

Cite as 5 WTD 107 (1988)

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

In the Matter of the Petition )	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u>
<u>N</u>	
For Refund of )	
)	No. 88-37
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. . . )	Registration No. . . .
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)	

- [1] **RULE 175 AND RCW 82.12.0254:** USE TAX -- EXEMPT USAGE -- WATERCRAFT. To qualify for the statutory exemption for a watercraft used in interstate commerce, a boat must be used primarily to carry persons or property for hire. Use of a boat for employee accommodations does not qualify. Weyerhaeuser v. Dept. of Revenue, 106 Wn.2d 557 (1986). 1 WTD 415 (1986).
- [2] **RULE 178:** USE TAX -- RESTRAINT ON INTERSTATE COMMERCE. The imposition of use tax on a boat is not an unreasonable restraint on interstate commerce so long as the four constitutional requirements are met: (1) nexus; (2) fair apportionment; (3) non-discriminatory; (4) related to services provided. UPS v. Dept. of Rev., 102 Wn.2d 355 (1984).
- [3] **RULE 134, RULE 112 AND RCW 82.04.240:** MANUFACTURING TAX -- MEASURE OF TAX -- VALUE. The value of an article manufactured for commercial use is the total cost attributed to the article, at the time the manufacturing is completed.
- [4] **RCW 82.32.050:** STATUTE OF LIMITATIONS -- MANUFACTURING TAX -- TIME OF IMPOSITION. The manufacturing tax is due when the article has been manufactured. Thus, expenditures made before the audit period and outside of the statute of

limitations are includable in the measure of the tax because the tax is imposed when the manufactured for commercial use article is completed.

- [5] **RCW 82.32.050:** STATUTE OF LIMITATIONS -- USE TAX -- TIME OF IMPOSITION. The use tax on an article manufactured for commercial use arises at the time the completed article is used, even though some of the expenses were incurred and paid outside the four-year statute of limitations. Credit against the tax will be allowed for actual sales or use tax paid.
- [6] **RCW 82.32.050 AND RCW 82.08.0266:** STATUTE OF LIMITATIONS -- MISREPRESENTATION. The use, by a Washington corporation, of an exemption certificate, claiming exemption from tax on the purchase of a water vessel because it is "a non-resident [purchasing] for use outside the state" is a misrepresentation of a material fact sufficient to toll the statute of limitations and subject the sale to deferred sales tax.

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: . . .  
. . .

HEARING CONDUCTED BY: Marguerite M. Burroughs, Administrative  
Law Judge

DATE OF HEARING: February 6, 1987

NATURE OF ACTION:

Taxpayer petitions for refund of use tax and manufacturing tax paid on a boat.

FACTS AND ISSUES:

Hesselholt, A.L.J. -- Taxpayer is a Washington corporation engaging in business as a general contractor. The bulk of its work in the last few years has been in Alaska.

In 1981 taxpayer contracted with a builder to construct and deliver a boat. The boat was delivered to taxpayer in

Washington in October or November of 1981. No sales tax was paid on the boat. In June, 1983, taxpayer provided the boat vendor with an out-of-state resident exemption certificate declaring the boat exempt from tax under RCW 82.08.030(15), (now RCW 82.08.0266.) Taxpayer moored the vessel in Bellingham and made improvements on it, including adding custom fittings, a hydraulic boom, etc. No sales or use tax was paid on the improvements to the boat. As of December 31, 1981, the cost of the boat was \$280,949. The boat was put on taxpayer's records as a capitalized item in July 1, 1982, with a value of \$413,356.

The boat is in Alaska from late May or early June until about Thanksgiving. Repairs are performed on the boat while it is moored in Washington during the rest of the year. The boat does not make multiple trips back and forth, but rather hauls materials for

taxpayer up when it goes and back when it returns. The vessel is used around Alaska as a carrier for taxpayer and its affiliates and for housing for the taxpayer's employees and chief stockholder.

The Department audited taxpayer's records for the period January 1, 1982 through September 30, 1985. The assessment found use tax and manufacturing tax due on the boat which taxpayer paid. Taxpayer petitions for a refund of the use tax and manufacturing tax imposed on it for the full value of the boat.

