

Cite as Det. No. 91-174, 11 WTD 353 (1992).

BEFORE THE INTERPRETATION AND APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Correction of Assessment	)	
of	)	No. 91-174
	)	
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .
	)	

[1] **RULE 103:** RETAIL SALES TAX -- DELIVERY OF GOODS SOLD -- TIME OF SALE -- CONSTRUCTIVE DELIVERY -- STORAGE IN SELLER'S PREMISES. Where taxpayer/seller sells and invoices for the goods sold, and then stores the goods for a lengthy period of time pending disposition by the buyer, there has been constructive delivery to the buyer with the seller deemed as agent of the buyer to provide storage. The sale took place for tax reporting purposes as of the time of the invoicing when the taxpayer is on the accrual basis. Accord: Det. No. 88-155, 5 WTD 179 (1988); and Det. No. 89-509, 8 WTD 345 (1989).

[2] **RULE 102:** RETAIL SALES TAX -- RESALE CERTIFICATE -- INTERVENING BAILMENT AND USE -- BUYER'S USE OF THE PROPERTY BOUGHT AS A BAILOR -- SELLER/BAILEE'S USE OF THE PROPERTY SOLD. The buyer of property, retained and used by the seller as a bailee, is ineligible to give a bona fide resale certificate. Sales tax applies to the sale even though the buyer intends to resell the property after the intervening use/bailment. Accord: ETB 114.

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: . . .

NATURE OF ACTION:

Petition protesting the assessment of Retailing B&O tax and sales tax liability on unreported sales. The petition also protests an alleged audit procedural error.

#### FACTS AND ISSUES:

Krebs, A.L.J. -- . . . (taxpayer) is engaged in the business of manufacturing and selling plastic products.

The Department of Revenue (Department) examined the taxpayer's business records for the period from July 1, 1986 through September 30, 1989. As a result of this audit, the Department issued the above captioned (adjusted) tax assessment [in October 1990] asserting excise tax liability and interest due in the total net amount of \$ . . . which remains due.

The taxpayer's protest involves Schedule V of the original audit report and Schedule II of the adjusted audit report..

#### Schedule V of the original audit report.

In this Schedule, the auditor assessed Retailing business and occupation (B&O) tax and sales tax liability on unreported sales of tooling/patterns to two customers, . . . ([One]) in June 1989, and . . . ([Two]) in June 1988.

[One] transaction. The auditor reports that the taxpayer's records show that the taxpayer sold tooling to [One] in June 1989 for \$150,000 and that it was understood between the taxpayer and [One] that the taxpayer would use the tooling as bailee to manufacture a product for sale to [One] who, in turn, would sell the product to its customer. The auditor's position is that "constructive possession has been taken place within this state" by the taxpayer as agent/bailee for [One]. The auditor asserts that even though the tooling is not currently in use, the taxpayer has been entrusted with its care and safety since 1989. Therefore, the auditor affirmed his assessment of Retailing B&O tax and sales tax liability on the transaction.

The taxpayer reports the following: It received a purchase order for the tooling from [One] which indicated that it was being purchased for resale. As of the audit date, [One] had not decided which subcontractor would be awarded a parts production contract for which this tooling will be used. The taxpayer acknowledges that, as of the audit date, it was negotiating with [One] for the parts contract and had no guarantee from [One] that it would be awarded the contract. The taxpayer cites WAC 458-20-103 (Rule 103) as stating: "For the purpose of determining tax liability of persons selling tangible personal property, a sale takes place in this state when the goods sold are delivered to the buyer in this state". Because delivery had not yet occurred

in this state to the buyer, and even though a resale certificate in good faith had not been taken from the buyer, the taxpayer asserts that a sale had not taken place and no tax liability had come into existence.

The issue here is whether a taxable sale had taken place in this state.

[Two] transaction. The auditor reports that the taxpayer's records show that the taxpayer sold tooling to [Two] in June 1988 for \$60,000 and he was informed that a resale certificate was taken by the taxpayer from the buyer. The taxpayer informed the auditor that [Two] resold the tooling to the [X], who, in turn, sold the tooling to the U.S. Government. The taxpayer informed the auditor and acknowledges in its petition that it had used the tooling to manufacture parts.

