

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment)	
)	No. 87-354
)	
. . .)	Registration No. . . .
)	Tax Assessment No. . . .
)	

- [1] **RULES 178 AND 211, RCW 82.04.050(5), RCW 82.08.020:** RETAIL SALES TAX -- SALE/LEASEBACK. If a taxpayer sells and immediately leases back tangible personal property, retail sales tax is due on each monthly lease payment.
- [2] **RULES 178 AND 211, RCW 82.04.050(5), RCW 82.08.020:** RETAIL SALES TAX -- SALE/LEASEBACK -- FEDERAL TAX RETURNS. A taxpayer may not treat a transaction one way (a sale/leaseback) for federal tax purposes, but another way (a loan) for state tax purposes.
- [3] **RCW 82.32.070:** DUTY TO MAINTAIN RECORDS.
A Washington taxpayer must maintain business records for five years past.
- [4] **RULE 170, RCW 82.04.050(2)(b), RCW 82.08.020:** RETAIL SALES TAX -- PRIME CONTRACTOR. Prime contractors are required to collect retail sales tax from consumers, measured by the full contract price.
- [5] **RULE 178, RCW 82.12.020:** USE TAX -- CONSUMABLES -- TEST PERIOD.
Use tax is due, in an amount equal to the sales tax, when tangible personal property is used in this state without payment of retail sales tax. A test period for consumable purchases may be used to project tax liability over an entire audit period.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: August 6, 1986

NATURE OF ACTION:

The taxpayer petitions for correction of an assessment of deferred sales and use tax.

FACTS AND ISSUES:

Normoyle, A.L.J. (Successor to Chandler, A.L.J.) -- The taxpayer, a dentist, was audited for the period from January 1, 1982, through September 30, 1985. He was assessed deferred sales or use tax on equipment leases, equipment purchases, and consumables.

There are three areas of dispute. The first is the sales/use tax on payments made by the taxpayer to his father. The taxpayer claims that he was simply repaying a loan. The auditor concluded that the taxpayer was making lease payments, and assessed retail sales tax on each payment. The taxpayer explains that he needed financing for expansion of his business. Because interest rates were prohibitive, and because his father was willing to loan money to at a lower rate, the two of them entered into a verbal agreement whereby the father loaned the taxpayer more than \$100,000. During the audit period, \$55,250 was paid on this loan, all of which was considered to be interest only.

Based on professional advice, the father reported the payments as income from "leased equipment" on his federal returns, and included the equipment on his depreciation schedule. The taxpayer, in his 1982 federal tax return, treated the "sale" as a net gain and removed the equipment from his depreciation schedule. No sale/leaseback contract was signed, but the taxpayer's files contained an unsigned standard lease agreement.

The taxpayer's position, summarized, is that he borrowed money from his father, gave his equipment as collateral, and that there was no sale/leaseback. Because the \$55,250 represented repayment of a loan, no taxable event occurred.

The auditor's position is that the transaction was a sale of equipment by the taxpayer to his father, with a leaseback from the son. The auditor relied on the information contained in the two federal tax returns, concluded that the transaction was a sale/leaseback, and assessed retail sales tax against the taxpayer on the full \$55,250.

The second issue also involves the father. The taxpayer remodeled an office, as part of a business expansion. The father acted as prime contractor. The taxpayer claims that purchases of material

and labor were made by the father, with funds supplied by the taxpayer. Rather than giving a resale certificate, the father paid sales tax on some of these purchases. On others, sales tax was not paid, nor was a resale certificate given. The auditor assessed retail sales tax on the taxpayer, based on the full amount of the contract between the taxpayer and his father. The taxpayer asserts that he should receive a credit for the retail sales tax paid by his father on the purchases of materials and labor, because the father could have given a resale certificate. The taxpayer believes this to be a case of double taxation: 1) the father, using the taxpayer's money, paid sales tax at the source; 2) the Department of Revenue then assessed tax against the taxpayer for the full contract price.

Because the taxpayer and the father agreed that any credit due the father for these at source purchases would be used as a credit to the taxpayer, a partial audit of the father's business was performed. B&O tax was assessed against the father on the lease payments and on the remodeling work. The father was then credited with some of the at source taxes paid. The balance of the father's credit was applied (post taxpayer audit) to the taxpayer's deferred sale/use tax liability. The taxpayer still maintains that there was double taxation and points to some \$30,000 in purchases on which sales tax was paid by the father with funds supplied by the taxpayer. The invoices for these purchases purportedly show that retail sales tax was paid. However, the taxpayer states that they were lost.

