

Cite as Det. No. 05-0020R, 25 WTD 25 (2006)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petitions For Correction of)	<u>F I N A L</u>
Assessment of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 05-0020R ¹
)	
...)	Registration Nos. ... and
)	...
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...)	Registration No. ...
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)	Docket No. ...

- [1] RULE 203, RULE 178; RCW 82.04.030, RCW 82.12.020: USE TAX -- CORPORATE DISREGARD – ALTER EGO DOCTRINE. Where a corporate entity is a mere shell with no purpose besides avoiding taxation, its only activity is holding title to assets that are for the exclusive personal convenience and benefit of its only shareholders, it has operated as the mere alter ego of the shareholders, and regarding it as separate from its shareholders would aid in the consummation of a wrong on the State, the Department may look beyond the legal fiction of distinct corporate existence and disregard the corporate entity.
- [2] RULE 193: INTERSTATE LEASES -- NEXUS. Washington has jurisdiction to tax an out-of-state lessor’s receipts from the lease of tangible personal property used in this state where the lease or the parties to the lease contemplate that the lessor’s property will be principally stored and substantially used in Washington by a Washington consumer.
- [3] RULE 178; RCW 82.12.020: USE TAX – APPORTIONING MEASURE OF USE TAX. A Washington consumer who leases a motor home from an out-of-state lessor for personal use in Washington and other states cannot apportion the measure of its use tax obligation between Washington and the other states where it uses the vehicle.

¹ The original determination, Det No. 05-0020, is published at 25 WTD 12 (2006).

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

A Washington husband and wife, and a [State A] corporation they formed to purchase and lease back to them a motor home and trailer, appeal Det. No. 05-0020, which upheld use tax assessments against both the couple and the corporation on the full value of the motor home and trailer. The taxpayers assert that Det. No. 05-0020 erred in applying the doctrine of entity disregard, erred in concluding Washington had jurisdiction to tax the corporation, and erred in other respects. We find no error of law or of fact that necessitates reconsideration of the decision, and deny the petition.²

ISSUES

- [1] Did Det. No. 05-0020 err in concluding that the corporate entity should be disregarded?
- [2] Did Det. No. 05-0020 err in concluding that Washington would have jurisdiction to tax Corporation (assuming the corporate entity was not disregarded)?
- [3] Did Det. No. 05-0020 err in concluding that the rental amounts or values on which retail sales tax or use tax would be owed could not be apportioned between Washington and other states where the motor home and trailer were used?
- [4] Were there material errors of fact in Det. No. 05-0020 requiring reconsideration of the decision?

FINDINGS OF FACT

Prusia, A.L.J. – . . . are husband and wife. At all times relevant to this appeal, they have resided in [Washington City], Washington, where they own and operate several [businesses]. . . . (“Corporation”) is a [State A] corporation wholly owned by the [Husband and Wife]. The [Husband and Wife] and Corporation petition for reconsideration of Det. No. 05-0020, which upheld a use tax assessment against the [Husband and Wife] (and a use tax assessment against Corporation, as merely duplicative) on the full value of a motor home and trailer that the [Husband and Wife] used in Washington and other states. The additional facts below are drawn from Det. No. 05-0020, and exhibits previously submitted.

On January . . . , 1999, the [Husband and Wife] applied for a loan to purchase a . . . motor home, stating to the lender that they wanted the motor home in a shell corporation and would not be using it for business. On the same day, . . . , an attorney in [State A Location], formed Corporation for the [Husband and Wife]. Corporation was formed for the stated purpose of

² Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

acquiring personal property. On January . . . , 1999, Corporation purchased the . . . motor home for \$. . from a [State C] seller, paying \$. . down and agreeing to finance the balance of \$. . over a fifteen-year period, with installments of \$. . due monthly. On January . . . , 1999, the following occurred. Corporation held an organizational meeting in attorney[’s] office in [State A Location], by phone, electing [Husband] as President and [Wife] as Treasurer Secretary, and receiving from the [Husband and Wife] the transfer of their title and interest in the motor home in return for 500 shares each in Corporation. [Husband] signed an affidavit of acceptance of the motor home in [State D]. Corporation provided the lender with a corporate resolution to obtain credit, signed by the [Husband and Wife] as President and Secretary. The [Husband and Wife], as individuals, gave the lender a general continuing guaranty of extension of financial accommodations by the lender to Corporation.