The taxpayer asserts in its petition that it "should not be subject to use tax (which was not assessed) since [Two] should have paid the use tax directly to the State as bailee". (We believe the taxpayer meant bailor here instead of bailee unless [Two] was a bailee to [X].) The taxpayer believes that if [Two] did not pay the tax directly or as the result of an audit to the State, then [Two]'s customer would have paid the tax directly to the State and, if not, would be assessed the tax in (a subsequent audit). Furthermore, the taxpayer in its petition asserts "any use tax paid or assessed should have been on a rental value based on the life of the tool (10-year estimate)".

The issue here is whether there was a retail sales taxable sale by the taxpayer to [Two] or whether [Two] was eligible to give a bona fide resale certificate to the taxpayer/seller.

#### Adjustment Schedule II, Use Tax on Recurring Purchases.

On page one of the adjustment Schedule II of the audit report pertaining to the adjusted tax assessment, the auditor detailed purchases of a recurring nature totaling \$ . . . on which one of the following had occurred:

1. retail sales tax had been paid at the time of purchase.
2. use tax had been reported on the combined excise tax return.
3. use tax had been paid on items purchased for purposes of resale.

The auditor then subtracted the \$ . . . from the total of \$ . . . subjected to tax in Schedule VI of the original audit to arrive at \$ . . . ( . . . ) as subject to tax for the 1988 test period.

The auditor then divided . . . by the total income (which remains constant) for the 1988 test period of . . . Schedule VI of the original audit report to arrive at the projection factor of .000364 to be applied against total income for yearly periods of the audit period. Thus, the auditor computed the tax on amounts unreported as subject to use/deferred sales tax as totaling \$ . . . versus the \$ . . . assessed in the original audit. This resulted in a tax credit . . . . See Schedule II, page 2 of the adjusted audit report.

The taxpayer points out that although the auditor did give credits for overpayments of sales/use tax on adjustment (supplemental as termed by the taxpayer) Schedules III, IV and VI, the credits should have been granted in adjustment Schedule II because they were also of a recurring nature.

Adjustment Schedule III gives credit for nonrecurring purchased items that were capital asset additions on which sales/use taxes had been paid but subjected to tax in the original audit.

Adjustment Schedule IV gives credit for use tax overpaid on printing artwork.

Adjustment Schedule VI gives credit for overpaid use tax on brochures distributed outside Washington.

The issue here is whether the auditor should have given credit in adjustment Schedule II for taxes paid on recurring purchases instead of in adjustment Schedules III, IV and VI.

#### DISCUSSION:

Schedule V of the original audit report. [One] transaction.

The taxpayer sold tooling to and invoiced [One] in June 1989. The taxpayer retained possession of the tooling at least until the audit was completed in January 1990 and thereafter while the taxpayer was negotiating with [One] to obtain a parts production contract which would require use of the tooling in question. As of the audit date, [One] had not decided which subcontractor would be awarded the parts production contract.

RCW 82.04.040 defines the term "sale" to mean

...any transfer of the ownership of, title to, or possession of property for a valuable consideration...(Emphasis added.)

[1] In this case, ownership of the tooling in question passed to [One] upon the taxpayer's billing [One] for it and the vesting of

the chief incidents of ownership in [One], that is, the right to its possession and use, and to sell or otherwise dispose of it according to the will of [One]. Wasser & Winters v Jefferson County, 84 Wn.2d 597 (1974). Because there was a transfer of ownership of the tooling for a valuable consideration, a "sale" had occurred.

Rule 103 repeats the statutory definition of the term "sale" and further provides:

For the purpose of determining tax liability of persons selling tangible personal property, a sale takes place in this state when the goods sold are delivered to the buyer in this state, irrespective of whether title to the goods passes to the buyer at a point within or without this state. (Emphasis added.)

WAC 458-20-197 (Rule 197) explains "when tax liability arises" and in pertinent part provides:

(1) Gross proceeds of sales and gross income shall be included in the return for the period in which the value proceeds or accrues to the taxpayer. For the purpose of determining tax liability of persons making sales of tangible personal property, a sale takes place when the goods sold are delivered to the buyer in this state...

(2) ACCRUAL BASIS.

(a) When returns are made upon the accrual basis, value accrues to a taxpayer at the time:

(i) The taxpayer becomes legally entitled to receive the consideration, or

(ii) In accord with the system of accounting regularly employed, enters as a charge against the purchaser, customer or client the amount of the consideration agreed upon, whether payable immediately or at a definitely determined future time.

