Cite as Det. No. 13-0263, 33 WTD 562 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment and Refund of	)	D E T E R M I N A T I O N
	)	No. 13-0263
. . .	)	Registration No. . . .
	)	And
. . .	)	Registration No. . . .

[1] RULE 247; RCW 82.08.010(1): TRADE-IN PROPERTY OF LIKE KIND. While video game, video game controller, and video game consoles are interdependent and act as one unit, each of those items functions differently, so they are not in the same nature of the trade-in property and do not have the same function or use of the trade-in property as required under Rule 247. Because video games are not property of the same generic classification as the video game controller or the video game console, they are not "like kind" property under RCW 82.08.010.

[2] RULE 228; RCW 82.32.105: WAIVER OR CANCELLATION OF PENALTIES AND INTEREST. A taxpayer is precluded from denying liability for the delinquent penalty based on a claim that a tax assessment notice was not received by mail. It has been the Department's position that its duty to notify the taxpayer of an assessment is satisfied where the Department sends the notice of assessment to the address given by the taxpayer.

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.

Callahan, A.L.J. – Affiliated entities ("Taxpayers") that sell new and used video games, video game controllers, video game consoles,[1] and other miscellaneous items protest retail sales tax

[1] A video game console is "an interactive computer that produces a video display signal which can be used with a display device (a television, monitor, etc.) to display a video game. The term "video game console" is used to distinguish a machine designed for people to buy and use primarily for playing video games on a TV in contrast to

and retailing business and occupation (B&O) tax assessed on disallowed deductions it had claimed for like kind trade-ins. We deny the petitions.[2]

ISSUES

1. Have Taxpayers demonstrated that they were entitled to the trade-in credits under RCW 82.08.010(1)(a) and WAC 458-20-247 (Rule 247)?

2. . . .

3. Under RCW 82.32.105 and WAC 458-20-228 (Rule 228), did Taxpayers fail to pay the assessments timely due to circumstances beyond their control?

FINDINGS OF FACT

. . .

During the audit period, Taxpayers allowed their customers to trade their used video games, video game controllers and consoles, and other related products, such as the mouse for the console towards the purchase of new or used products, or for store credits towards future purchases or for cash.[3] Neither Audit nor Taxpayers stated any issues with respect to the transactions where the customers received cash for their used products. With respect to the transactions where a customer purchased a new item at the time and place it traded in the used item, Taxpayers applied the value of the traded in product against the retail sales price of the new product, charged retail sales tax on the difference, and reported B&O tax on the original retail price.[4] Audit allowed the retail sales tax deductions Taxpayers took during the audit period when a product of like kind was traded in and was used against the immediate purchase of the same

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arcade machines, handheld game consoles, or home computers." Video game console, *Wikipedia, The Free Encyclopedia*, http://en.wikipedia.org/wiki/Video_game_console (last visited July 29, 2013).

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

[3] For example, when a customer brings in a video game that valued at $20 and wishes to trade the video game for cash, Taxpayers take a 20% deduction off the $20 product value and gives the customer $16 in cash. Taxpayers do not report any taxes on such transactions treating them as inventory purchases for resale. Audit did not assess tax on these transactions.

[4] For example, when a customer brings in a product that is valued at $20 to trade for another product in the store that is valued at $60, Taxpayers collect retail sales tax from the customer on the difference of the value of the traded-in product and the newly acquired product, in this case, $40. Taxpayers report and remit the collected retail sales tax to the Department and take a trade-in retail sales tax deduction for $20. Taxpayers report the retailing B&O tax on $60. With respect to the future trade-in sales, same as the example above, except that the customer does not want to purchase another product at the time when he brought in his trade-in product but wishes to receive a store credit for $20. Taxpayers will issue a $20 lifetime store credit to the customer. Taxpayers will not report any taxes to the Department for that transaction at the time when they issue the trade-in credit to that customer. When that same customer purchases another product in one of Taxpayers' stores valued at $60 in a future transaction with his store credit, Taxpayers collect retail sales tax on $40. Taxpayers report and remit the collected retail sales tax to the Department and take a trade-in retail sales tax deduction for $20. Taxpayers report retailing B&O tax on $60.

type of products in a single transaction.[5] However, Audit disallowed the deductions for transactions involving trades of non like-kind property and also disallowed deductions for the trade-in credits used for future transactions.[6]

Taxpayers argue that RCW 82.08.010(1)(a) provides a "sales price" exclusion for the value of trade-in property of like-kind and that video games, video game consoles, and video game accessories are all tangible personal property of the same generic classification.