The third issue relates to consumable items purchased by the taxpayer. A test period (1984) was jointly chosen by the taxpayer and the auditor. The taxpayer claims that this test period was not representative. Both during and after the audit, the auditor offered to either expand the test period or do an actual audit of all the consumables. The taxpayer chose to stay with the test period, but believes that the assessment should be reduced because 1984 was the first year that he began operation of an additional clinic and the first year that he bought a large number of consumables from a particular out-of-state seller. The taxpayer did not maintain invoices for years prior to 1984, to substantiate that the test period was not representative.

DISCUSSION:

Issue No. 1 (SALE/LEASEBACK VS. LOAN).

[1] If the transaction between the father and the taxpayer was a loan, with the equipment simply used as collateral, the payment from the taxpayer to his father would not be subject to retail sales tax. On the other hand, if this was a sale/leaseback, retail sales was due on each lease payment, in accordance with RCW 82.04.050(4), RCW 82.08.020, Washington Administrative Code (WAC)

458-20-178, and WAC 458-20-211. If retail sales tax was not paid, use tax liability arises under RCW 82.12.010 and .020.

[2] There is no evidence tending to show that this was a loan, as opposed to a sale/leaseback, except the unsubstantiated assertion of the taxpayer. The federal tax returns of both the father and the taxpayer, on the other hand, tend to show that each treated this transaction as a sale/leaseback. The fact that an unsigned standard form lease agreement for this equipment was found in the taxpayer's file is given little weight, but does tend to support the conclusion that the parties intended to treat this as a sale/leaseback.

[3] RCW 82.32.070 requires that a taxpayer "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" Here, the taxpayer has no records to substantiate his assertion that the transaction with his father was anything but what it appears to be on both of their federal returns: a sale/leaseback. The taxpayer, in essence, argues that the auditor should disregard accounting procedures followed by the taxpayer when recording this transaction for federal tax purposes (sale/leaseback), and to consider the transaction to be non-taxable (a loan) for state excise tax purposes. By Department of Revenue precedent, a taxpayer may not treat a transaction one way for federal tax purposes and yet another way for state tax purposes.

For the preceding reasons, the assessment of retail sales/use tax on the lease payments is sustained.

Issue No. 2 (USE TAX ON REMODELING CONTRACT).

[4] The remodeling work by the father was a retail sale and tax was due from the taxpayer, measured by the full contract price of the project. The taxpayer simply cannot verify that he paid the tax to his father for that project. To the extent that the father incorrectly paid sales tax on items purchased for resale to the son, the Department credited both the father's tax account (B&O) and the taxpayer's use tax assessment. Thus, there is no double taxation.

RCW 82.32.070 is again pertinent. The taxpayer claims that retail sales tax was paid by him on some \$30,000 of purchases. However, his failure to keep the invoices precludes us from giving credit for any taxes paid on those purchases.

Issue No. 3 (USE TAX ON CONSUMABLES).

[5] Use tax is due, in an amount equal to the sales tax, when tangible personal property is used in this state without payment of retail sales tax. RCW 82.12.020 and WAC 458-20-178.

The taxpayer was assessed use tax for consumables. He does not dispute that some tax is due. He does claim, however, that the test period was not representative. The use of test period projections is a common and widely accepted auditing method. Auditors are instructed to seek the taxpayers concurrence in determining an equitable basis upon which a representative test period can be selected. From that test period, tax liability is projected over the entire audit period. Considering the time and inconvenience involved in separately revealing every transaction, it is usually in the best interest of both the Department and the taxpayer to use the test period method.

The taxpayer apparently agreed to the test period at the time of the audit, but disputes it on appeal. The auditor made a post-audit trip to the taxpayer's business to do an actual audit on the consumables for 1982 and 1983, but the taxpayer had not retained any invoices for those periods. Further, despite his statement that he would do so, the taxpayer did not send to the administrative law judge who conducted the appeal hearing documents which allegedly support his position that the 1984 test was not representative of the consumables purchased during the entire audit period. Again, because of the failure to maintain records supportive of his position, we must sustain this portion of the assessment.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 24th day of November 24, 1987.