

Cite as Det. No. 13-0269, 33 WTD 144 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 13-0269
. . .)	
)	Registration No. . . .
)	

[1] RULE 180; RCW 82.04.220: RETAIL SALES TAX – PACKING MATERIALS – MOVING COMPANY. Boxes and other items sold by a moving company to its customers that are separately itemized on a bill of lading are subject to the retail sales tax and retailing B&O tax. Materials re-used by the moving company in the course of doing business (e.g. ropes, pads, and dollies) are subject to use tax as the moving company is the consumer of those materials.

[2] RCW 82.04.220; RCW 82.04.080: B&O TAX – GROSS INCOME OF THE BUSINESS – VALUE PROCEEDING OR ACCRUING – BUSINESS ENGAGED IN – LEGAL SETTLEMENTS. Legal settlements that are compensation for lost taxable business income are taxable in the same manner as the lost business income. Legal settlements that are compensation for personal injuries or (non-merchandise) property damages are not taxable.

[3] RULE 106; RCW 02.04.040: CASUAL AND ISOLATED SALE – AUCTION SALES – ABANDONED ITEMS - STORAGE UNITS. Items sold at auction by a moving company after its customers abandon those items by defaulting on their storage payments are taxable, because they are routinely and continuously sold by the moving company and the income derived from those sales are an integral part of the moving company's business.

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.

Weaver, A.L.J. – A moving and storage company petitions for correction of assessment of tax on a number of issues, including . . . whether it is required to collect retail sales tax on packing

materials it sells to its customers, whether it owes use tax on packing materials it uses in providing packing services to its customer, whether the proceeds it received from its landlord for prematurely breaching a lease agreement, and future instructions on whether to report retailing business and occupation (“B&O”) tax on auction sales of items abandoned by customers who defaulted on their storage payments, and the proper documentation required to be eligible for the intrastate carrier exemption on purchases of motor vehicles and trailers. Taxpayer’s petition is granted with respect to the proceeds it received from its landlord for the breach of a lease agreement, but is denied on all other issues.¹

ISSUES

1. [. . . .]
2. Whether, under WAC 458-20-180, a taxpayer is required to collect retail sales tax upon the gross retail sales price of packing materials it sold to its customers.
3. Whether, under WAC 458-20-115 and Det. No. 98-169, a taxpayer is required to pay use tax on packing materials that a taxpayer uses in its commercial packing business.
4. Whether, under RCW 82.04.080, are the proceeds a taxpayer receives from its landlord after the landlord breaches a rental contract taxable income to the taxpayer.
5. Whether, under RCW 82.04.040 and WAC 458-20-106, a taxpayer is required to pay retailing business and occupation tax on auction sales.
6. Whether, under RCW 82.12.0254 and WAC 458-20-17401, a taxpayer is required to document and support its motor vehicle tax exemptions for vehicles used for interstate transport.

FINDINGS OF FACT

Taxpayer operates a moving and storage business. Taxpayer offers local and regional moves and receives income from the moving, packing, and storage of goods. As an agent for [a moving company], Taxpayer also facilitates interstate and international moves. The Department of Revenue (“Department”) audited Taxpayer’s books and records for the period of January 1, 2007 through March 31, 2011. During the audit period, Taxpayer received additional revenues in the form of proceeds from sales of forfeited storage content, income received from a landlord’s breach of lease, and income from furniture assembly. The audit examination resulted in a tax assessment, issued on July 9, 2012, in the amount of \$. . . . That assessment included \$. . . in retail sales tax, \$. . . in retailing business and occupation (“B&O”) tax, \$. . . in service and other activities B&O tax, \$. . . in motor transportation public utility tax (“PUT”), \$. . . in warehousing B&O tax, \$. . . in royalty B&O tax, a wholesaling B&O tax credit of \$. . . , a use tax credit of \$.

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

. . . , an urban transportation tax credit of \$. . . , and interest of \$. . . Taxpayer filed a timely appeal of this assessment.

Much of the tax assessment resulted from the following issues, as documented in the enumerated schedules:

. . .

• Schedule 3C & 3D – Retailing Tax Due on Income Reconciliation Differences

The Audit Division reconciled income taxable under the retailing B&O tax and retail sale tax classifications through a comparison of the amounts recorded in Taxpayer's business records with the amounts reported to the Department. The retail-taxable amounts were calculated as a total of material and equipment sales in the State of Washington based on Taxpayer's sale summaries, plus furniture assembly labor charges that were recorded outside the sales summaries. In addition, taxable amounts from two casual sales (in 2008 and 2009) were added.