Taxpayers also petitioned for a cancellation of the penalties and interest assessed against [the affiliated entity] for late payment of the assessment, because it allegedly did not receive the assessment in time for it to timely pay the assessment. The Department's records show that Audit mailed the assessment to [the affiliated entity] on July 25, 2012, to the address that the Department has on file, which is the same address as [the Taxpayer].

ANALYSIS

Washington imposes a retail sales tax on the sale of tangible personal property in Washington, which the seller collects from the buyer. RCW 82.04.050; 82.04.190; 82.08.020; 82.08.050. Retail sales tax is calculated as a percentage of the "selling price" of the property sold. RCW 82.08.020(1). The value of certain "trade-in property" is excluded from the "selling price." RCW 82.08.010. WAC 458-20-247 (Rule 247) explains the trade-in property exclusion as follows:

> RCW 82.08.010 and 82.12.010 define the terms "selling price" and "value of the article used," in pertinent part, to mean the total amount of consideration, except separately stated trade-in property of like kind, including cash, credit, or tangible personal property, expressed in terms of money paid or delivered by a buyer to a seller. As a result, the buyer of tangible personal property is entitled to reduce the measure of retail sales or use tax if:
>
> - The buyer delivers the trade-in property to the seller;
> - The trade-in property is delivered as consideration for the purchase; and
> - The property traded in is "property of a like kind."
>
> (a) The trade-in exclusion applies to all trade-in property of like kind delivered by a buyer to a seller as consideration for a purchase. Thus, if a

[5] For example, if a customer traded in several video games that valued at $100 for an immediate purchase of a game valued at $50, and a console valued at $40. Taxpayers gave the customer a store credit for $10. Audit only allowed Taxpayers to take a trade-in credit deduction of $50 for the purchase of the new game. When that customer used his store credit of $10 to purchase another item in one of Taxpayers' stores in future, Audit did not allow Taxpayers to take the $10 trade-in credit deduction.

[6] For example, if a customer traded in several games and Taxpayers allowed $100 for the values of those games against the immediate purchase price of a game of $40, a console for $40, and a $20 for store credits, Taxpayers took retail sales tax deduction on $80 immediately (the game valued at $40 and the console valued at $40) and took retail sales tax deduction on the $20 when the customer used the $20 credit to purchases a new item at a different transaction. Audit allowed the $40 retail sales tax deduction Taxpayers took for the sale of the game, but disallowed the $40 retail sales tax deduction Taxpayers took for the sale of the console. Audit disallowed the $20 retail sales tax deduction Taxpayers took when the customer utilized the $20 store credits to purchase items from the store in a different transaction.

> buyer trades in two motor vehicles when purchasing one motor vehicle, the buyer is entitled to a reduction in the measure of retail sales tax based on the value of both trade-in vehicles.
> (b) The trade-in exclusion is limited to retail sales and use taxes. There is no comparable exclusion for business and occupation (B&O) tax. (See definition of "gross proceeds of sales" in RCW 82.04.070 and of "value proceeding or accruing" in RCW 82.04.090.) Sales tax need not have been paid on the item being traded in to be eligible for the trade-in exclusion.

Rule 247 (emphasis added).

Trade-in property reduces the measure of the buyer's sales tax liability or the consumer's use tax liability, but not the measure of the seller's B&O tax provided that all the criteria listed above are met. In this case, however, Taxpayers deducted from their reported gross proceeds of sales the amounts they identified as trade-in credits. Taxpayers explained that trade-in credits occur when a customer brings into the store used merchandise for which Taxpayers ascribe a value, but, rather than pay the customer that value or immediately apply that value to a product the customer is purchasing, they issue a credit equal to that value to that customer for its use when purchasing merchandise from Taxpayers sometime in the future. In this matter, the first element under Rule 247 is met when the customer brings the used merchandise to the seller. However, the second element requires that the merchandise be brought to the seller as consideration for a purchase.

Rule 247(4) explains:

> Property traded in must be consideration delivered by the buyer to the seller. The sales documents must identify the tangible personal property being purchased and the trade-in property being delivered to the seller. This does not require simultaneous transfers of the property being traded in and the property being purchased, but it does require that the delivery of the trade-in and the purchase be components of a single transaction. Sales documents, executed not later than the date the trade-in property is delivered to the seller, must identify the property purchased and the trade-in property as more fully explained in subsection (8) of this section.

(Emphasis added).