The Department has previously ruled that where a taxpayer/seller provides storage of the goods sold at its own Washington facility at the request of the buyer pending the buyer's future disposition of the goods, the taxpayer in accepting the responsibility for the storage is acting as an agent for the buyer and constructive delivery thus takes place in this state. Det. No. 88-155, 5 WTD 179 (1988). In this case, the taxpayer invoiced [One] for the tooling in June 1989. As of December 1990, the taxpayer has received no delivery instructions from the buyer. The taxpayer has provided storage at the request of the buyer pending the buyer's future disposition of the tooling. In

view of the fact that the tooling has been stored in the taxpayer's premises for over one and one-half years and the taxpayer has accepted responsibility for the storage so as to be deemed the buyer's agent, we conclude that constructive delivery has occurred in this state. Furthermore, not to be ignored is that under Rule 197 the taxpayer was obligated to report the amount received or accrued on the sale in the tax return for the period of June 1989. The auditor's assessment of Retailing B&O tax and sales tax liability on this transaction is sustained.

Schedule V of the original audit report. [Two] transaction.

The taxpayer sold tooling to [Two] and invoiced [Two] in June 1988. The taxpayer then used the tooling to manufacture parts. The taxpayer informed the auditor that [Two] later resold the tooling to [X], who then sold the tooling to the U.S. Government. The taxpayer informed the auditor that it had taken a resale certificate from [Two], but did not show it to the auditor.

[2] WAC 458-20-102 (Rule 102) in pertinent part provides:

Except as hereinafter noted, all sales are deemed to be retail sales unless the seller takes from the buyer a resale certificate signed by and bearing the registration number and address of the buyer, to the effect that the property purchased is:

(1) For resale in the regular course of business without intervening use, or...

When a vendor receives and accepts in good faith from a purchaser a resale certificate as described in this rule, the vendor is relieved of liability for retail sales tax with respect to the transaction.

In this case, after the taxpayer sold the tooling, [Two] permitted the taxpayer to retain the tooling to manufacture parts which were sold to [Two]. In effect, the taxpayer became the bailee/borrower of the tooling sold to [Two] who was the bailor/lender. Nevertheless, the taxpayer had made a sale of the tooling to [Two], and [Two] as bailor had made intervening use of the tooling prior to selling it to [X]. Thus, [Two] could not in good faith issue a resale certificate as it was making intervening use prior to its reselling of the tooling. The taxpayer/vendor with knowledge of the intervening use cannot be deemed to receive and accept in good faith the resale certificate. Furthermore, the purchase of tangible personal property for the purpose of loaning it to others is a sales taxable purchase, notwithstanding an intent to subsequently resell the property. See Excise Tax Bulletin 114.12.102 (ETB

114). Again, not to be ignored is that under Rule 197 the taxpayer was obligated to report the amount received or accrued on this sale in the tax return for the period of June 1988. The auditor's assessment of Retailing B&O tax and sales tax liability on this transaction is sustained.

[Two]'s failure to pay sales tax on its purchase of the tooling and the consequential assessment of sales tax liability against the taxpayer pursuant to RCW 82.08.050 renders irrelevant and insignificant the taxpayer's speculative assertions that [Two] may owe and may have paid use tax directly to the state or that [Two]'s customer, [X], will become liable for the use tax when it is audited by the Department.

Adjustment Schedule II, Use Tax on Recurring Purchases.

This adjustment Schedule II shows the auditor's work in adjusting Schedule VI of the original audit where use tax/deferred sales tax liability was assessed on purchases of "consumable supplies" without payment of sales tax. The consumable supplies are deemed to be in the nature of recurring purchases and generally are correlated to gross income.

The auditor gave credits also on adjustment Schedule III for items taxed on Schedule VII of the original audit report with respect to capital asset additions, that is, items of a nonrecurring nature.

The auditor gave a credit also on adjustment Schedule IV for overpayment of use tax on printing artwork. This item was not addressed in the original audit.

The auditor gave a credit also on adjustment Schedule VI for overreported use tax paid on brochures distributed outside Washington. This item was not addressed in the original audit.

The taxpayer, as stated in its petition, believes that the credits allowed in adjustment Schedules III, IV, and VI should have been correctly granted in adjustment Schedule II. We disagree. These credits did not involve items taxed in the original Schedule VI which were of a recurring nature and which formed the basis for use of the test period projection factor applied against other years in the audit period. We believe that the method used by the auditor was correct in all respects. If the taxpayer believes that the auditor still made an error, which is not visible to nor ascertainable by us or the auditor, it should discuss it with the auditor who stands ready to make the appropriate adjustment.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 27th day of June 1991.