Taxpayer's current business practice is to itemize all packing materials sold on both local and out-of-state moves on a standardized bill of lading. The materials are marked up at an estimated 70% over cost. The amounts of materials Taxpayer sold were deducted by Taxpayer from its retailing B&O and retail sales tax base and were reported at cost for use tax purposes. Taxpayer did not report use tax on materials sold on out-of-state moves. The Audit Division granted Taxpayer a use tax credit for the sales of packing material but assessed retailing B&O and retail sales tax on the sale price of the packing material.

• Schedule 3F – Service & Other Activities Tax Due on Income Reconciliation Differences

The Audit Division identified taxable differences between service and other income recorded in Taxpayer's sales summaries when compared to the amounts reported by Taxpayer on its excise tax returns. \$. . . in miscellaneous revenue was received by Taxpayer from [a landlord] as compensation for a breach of a lease agreement. The landlord . . . requested Taxpayer leave the premises so [it] could expand its operation and paid that sum as damages for breach of contract. The Audit Division added the damages amount to Taxpayer's service and other activities income.

Taxpayer appeals the issues listed above.

• Future Instructions – Auction Sales Revenue & Interstate Carriers Exemption

Taxpayer also appeals the future instructions received from the Audit Division with respect to the proper tax treatment of auction sales and the exemption for interstate carriers. Taxpayer regularly sells the contents of abandoned storage units at auction when its customers default on their storage payments. Taxpayer takes the position that auction sales are not subject to retailing B&O tax. The Audit Division instructed Taxpayer as follows:

A formal form of accounting should be introduced to track your auction sales and subcontracted labor sales (furniture assembly). Both fall under the Retailing and Retail Sales income classifications and are currently traced outside your sales reports and your QuickBooks.

See Auditor's Detail of Differences and Instructions to Taxpayer, p. 8.

With respect to the interstate carrier exemption, Taxpayer operates two "brands" of equipment. [Brand A] equipment is used exclusively for intrastate moves and Taxpayer pays retail sales tax on [Brand A] vehicles at the time of purchase. Taxpayer maintains that it pays retail sales tax on the [Brand B] vehicles that are used intrastate at the time of purchase, but does not pay retail sales tax on the [Brand B] vehicles that are used for interstate transportation. Taxpayer maintains that most of the [Brand B] trucks and tractors are used on a dual basis. According to Taxpayer, [Brand B] trailers are primarily used in interstate transportation. Taxpayer claimed an exemption for the equipment used for interstate transportation.

The Audit Division did not disallow the exemption for the audit period, but gave Taxpayer instructions on how to report in the future on transportation vehicles owned by Taxpayer and purchased with the retail sales tax exemption. Specifically, Taxpayer was instructed:

Interstate Carriers – Exemption Requirements

RCW 82.12.0254 and WAC 458-20-17401 explain that motor vehicles and trailers used for transporting persons or property for hire in interstate or foreign commerce, whether such use is by the owner or whether such motor vehicles are leased to the user with or without driver, are not subject to retail sales or use tax provided both of the following requirements are met:

- The user is, or operates under contract with, a holder of a carrier permit issued by the Interstate Commerce Commission or its successor agency.
- The vehicle is used in substantial part in the normal and ordinary course of the user's business for transporting therein persons or property for hire across the boundaries of the state.

"In substantial part" means that the motor vehicle or trailer for which the exemption is claimed actually crosses Washington State boundaries and is used a minimum of 25 percent in interstate hauling for hire.

WAC 458-20-17401 provides various methods for determining the interstate percentage.

Per information provided during the audit review all trucks and trailers with [Brand A] logos are used primarily for intrastate moves. Retail sales tax was paid at the time of the vehicle purchase.

Trucks and trailers owned by [Taxpayer] with the [Brand B] logos are used for interstate and international moves and were purchased with the sales tax exemption. A formal recording process needs to be introduced to support the tax exemption and annual testing as described in WAC 458-20-17401.

See Auditor's Detail of Differences and Instructions to Taxpayer, p. 8.

Taxpayer filed a timely appeal of these issues.

ANALYSIS

Taxpayer protested multiple issues that arose during the audit process. We will address these in turn.

A. . . .

B. Retail Sales Tax and Use Tax on Packing Materials

Taxpayer itemizes all packing materials sold on both its local and its out-of-state moves on a standardized bill of lading. Taxpayer marked up the packing material at an estimated 70% over Taxpayer's cost. Tax is measured by gross proceeds of sales. RCW 82.04.220. A sale is defined at RCW 82.04.040 as ". . . any transfer of the ownership of, title to, or possession of property for a valuable consideration . . ." On its excise tax returns, Taxpayer deducted the amounts of packing materials it sold for both retailing B&O and retail sales purposes and reported use tax on the packing materials it used on local moves.