#### TAXPAYER'S EXCEPTIONS:

The taxpayer petitions as follows:

##### A. Use Tax

1. Exempt Usage - The vessel was intended to be used by the taxpayer primarily as a carrier of goods between Washington and Alaska. The taxpayer originally considered the vessel to be exempt from sales and use tax pursuant to one or more of RCW subsections 82.08.0262 and 82.12.0254 (vessels used primarily in interstate or foreign commerce), 82.08.0254 and 82.12.0255 (property constitutionally prohibited from taxation).

The vessel is moored within this state but only a small portion of the taxpayer's business use of the

vessel occurs within this state. The predominant portion of taxpayer's business use of the vessel occurs outside Washington waters. The vessel is used to haul goods to Alaska for taxpayer and others and to provide office and living accommodations for employees of taxpayer while on business in Alaska.

To assess the full retail sales or use tax on this vessel represents an unreasonable restraint on interstate commerce. The state has insufficient nexus to assess the full tax and this precludes a fair apportionment of the tax. The tax discriminates against interstate commerce in that if other states chose to tax the use of the vessel therein in a similar manner, the overall tax would be prohibitive in amount. The tax is excessive in comparison to the degree of use that the vessel has within this state.

2. Statute of Limitations - If the taxpayer is not eligible for an exemption from sales or use tax under the above reasoning, then the taxpayer is only liable for use tax and manufacturing tax on the value of taxpayer's improvements to the vessel made after 1981.

During 1981, the hull of the vessel was acquired from . . . at a cost of \$261,983. As of 12/31/81 the taxpayer's total capital expenditures related to the vessel were \$280,949. The taxpayer merely contracted to acquire a hull from . . . . See WAC 458-20-136 which provides that . . . is presumed the manufacturer of the hull where at least 20% of the value of the manufactured item is comprised of labor and mechanical services furnished by . . . . The hull materials were not the property of the taxpayer prior to the acquisition of the hull. See RCW 82.04.110. Ownership of materials by . . . occurs where the goods are ordered, paid for, and delivered in the name of . . . . See, American Sign, 610 P.2d 353, 93 Wash. 2d 427 (1980).

The purchase of the hull if not otherwise exempt, would be subject to the retail sales tax at a date no later than October or November, 1981 when the hull was acquired by the taxpayer. The statute of limitations is closed on the 1981 year.

In the alternative, to the extent the taxpayer is deemed the manufacturer of the hull then the statute of limitations has run as to any tax due on improvements made prior to 1982.

. . . .

3. Applicability of Statute of Limitations - Except in cases of failure to register, or execution of a waiver, or upon a showing of fraud or misrepresentation of a material fact by the taxpayer, the statute of limitations for assessment and collection of tax ceases four years after the close of the tax year in which the additional tax liability arises. RCW 82.32.050. WAC 458-20-230. In the present case there are no such excepted circumstances and the statute of limitations on 1981 was closed as of 1/1/86.

The taxpayer had reasonable grounds upon which to assert that no use tax or manufacturing tax liability existed with respect to the 1981 acquisition of the hull of the vessel. Further, the combined excise tax return has no place or section on which to indicate acquisition of equipment which is not subject to use tax.

The auditor's report implies or assumes that use and manufacturing tax liabilities are incurred when construction of the item is completed. Taxpayer finds no authority for this treatment.

. . . .

The following authorities support the fact that any use tax due which is attributable to the 12/31/81 value of the vessel would be due for the year 1981. Mere possession of the hull by the taxpayer in 1981 would have then caused any applicable use tax to be imposed. Additionally, no subsequent liability (as to the 12/31/81 value) can arise from use thereafter.

"There is hereby levied and there shall be collected from every person in this state a tax or excise for the privilege of using within this state as a consumer any tangible personal property. . . ." RCW 82.12.02. Consumer means "any person who purchases,

acquires, holds, or uses any article of tangible personal property . . ." RCW 82.04.190(1). Use means "the first act within this state by which the taxpayer takes dominion or control over the article of tangible personal property (as a consumer)" . . . RCW 82.12.010(2). The terms "use," "used," "using," or "put to use" include any act by which the taxpayer takes or assumes dominion or control over the article and shall include installation, storage, withdrawal from storage, or any other act preparatory to subsequent actual use of consumption within the state. WAC 458-20-178. A consumer includes "any person who is an owner, lessee, or has the right of possession of personal property which is being constructed, repaired, improved, . . . or otherwise altered by a person engaged in business. RCW 82.04.190(5).