Rule 247(8) explains the recordkeeping requirement for trade-in property:

> **(8) Recordkeeping.** RCW 82.32.070 requires every person liable for any tax to keep and preserve records from which tax liability can be determined. To substantiate a claim for the trade-in exclusion, the sales agreement and/or invoice must identify both the property being purchased and the trade-in property. Such identification includes the model number, serial number, year of manufacture, and other information as appropriate. The sales agreement and/or invoice must also specify the selling price and the value of the trade-in property. . . .

(Emphasis added).

In this matter, the customer can use the trade-in credit at the time it brings in the merchandise or at sometime in the future and can use it at either store. Audit found that Taxpayers failed to keep records to identify both the property being purchased and the trade-in property when they took the trade-in retail sales tax deduction during the audit period.

Moreover, the third requirement as explained in Rule 247(5) requires that the property traded-in must be of like kind to the property acquired in order to apply the trade-in value (of the used merchandise) against the selling price (of the purchased property). Rule 247(5) defines the term "property of like kind" as:

> articles of tangible personal property of the same generic classification. It refers to the class and kind of property, not to its grade or quality. The term includes all property within a general classification rather than within a specific category in the classification. Thus, as examples, it means furniture for furniture, motor vehicles for motor vehicles, licensed recreational land vehicles for licensed recreational land vehicles, appliances for appliances, auto parts for auto parts, and audio/video equipment for audio/video equipment. These general classifications are determined by the nature of the property and its function or use.

(Emphasis added).

Therefore, under RCW 82.08.010, the selling price of merchandise a buyer purchases may be reduced by the value of the property that the buyer delivers to the seller but that property must be of like kind in order for the seller to successfully claim the retail sales tax or use tax trade-in deduction. 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. Dep't of Revenue*, 81 Wn.2d 171, 500 P.2d 764 (1972). Therefore, Taxpayers have the burden of showing that the deductions at issue qualify for this tax exemption.

Audit disallowed the deductions for transactions it found to be for non like kind property traded. For example, it disallowed transactions where the trade-in property was several games and the purchased property was a video game console and vice versa. Transactions such as these constituted the majority of the assessments. Taxpayers disagree that the traded properties are not like kind. They argue that all the items that they carry in their stores, such as a video game and a video game console fall under the same generic video game classification.

Rule 247(5) defines the term "property of like kind" as tangible personal property of the same generic classification, which is to be "determined by the nature of the property and its function or use." Thus, we will examine the nature of the majority of the disallowed traded properties, i.e., the video games, video game consoles, and video game accessories such as controllers. A video game is an electronic game that "employs electronics to create an interactive system with which

a player can play."[7] The video games that Taxpayers carry in their stores are "prewritten computer software" as defined under RCW 82.04.215. Computer software is defined as "a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task." RCW 82.04.215(2). The video games are prewritten computer software, and not custom software, because the computer software is not designed to "the specifications of a specific purchaser." RCW 82.04.215(6).

The games as prewritten software must have a means to be displayed or manipulated. The game consoles, which Taxpayers also sell, serve this purpose. A video game console is "an interactive computer that produces a video display signal which can be used with a display device (a television, monitor, etc.) to display a video game."[8] RCW 82.04.215(1) defines the term "computer" as "an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions." The game console is the physical equipment, the computer hardware, needed to play the game. WAC 458-20-15501(3)(a) (Rule 15501) provides that the term computer hardware:

> … includes, but is not limited to, the mechanical, magnetic, electronic, or electrical components of a computer system such as towers, motherboards, central processing units (CPU), hard disk drives, memory, as well as internal and external peripheral devices such as compact disk read-only memory (CD-ROM) drives, compact disk rewritable (CD-RW) drives, zip drives, internal and external modems, wireless fidelity (Wi-Fi) devices, floppy disks, compact disks (CDs), digital versatile disks (DVDs), cables, mice, keyboards, printers, monitors, scanners, web cameras, speakers, and microphones.

(Emphasis added).

Therefore, we conclude that a video game console is a computer hardware device. Rule 15501.