WAC 458-20-180 ("Rule 180") reads, in pertinent part, as follows:

Persons engaged in either motor or urban transportation may also sell, lease, or rent tangible personal property . . . Gross income from the sale, lease, or rental of tangible personal property without an operator to a consumer, is subject to retailing B&O and retail sales taxes

Rule 180(8)(c).

In this case, the Audit Division assessed retail sales tax and retailing B&O tax on Taxpayer's sales of packing materials and gave Taxpayer a credit for use tax it paid on the packing materials for local moves. Under Rule 180(8)(c), Taxpayer is required to collect retail sales tax and retailing B&O tax on the sale of tangible personal property. The Audit Division was authorized to assess retail sales tax and retailing B&O tax on the packing materials that were separately itemized as being sold to Taxpayer's customers.

In the audit, the Audit Division made a distinction between packing materials sold to customers during a move (e.g., boxes) and materials that the Taxpayer uses on most moves and reuses in the course of doing business (e.g., ropes, pads, and dollies). For the reasons discussed above, the Audit Division determined that the boxes and other items sold to Taxpayer's customers and separately itemized on the bill of lading are subject to the retail sales tax and retailing B&O tax.

The Audit Division determined that the latter categories were being used by the Taxpayer in the course of doing business and were subject to the use tax, as Taxpayer was the consumer. Taxpayer previously appealed this issue and was instructed in Det. No. . . . that it is required to pay use tax on the purchase of blankets, ramps, dollies and other moving equipment it uses as a consumer. *See* Det. No. . . . For these reasons, we agree with the distinction drawn by the Audit Division and the specific written instructions in Det. No. . . . are affirmed and remain in force and effect.

Taxpayer claims that there is a conflict between the Utilities and Transportation Commission and the Department of Revenue on the issue of whether retail sales tax can be charged on packing materials. However, Taxpayer fails to cite any authority to evidence any such conflict. Taxpayer also alleges that the Audit Division used an improper local area reference when calculating local taxes, but does not provide any documentation to substantiate this claim.

Taxpayer's petition is denied on these issues.

C. Taxation of Proceeds from Early Lease Termination

During the audit period, Taxpayer received \$. . . from the [Landlord]. Taxpayer was a tenant of the [Landlord] and, in 2007, the [Landlord] informed Taxpayer of its intention to use the building for its own purposes. The [Landlord] paid Taxpayer \$. . . to entice Taxpayer to move before the end of Taxpayer's lease term. The Audit Division assessed tax on this payment Taxpayer received as a result of the early lease termination.

Taxpayer argues that that amount does not constitute "gross income of the business" because the payment was not received by reason of the transaction of the business it engages in. The B&O tax is "extensive and intended to impose . . . tax upon virtually all business activities carried on in the State." *Analytical Methods, Inc. v. Dep't of Revenue*, 84 Wn. App. 236, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep't of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). For purposes of the B&O tax, "business" is broadly defined to include "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly, or indirectly." RCW 82.04.220, in turn, imposes the B&O tax on persons engaged in business. It provides:

There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

RCW 82.04.220. "Gross income of the business" is broadly defined by RCW 82.04.080 as:

[T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest,

discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated

RCW 82.04.080(1). In this case, Taxpayer received the \$. . . payment from its landlord as a result of its landlord's expressed intent to breach the lease agreement. Taxpayer maintains that the payment is a pre-litigation settlement of a breach of contract claim and it received the amount to compensate it for having to move its business operations before the expiration of the lease term.

Taxpayer is arguing that the pre-litigation negotiated settlement of a breach of contract claim is analogous to a liquidated damages or a legal settlement. On December 27, 2011, the Department issued a Tax Topics article entitled: "Are Legal Settlements Taxable?" The article stated:

Are legal settlements taxable?

The taxability of amounts received from the settlement of an insurance claim or a lawsuit depends upon the nature of the settlement. That is:

- If the settlement is compensation for lost business income that would have been taxable if the income had been received in the first place, the settlement is taxable in the same manner as the business income would be taxable.
- If the settlement is compensation for personal injuries or (non-merchandise) property damages, the settlement amounts would not be taxable.

. . . .

Tax Topics article, dated December 27, 2011. Consistent with the general B&O taxing scheme, the Tax Topics article reaffirms that settlements related to a business purpose are taxable and that payments to a non-business activities are not.

The Department has issued published determinations that illustrate the distinction between settlements related to a business purpose versus settlements that make an injured party whole. In Det. No. 98-164, 19 WTD 393 (2000), the Department determined that the compensation received by a city's public utility district from the State of Washington in order to relocate utility lines necessitated by road construction performed by the Department of Transportation was not taxable. The payment in 19 WTD 393 was characterized as a "payment in lieu of eminent domain proceedings" as it was negotiated between the city and the State prior to litigation. *See* 19 WTD 393, at 395. While, by its terms, 19 WTD 393 addresses the specific issue of the taxability of payments received by a public utility district as a result of eminent domain action, the rationale for non-taxability was the following:

[T]hese appeals involve . . . forced relocation of utility facilities, because DOT was changing the route of a state highway. Thus, the contracts entered into between DOT and the taxpayers were in lieu of eminent domain proceedings and for the purpose of mitigating the damages to the taxpayers' facilities.

