Cite as 11 WTD 67 (1990).

BEFORE THE INTERPRETATION AND 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. 90-298
. . .	)	Registration No. . . .
	)	TA # . . .
	)	TA # . . .
	)	. . ./Audit No. . . .

[1] RULE 178: USE TAX -- EQUIPMENT ACQUIRED OUT OF STATE -- PARTS USED IN REPAIRS -- EQUIPMENT USED IN STATE. Use tax sustained on the value of repair parts installed outside of Washington into equipment that was later brought into the state for use on a construction contract.

[2] RULE 178: & RCW 82.12.020 -- USE TAX -- VALUE OF ARTICLE USED -- ACQUIRED OUT OF STATE -- FAIR MARKET VALUE -- PERSONAL PROPERTY TAX SCHEDULES. Equipment acquired outside the state and subsequently used in the state is subject to use tax on the fair market value of the equipment at time of first use within this state. Absent objective evidence supporting a different fair market value of equipment brought into this state, valuation based on personal property tax schedules sustained. Accord: Det. 89-375, 8 WTD 129 (1989); Dist. 87-105, 3 WTD 1 (1987).

[3] RULE 178: USE TAX -- DREDGING ON THE BORDER -- APPORTIONMENT -- SUPPLIES CONSUMED ON THE JOB. Where a taxpayer performed dredging services . . . along the Washington and Oregon border, apportionment of supplies actually consumed during the dredging activity was allowed. No apportionment, however, is allowed on repair parts.

[4] RULE 229: & RCW 82.32.060 & RCW 82.32.050 -- NON-CLAIM PERIOD -- TAX ASSESSMENT -- DETERMINING AMOUNT OF USE TAX PROPERLY DUE -- OVERPAYMENTS. In computing the amount of additional use tax "properly due" for a tax assessment, an auditor must take into consideration all use tax liability and all payments during the audit period, including double payments or payments made in error even though the period for claiming a refund for a particular payment of taxes under 82.32.060 may have passed. Accord: Puget Sound Power & Light Co. v. State, 70 Wn.2d 493, (1967).

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF ORIGINAL HEARING: . . .
(Conducted by Potegal, ALJ.)
DATE OF REHEARING: . . .
(Conducted by Okimoto, ALJ.)

NATURE OF ACTION:

A taxpayer protests additional taxes and interest assessed in an audit report.

FACTS:

Okimoto, A.L.J. -- . . . (taxpayer) operates a marine construction business based in . . . , Oregon. The taxpayer's books and records were audited for the period January 1, 1977 through December 31, 1980. As a result, TA # . . . (1981 tax assessment) was issued [in March 1981] which the taxpayer paid in full [in April 1981]. A subsequent partial audit covering the same period and resulting in TA # . . . was issued [in September 1981]. [In December 1985], the taxpayer filed a written petition for correction of the 1981 tax assessment, and requested the appropriate credit. At that time, the Department was in the process of conducting a separate examination of the taxpayer's records for the period January 1, 1981 through June 30, 1985. As a result of this second audit examination, TA # . . . (1985 tax assessment) was issued [in December 1985].

A post-assessment adjustment #2 correcting the 1981 tax assessment was issued [in April 1986] and the credit due was applied to the currently outstanding 1985 tax assessment. Because the taxpayer believed that additional credit should have been given, it filed an amended petition for appeal of the 1981 tax assessment [in April 1986].

A post-assessment adjustment #1 covering the 1985 tax assessment was issued [in December 1986]. Because the taxpayer believes that additional adjustments should be made on the 1985 assessment, the taxpayer has appealed, and the balance of the assessment remains due.

TAXPAYER'S EXCEPTIONS:

Issue #1: Use Tax Applied to Component Parts; Articles Previously Assessed

In the audit report, the auditor assessed use tax on the value of parts installed into equipment during the course of repairs or refurbishment at the taxpayer's [Oregon] maintenance facility. The taxpayer describes the situation in its petition as follows:

> Articles of tangible personal property, primarily heavy construction equipment, were previously reported or assessed Use Tax at point of "first use." At a later date these same articles were then sited at [taxpayer's Oregon] Maintenance Facility for extensive repair, maintenance and/or necessary improvement. These particular articles eventually re-entered Washington whereupon Use Tax was again asserted. The measure of the tax was confined to the depreciated value of component parts as were replaced or added.