In February 1999, attorney . . . , as agent for Corporation, applied for a [State A] certificate of title for the motor home. The application stated Corporation’s address as . . . [State A Location], which was then the office address of attorney . . . [State A] issued a certificate of title to Corporation. Subsequent [State A] registrations show the motor home continuously registered to Corporation at office addresses of attorney

In May 1999, [a State B] manufacturer sold a . . . utility trailer to Corporation. The Manufacturer’s Certificate of Origin stated that the buyer’s address was a street address in [State A Location]. In June 1999, Attorney . . . , as agent for the purchaser, applied for a [State A] certificate of title for the trailer. [State A] issued a certificate of title to Corporation. Subsequent [State A] registrations show the trailer continuously registered to Corporation at an office address of attorney

Corporation’s annual minutes for 2003 and 2004 recite that Corporation and the [Husband and Wife] entered into rental arrangements for use of the motor home and trailer in 1999; the specific date is not specified. Those minutes recite the arrangement as follows:

[T]he arrangement provided that all costs associated with the custody and operation of the coach and trailer be paid by the tenant and that the tenant pay rent based upon road mileage with minimum rents by the Shareholders as tenants equal to the payments due by the Corporation on the acquisition debt of the coach and trailer, payable directly to the lender.

There was no written rental agreement between Corporation and the [Husband and Wife]. At a hearing in July 2004, [Husband] stated that the [Husband and Wife] had rented the motor home and trailer from Corporation continuously since 1999, for their business and personal use. He stated the rental arrangement between Corporation and the [Husband and Wife] was that the [Husband and Wife] would pay all costs associated with storing, licensing, insuring, fueling, and maintaining the vehicles, and additionally would pay the greater of: a) \$2.50 per mile for the first 20,000 miles the motor home was used annually, plus \$5.00 per mile for additional annual miles, or b) the monthly installments due the financing company. The [Husband and Wife] paid all costs associated with custody and operation, and paid the monthly installments to the financing company. They never drove the vehicle enough in any year to owe Corporation more than the

amount of the monthly installments. [Husband] has been listed as the insured on the automobile insurance policy for the motor home and trailer, and Corporation listed on the policy as an additional loss payee.

Corporation engaged in no business activity other than renting the motor home and trailer to the [Husband and Wife]. The [Husband and Wife] were the sole operators of the motor home and trailer.

Corporation has held annual corporation meetings, by conference call, since it was formed. Corporation provided the Department with copies of the 2003 and 2004 annual meetings, as examples. The wording of the two sets of minutes is identical, except for the dates and the signatures of the officers. Regarding the lease to the [Husband and Wife], the minutes simply state that [Husband] reported that the agreement had been renewed for an additional year. There is no evidence that Corporation has maintained its own financial records, has maintained a separate checking account, or has filed federal income tax returns.

The [Husband and Wife] state they used the motor home and trailer entirely outside Washington during 1999, and never brought either vehicle into the state.

On May 24, 2000, [Husband] rented a storage unit in [Washington City]. The [Husband and Wife] stated they brought the motor home and trailer into Washington in June 2000, and stored the vehicles at the storage facility.

The [Husband and Wife] provided a statement of the general whereabouts of the motor home and trailer between June 2000 and the end of 2003. That statement is summarized in Det. No. 05-0020. It lists the vehicles as stored in [Washington City] during parts of each year, and mostly used outside Washington when not stored in [Washington City]. The [Husband and Wife] stated that the vehicles' only use in Washington was traveling to and from storage at the end and beginning of the [Husband and Wife's] . . . business and personal trips outside the state. When in [Washington City], it was stored at a storage facility except just before and just after trips out of state, when it was parked at the [Husband and Wife's] residence. When it was outside Washington, it was temporarily stored much of the time at various locations.

