

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition Refund of:)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 98-098
)	
...)	Registration No. . . .
)	Petition for Refund
)	

RULE 235; RCW 82.08.02565: MACHINERY AND EQUIPMENT – EXEMPTION – SALES CONTRACTS – SALES PRIOR TO EFFECTIVE DATE OF EXEMPTION. A taxpayer need not collect and remit retail sales tax to the Department of Revenue, on amounts received for sales of machinery or equipment that otherwise qualify as exempt under RCW 82.08.02565, when the unconditional sales contract was entered into prior to the effective date of that statute and the amounts were received prior to the effective date of that statute, if the machinery or equipment was delivered after the effective date of RCW 82.08.02565.

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:

An out-of-state corporation seeks a refund of sales tax paid to it by its customer, claiming that certain machinery sold to its customer qualified for the exemption in RCW 82.08.02565.¹

FACTS:

Gray, A.L.J. -- The taxpayer is a corporation whose principal place of business is outside of Washington state. In 1994, it procured orders for “traveling water screens” that would be used by its customer at the customer’s Washington paper mill.

The taxpayer produced copies of purchase orders from its customer, invoices to the customer from the taxpayer, copies of the bills of lading under which the goods were shipped, and hard copies of computer records from the customer’s receiving department. The documents can be

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410

matched by the requisition number, the code number used by the customer to identify the taxpayer, and the purchase order number. The taxpayer's invoices (three in number) show that the taxpayer billed its customer on November 18, 1994, January 27, 1995, and May 2, 1995, for 5%, 10%, and 20%, respectively, of the sale price, pursuant to the agreement between the taxpayer and its customer. The taxpayer's bill of lading and the customer's receiving department documents show that none of the machinery was shipped or received until after July 1 1995, the effective date of RCW 82.08.02565 and 82.12.02565, the exemptions from sales and use tax, respectively, for certain types of machinery and equipment.

Except for the timing of these three payments, it appears that the taxpayer qualifies for the exemption, subject to proof that its customer executed a Manufacturer's Sales and Use Tax Exemption Certificate (a copy of the form is attached). See, *infra*.

The taxpayer argues that it is entitled to a refund of retail sales tax because the machinery was not delivered until after July 1, 1995, and cites WAC 458-20-197(1) ("Rule 197") to support its argument. The customer paid sales tax to the taxpayer when it paid the installments of 5%, 10% and 20% prior to July 1, 1995. However, when the customer later protested payment of the sales tax to the taxpayer, the taxpayer credited the customer with the amount of the tax and became subrogated to the customer's claim for a sales tax refund.

ISSUES:

Is the taxpayer entitled to a refund of sales tax on the sale of equipment that qualifies under RCW 82.08.02565, where the taxpayer uses the accrual system of accounting and was entitled to receive portions of the sale price prior to the effective date of the RCW 82.08.02565?

DISCUSSION:

RCW 82.08.02565 provides for an exemption from sales tax for sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation and to sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving the machinery and equipment. The traveling water screens certainly qualify as "equipment" within the scope of the exemption in RCW 82.08.02565. That statute took effect on July 1, 1995. The question is whether the taxpayer is entitled to a refund of sales tax remitted on amounts received by the taxpayer from its customer prior to July 1, 1995.²

Rule 197(1) states, in part:

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 Sales tax is paid by the consumer. RCW 82.08.050. Here, however, the named taxpayer is subrogated to the actual consumer's claim for a sales tax refund because it credited the consumer with the amount of the sales tax previously paid. This fact will allow a refund, subject to audit verification of the crediting of its customer's sales tax. See, WAC 458-20-229(3)(b)(ii).

It is undisputed that delivery of the goods to the taxpayer's customer did not begin until after July 1, 1995. However, Rule 197(2) discusses the tax liability of taxpayers that use the accrual method of accounting:

(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.

(b) Amounts actually received do not constitute value accruing to the taxpayer in the period in which received if the value accrues to the taxpayer during another period. It is immaterial if the act or service for which the consideration accrues is performed or rendered, in whole or in part, during a period other than the one for which return is made. The controlling factor is the time when the taxpayer is entitled to receive, or takes credit for, the consideration.

Though not directly resolving the issue, Rule 197(2) makes clear that the taxpayer was entitled to receive payment on portions of the sale price before the exemption took effect. The remaining question is how to treat those three payments: are they subject to sales tax because the exemption was not yet in effect, or are they exempt from sales tax because delivery of the equipment ultimately was made after the exemption took effect?

WAC 458-20-235 ("Rule 235") is the Department's administrative rule regarding the effects of rate changes on prior contracts and sales agreements. Rule 235 provides, in part:

When an unconditional contract to sell tangible personal property is entered into prior to the effective date of a rate change, and the goods are delivered after that date, the new rates will be applicable to the transaction. When an unconditional contract to sell tangible property is entered into prior to the effective date, and the goods are delivered prior to that date, the tax rates in effect for the prior period will be applicable.

Although Rule 235 pertains to rate changes, its logic reasonably applies to the question whether sales tax applies to pre-exemption installment payments. Its provisions relate to the statutory requirements for the exempt purchase requirements of RCW 82.08.02565.

To the extent that the contract might have included charges for installation of the traveling water screens, Rule 235 states:

Persons installing, repairing, cleaning, altering, imprinting or improving tangible personal property for others, or constructing, repairing, decorating or improving buildings or other structures upon the real property of others will collect retail sales tax and pay the business and occupation tax at the new rates with respect to all such services performed and billed on and after the effective date of a rate change. With respect to

contracts requiring the above services or construction which were executed prior to the effective date of a change in rates, the new rates will be applicable to the full contract price unless the contract work is completed and accepted prior to the effective date.

Here it is clear that labor charges would also be taxed at the “new” rate, so that by analogy, the taxpayer’s labor charges would similarly not be subject to sales tax.

We conclude that the taxpayer is entitled to a refund of sales tax on the value of the three installment payments made prior to the effective date of RCW 82.08.02565.

DECISION AND DISPOSITION:

The petition is granted, subject to verification by the Audit Division that the taxpayer actually credited its customer with the amount of sales tax charged on the three installment payments made prior to July 1, 1995, and subject to verification by the Audit Division that the taxpayer’s customer has supplied it with a Manufacturer’s Sales and Use Tax Exemption Certificate. If the customer did not previously execute such a certificate, it may do so now.

Dated this 29th day of May 1998.