At the hearing, the taxpayer protested this assessment for the following reasons:

1. The taxpayer argues that RCW 82.12.010 & .020 imposes a use tax upon the "value of the article used." The taxpayer argues that the phrase "article used" refers only to the completed piece of equipment, and not the individual component parts that make up that equipment. The taxpayer contends that once a part is installed, it loses its separate identity, and can no longer be taxed as a separate article used. In support of this proposition, the taxpayer cites International Business

Machines v. State of Missouri; 408 SW 2d 833, (1966) and Commercial Leasing, Inc. v. Johnson, 197 A.2d 323, (1964).

2. The taxpayer next argues that the total value of this equipment had already been subjected to use tax in previous audits or reported on previous tax returns. The taxpayer refers to RCW 82.12.0252 as exempting from "use tax" property upon which tax has already been paid by the user. Since the equipment has already been subjected to use tax, the taxpayer argues that RCW 82.12.0252 precludes the Department from taxing that same equipment or any component part thereof, a second time.

3. Next, the taxpayer argues that by assessing use tax on the value of the parts used to repair equipment subsequently brought into the State, the Department is grossly inflating the value of the equipment in a manner unsupported by either RCW 82.12.010 or Rule 178. In support of this, the taxpayer cites a study where a used car valued at $2,500 was "parted out" for a total of $13,000. The taxpayer refers to this study to illustrate that in many cases, the sum of the parts greatly exceeds the value of the entire car. Using this analysis, the taxpayer argues that by assessing use tax on individual parts, the auditor is artificially inflating the taxpayer's use tax liability.

4. The taxpayer also argues that by interpreting the use tax as separately applying to repair parts installed into equipment outside the State and subsequently used in the State, the Department is unconstitutionally discriminating against interstate commerce under the United States Supreme Court's holding in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 51 L.Ed. 2d 326, (1977). The taxpayer explains its position in a supplemental brief as follows:

> Although the Washington use tax does not appear to be "facially discriminatory" as to the taxation of repair or component parts installed out of state, because similar parts are taxed when installed on equipment or machinery with a situs within the State of Washington, nevertheless, there is an "actual discriminatory impact" on out-of-state taxpayers (. . .) on account of the burdensome record-keeping requirement imposed by the State with respect to the repair or component parts installed. ... At the time of the installation of the part on the article previously taxed, it is unknown whether that part will ever be used in the State of Washington.

> Therefore, the use tax imposed does not pass the discrimination test in Complete Auto Transit, supra, because instate taxpayers are not similarly burdened, having simply paid sales or use tax when the part is purchased or installed in Washington....

Finally, the taxpayer argues that if use tax is due on the parts, it seeks the following:

1. A trade-in credit for the value of the part removed upon which tax was paid.

2. A valuation based on the reasonable rental value of parts temporarily brought into the state and used less than 90 days under RCW 82.12.010 (hereinafter referred to as the 90-day rule).

Issue #2: Measure of Use Tax; Valuation Method

When assessing the use tax on the value of construction equipment acquired by the taxpayer outside the state, and subsequently used in Washington, the auditor would normally accept the taxpayer's book value. On older equipment that was fully depreciated, however, the taxpayer carried the equipment at zero value. In such cases the auditor resorted to personal property tax schedules to arrive at the value of the equipment. These values ranged from a low of 20% of acquisition costs to a high of 62%.

The taxpayer objects to the auditor's use of personal property tax valuation schedules to determine the value of fully depreciated equipment. The taxpayer questions the validity of schedules which value fully depreciated equipment at up to 62% of their acquisition costs. The taxpayer also states that this equipment is overused and abused construction equipment, and should not be valued based on a non-business user. Although the taxpayer concedes that the equipment does have some value, it suggests that "an estimated minimum salvage value be attached to these assets." The taxpayer has presented no objective evidence supporting a different valuation, but suggests that the Department has used a 10% salvage value for other taxpayers in similar situations and believes that it is only fair and equitable that this method be used in its case.