The [Husband and Wife] paid, from their personal and . . . business funds, all expenses for operating, storing, maintaining, licensing, and insuring the motor home and trailer. The [Husband and Wife] provided the Department with repair invoices verifying repairs outside Washington, which show dates of repairs and mileage on the motor home. They stated those and other maintenance records they could produce show the miles they actually drove the motor home annually in and outside Washington. They provided a statement of in-state and out-of-state mileage shown by those records, which is summarized in Det. No. 05-0020. The statement shows the vehicles were not driven in Washington at all in 1999, and the Washington percentage of annual miles driven as varying between 9.07% and 2.39%.

During a 2002 audit of the [Husband and Wife's] . . . business, the Department became aware of, and inquired about, the motor home. At that time, [Husband] told the Audit Division that the

motor home was purchased out of state and stored in [State A]. During Christmas week 2002, an officer of the Washington State Patrol observed the motor home and trailer, bearing [State A] plates, parked near the [Husband and Wife's] residence in [Washington City]. The Department's Compliance Division investigated, and on November 11, 2003, issued separate uses tax/deferred sales tax assessments against Corporation and the [Husband and Wife], on both the motor home and the trailer. The measure of the use tax, in both assessments, was the value of the vehicles, stated as \$. . .and \$. . . respectively. The total tax assessed in each assessment was \$. . . . Interest of \$. . .and penalties of \$. . . also were assessed. . . .

Prior to the assessments, neither the [Husband and Wife] nor Corporation reported or paid any retail sales tax or use tax to Washington on the motor home or trailer. The assessments remain unpaid.

Both the [Husband and Wife] and Corporation appealed their respective assessments. Corporation requested cancellation of the assessment against it, in its entirety. The [Husband and Wife] requested that the assessment against them be adjusted to limit their use tax liability to the portion of their rental payments associated with the miles they actually drove the motor home in Washington.

Det. No. 05-0020 disregarded the corporate entity, and upheld the assessments; it upheld the assessment against Corporation as merely duplicative of the one against the [Husband and Wife]. The [Husband and Wife] and Corporation jointly petition for reconsideration of Det. No. 05-0020, alleging that the determination made errors of fact and law that necessitate reconsideration.

ANALYSIS

This appeal concerns identical, alternative use tax assessments against two taxpayers, a [State A] corporation and its Washington owners, on the use of a motor home and trailer in Washington. Washington imposes a use tax for the privilege of using within this state as a consumer, any article of tangible personal property purchased at retail, upon which retail sales tax has not been paid. RCW 82.12.020.

Det. No. 05-0020 concluded that the corporate entity should be disregarded, under the alter ego doctrine. The facts and case law supporting that conclusion are set out in Det. No. 05-0020. After disregarding the corporate entity, Det. No. 05-0020 summarized the situation as one of Washington residents (the [Husband and Wife]) who purchased a motor home and trailer out of state, did not pay retail sales tax or use tax, and subsequently used both the motor home and the trailer as consumers in Washington. The [Husband and Wife] were liable for use tax in that situation. Use tax liability arose when the property was first put to use in this state. The measure of the use tax was the value of the articles at the time of first use in Washington. Det. No. 05-0020 referenced the applicable statutes and rules.

Det. No. 05-0020 also analyzed the tax consequences if the corporate entity were not disregarded. Regarding the assessment against Corporation, Det. No. 05-0020 concluded that the Department had jurisdiction to tax Corporation's lease receipts, because the property was leased

for use in this state, and the parties to the lease knew and agreed that it would be used in Washington. We cited Det. No. 87-171, 3 WTD 153 (1987), Det. No. 87-171A, 5 WTD 281 (1988), and Det. No. 91-313, 12 WTD 29 (1993), in support of our conclusion. Det. No. 05-0020 rejected the argument that Corporation would have the right to apportion its lease receipts for sales tax purposes based upon the [Husband and Wife's] use of the property in more than one state. It concluded that Corporation would be liable for uncollected retail sales tax on the [Husband and Wife's] rental payments.