Taxpayers also sell game controllers. A game controller is a peripheral device "used with games or entertainment systems to provide input to a video game, typically to control an object or character in the game."[9] *See* Rule 15501(3)(a). Computer hardware includes peripheral devices such as a mouse or a keyboard. Rule 15501(3)(a). As defined, a game controller functions like a mouse or a keyboard. We conclude, therefore, a game controller is a computer hardware device. *Id.*

Taxpayers argued in its petition that

> … the Tax Assessment and the examples in WAC 458-20-247 in respect to what qualifies as trade-in property of a like kind are unreasonably narrow interpretations of RCW

[7] Electronic game, *Wikipedia, The Free Encyclopedia*, http://en.wikipedia.org/wiki/Electronic_game (last visited July 29, 2013).
[8] Video game console, *Wikipedia, The Free Encyclopedia*, http://en.wikipedia.org/wiki/Video_game_console (last visited July 29, 2013).
[9] Game controller, *Wikipedia, The Free Encyclopedia*, http://en.wikipedia.org/wiki/Game_controller (last visited July 29, 2013).

> 82.08.010 that provides that the sales price excludes the value of trade-in property of a like kind. Video games, video game systems and video game system accessories are all articles of tangible personal property of the same generic classification. Each of these items has no independent use apart from each other and are all required components for a video gaming experience.

We previously addressed a similar issue in Det. No. 91-044, 10 WTD 395(1991) where the taxpayer had claimed under Rule 247 a trade-in deduction involving computer hardware and software and which the Department had disallowed. In that determination we said:

> Hardware is generally the mechanical and electronic parts of a computer; software (programs) is generally the instructions that command the hardware. Indeed, Rule 155[10] defines hardware and software separately. Software and hardware are like a car and gasoline; the hardware is like the car and the gas is like the software. A trade of gas for a car is not a like- kind exchange. Software and hardware do not serve the same purpose and are not of the same general class.

(Emphasis added).

Similarly, the video game, the video game controller, and the video game console have different functions and uses. The game provides the software that contains the instructions that command the hardware, i.e., the console and the controller. While they are interdependent and act as one unit, this does not make the computer software and computer hardware property of the same general class of property. Each of those items functions differently and they are not in the same nature of the property and do not have the same function or use as required under Rule 247. Therefore, we conclude that the video games are not property of the same generic classification as the video game controller or the video game console, and are not like kind under RCW 82.08.010. Thus, for those transactions that Audit found did not qualify for the trade-in deductions because the traded-in property was video games and the purchased property was either the console or the controller, we conclude Audit properly disallowed the deduction.

As to the issue of whether Taxpayers met the criteria of establishing that the trade-in credit was used to purchase like kind merchandise as part of a single transaction, we find that Taxpayers did not meet its burden. Under the recordkeeping requirement of Rule 247, Taxpayers, the sellers, were required to "identify the tangible personal property being purchased and the trade-in property being delivered to the seller" in order to substantiate not only that the trade-in property and the purchased property were properties of the same generic classification, but were also a single transaction. Here, the facts show that Taxpayers' records failed to identify the traded-in property for which the customer received the store credit so that when the customer subsequently used the store credit to purchase another property, the records of that subsequent transaction only identified the property being purchased with the store credit and failed to identify the traded-in property. It is Taxpayers' burden to maintain and produce records to support their claim for the exclusion. Rule 247(8) states specifically what documentation is required for Taxpayers to show

[10] WAC 458-20-155 was the predecessor of WAC 458-20-15501 and WAC 458-20-15502.

that they are entitled to exclude certain sales from the measure of the retail sales tax. RCW 82.32.070 states generally a taxpayer's recordkeeping requirements:

> Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue. . .

Taxpayers failed to keep records pursuant to RCW 82.32.070 to substantiate the "trade-in property of like kind property" retail sales tax deductions that they took during the audit period. When Taxpayers' customer brings property into the store to trade and receives a store credit for a future purchase, Taxpayers do not maintain any records to identify the tangible personal property being purchased and the trade-in property being delivered to Taxpayers as a single transaction. Taxpayers' records only identify the customer that uses the store credit to reduce or eliminate the price of the merchandise being purchased at the time the customer uses the credit. Thus, there is no record linking the trade-in transaction, for which the credit was received, to the property purchased with the credit. Accordingly, Audit properly disallowed the deductions for the credits that were used in the future when Taxpayers failed to "identity the tangible personal property being purchased and the trade-in property being delivered to the seller."

With respect to the late payment penalties and interest, RCW 82.32.090(1)[11] requires that the Department impose penalties when a taxpayer makes a late or deficient tax payment. The amount of the penalty varies depending on how long a return is delinquent. *Id.*

The Legislature has granted the Department limited authority to waive or cancel penalties, set out in RCW 82.32.105 and RCW 82.32A.020.