Issue #3: Allocation Procedures - Use Tax, Consistent Application

The taxpayer complains that, the auditors asserted use tax on 100% of supply materials withdrawn for their [Oregon] facility and coded to certain dredging jobs on the . . . River. The taxpayer explains that these dredging jobs are performed entirely within the confines of the . . . River. Sometimes the barge is working and consuming materials on one side of the border and sometimes on the other. The taxpayer contends that it is impossible to accurately determine what portion of supplies is used in Washington and what portion is used in Oregon. The taxpayer recounts that this problem was discussed with prior auditors and that they agreed that the best method was to apportion the consumable supplies 50/50 between the two states. The taxpayer now contends that it has relied on these instructions to its detriment and that the Department should be estopped from changing them retroactively.

Issue #4: Statute of Limitations - Credits Disregarded

In the original audit report which was issued [in December 1985], the auditors assessed additional use and/or deferred sales taxes due during the tax year 1981. [In December 1985] the non-claim period for refunds of overpaid taxes for the 1981 tax year expired. When the taxpayer reviewed the audit report in the early part of 1986, the taxpayer discovered that during the months March of 1981
through October of 1981, it had double reported use tax on 12 pieces of equipment. When the taxpayer brought this error to the attention of the auditors, it was told that a credit for overreporting use tax could not be allowed because the non-claim period for 1981 had expired, and the taxpayer had not filed a refund request by the . . . deadline.

The taxpayer disagrees and argues in its petition as follows:

> RCW 82.32.060 allows a taxpayer four years (`the statutory period ... prescribed by RCW 82.32.050') to determine if a tax has been paid in excess. As the current audit stands, tax has been assessed in excess and, if paid, the taxpayer will be entitled to credit or refund at his option. We are not challenging the limitation whereby `no refund or credit shall be made for taxes paid more than four years prior.' We challenge the 1986 assessment which asserts deficiency in 1981 proven to be $ . . . in `excess of that properly due.'

ISSUES:

1. Does the use tax separately apply to parts installed into equipment repaired outside the state and subsequently brought into the state even though tax may have been previously paid on that same piece of equipment?

2. Upon what value is use tax to be assessed on fully depreciated equipment brought into the State of Washington for use in a construction job?

3. Should use tax be apportioned on supplies consumed during dredging jobs performed entirely within the confines of the . . . River along the Washington/Oregon border?

4. Where use tax is assessed in a tax assessment may a credit for double payment of use tax be considered when determining the amount of additional use tax "properly due", even though the period for claiming refunds under RCW 82.32.060 has passed?

DISCUSSION:

[1] RCW 82.12.020 imposes upon:

> ...every person in this state a tax or excise for the privilege of using within this state as a consumer any article of tangible personal property purchased at retail, or acquired by lease, gift, repossession, or bailment, or extracted or produced or manufactured by the person so using the same, or otherwise furnished to a person engaged in any business taxable under RCW 82.04.280, subsections (2) or (7). ... This tax shall apply to the use of every article of tangible personal property, ...

We have examined the two cases cited by the taxpayer from other jurisdictions and although we find them persuasive, do not find them controlling. This issue is simply not one of first impression before the Department. The Department has consistently held that use tax separately applies to the value of repair parts installed into equipment outside the state and subsequently brought into and used in Washington. Installation notwithstanding, for purposes of use tax these parts retain a taxable identity separate and apart from the equipment in which they are installed. Consequently, they are fully subject to use tax on their fair market value if no retail sales tax has been previously paid. Support for this position can be seen in WAC 458-20-178 (Rule 178) which is the duly promulgated regulation implementing the above statute and

has the same force and effect unless declared invalid by the judgment of a court of record not appealed from. RCW 82.32.300. It states in part:

> (2) In general, the use tax applies upon the use of any tangible personal property, the sale or acquisition of which has not been subjected to the Washington retail sales tax. Conversely, it does not apply upon the use of any property if the sale to the present user or to the present user's donor or bailor has been subjected to the Washington retail sales tax, and such tax has been paid thereon. Thus, these two methods of taxation stand as complements to each other in the state revenue plan, and taken together, provide a uniform tax upon the sale or use of all tangible personal property, irrespective of where it may have been purchased or how acquired. (Emphasis ours.)