19 WTD 393, at 396. This reasoning, while in a different context, is similar to the case at hand. Here, Taxpayer accepted a negotiated payment “in lieu” of a breach of contract lawsuit, and the proceeds were paid by Taxpayer’s landlord to mitigate the costs that Taxpayer would necessarily incur in moving its operations to a new location prior to the expiration of a lease term.

Conversely, in Det. No. 89-505, 11 WTD 39 (1989), the Department held that liquidated damages received by a company engaged in the leasing of automobiles resulting from the early termination of a lease by a customer are taxable compensation. 11 WTD 39 holds as follows:

Because these liquidated damages are derived from the taxpayer’s rental property they must be considered an integral part of the business of leasing automobiles. As such, these amounts are fully taxable

11 WTD 39, at 6. These cases are illustrative of the distinction between funds received in settlement of a claim for lost business income and settlement of a claim where a party is made to mitigate injury or property damages suffered by a party. Because Taxpayer, in this case, received payment from its landlord as a result of the landlord’s stated intention of breaching its lease with Taxpayer before the lease expiration date, the payment was made to make Taxpayer whole for its landlord’s breach of contract. As such, the payment is not “gross income of the business,” because Taxpayer is not “engaged in the business” of being forced to relocate.

Taxpayer’s petition is granted on this issue.

D. Auction Sales

According to RCW 82.04.040, a “casual or isolated” sale is defined to mean “a sale made by a person who is not engaged in the business of selling the type of property involved.” RCW 82.04.040(2). WAC 458-20-106 (“Rule 106”) explains that the business and occupation tax does not apply to casual or isolated sales.

Taxpayer argues that the proceeds it receives when it sells the contents of abandoned storage units at auction are exempt from the retailing B&O tax. For tax purposes, “business” is not limited to the taxpayer’s primary or principal business activity but includes “all activities engaged in with the object of gain or advantage to the taxpayer.” RCW 82.04.140. “Casual” means something occurring without regularity and “isolated” connotes a lack of continuity. In determining whether sales are casual or isolated, one factor is whether the sales were made on a regular and continuous basis. This is the position taken by the Washington Supreme Court in *Budget Rent-A-Car v. Dep’t of Revenue*, 81 Wn.2d 171 (1972). In *Budget Rent-A-Car*, the Court held that sales of automobiles used in the taxpayer’s car rental business were sales made by a person “engaged in the business of selling the type of property involved.” *Id.* at 176. In denying casual or isolated sale treatment the Court reasoned that the car sales were “routine” and “continuous” and, therefore, an integral part of the taxpayer’s business operations. *Id.*

Incorporating the language of *Budget Rent-A-Car*, Rule 106 states that any sales which are routine and continuous must be considered to be an integral part of the business operation and not casual or isolated sales.

Here, Taxpayer regularly auctions the items abandoned by customers who default on their storage payments. These auction sales are routine, continuous, and are an integral part of Taxpayer's business activity.

Taxpayer's petition on this issue is denied and we sustain the following future instructions given to Taxpayer by the Audit Division:

A formal form of accounting should be introduced to track your auction sales and subcontracted labor sales (furniture assembly). Both fall under the Retailing and Retail Sales income classifications and are currently traced outside your sales reports and your QuickBooks.

See Auditor's Detail of Differences and Instructions to Taxpayer, p. 8.

E. Future Instructions on Interstate Carriers

RCW 82.12.0254 and WAC 458-20-17401 grant a retail sales tax and use tax exemption on motor vehicles and trailers used for transporting persons or property for hire in interstate or foreign commerce. The Audit Division instructed Taxpayer that it needs to introduce a formal recording process to support these tax exemptions on its equipment purchases, whether it purchases equipment under its [Brand A] or under [Brand B].

RCW 82.32.070 requires taxpayers to keep and preserve suitable records as may be necessary to determine the amount of tax for which they may be liable. The Audit Division's future instructions, listed in their entirety above, relating to Taxpayer's duty to support its tax exemptions are consistent with RCW 82.32.070, and, as such, they are affirmed.

Taxpayer's petition is denied on this issue.

DECISION AND DISPOSITION

Taxpayer's petition is granted in part and denied in part.

Taxpayer's petition is granted on the issue of the early termination of lease payment. Taxpayer's petition is denied on all other issues.

Dated this 26th day of August, 2013.