BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Prior Determination of Tax Liability of	)	D E T E R M I N A T I O N
	)	No. 98-070
. . .	)	Not Registered

RULE 247; RCW 82.08.010: RETAIL SALES TAX -- SELLING PRICE -- EXEMPTION FOR TRADE-IN PROPERTY -- The measure of retail sales tax owing on a new leased vehicle may not be reduced by the difference between the residual amount due on a used leased vehicle and its trade-in value if the lessee is trading in the used leased vehicle as a lessee and not as the owner of it.

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:

A person requests a ruling that would permit a lessee of a motor vehicle to trade in that used vehicle for a new leased motor vehicle and receive a trade-in credit or allowance against the measure of sales tax.[1]

FACTS:

De Luca, A.L.J. (Successor to Breen, A.L.J.) -- A person sought a letter ruling from the Taxpayer Information and Education Section (TI&E) of the Department of Revenue (the Department). The person inquired whether a lessee of a motor vehicle could trade-in the used leased vehicle for a new leased one and reduce the measure of sales tax owing on the new vehicle lease by the difference between the residual amount due on the used vehicle and its trade-in value. The person refers to this difference as the lessee's "equity" in the used vehicle. TI&E ruled that a lessee can not receive a trade-in allowance or credit for the used vehicle because the lessee does not own the property. TI&E referenced the Department's *Washington State Auto Dealers Guide to Excise Taxes* 38-2 (August 1993), which states that "[l]eased items cannot be used to receive a trade-in credit because the lessee is not the owner."

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

The person disagreed with TI&E's ruling and appealed that ruling to the Department's Appeals Division. The person describes a situation where a lessee. . .

> has built some equity in their [sic] leased vehicle, either by originally paying a capitalization reduction in cash, to which the tax was already paid, or in trade, again to which the tax was already paid, or finally by change in market value which increases the equity value in the vehicle. The equity should be tax exempt since the payments, made up to this point have been made on time and the tax per payment has been made.

The person gives an example of a used leased vehicle that has a trade-in value of $10,000 with a residual amount due of $8500. The person argues that the $1,500 difference between the two amounts should not be subject to retail sales tax for either of two reasons. One, the lessee has already paid sales tax on any difference between the actual value and the residual or, two, the lessee kept its payments current and was able to exercise a purchase option at the end of the lease. The person concedes that the $8,500 residual is not exempt from sales tax because the lessee has not paid tax on that amount.

ISSUE:

May a lessee of a motor vehicle trade in that used vehicle for a new leased vehicle and reduce the measure of retail sales tax owing on the lease of the new vehicle by the difference between the residual amount due on the trade-in vehicle and its trade-in value?

DISCUSSION:

WAC 458-20-247 (Rule 247) explains the sales tax exemption pertaining to the trade-in of like-kind property:

> Initiative Measure No. 464, approved November 6, 1984 amended RCW 82.08.010(1), the statutory definition of "selling price," by excluding from that term the value of "trade-in property of like kind." The effective date of this exclusion is December 6, 1984. As a result, the retail sales tax measure on trade-in sales is reduced by the value of the property traded in. Thus, on and after the effective date, the value of "trade-in property" may be excluded from the measure of retail sales tax to be collected and reported by the seller who accepts the trade-in property as payment for new or used property sold. Actual DELIVERY of the property to the buyer determines when the sale is made (see WAC 458-20-103). The initiative applies only to sales where the property is delivered to the purchaser on or after December 6, 1984.
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> Under RCW 82.08.010, as amended by the initiative, "the term 'selling price' means the consideration, whether money, credits, rights, or other property EXCEPT TRADE-IN PROPERTY OF LIKE KIND, expressed in terms of money, paid or delivered by a buyer to a seller, all without any deduction, on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discounts, delivery costs, taxes other than taxes imposed under this chapter if the seller advertises the price as including the tax or that the

> seller is paying the tax, or any other expense whatsoever paid or accrued and without any deduction on account of losses." (Amendatory language underscored.)

Exemptions to a tax law must be narrowly construed. Taxation is the rule and exemption is the exception. A taxpayer has the burden to show that he/she qualifies for the claimed exemption. Budget Rent-a-Car of Washington-Oregon, Inc. v. Department of Rev., 81 Wn.2d 171, 500 P.2d 764 (1972). Therefore, the person requesting this ruling has the burden of showing that his proposal qualifies for this tax exemption.

We agree with TI&E that the person requesting this ruling has not met that burden because construing the statute narrowly does not allow a lessee of the trade-in property to be treated as an owner of such property. For example, lessees of motor vehicles are not free to trade-in or sell the leased vehicles to whomever they choose. The lessees must either return the vehicles to the lessors when their leases expire, or exercise their options (if available) to purchase them. Consequently, a lessee does not have the right to sell leased property because of the terms of the lease agreement and because the lessee does not have title to it. In other words, a true trade-in cannot occur because a lessee cannot transfer title in the leased property to a seller of property that the lessee wants to buy or lease. Rule 247 supports the requirement that the trade-in property must be owned by the party trading it in by providing:

> ENCUMBERED PROPERTY TRADED-IN -- Sellers are allowed to consider as nontaxable the value of property traded-in even though ownership of the property may be encumbered by a conditional sale, retail installment contract, or security interest; provided that, the property traded-in must be actually transferred to the seller of the new or used property for which it is traded-in.

(Underlining added.) Rule 247 does allow an owner of property to trade-in the property to rent or lease like-kind property, but that situation differs significantly from a lessee trading-in property that it does not own. Specifically, the rule provides:

> TRADE-IN FOR RENTAL PROPERTY -- Under RCW 82.04.050, rentals or leases of tangible personal property are "retail sales." The term "selling price" as amended by Initiative 464 is also the tax measure for such rentals and leases. Thus, where tangible property is traded-in as part payment for the rental or lease of property of like kind (e.g., a used computer against the rental of a new one) the sales tax will apply to all payments after the value of the property traded-in has been depleted or consumed and the lessor of the property actually begins making charges for the lease or rental of tangible property.

We cannot construe this language beyond what the rule allows. That is, an owner of tangible personal property may trade-in the property to rent or lease like kind property. Furthermore, we agree with a statement by TI&E that unless the lessee enters into a new lease with the lessor or pays off the residual amount, the lessee likely will not realize the “equity” in the vehicle once the lease expires. Instead, the lessor is entitled to that amount. Naturally, if the lessee decides to pay off the residual and buy the vehicle, it could trade-in the used vehicle for another vehicle and receive a credit against the sales tax.

In sum, the measure of retail sales tax owing on a new leased vehicle may not be reduced by the difference between the residual amount due on the used leased vehicle and its trade-in value if the lessee is trading in the used leased vehicle as a lessee and not as the owner of it.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

Dated this 27th day of April 1998.