The rule makes it clear that the Legislature intended that the two taxing statutes should complement each other and uniformly tax all non-exempt tangible personal property used within the state. To narrowly construe the definition of "article used" as suggested by the taxpayer would result in the taxpayer being able to completely avoid use tax on these repair parts which the taxpayer is undeniably using as a consumer within this state. We believe that such a result would be clearly contradictory to the Legislature's intent.

We do not believe that RCW 82.12.0252 provides relief. It states in part:

> The provisions of this chapter shall not apply in respect to the use of any article of tangible personal property purchased at retail or acquired by lease, gift or bailment if the sale thereof to, or the use thereof by, the present user or his bailor or donor has already been subjected to the tax under chapter 82.08 or 82.12 RCW and such tax has been paid by the present user or by his bailor or donor;

Since we have already held that the parts retain a separate taxable identity exclusive of the equipment, and the taxpayer concedes that no sales or use tax has been paid on those parts, RCW 82.12.0252 does not apply.

Nor do we agree with the taxpayer's argument that separately taxing the parts distorts the valuation of the equipment. As

stated above, the auditor is not taxing the equipment, but only the value of repair parts installed into the equipment. As such, it is the retail value of those parts upon which the use tax applies. RCW 82.12.010. We also note that if the taxpayer had installed the parts in Washington, it would have been taxable on the value of those parts. We fail to see the distortion if a similar result occurs when the taxpayer installs the parts outside the state.

In addition we do not believe that requiring an out-of-state taxpayer to keep records substantiating an exemption which is not available to an instate taxpayer is an unconstitutional application of the tax under the holding of Complete Auto Transit. We note that RCW 82.32.070 states in part:

> Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable,... (Emphasis ours.)

The statute places the same burden on every person engaged in business within the state. In addition, all taxpayers must document their exemptions. We do not believe the fact that an exemption may only be available to out-of-state taxpayers, thus requiring only out-of-state taxpayers to keep documentation, is sufficient to render a tax unconstitutional. Accordingly, we must deny the taxpayer's petition on this issue.

Next, WAC 458-20-247 (Rule 247) states in part:

> RCW 82.12.010 defines the measure of the use tax as the "value of the article used." Under certain circumstances that value is determined by the "selling price" of the article or property used. Also, this use tax statute provides that the meaning of words in chapter 82.08 RCW (retail sales tax) shall have full force as well with respect to the use tax chapter. Thus, the Initiative 464 amendment of the definition of "selling price" will apply equally for use tax purposes. Therefore, the measure of the use tax for tangible property upon which no retail sales tax has been paid (e.g., if it were purchased in another state with no sales tax) is the same "selling price" as defined for retail sales tax purposes. In such cases the value of the

> property traded-in will be excluded from the use tax measure. (Emphasis ours.)

Accordingly, if the taxpayer can provide documentation that it traded-in a used part to a retail dealer during the purchase or acquisition of the new part that is now being taxed, it is entitled to the deduction. This deduction, however, only applies to parts purchased from a retail dealer and delivered to the taxpayer after the December 6, 1984 effective date of the initiative.

Finally, although the 90-day rule for valuation may apply to parts subjected to tax in the future, it has no application during the current or past audit periods. The Washington State Legislature passed Chapter 222, Sect.1 during the regular legislative session of 1985. This law amended RCW 82.12.010 to allow a reduced valuation for property brought temporarily into the state by out-of-state businesses and used for less than 90 days. However, Article II Sect. 41 of the Washington State Constitution provides:

> No act, law, or bill subject to referendum shall take effect until ninety days after the adjournment of the session at which it was enacted.

