Cite as Det. No. 92-166, 12 WTD 211 (1993).

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. 92-166
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] RCW 82.04.040: RETAIL SALE. Where the taxpayer transfers title to tangible personal property to its sole shareholder in exchange for reduction in the debt owed to its shareholder, there has been a retail sale.

[2] MISCELLANEOUS: SUBSTANCE OVER FORM. Generally, a taxpayer may not question the form of its transactions and the resulting tax ramifications. Citing: Det. No. 85-112A, 1 WTD 343 (1985).

[3] MISCELLANEOUS: SUBSTANCE OVER FORM. The Department adopts the established federal rule concerning the availability of the substance over form argument to a taxpayer. Specifically, the taxpayer must prove by clear, cogent, and convincing evidence that the transaction in question could have been avoided because there was a lack of contractual assent.

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 TELEPHONE CONFERENCE: . . .

NATURE OF ACTION:

The taxpayer is appealing the assessment of retail sales tax and retailing business and occupation tax on the transfer of title to a yacht from the corporation to its owner.

FACTS:

Coffman, A.L.J. -- The taxpayer is a licensed yacht dealer. It is the wholly-owned corporation; its sole shareholders are a marital community. For clarity, we will refer to them as the "owner." The taxpayer's books and records were audited by the Department's Audit Division for the period of January 1, 1986 through September 30, 1989 and an assessment was issued.

In 1985, the taxpayer became a distributor for a boat builder. The builder manufactures vessels which historically have had an average retail selling price of over $300,000. In 1985, the taxpayer purchased a demonstrator from the manufacturer. The taxpayer sold 3 or 4 similar vessels and then sold the demonstrator. In order to continue to sell these vessels, it was deemed necessary to acquire another demonstrator. The taxpayer accomplished the acquisition through the use of an international letter of credit issued in the its name. It is the transfer of title of the second "demonstrator" from the taxpayer to the owner of the corporation which is the issue in this case.

The taxpayer claims that when the vessel was delivered in Washington, the bank required the vessel to be titled in the taxpayer's owner's name. The taxpayer has provided the Department with a letter from the bank which states that the bank "strongly prefers to lend directly to the individual and not to the corporation in a closely held company." This letter was written after the hearing in this matter. The owner stated at the hearing that he would provide copies of the closing documents prepared by the escrow company handling the transaction. The only documents provided were:

1. A Certificate of Insurance which named the builder and the taxpayer as insured.
2. A copy of a teletype which amends the letter of credit for the account of the taxpayer by correcting the builder's address, but the original letter of credit was not provided.
3. A copy of the invoice for the vessel and the bill of lading.

The owner claims that the vessel was used solely as a demonstrator for its business. There was, according to the owner, little, if any, personal use of the vessel. In fact, the owner testified that the vessel was not operated as a demonstrator unless the taxpayer had on file a firm offer to purchase a similar vessel. The taxpayer did not keep a log of the vessel's use; however, the testimony was that the vessel has been used [nearly 400 hours]. The taxpayer claimed that ten similar vessels were sold by the taxpayer as a result of the use of the vessel as a demonstrator. The testimony was that the subject vessel has been advertised for sale since its receipt.

The taxpayer's books showed the transfer of the vessel to the owner and a corresponding reduction in debt owed to the owner. It was on the basis of the journal entries that the Department's Auditor determined that a sale of the vessel occurred and was not reported. Additional facts will be presented in the discussion.

ISSUES:

1. Was there an unreported retail sale of the vessel to the owner?

2. The taxpayer has requested a ruling that yacht dealers be allowed to utilize the same method to determine its use tax liability for vessels as is available to automobile dealers.

DISCUSSION:

[1] RCW 82.04.040 defines a sale as "any transfer of ownership of, title to, or possession of property for a valuable consideration ...". We requested that the taxpayer provide copies of all escrow documents. It is significant that copies of the transfer of title, U.S. Coast Guard registration, and similar documents were not provided. However, the owner stated during the hearing that the original Master Builder's certificate showed the taxpayer as the purchaser of the vessel and that he obtained title to the vessel. We find that there was a transfer of title to the vessel from the taxpayer to its owner. Further, the taxpayer adjusted its books and records to reduce the amount of debt owed by the taxpayer to its owner. This adjustment is reflected on the taxpayer's federal income tax return. In addition, the auditor found that the transaction was treated as a sale for income tax purposes. As a result, there was valuable consideration. Without further evidence, we would find that there was a sale of the vessel to the owner.