RCW 82.32A.020(2) gives taxpayers the right to have penalties waived where they have detrimentally relied on specific, official written advice or instructions they received from the Department. There is no evidence that Taxpayers received specific and official written advice informing them not to pay the assessment for [the affiliated entity] by the due date. We conclude, therefore, that RCW 82.32A.020(2) does not provide a basis for relief in this basis.

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[11] RCW 82.32.090(1) provides:

> If payment of any tax due on a return to be filed by a taxpayer is not received by the department of revenue by the due date, there is assessed a penalty of five percent of the amount of the tax; and if the tax is not received on or before the last day of the month following the due date, there is assessed a total penalty of fifteen percent of the amount of the tax under this subsection; and if the tax is not received on or before the last day of the second month following the due date, there is assessed a total penalty of twenty-five percent of the amount of the tax under this subsection. No penalty so added may be less than five dollars.

The other penalty waiver statute, RCW 82.32.105, provides, in pertinent part:

> (1) If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any penalties imposed under this chapter with respect to such tax.

(Emphasis added).

Circumstances beyond the control of the taxpayer are generally those which are immediate, unexpected, or in the nature of an emergency. Rule 228(9)(a)(ii). Such circumstances result in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise timely file and pay. *Id*. Rule 228(4)(d) provides that " [i]f a taxpayer suspects that it will not be able to file and pay by the coming due date, it may be able to obtain an extension of the due date to temporarily avoid additional penalties."

Here, the circumstances Taxpayers allege do not appear to be unexpected or in the nature of an emergency. Taxpayers bear the burden of establishing that the circumstances went beyond their control and directly caused the late payment. Rule 228(9)(a)(i). Taxpayers assert that the basis for the penalty waiver is [the affiliated entity]'s lack of control over the mail delivered through the United States Postal Service because [the affiliated entity] did not receive its notice of assessment until the Department's Compliance Division contacted it for collection. Taxpayers assert that the Department's Audit Division audited [the affiliated entity] and [the Taxpayer] and Taxpayers had received a timely notice of assessment for [the Taxpayer] but not for [the affiliated entity].

Applying RCW 82.32.105 and Rule 228, we conclude that the late penalties were properly assessed and Taxpayers' alleged failure to receive the assessment is not a basis for cancelling the late payment penalties. The Department mailed the notice of assessment to [the affiliated entity] at its address of record. The Department never received the mail back as undeliverable. We can only assume that the assessment reached its destination as mailed. The Department is authorized by statute, RCW 82.32.050,[12] to mail tax assessments. RCW 82.32.130 in pertinent part provides:

> [i]f the notice or order is mailed, it shall be addressed to the address of the taxpayer as shown by the records of the department, or, if no such address is shown, to such address as the department is able to ascertain by reasonable effort. Failure of the taxpayer to receive such notice or order whether served, mailed, or provided electronically as

[12] If upon examination of any returns or from other information obtained by the department it appears that a tax or penalty has been paid less than that properly due, the department shall assess against the taxpayer such additional amount found to be due and shall add thereto interest on the tax only. The department shall notify the taxpayer by mail, . . . of the additional amount and the additional amount shall become due. . . . RCW 82.32.050(1). (Emphasis added).

> provided in RCW 82.32.135 shall not release the taxpayer from any tax or any increases or penalties thereon.

(Emphasis added).

The underscored portion of RCW 82.32.130, quoted above, makes it clear that taxpayers are precluded from denying liability for the delinquent penalty based on a claim that a tax assessment notice was not received by mail. It has been the Department's position that its duty to notify the taxpayer of an assessment is satisfied where the Department sends the notice of assessment to the address given by the taxpayer. Det. No. 90-130, 9 WTD 280-7 (1987); Det. No. 87-344, 4 WTD 261 (1987). Accordingly, we sustain the delinquent penalty.

With respect to Taxpayers' interest waiver request, RCW 82.32.105(3) and Rule 228(1) provide that the Department shall waive or cancel interest only if: (a) the failure to timely pay the tax was the direct result of written instructions given the taxpayer by the department; or (b) the extension of a due date for payment of an assessment of deficiency was not at the request of the taxpayer and was for the sole convenience of the department. Det. No. 93-004, 12 WTD 553 (1993).

In this case, the Department gave [the affiliated entity] neither written instructions nor an extension of the due date for payment of the taxes assessed. Under these circumstances, we have no authority to waive the additional interest that was charged. We therefore deny Taxpayers' petition to waive the interest.

DECISION AND DISPOSITION

We deny Taxpayers' petitions.

Dated this 20th day of August 2013.