Since the legislative session at which Chapter 222, Sect.1 was enacted was adjourned on April 28, 1985, the law does not take effect until ninety days after that date. Unfortunately, the taxpayer's audit period ends on June 30, 1985, or approximately 30 days prior to the effective date of the legislation.

[2] Measure of Use Tax; Valuation Method

RCW 82.12.020 imposes the use tax on the "value of the article used." RCW 82.12.010 defines the "value of the article used" as:

> ... the consideration, ..., paid or given or contracted to be paid or given by the purchaser to the seller for the article of tangible personal property, the use of which is taxable under this chapter. ... In case the article used is ... sold under conditions wherein the purchase price does not represent the true value thereof, the value of the article used shall be determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and

> character under such rules and regulations as the department of revenue may prescribe. (Emphasis ours.)

When equipment is acquired and used outside the state for an extended period of time and is then subsequently brought into and used inside the state of Washington, we believe that it is acquired under conditions wherein the original purchase price does not represent the true value of the equipment at the time of first use within Washington. Under such circumstances, the statute provides that the value upon which use tax is to be computed is the retail selling price at place of use of similar products of like quality and character. The Department has consistently interpreted this as meaning the fair market value of the article at the time and location of first use within the state.

Although the taxpayer argues that a 10% salvage value should be applied to this equipment, we must disagree. Salvage value implies that the equipment is not working properly and must be sold for scrap or otherwise liquidated. We presume that the equipment assessed in the audit report would not have been brought into Washington unless it was in proper working order and accordingly, we reject valuation based on salvage value.

Nor are we swayed by the taxpayer's objections to valuations based on personal property tax valuation schedules[1]. Although it is true that certain fully depreciated items were valued at 62% of acquisition costs under the schedules, we do not think those valuations unreasonable under the circumstances. One of the items in question was originally acquired in 1978 for

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[1] These valuation schedules are prepared by the Department of Revenue annually and distributed to County Assessors to be used as a guide in estimating market values of equipment in average condition. The percentages are derived through a two-step process. First, replacement value of the equipment is computed based on the Producer Price Index as determined by the United States Bureau of Labor Statistics. The replacement value is then reduced at yearly intervals based on the declining balance method of depreciation throughout its predicted useful life to a minimum value of 20% of acquisition costs. The percentage applied to the declining balance varies depending on the type of industry involved and the expected useful life of the equipment. It appears that the auditor used the "General Construction" category which presumes a useful life of 12 or 13 years and applies a 16% depreciation factor to the declining balance.

$135,000 and depreciated over a useful life of two years[2]. At the time it was brought into the State of Washington for use on a construction job in 1982, it was only four years old, and had been operating a full two years after its "predicted" useful life. We further note, that assuming a useful life of 10 years, the straight line method of depreciation would value the four-year-old asset at nearly the same 62% derived from the personal property tax valuation schedules. We do recognize, however, that these schedules are only meant to be used as guides and may not be applicable to individual pieces of equipment. However, since the taxpayer has failed to present any objective evidence[3] to establish a different value we must deny the taxpayer's petition on this issue. If the taxpayer should obtain additional valuation evidence, it may present it to the audit section for consideration.

[3] Allocation Procedures - Use Tax, Consistent Application

Although the taxpayer complains that the auditors assessed use tax on 100% of consumable supplies on . . . dredging jobs, we do not agree. Schedule XVII: Use Tax or Deferred Sales Tax on Consumable Supplies, page 20, lines 27 & 28 clearly state:

> Less 50% reduction of supply items on [dredging] jobs which included Washington & Oregon work: . . .

The schedule then reduces the taxable base by some $410,000.[4] We further agree with the auditors that apportionment applies only to supplies consumed during the dredging activity, and

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[2]Schedule XXV, page 2, Equipment # . . .

