'s affidavit concludes, "[o]nce all paper work and source inspection procedures have been completed by this second set of eyes, the [product] can go in a box and be shipped."

The second affidavit was from B.W., another employee of the taxpayer. B.W. said he was familiar with the Washington customer's procedures when the taxpayer's product arrived in Washington. He said the Washington customer makes a "cosmetic review" limited to the external parts of the product. If the Washington customer sees an "external discrepancy," it notifies one of the taxpayer's "field service" persons. The discrepancy is included in a "quality score" for the taxpayer that encourages corrective steps on future deliveries. He said the Washington customer's review is essentially an "identification" and damage assessment. The Washington customer does not repeat the comprehensive inspections performed at the taxpayer's out-of-state facilities.

The taxpayer argued that acceptance of the taxpayer's products by the Washington customer occurred at the taxpayer's out-of-state facilities, rendering the sales nontaxable under WAC 458-20-193 (Rule 193); alternatively, if the sales are held taxable under Rule 193, then Rule 193 will be invalid because it will operate to shift the place of sale to the destination state in violation of both Washington commercial law and the Commerce Clause of the United States Constitution.

Regarding the Quality Assurance Program, the taxpayer argued that the "final inspection and acceptance" contract language, upon which we rested our prior determination, are "just words" that no longer appear in the Washington customer's contracts with the taxpayer. However, they did appear on the controlling contracts throughout the audit period. To the extent this contract language had meaning during the audit period, the taxpayer argues the words were limited to protection of the Washington customer's warranty rights under the Uniform Commercial Code. The taxpayer further contends that these contract terms should be disregarded because:

(1) the right of inspection was never in fact exercised by the buyer in Washington-- "what is written should not prevail over what has happened." In other words, the parties' conduct modified the written contract;
(2) the Department, through ETA 561.04.193, has held that the fact of inspection, not written authorization to inspect, is the critical fact upon which delivery turns;
(3) actual inspection can not be done in Washington because the necessary documentation is not here; and
(4) in addition to the thorough inspection of the goods by the quality assurance team authorized by the Washington customer, the customer also selected the common carrier, instructed the taxpayer as to how to ship the goods, and paid the freight. The taxpayer contends that these two acts satisfy Rule 193 and ETA 561.04.193's requirement of inspection/acceptance and first possession out-of-state.

After the Proposed Executive Level Determination was issued, the taxpayer made four arguments:

That the determination inaccurately characterized the taxpayer's admission that some inspection occurs in Washington;

That the determination placed a "spin," or was a "play on words," on the contract language regarding final acceptance in Washington;
That the determination ignored the agent's power to accept the goods out-of-state on behalf of the taxpayer; and
That the determination ignored the contention that the parties' conduct modified the written terms of the contract.

ISSUE:

Whether the Washington customer's contract with the taxpayer means that final acceptance of the taxpayer's product by the Washington customer occurs in Washington, notwithstanding the taxpayer's quality control program at the taxpayer's out-of-state facility?

DISCUSSION:

The taxpayer has raised, in its extensive Petition for Reconsideration, issues identical to those raised by the taxpayer in Det. No. 99-216E, 18 WTD 264 (1999), a copy of which is enclosed. That determination rejected arguments that the sales involved were out-of-state sales. For the reasons stated in that determination, we hold that the goods at issue in this appeal are also delivered in Washington, are received by the customer in Washington, and constitute Washington sales.

The effect of a Quality Assurance Program was not addressed in Det. No. 99-216E, 18 WTD 264 (1999). At the hearing on this reconsideration, and in its written presentation, the taxpayer argued that inspection out-of-state by an agent of the taxpayer on behalf of the customer constitutes delivery to the customer out-of-state. We held to the contrary in Det. No. 97-202. There we said that delivery occurred in Washington because the General Terms Agreement between the customer and the taxpayer, in effect during audit period, stated that the Washington customer reserved the right to final inspection and acceptance in Washington.

[1] We do not agree that the contract may be disregarded. As long as the parties have agreed in writing that final inspection and acceptance is to occur in Washington State, these sales are Washington sales, assuming the goods are actually delivered to and received in Washington by the buyer. In response to taxpayer's initial four arguments, as well as its objections to the proposed determination, we find the following.

First, although the representative of the out-of-state taxpayer asserted that the inspections performed in Washington are not as extensive as those performed at the taxpayer's out-of-state plant, the affidavit of the taxpayer's employee, B.W., admits that inspection at least for "external discrepancies" does occur in Washington.

Second, the reliance by the taxpayer on ETA 561.04.193 is misplaced. The purpose of ETA 561.04.193 was to clarify that goods will not be considered delivered out-of-state where a buyer

merely confers on a common carrier an ostensible right to inspect goods, if such inspection is not actually performed. Thus under the ETA, a buyer may not transform what would otherwise be Washington sales into out-of-state sales merely by authorizing an inspection out-of-state although no such inspection would actually be performed. The inference the ETA seeks to preclude could not be drawn where the buyer itself specifically reserves the right to inspect in Washington.

[2] Third, an out-of-state inspection of goods for quality and even acknowledgement that the goods are acceptable, are not synonymous with the act of final acceptance of and first possession of the goods themselves. Thus, the fact that all the documentation available to the out-of-state quality control team may not be available at the final destination does not preclude the customer from finally accepting the goods here, as opposed to acknowledging the quality of the goods. The contract language itself makes this clear: "[p]roducts shall be subject to final inspection and acceptance by Buyer at destination, notwithstanding any payment or prior inspection." The plain meaning of the actual contractual language cannot be characterized as "spin" or a "play on words."

Fourth, WAC 458-20-103 (Rule 103) and WAC 458-20-193 (Rule 193) read together clarify where delivery occurs for purposes of determining where a sale occurs. A sale takes place when the goods are delivered to and received by the buyer in this state. For tax purposes, delivery does not depend upon the identity of the party who orders and pays for shipping the goods. The mere involvement of the customer in shipping arrangements of the goods does not affect where the goods are accepted and first possessed by the customer.

Finally, the taxpayer characterizes our position, in part, as holding that automatic delivery occurs in Washington where the General Terms Agreement between the customer and the taxpayer in effect during the audit period stated that the Washington customer reserved the right to final inspection and acceptance in Washington despite conduct by the parties to the contrary. We disagree. Despite a quality assurance program out of state, where the contract language reserves the right to final inspection and acceptance in Washington and inspection or acceptance does occur in Washington, a Washington sale arises. The taxpayer's further argument that the contract language was rendered inoperative by the conduct of the parties does not square with the fact that some inspection occurred in Washington.

We find sales are Washington sales where a Washington customer by contract reserves the right to final inspection and acceptance in Washington. We make no finding regarding the legal effect of a quality assurance program such as the one presented here where the right of final inspection and acceptance in Washington State has not been reserved in the contract nor the legal effect when the final inspection and acceptance has been reserved in the contract, but no inspection or acceptance in Washington has occurred.

DECISION AND DISPOSITION:

The taxpayer's petition for refund and the request for reconsideration of Det. No. 97-202 are denied.

Dated this 26th day of August 1999.