Cite as Det. No. 97-219R, 17 WTD 162 (1998)

BEFORE THE 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. 97-219R
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULES 109 AND 224: FINANCE CHARGES -- CARRYING CHARGES -- USED CARS -- INSTALLMENT SALES -- SERVICE B&O TAX. A used car dealer who charged installment buyers amounts that were disguised as insurance premiums was liable for service business and occupation tax because the amounts actually were payments for the right to purchase the vehicles over time.

[2] RULE 196: INSTALLMENT SALES -- STOLEN OR DESTROYED MOTOR VEHICLES -- BAD DEBTS. A used car dealer may not treat installment sales as bad debts for Rule 196 purposes when it forgives debts for vehicles that are stolen or destroyed and it has charged the buyers additional amounts in anticipation that such events might occur.

NATURE OF ACTION:

A used-motor-vehicle dealer (the taxpayer) seeks reconsideration of a determination that sustained an assessment of retail sales tax and retailing business and occupation (B&O) tax. [1]

FACTS:

De Luca, A.L.J. -- The facts are stated in Det. No. 97-219 and will be restated only where necessary. The taxpayer sells used motor vehicles either on a cash basis or an installment sales contract basis. Outright cash sales of vehicles are not at issue in this appeal. When the taxpayer sells vehicles through installment contracts it retains a security interest in the vehicles. However, the taxpayer is concerned that the value of its security interests could be jeopardized by theft or damage to the vehicles. Therefore, the taxpayer's installment sales contracts require the buyers either to purchase insurance from third party insurers that make the taxpayer the loss

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

payee, or the buyers can pay the taxpayer additional amounts for what the taxpayer describes as "VSI" (vendor single interest) insurance coverage, which protects only the taxpayer's interest. "VSI" is defined by RCW 48.22.110 (4) as insurance coverage insuring primarily or solely the interest of a secured party in a motor vehicle or vessel serving as collateral and obtained by the secured party after the borrower has failed to obtain or maintain insurance coverage required by the financing agreement.[2]

Vehicle sales on the installment sales basis where the buyers independently obtain and maintain insurance from third-party insurers that protect the taxpayer's security interests in the vehicles also are not at issue. However, buyer payments made directly to the taxpayer for supposed "VSI" coverage are in dispute because the taxpayer retained the payments rather than purchase such insurance with them from third-party insurers. The taxpayer set the amounts it charged the buyers for the supposed "VSI" coverage and did not pay an insurance premium tax to the state insurance commissioner.

The Audit Division (Audit) of the Department of Revenue (the Department) reviewed the taxpayer's books and records for the period January 1, 1992 through December 31, 1995. The taxpayer protests Schedules 4A and 4B, which pertain to the disputed "VSI" payments.

The taxpayer asserted that the "VSI" payments were exempt from excise taxes per RCW 48.14.020(2) because they were insurance premiums. Audit found that such payments retained by the taxpayer were not exempt from excise taxes as insurance premiums, but were part of the vehicles' selling prices and subject to retail sales tax. We affirmed the tax assessment in Det. No. 97-219.

In its reconsideration petition, the taxpayer states it ". . . will assume, arguendo, that the taxpayer's charges do not perfectly meet the criteria for insurance premiums and, therefore, such charges are not exempt from sales tax pursuant to RCW 48.14.020."[3] However, the taxpayer cites WAC 458-20-109(3) (Rule 109) in support of its argument that the "VSI" payments are not subject to retail sales tax because finance charges, carrying charges, service charges, interest, and penalties are not subject to sales tax when: i) the charge is in addition to the usual and established selling price; ii) the charge is segregated in the taxpayer's accounts; and iii) the amount is separately billed to customers. The taxpayers contends it meets this Rule 109 criteria because the charge applies only to customers electing to purchase vehicles under an installment sale, and who do not elect to purchase full "VSI" coverage from a licensed third-party insurer to protect the taxpayer's security interests. The charge is separately stated in the sales contract from the cost of the vehicle itself. The charge is separately stated in the taxpayer's records and accounts, apart from the amounts representing the vehicle's sales price. The taxpayer claims the charge protects its interest in financing rather than the taxpayer's interest in sales generally and

[2] VSI does not include insurance coverage purchased by a secured party for which the borrower is not charged.

[3] For convenience only, we will continue to identify the disputed charges as "VSI." Identifying the charges as such does not imply that we consider them to be for insurance purposes. We reiterate our holding in Det. No. 97-219 that they are not payments for insurance.

the charge relates only to financing under particular conditions rather than to sales in general. In short, the taxpayer claims it is a finance charge.

The taxpayer further contends that the "VSI" charges are subject to service B&O tax under WAC 458-20-224 (Rule 224) because the taxpayer is not aware of any authority that classifies these charges as retail sales or anything else that would preclude them from being classified as a service activity.