[3]We would consider third party appraisals, evidence of comparable sales from such publications as Forke Brothers, The Auctioneers Blue Book, objective evidence that the equipment was worth less than average equipment or objective evidence that the presumed 12 to 13 year useful life was incorrect, to be sufficient to adjust the valuation of individual assets. For example, we note that nearly all of the assessed assets were acquired more than 12 years ago. If any of these assets have been written off or disposed of prior to the auditor's presumed 12 or 13 year useful life, then the valuation should be adjusted accordingly. Any such adjustments, however, must be made on an individual or test basis.

[4]A similar apportionment can be seen on Schedule XX, page 6, lines 4 & 5.

does not apply to repair parts. Accordingly, the taxpayer's petition is denied on this issue.

[4] Statute of Limitations - Credits Disregarded

RCW 82.32.050 authorizes the Department to assess additional taxes and states in part:

> If upon examination of any returns or from other information obtained by the department it appears that a tax or penalty has been paid less than that properly due, the department shall assess against the taxpayer such additional amount found to be due...
>
> No assessment or correction of an assessment for additional taxes due may be made by the department more than four years after the close of the tax year, ... (Emphasis ours.)

RCW 82.32.060 authorizes the Department to grant refunds and states in part:

> If, upon receipt of an application by a taxpayer for a refund or for an audit of the taxpayer's records, or upon an examination of the returns or records of any taxpayer, it is determined by the department that within the statutory period for assessment of taxes prescribed by RCW 82.32.050[5] a tax has been paid in excess of that properly due, the excess amount paid within such period shall be credited to the taxpayer's account or shall be refunded to the taxpayer, at the taxpayer's option. No refund or credit shall be made for taxes paid more than four years prior to the beginning of the calendar year in which the refund application is made or examination of records is completed. (Emphasis ours.)

The Washington State Supreme Court faced a similar problem under the predecessor of the above statute[6] in Puget Sound

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[5] RCW 82.32.050 states "No assessment or correction of an assessment for additional taxes due may be made by the department more that four years after the close of the tax year..."

[6]RCW 82.32.060 was amended in 1979 to make the time period for filing a claim for refund the same as for filing tax assessments.

Power & Light Co. v. State, 70 Wn.2d 493, (1967). In granting the taxpayer a refund, the Court stated:

> Where a taxpayer, in computing his particular tax liability for a given period, erroneously includes certain items in his computation which are subsequently declared nontaxable, and pays a sum deemed owed by reason of the erroneous inclusion, two situations may arise:
>
> ... (2) If the amount paid is more than he actually owed, based on properly taxable items, he will be entitled to a refund of the excess amount, provided petition for refund is timely filed. However, his refund will be limited to the amount exceeding that "properly due," regardless of the amount attributable to the erroneous inclusion of nontaxable items. Only the amount exceeding that which is properly due would be refundable under the statute.
>
> If the amount the taxpayer has paid exceeds his proper tax liability for a given period and for a particular tax, certainly no additional assessment therefore could be a sum "properly due." In this case, appellant has paid an amount in excess of the public utility tax properly due from it. The excess portion paid before 1957 is not refundable since more than 2 years had elapsed before he filed his petition for a refund. However, the deficiency assessment for an additional amount, under the analysis set forth above, is not an amount "properly due" from appellant. Since this amount was not properly due, the statute allowed its refund upon petition timely filed. Appellant's petition for refund was filed within 2 years of the October 15, 1959 payment on the deficiency assessments and was, therefore, timely made. (Emphasis ours.)

Id. at 496-97

Although this amendment significantly changed the statute, the basis upon which the court relied in the Puget Sound case remained intact. (ie. an interpretation of when assessments for additional taxes were a sum "properly due").

We believe that the taxpayer's case falls squarely within the holding of the Puget Sound case. In order to assess additional use tax in a tax assessment, the auditor must first determine the amount of use tax "properly due" during the audit period. In making this determination, the auditor must take into consideration all use tax liability and payments (including double payments or payments made in error) during that audit period. Additional use tax may only be assessed to the extent that the amount of use tax paid is less than the amount "properly due." Accordingly, we will conditionally sustain the taxpayer's petition on this issue subject to verification by the audit section.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. The taxpayer's file shall be remanded to the audit section for adjustment consistent with this determination.

DATED this 31st day of July 1990.