Cite as Det. No. 92-044R, 13 WTD 63 (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. 92-044R[1]
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] RULES 178 AND 247 - DEMONSTRATORS - TRADE-IN DEDUCTION. A use tax trade-in deduction is properly available under WAC 458-20-247 if a taxpayer actually trades used demonstrators into inventory for newer demonstrators out of inventory, and therefore actually transfers its used demonstrators back into inventory before their ultimate sale. Trade-ins will not be imputed for purposes of the trade-in deduction, however, in those instances in which the taxpayer simply sells demonstrators to customers and brings newer demonstrators out of inventory to replace them.

This headnote is provided as a convenience for the reader and is 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 requesting a reconsideration of a ruling concerning use tax on demonstrators.

FACTS:

Bauer, A.L.J. -- The facts concerning this case are adequately addressed in Determination No. 92-044 and will not be repeated here except as necessary to explain our ruling.

TAXPAYER'S EXCEPTIONS:

The taxpayer claims that Determination No. 92-044 errs in the following regards:

[1] The original determination, Det. No. 92-044, is published at 13 WTD 51 (1993).

1. It claims that the taxpayer "highly discounts" its demonstrators, but fails to recognize that the taxpayer often "highly discounts" other of its products.

2. The determination implies that the quantity of demonstration use is determinative of whether or not a demonstrator is or is not subject to use tax. Apparently, the ALJ concluded ETB 332 compelled such a quantitative analysis. To the extent ETB 332 establishes such, it is directly contrary to law. A single taxable use is all that is required for a product to be subject to use tax. Thus, if demonstration is a taxable use, demonstrators are taxable. It does not matter if a product is demonstrated once or a thousand times. The issue is only whether demonstration is a taxable use. That issue is answered negatively every day. All retailers demonstrated products in the course of selling those products. That use has never been taxed. ETB 332 merely sets forth a presumption that "demonstrators" which are carried on the taxpayer's books of accounts as demonstrators or are so extensively used for demonstration that they can no longer be sold as new, will be presumed to be subject to use tax. That presumption arises because the Department apparently believes as a matter of fact that such products are not held for sale. But that issue of fact was conceded here. Thus as a matter of law, [the taxpayer's] demonstrators are not taxable.

3. The determination denies taxpayer the benefits of WAC 458-20-132 on the basis that the rule only applies to automobile dealers who presumably rotate vehicles used as demonstrators more frequently than does [the taxpayer]. The ALJ did not realize that, in fact, WAC 458-20-132 provides a complete exemption for automobile dealer demonstrators. Under that regulation, only what are commonly called executive cars are subject to use tax. Cars which are actually demonstrated to customers are not subject to tax in Washington.

4. The determination fails to give the taxpayer the benefit of the trade-in deduction to the use tax.

5. The determination requires the taxpayer to report and pay manufacturing tax on products which are sold on the return for the period in which the manufacturing activity occurred. Our understanding of the Department's normal practice is that taxpayers are to report both the manufacturing and selling business and occupation taxes on the same return.

DISCUSSION:

The taxpayer's concerns will be addressed in the order recited above:

1. The taxpayer argues that the Determination fails to recognize that the taxpayer highly discounts some of its other products as well as demonstrators. Such a fact, however, does not change the result. Discounts may have been offered to customers for many and varying business reasons. The

taxpayer's stated reason for highly discounting its demonstrators is that, because of their use as such, they have

> . . . a higher chance of being obsoleted by a new product, they may not have new modifications and they may have a battered appearance. For these reasons it may be necessary to highly discount demo units. . . .

[Paragraph 3.3, S.O.P. 3.7 dated August 1986].

> . . . After determining that it is necessary to offer a discount in order to sell available equipment, whether in the field or in the pool, the following discounts may be applied without further approvals:
>
> | AGE | DISCOUNT |
> |---|---|
> | 2 - 6 months | 7% |
> | 6 - 12 months | 10% |
> | 12 - 18 months | 15% |
> | Over 18 months | 20% |

[Policy #1.4 dated October 1988.]

It is clear from the taxpayer's own policies that demonstrators are discounted only because they have been used as demonstrators and are therefore "used" and somewhat, if not totally, obsoleted. The fact that other non-demonstrator products might also have been highly discounted for other business reasons is not dispositive of the issue in this case.