The taxpayer claims that the transfer was in form only and in substance the vessel was always treated as inventory and a demonstrator of the taxpayer. However, its federal tax returns show that the value of the taxpayer's inventory decreased after acquiring the vessel and the interest on the loan for its acquisition was not deducted. These acts are inconsistent with the claim that the vessel was inventory, but they are consistent with the owner having purchased it. Further, the bank did not say in its recent letter that it required the financing to be modified after it had issued a letter of credit in the taxpayer's name, rather the letter says that the bank prefers to lend to the owners of closely-held corporations.

The owner testified that the taxpayer did not demonstrate the vessel unless it had a signed offer to purchase and that there were ten such vessels sold. There have been [nearly 400] hours of operation of the vessel. If there was no personal use of the vessel, then there were [nearly 40] hours of demonstration for each sale. This appears to be excessive, in view of the taxpayer's restrictive policy on demonstrations. The taxpayer did not maintain a log of the vessel's use which would have shown the actual use thereof.

The owner testified that the vessel was moored at the taxpayer's dock and that a "for sale" sign was placed on it. Neither the moorage of the vessel nor the advertising show the lack of a retail sale to the owner.

[2] We said in Det. No. 85-112A, 1 WTD 343 (1985), citing Higgins v. Smith, 308 U.S. 473, 60 S.Ct. 355, 84 L.Ed. 409 (1940):

> [W]e believe it to be sound policy to limit the taxpayer's use of elevating substance over form. The taxpayer was free to choose the form of which it desired, and there is no reason, other than to escape the clutches of the tax collector, to disregard that form. The availability of that kind of analysis is generally limited to use by the Department when it believes that the transactions may be sham and lack economic reality. To allow the taxpayer to elevate substance over form would make predictable tax administration nearly impossible if it became the policy to allow the taxpayer to determine its tax liability on what it believes it has done as opposed to what it says it does.

(Emphasis supplied.)

We did not say that the taxpayer may never use the argument of substance over form; rather its use by the taxpayer is severely limited. The Washington Courts have not addressed this issue. However, in the federal tax arena the issue has been visited several times. Beginning with Higgins, supra, through In Re Tax Refund Litigation, 766 F. Supp. 1248 (E.D.N.Y., 1991), the courts have confronted the problem. In Spector v. Comm'r of Internal Rev., 641 F.2d 376 (5th Cir., 1981), cert. denied, 454 U.S. 868 (1981), the Court stated at 385-6:

> . . . the principal justification for allowing taxpayers to escape the general rule that prevents unilateral attempts to dispute the form of their agreements is the prevention of unjust results. By allowing parties to challenge the form of an agreement upon showing a mistake, overreaching, duress or other reason which, in an action between the parties to the

> transaction, would be sufficient to alter that construction or set it aside, the Danielson [378 F.2d 771 (3rd Cir., 1967), cert. den. 389 U.S. 858 (1967)] rule provides an appropriate balance between the interest of the Commissioner in the efficient and orderly administration of the tax laws and the need to ensure flexibility and fairness in individual cases.

(Brackets added.)

[3] Phrased another way, the federal courts would allow the taxpayer to attack the form of its transactions only if it can show a lack of contractual assent. We adopt this approach. The taxpayer must show the lack of contractual assent by clear, cogent, and convincing evidence.[1]

In this case, the taxpayer has not demonstrated that there was a lack of contractual assent in the subject transaction. Every basis for the taxpayer's claim has an equally plausible explanation which supports the auditor's findings. As such, we find that the taxpayer has failed to meet its burden in this case. Therefore, we find that a retail sale occurred and the petition is denied.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 25th day of June 1992.

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[1] See: Simonson v. Fendell, 101 Wn. 2d 88 (1984) (mutual mistake); Binder v. Binder, 50 Wn. 2d 142 (1957) (mental competency); and Tecklenburg v. Wash. Gas and Electric Co., 40 Wn.2d 141 (1952) (fraud).