Continuing to assume, hypothetically, that the corporate entity was not disregarded, Det. No. 05-0020 considered the assessment against the [Husband and Wife]. The [Husband and Wife] had agreed to an annual rent. They were liable for deferred retail sales tax or use tax on the reasonable rental value of the items. Det. No. 05-0020 found that the rental agreed upon between Corporation and the [Husband and Wife] was not a reasonable rental value. The [Husband and Wife] would be liable for tax on the full annual reasonable rental value of the motor home and trailer.

On reconsideration, Corporation and the [Husband and Wife] assert that Det. No. 05-0020 made three errors of law, one relating to the requirements for the application of the doctrine of entity disregard, one relating to whether Corporation had sufficient nexus for Washington to assess tax against it, and one relating to the measure of retail sales tax or use tax on the leased property used in more than one state (proration or apportionment issue). They assert that Det. No. 05-0020 made two errors of fact, one being the reasonableness of the rentals, and the other being that the lease lacked a profit element. We first consider their arguments on the entity disregard issue.

Entity disregard

We understand the arguments of the [Husband and Wife] and Corporation to be:

- Det. No. 05-0020's analysis of the doctrine of entity disregard is, as a matter of law, in error. It ignores the second prong of the disregard test, which is that the abuse of the corporate form cause harm to the party seeking relief. *See Rogerson Hiller Corp., v. Port of Port Angeles*, 96 Wash. App 918, 982 P.2d 131 (1999), *Meisel v. M & N Modern Hydraulic Press Co.*, 97 Wn.2d 403, 645 P.2d 689 (1982), and *Morgan v. Burks*, 93 Wn.2d 580, 611 P.2d 751 (1980), which hold that there must have been an intentional disregard of the corporation and its separate identity, that disregard must have been for the purpose of damaging a third party, and that disregard must have caused losses to the third party.
- Disregard is considered only if the corporate form was abused to avoid a duty to a third party. Corporation's only duties were to the lender and the shareholders. It performed those duties. Corporation had no duty to the Department.

- There is no evidence that the Department was injured by any corporate informality in this case. The reduction in use tax arose not because the [Husband and Wife] used the corporate form, but because they used the motor home principally out of state. Had they used it only in Washington, the Department would have collected the use tax on the rental payments over a period of years.
- Det. No. 05-0020's reliance on *Platt v. Bradner Co.*, 131 Wash. 573, 580, 230 P. 633 (1924), in support of its conclusion that entity disregard is proper, is legally questionable. *Platt* has not been favorably cited for the proposition upon which Det. No. 05-0020 relies in more than 40 years.
- Det. No. 05-0020's analysis conflicts with the Department's longstanding position to give effect to all entities with a view to collecting taxes on inter-entity transactions. The Department cannot urge that the entity existence should be given effect for purposes of imposing the B&O tax and, on the other hand, urge that the entity should be ignored when it shields a taxpayer from use tax. See, e.g., *Sav Mor Oil Co. v. State Tax Comm'n*, 58 Wn.2d 518, 520-23 (1961); *Rena Ware Distributing, Inc. v. State*, 77 Wn.2d 514, 518 (1977). . . .

[1] A difficulty with both Det. No. 05-0020's analysis and Corporation/[Husband and Wife's] analysis is that none of the Washington court decisions discussed is exactly on point. However, we continue to conclude that the alter ego doctrine of entity disregard applies in this case. In general, a corporation is a separate legal entity. But when there is such a unity of interest and ownership that the separate personalities of the corporation and the individual do not exist, and the corporation is instead a mere simulacrum, an alter ego of one or a few individuals, the courts will not be blinded by the mere corporate form, and if observance of the corporate form would sanction a fraud, injustice, or violation of public policy, will disregard it. *Platt, supra*.