2. The taxpayer argues that ETB 332, to the extent it implies that the quantity of demonstration use is determinative of whether or not a demonstrator is or is not subject to use tax, is directly contrary to law. The taxpayer argues that even a single taxable use is all that is required for a product to be subject to use tax, and that if a product is demonstrated even once, even if it is for the purpose of its own sale, it is a taxable use. Because the Department does not impose a use tax on each product which is demonstrated for purposes of its own sale, the taxpayer implies that demonstration is therefore not a taxable use at all.

The taxpayer further argues that ETB 332 raises a presumption that products used for demonstration can no longer be sold as new and will be "presumed" to be subject to use tax. The taxpayer contends the Department adopts this presumption because it believes that such products are not held for sale, and that this case requires a different result because the taxpayer's demos are in fact for sale.

As quoted in the original determination issued in this matter, the rationale set forth in both ETB 61 and the ETB 332 for distinguishing between products demonstrated in order to sell other similar products, and products demonstrated in order to sell those particular products, is as follows:

> . . . The taxpayer was using a specific machine for demonstration purposes only in connection with efforts to sell that same machine. As such the Use Tax was not applicable as the demonstration was a part of the retail sale process, and not a separate use of the machine by the taxpayer. [ETB 61]
>
> . . . As a general guide, such articles will be deemed to have been substantially used, and subject to the Use Tax, when carried in the taxpayer's books of account as demonstrator or display merchandise, or when so extensively used for demonstration or display purposes that they can no longer be sold as new merchandise. [ETB 332]

Therefore, if a product is demonstrated in furtherance of its own sale, its demonstration is part of the selling activity and is not separately use taxable. However, if a product is used in furtherance of the sale of other like products, such demonstrator use will be use taxable if the product is either carried on the taxpayer accounts as a demonstrator or if its use in furthering sales other than its own is so extensive that it can no longer sold as a "new" product.

The Department in this case recognizes that the demonstrators at issue were in fact held for sale. But the taxpayer not only carried these demonstrators on their own books and records as such, but, by the taxpayer's own published directives, highly discounted them upon their sale because of use and age. The taxpayer's arguments must fail as to this issue.

3. The taxpayer next contends that WAC 458-20-132 does not subject demonstrator automobiles to the use tax at all. Since the taxpayer's original petition requested a formulary approach to the use taxation of demonstrators such as that given the automobile industry in WAC 458-20-132, we are perplexed by the taxpayer's recent contention that WAC 458-20-132 does not apply to demonstrators at all. However, although the "demonstrator" definition within that rule does not apply to automobiles used merely for display, the principles remain the same. Consistent with the rationale stated in ETB's 61 and 332, there is no use tax on automobiles used for merely for display in showrooms or test drives, since those automobiles are not carried on the dealers books as demonstrators or sold at any discount because of "substantial use" as display vehicles.

4. Although the taxpayer complains that the determination fails to give the taxpayer the benefit of the trade-in deduction to the use tax, that was not an issue that was raised in the taxpayer's previous petition.

[1] The use tax trade-in deduction would be properly available in this case under WAC 458-20-247 if the taxpayer actually traded used demonstrators into inventory in exchange for newer demonstrators out of inventory, and therefore actually transferred its used demonstrators back into inventory before their ultimate sale. Trade-ins will not be imputed for purposes of the trade-in deduction, however, in those instances in which the taxpayer simply sold demonstrators to customers and brought newer demonstrators out of inventory to replace them. In other words, there must have been an actual trade-in of a used demo into inventory in exchange for a newer demo out of inventory, traceable in the taxpayer's books and records, for the deduction to apply.

5. The taxpayer complains that it should not have to report and pay manufacturing tax on products which are sold on the return for the period in which the manufacturing activity occurred, and then later pay a selling tax when the product is sold in state. The taxpayer bases this complaint on its "understanding of the Department's normal practice" that taxpayers report both the manufacturing and selling business and occupation taxes on the same return.

When an article is manufactured for a taxpayer's own commercial use, tax will be reported under the manufacturing classification of the B&O tax. The measure will be the fair market value of the product at the time it is converted to commercial use (in this case, the full fair market value of the product). When and if it is later sold within the state of Washington, a selling tax will be due. The measure will be the selling price (probably a "highly discounted" selling price in accordance with the taxpayer's directives). If the product is sold to an out-of-state customer in interstate commerce, no tax will be due if manufacturing tax has already been paid. If a MATC credit is due, it will be taken at this time.

The "normal practice" of reporting to which the taxpayer refers does not apply when there is intervening use of a product by the manufacturer before its ultimate sale.

DECISION AND DISPOSITION:

The taxpayer's petition is denied. Taxpayer's petition is remanded to the Audit Division for adjustment in accordance with this decision.

DATED this 29th day of March 1993.