Tax liability imposed under the use tax arises at the time the property purchased, received as a gift, acquired by bailment, or extracted or produced or manufactured by the person using the same is first put to use in this state. WAC 458-20-178. Tax liability arises as to that use only which first occurs within the state and no additional liability arises with respect to any subsequent use of the same article by the same person. WAC 458-20-178.

. . .

#### B. Manufacturing Tax

The taxpayer concedes that the manufacturing tax is due on the portion of the vessel constructed by taxpayer. However, no such tax is due on the \$261,983 of cost paid to . . . for the vessel hull. Taxpayer was not the manufacturer of the hull. Taxpayer merely contracted to acquire a hull from . . . See RCW 82.04.110, WAC 458-20-136 and other authorities discussed above as to this issue. Accordingly, the purchase of the hull if not otherwise exempt, would be subject to the retail sales tax at no later than October or November, 1981 when the hull was acquired by the taxpayer. The statute of limitations is closed on the 1981 year as discussed above.

In the alternative, to the extent the taxpayer is deemed the manufacturer of the hull then the statute of limitations has run as to any manufacturing tax due on improvements made prior to 1982.

#### DISCUSSION:

#### 1. Use Tax

##### A. EXEMPT USAGE

[1] RCW 82.12.020 imposes a use tax on property on which no retail sales tax was paid. RCW 82.12.0254 states in relevant part:

The provisions of this chapter [82.12] shall not apply in respect to the use of any airplane, locomotive, railroad car, or watercraft used primarily in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire . . . and in respect to use of tangible personal property which becomes a component part of any such . . . watercraft . . . . (Emphasis and brackets added.)

WAC 458-20-175 (Rule 175), the administrative rule that implements the statute, states "The use tax does not apply upon the use of . . . watercraft, including component parts thereof, which are used primarily in conducting" businesses as a private or common carrier. Private carrier is defined as "every carrier, other than a common carrier, engaged in the business of transporting persons or property for hire."

In Weyerhaeuser v. Dept. of Revenue, 106 Wn.2d 557 (1986), the Washington Supreme Court divided the definition of a private carrier into three parts:

1. Not a common carrier
2. In the business of transporting persons or property
3. For hire.

Taxpayer is clearly not a common carrier. Taxpayer does transport persons and/or property for itself, but does not transport for hire. It transports for its own use, or for the use of its affiliates. Thus, it fails to meet the definition of private carrier. The Department has consistently

maintained its position that the exemption provided in the statute is only available for watercraft that is used to carry property or persons for hire. Use of the vessel for accommodations for taxpayer's employees and stockholder does not qualify. Further, the boat is not used "primarily" to transport persons or property. To qualify for the statutory exemption, a boat must be used as an "inseparable part of a continuing interstate movement of property for hire." See, Determinations 85-308A and 86-20A, 1 WTD 415, 436 (1986). Taxpayer's use of the boat clearly does not meet this test. It seems to be used primarily for accommodations for taxpayer's employees and stockholder.

## B. INTERSTATE COMMERCE

[2] Taxpayer argues that to "assess the full retail sales or use tax on this vessel represents an unreasonable restraint on interstate commerce . . . because the state has insufficient nexus to assess the full tax." Taxpayer goes on to argue that the tax discriminates against interstate commerce because "if others tax the use of the vessel the total tax would be prohibitive in amount."

In United Parcel Service v. Department of Revenue, 102 Wn.2d 355 (1984), the Washington Supreme Court pointed out that:

The commerce clause, U.S. Const. art. 1, subsection 8, cl. 3, requires four things of a state tax on interstate commerce: (1) there must be a sufficient nexus between the interstate activities and the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 51 L.Ed. 2d 326, 97 S.Ct. 1076 (1977); Chicago Bridge & Iron Co. v. Department of Rev., 98 Wn.2d 814, 826, 659 P.2d 463, appeal dismissed \_\_\_ U.S. \_\_\_, 78 L.Ed. 2d 718, 104 S.Ct. 542 (1983).