Courts and administrative agencies in other jurisdictions have found especially significant in this analysis whether the corporation has any purposeful business activity besides avoiding taxation. See *National Investors Corp. v. Hoey*, 144 F.2d 466 (2d Cir. 1944); *U.S. v. Klein*, 139 F. Supp. 135 (S.D.N.Y. 1955), *aff'd* 247 F.2d 908 (2d Cir. 1957), *cert. denied* 355 U.S. 924; *Jackson v. C.I.R.*, 233 F.2d 289 (2d Cir. 1956); *Brown, Rudnick, Freed & Gesmer v. Board of Assessors*, 1982 WL 11673 (Mass. App. Tax. Bd., Feb. 04, 1982); *Coppa v. Taxation Div. Director*, 8 N.J. Tax 236 (N.J. Tax Ct. 1986); *In the Matter of the Appeal of Pacific American Equities, Inc.*, 1991 WL 169120 (Cal. St. Bd. Eq. 1991). To be afforded recognition, the form of business the taxpayer chooses must be a viable business entity, that is, it must have been formed for a substantial business purpose or actually engage in substantial business activity. Escaping taxation is not a substantial business activity. The Department has taken this view as well, holding that the doctrine of disregard will be invoked to serve the purpose of the tax statutes when the form of carrying out the challenged tax event is unreal or a sham. See Det. No. 04-0087, 23 WTD 307 (2004). . . .

Corporation and the [Husband and Wife] assert that the existence of economic substance beyond the mere avoidance of taxes on the formation of Corporation is shown by the fact that Corporation had the residual value of the motor coach after the repayment of the debt. This argument is without merit. The [Husband and Wife] would have had the residual value of the motor home after they paid off the loan even if they had not formed the corporation. They did not form the corporation with the object of any gain, benefit, or advantage beyond avoiding the payment of tax.

We find no merit in the argument that the Department is not injured by the [Husband and Wife's] use of the corporate form. It is the policy of this state that Washington consumers pay use tax on their use of articles of tangible personal property purchased at retail, in an amount equal to the value of the article used, at the time of first use in this state. RCW 82.12.020 and 82.12.010(3). The [Husband and Wife] seek to avoid that obligation by forming the corporation to hold the property and lease it to them. Under their proration argument, Washington would never collect more than a fraction of the use tax due on the purchase. Even when the proration argument is rejected, the Department might or might not eventually collect the same amount of tax, depending upon how long the [Husband and Wife] "lease" the motor home. If the Department did not collect use tax on the full value, it clearly would be damaged. Even if it did collect that amount over a period of years, it would be damaged by loss of the use of the money during the intervening years.

As for Corporation and the [Husband and Wife's] argument that Det. No. 05-0020's analysis conflicts with the Department's longstanding position to give effect to all entities, the general rule is that a taxing authority may penetrate the form of a transaction to determine its substance, but a taxpayer may not. Det. No. 86-296, 2 WTD 19 (1986).

We find no error in Det. No. 05-0020's application of the alter ego doctrine.

Jurisdiction to tax Corporation

On reconsideration, the [Husband and Wife] and Corporation assert that Det. No. 05-0020 erred in holding that Corporation has sufficient nexus with Washington for the state to have jurisdiction to tax its revenue from leasing the motor home and trailer to the [Husband and Wife]. We understand their argument to be as follows. Corporation had no minimum contacts with Washington. This was nothing more than an instance of leased property finding its way into the state, and that is not sufficient to establish nexus. Corporation did not bring the motor home or trailer into Washington, the [Husband and Wife] did. Under WAC 458-20-193 (Rule 193), the presence of the leased asset in Washington and the payment of rents to an out-of-state lessor is simply not sufficient nexus to meet the substantial presence test of the Commerce Clause.

This is not a situation of leased property merely "finding its way" into the state. Rather, this is a situation of a closely-held entity purchasing leisure goods for the sole purpose of leasing them to its only shareholders, who are Washington residents, for their personal use. The lessor knew and agreed that its property would be principally stored and substantially used in Washington.

[2] Corporation existed only to lease property to Washington residents. By its agreement with the [Husband and Wife], Corporation maintained personal property in Washington and did business here. It knowingly and purposefully entered the state for the purpose of deriving income here. Other than having its registered agent in [State A], it engaged in business only in Washington. It and its activities thus were within the reach of the Department. *Stoen v. Stapling Machines Co.*, 71 So.2d 205 (Miss. 1954); *Curray v. McCanless*, 307 U.S. 357 (1939); *Tacoma v. Fiberchem, Inc.*, 44 Wn. App. 538, 722 P.2d 1357 (1986).