ISSUE:

Are the "VSI" charges subject to retailing B&O tax and retail sales tax because they are part of the vehicles' selling prices, or are the charges subject to service B&O tax either because the revenue is not otherwise classified or the charges are the types of income described in by Rule 109(3) that are subject to service B&O tax?

DISCUSSION:

[1] A "retail sale" means every sale of tangible personal property to all persons irrespective of the nature of their business. RCW 82.04.050. "Selling price" means . . .

> the consideration, whether money, credits, rights, or other property except trade-in property of like kind, expressed in the terms of money paid or delivered by a buyer to a seller without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, 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 expenses whatsoever paid or accrued and without any deduction on account of losses;

RCW 82.08.010(1). RCW 82.08.020 imposes the retail sales tax on each retail sale in this state. See also WAC 458-20-107 (Rule 107). RCW 82.04.250 imposes the retailing B&O tax on retailers. Consequently, with few exceptions not applicable in this appeal, each motor vehicle that the taxpayer sells at retail is subject to sales tax on its selling price. That price includes the consideration paid by the buyer without deductions.

By comparison Rule 109 provides:

> (2) BUSINESS AND OCCUPATION TAX. Persons who receive finance charges, carrying charges, service charges, penalties and interest are taxable under the service and other business activities classification on the receipt of amounts from these sources.
>
> . . .
>
> (3) RETAIL SALES TAX. Retail sales tax applies as follows.

> (a) Finance charges, carrying charges, service charges, penalties and/or interest from installment sales are not considered a part of the selling price of such property and are not subject to the retail sales tax, when:
>
> (i) The amount of such finance charges, carrying charges, service charges, penalty, or interest is in addition to the usual or established cash selling price; and
>
> (ii) The amount is segregated on the taxpayers' accounts; and
>
> (iii) The amount is billed separately to customers.

Rule 224 provides in part:

> (4) Business and occupation tax. Persons engaged in any business activity, other than or in addition to those for which a specific rate is provided in chapter 82.04 RCW, are taxable under the service and other business activities classification upon gross income from such business.

The taxpayer does not charge customers for "VSI" when the taxpayer makes cash sales. Similarly, the taxpayer does not charge customers for "VSI" who purchase vehicles on an installment basis when those customers purchase "VSI" from licensed third party insurers. Instead, the taxpayer charges only those customers who purchase motor vehicles on an installment basis and decline to purchase "VSI" from third party insurers to protect the taxpayer's security interests. In such cases, the taxpayer and the customers execute written installment sale contracts and security agreements that separately identify "VSI" charges from the sales price, trade-in value (if any), sales tax, fees, finance charges, etc.

We find that the "VSI" payments are not part of the selling price for cash buyers, or for installment buyers who procure satisfactory insurance from third party insurers. Likewise, we find that installment buyers who purchase their vehicles and make the "VSI" payments to the taxpayer are not making the payments as part of the selling price, but are paying a charge to purchase the vehicles over time and to protect the taxpayer from future loss of its security interest. The taxpayer, in effect, is taking a greater risk in financing such sales when compared to installment sales to buyers who purchase "VSI" insurance from third parties.

Rule 109 subjects "finance charges" and "carrying charges" to the service B&O tax classification. The terms are not defined in the rule. Therefore, we look to their ordinary and common meaning. John H. Sellen Constr. Co. v. Department of Rev., 87 Wn.2d 878, 882, 558 P.2d 1342 (1976). "Finance charge" is defined in part as:

> The consideration for privilege of deferring payment of purchase price. The amount however denominated or expressed which the retail buyer contracts to pay or pays for the privilege of purchasing goods or services to be paid for by the buyer in installments; . . .

Black's Law Dictionary 568 (5th ed. 1979). "Carrying charge" is defined as "[c]harge made by creditor, in addition to interest, for carrying installment credit." Black's Law Dictionary 194

(5th ed. 1979). We find the "VSI" payments are subject to service B&O tax whether they are "finance charges" or "carrying charges" under Rule 109 or, according to Rule 224, they are payments that are not otherwise classified.

[2] However, the taxpayer cannot treat installment sales as bad debts when the vehicles that it sold are considered losses due to destruction or theft. The purpose of the "VSI" payments is to provide the taxpayer a measure relief from such losses. We understand when such losses occur, the taxpayer forgives the debt and retains the "VSI" payment. By contrast, WAC 458-20-196 (Rule 196) describes "bad debt" as follows:

> A dishonored (bad) check which proves to be uncollectible is a bad debt, to the extent it was taken as payment for goods or services on which business tax was previously reported and paid.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. The "VSI" payments are to be reported under the service B&O tax classification. We remand this matter to Audit to allow it to adjust the tax assessment accordingly.

Dated this 26th day of March 1998.