UPS at 366 - 7. A state may tax intrastate activity even though the activity is part of interstate commerce. UPS, supra, at 366, citing Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734, 745, 55 L.Ed. 2d 682, 98 S.Ct. 1388 (1978).



Firstly, taxpayer is a Washington corporation. The vessel in question was delivered to taxpayer in Washington, and is moored in Washington for approximately six months of the year. Repairs are performed on the vessel here, and taxpayer acknowledges use of the vessel in Washington. Thus, Washington has sufficient connection with the vessel to impose tax liability on it.

Secondly, the use tax "is imposed on the use, in Washington, of all tangible personal property on which the retail sales tax has not been paid, unless statutorily exempt. RCW 82.12.020, WAC 458-20-178 (Rule 178). (Emphasis added.) No sales tax has been paid. Taxpayer is not eligible for the exemption relating to interstate commerce under RCW 82.12.0254 as discussed above. Later, taxpayer did provide the vendor of the vessel with an out-of-state exemption certificate, claiming exemption from sales tax under what is now RCW 82.08.0266, "Sales of watercraft to nonresidents for use outside the state." This exemption is clearly not available to taxpayer, as it is a Washington corporation, and thus not a nonresident of the state. The tax is imposed on the value of the property used in Washington, and thus is fairly apportioned.

Third, the tax does not discriminate against interstate commerce. The use tax applies to the use of personal property on which the retail sales tax has not been paid. To be discriminatory, the tax must afford a "different tax treatment of interstate and intrastate commerce." Chicago Bridge & Iron, supra, at 830, citing Commonwealth Edison Co. v. Montana, 453 US 609, 618, 69 L. Ed. 2d 884, 101 S.Ct. 2946 (1981). No such differential tax treatment exists here, further, under RCW 82.12.035 credit is allowed for sales or use taxes paid to other states.

Finally, the tax must be "fairly related to the services provided by the state." The boat is used by the taxpayer in Washington in his business, and thus the tax imposed is fairly related to the business activities and the services and benefits provided by the state.

Taxpayer's contentions regarding this issue are rejected. There is no "unreasonable restraint on interstate commerce" by assessing use tax on the taxpayer's vessel.

## II. Manufacturing Tax

Taxpayer concedes that manufacturing tax is due on the value of the improvements made to the vessel, but denies liability on the amount initially paid for the hull, because it was not the manufacturer of that part of the vessel.

[3] RCW 82.04.240 imposes a tax upon persons engaging in business as a manufacturer. Under the statute, and WAC 458-20-134, the measure of the tax is the value of the product. WAC 458-20-112 (Rule 112) provides that when such products are for commercial or industrial use, the value "shall correspond as nearly as possible to the gross proceeds from other sales at comparable locations in the state . . . . In the absence of sales of similar products as a guide to value, such value may be determined upon a cost basis. In such cases, there shall be included every item of cost attributable to the particular article . . . including direct or indirect overhead costs."

There is no provision in the Rule to disallow amounts paid to others for parts of the finished product. Indeed, the Department has long taken the position that even minimal physical change to a product is sufficient to impose manufacturing tax on the entire value. See, for example, McDonnell & McDonnell v. State, 62 W.2d 553 (1963), (splitting peas is a manufacturing activity); Continental Coffee Company v. State, 66 W2d 194 (1965), (the changing of green coffee beans into roasted and blended coffee is manufacturing); Bornstein Sea Foods, Inc. v. State, 60 W2d 169 (1962), (the process of changing fish into fish filets is manufacturing); Stokeley-Van Camp, Inc. v. State, 50 W2d 492 (1957), (the packaging and freezing of fruits and vegetables held to be manufacturing); and J.J. Dunbar & Company v. State, 40 W2d 763 (1952), (the screening and filtering of raw whiskey constitutes manufacturing).

The tax is imposed on the value of the item manufactured, in this case a boat, at the time the manufacturing is complete. There is no deduction allowed for amounts paid to others for parts incorporated into the product at the time the manufacturing is completed. Thus, no deduction is allowed for the price paid to the vendor for the hull, and the manufacturing tax is assessed on the full value of the completed boat.