We continue to conclude that the Department would have jurisdiction to tax Corporation on the lease income.

A lease is not a single transaction, but a series of transactions. *Gandy v. State*, 57 Wn.2d 690, 695, 359 P.2d 302 (1961). Persons who lease tangible personal property to users or consumers are required to collect from their lessees the retail sales tax measured by gross income from rentals as of the time the rental payments fall due. WAC 458-20-211(6) (Rule 211(6)). Corporation and the [Husband and Wife] agreed upon an annual rent, and therefore the retail sales tax would have been collectable annually.

Proration or apportionment argument

On reconsideration, Corporation and the [Husband and Wife] contend Det. No. 05-0020 erred in holding that, if the corporation were not disregarded, the rental amounts or values on which retail sales tax or use tax would be owed could not be apportioned between Washington and other states where the [Husband and Wife] used the property. They argue that Det. Nos. 87-171 and 87-171A, *supra*, recognize that Washington can only tax the rents allocable to Washington when an out-of-state lessor leases mobile property to a lessee.

[3] Det. Nos. 87-171 and 87-171A dealt with a distinctly different situation, an out-of-state lessor leasing barges to an out-of-state consumer for use in interstate commerce. In the present case, the consumers were Washington residents, and they did not lease the motor home and trailer for use in interstate commerce. Corporation and the [Husband and Wife] cite no authority for the proposition that a Washington consumer who leases a vehicle from an out-of-state lessor for personal use can apportion the measure of its use tax obligation between Washington and other states when it uses the vehicle in Washington part of the time and outside the state part of the time.³

³ Washington law provides for proration of the use tax based on actual usage in Washington under extremely limited circumstances, *e.g.*, when motor vehicles and other vehicles are used primarily by persons engaged in operating as a private or common carrier in interstate or foreign commerce, and in certain bailment situations. RCW 82.12.0254; WAC 458-20-175 (Rule 175); Rule 211(7). Such vehicles are also subject to proration registration.

Because they were Washington residents, the [Husband and Wife] were required to register the motor home and trailer in Washington. They failed to do that. The fact that the vehicles were “leased” did not alter that requirement. *See* RCW 46.16.010 and WAC 308-56A-070.

Alleged factual errors

Corporation and the [Husband and Wife] argue that Det. No. 05-0020 erred in finding that the agreed rental payments did not represent a reasonable rental value.

We agree that there are insufficient facts in the record to support a finding whether the agreed-upon rents, at least for the period at issue, were reasonable. Det. No. 05-0020 is modified to delete the finding that the rents agreed upon were not a reasonable rental value. However, this error is immaterial. Det. No. 05-0020 was decided on the corporate disregard issue.

The Petition for Reconsideration alleges a second error of fact, Det. No. 05-0020's finding that the lease lacked a profit element. Corporation and the [Husband and Wife] argue that Corporation had the opportunity to earn a substantial benefit, the residual value of the motor coach after repayment of the debt. We agree that there are insufficient facts to support a finding that Corporation could not have earned a "profit." Whether it would or would not have, is speculative. This was not an ordinary commercial vehicle lease, in which the lessee pays a set rental amount for a set lease period, and agrees to either pay a predetermined residual payment at the end of the lease or return the vehicle. It was a verbal lease from year to year, on terms to be agreed upon each year. Whether Corporation would ever have realized a "profit" would have depended upon future terms agreed upon between its officers and themselves as individuals. Of course, any "profit" would simply have been money flowing from the [Husband and Wife] to Corporation and right back to the [Husband and Wife]. Det. No. 05-0020 is modified to find that the lease was not an ordinary commercial lease and was not structured to give Corporation a reasonable guarantee of a profit.

We find no mistake of law or fact in Det. No. 05-0020 that necessitates reconsideration of the decision. We deny the petition for reconsideration.

DECISION AND DISPOSITION

The taxpayers' joint petition for reconsideration is denied.

Dated this 28th day of October 2005.

Even if the rental value could be apportioned among the states, it is questionable whether it could be on the basis of miles driven. In Washington, "use" includes storage. RCW 82.12.010(3). The motor home and trailer were stored in Washington much of the time.