### III. Statute of Limitations

Taxpayer argues that expenditures made before January 1, 1982, are exempt from imposition of use or manufacturing tax because the four-year statute of limitations had expired at the time

the assessment was issued in 1986. RCW 82.32.050 provides that "no assessment or correction . . . for additional taxes due may be made by the department more than four years after the close of the tax year, except (1) against a taxpayer who has not registered as required . . . (2) upon a showing of fraud or of misrepresentation of a material fact by the taxpayer. . . ."

The taxpayer cites two cases to support its position. They are not persuasive. In Morrison Knudsen Co. v. State, 64 Wn.2d 86 (1964), the Washington Supreme Court upheld the imposition of use tax on pontoons and anchor shells manufactured by Morrison Knudsen for use in a bridge. The use and manufacturing tax was imposed on the products before their installation as part of the bridge [even though they had not yet been installed] because Morrison Knudsen had "used" the nearly finished products by storing them for up to two years or "actually using" them for other parts of the construction. Taxpayer quotes the court where it points out that the state is not limited to taxing finished products. This is true, but what the court was referring to was the imposition of tax on manufacturers of "parts," or products which become parts of other things. Id. at 91.

In C.V. Wilder Co. v. State, 48 Wn.2d 834 (1956), the Supreme Court upheld the imposition of the use tax on the charges made for labor and mechanical services furnished in the construction of beams to be used in the construction of snowsheds for the State Highway Department. The contractors were assessed use tax on their consumption of the beams in making the snowsheds. The beams were finished products when sold to the contractors, who then used them in constructing the snowsheds. The value of the snowshed would not be subject to use tax, because the contractor is not "using" it. The case does not apply to the situation involved in this appeal.

The manufacturing tax is due when the item has been manufactured. The tax is assessed on the value of the product manufactured (see Section II, above). Clearly it makes no sense to assess manufacturing tax on something that is still in the process of being manufactured. The tax is due when the product is finished. Here, the boat was finished in 1982. The statute of limitations does not apply.

[4] The use tax is imposed on the use as a consumer of tangible personal property manufactured on which the Washington retail sales or use tax has not been paid by that consumer. RCW 82.12.020, 82.12.0252. The property involved

here, a boat, was manufactured by taxpayer who used it as a consumer. No sales tax was paid on the purchase. Taxpayer argues that since the purchase of the hull and some of the parts took place in 1981, the statute of limitations bars the assessment of use tax on the expenditures made on the boat prior to January 1, 1982. Thus, taxpayer urges, there is no use tax liability on the \$280,949 spent as of December 31, 1981.

[5] The use tax liability, like the manufacturing tax liability, first arose at the time the boat was finished. Under Rule 134, when an article is manufactured for commercial use, use tax is imposed on the "value of the article used." Under Rule 178(13), that is defined as the "total of the consideration paid or given by the purchaser to the seller for the article used . . . in case the article used was . . . manufactured by the person using the same . . . the value of the article used must be determined as nearly as possible according to the retail selling price, at the place of use, of similar products of like quality, quantity and character." Under Rule 112, in the absence of such sales, "value may be determined upon a cost basis. In such cases, there shall be included every item of cost attributable to the particular article . . . including direct and indirect overhead costs." WAC 458-20-112. The use tax is due, not on the partial value of the boat, but on the total expenditures made to manufacture the boat at the time it was completed. The statute of limitations does not apply, because the tax is assessed on the value of the boat at the time of completion in 1982, not just the value of the individual parts.

[6] Finally, we are of the opinion that by using an exemption certificate for a non-resident purchasing watercraft for use outside Washington, taxpayer, a Washington corporation, tolled the statute of limitations because the use of the certificate was a misrepresentation of a material fact under RCW 82.32.050. This misrepresentation, that taxpayer was a non-resident, tolled the statute in 1983, leaving the acquisition of the hull within the four-year limit of the statute.

#### DECISION AND DISPOSITION:

The taxpayer's petition is denied. The file will be referred to the Audit Section for a determination of any credit that should be allowed against the use tax for sales tax paid.

DATED this 26th day of February 1988.