Cite as Det. No. 87-171A, 5 WTD 281 (1988)

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition	)	F I N A L
For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	
	)	No. 87-171A[1]
	)	
. . .	)	Registration No. . . .
	)	
	)	

[1] **RULE 193B:** B&O TAX -- RETAIL SALES TAX -- INTERSTATE LEASES -- NEXUS -- DUE PROCESS. Under Rule 193B Washington State has jurisdiction to tax apportioned lease receipts under B&O tax and retail sales tax where the property is leased by an out-of-state lessor to an out-of-state consumer for use in this state during any part of the lease period, where the lease agreement or the parties contemplate such use in this state. The nexus requirements under due process are the same for interstate leases as for interstate sales.

[2] **RULE 193B:** B&O TAX -- RETAIL SALES TAX -- INTERSTATE LEASES -- OUT-OF-STATE DELIVERY -- MOBILE LEASED PROPERTY -- MOVEMENT AND USE BY LESSEE. Under Rule 193B Washington State does not assert tax jurisdiction for B&O tax or sales tax upon receipts from interstate leases of mobile property, delivered to an out-of-state lessee at a point outside this state by an out-of-state lessor with no contacts in this state, where the sole discretion to move the mobile property into Washington for use here is that of the lessee.

[3] **RULE 193B:** B&O TAX -- DUE PROCESS -- NEXUS -- INTERSTATE LEASES. Under a gross receipts, business privileges tax structure some nexus activity more than mere happenstance physical presence of an out-of-state lessor's leased mobile property within this state is required for B&O taxing jurisdiction. The business privilege engaged in here must be known

[1] The original determination, Det. No. 87-171, is published at 3 WTD 153 (1987).

and intended by the out-of-state lessor. The same due process nexus standards apply for interstate leases as for interstate sales.

[4] **RCW 82.12.020:** USE TAX -- LEASED MOBILE PROPERTY -- TAX EXCLUSION --STATUTES -- CONSTRUCTION -- POPE & TALBOT V. REVENUE. The statutory tax imposing provisions of RCW 82.12.020 do not exclude leased mobile property regularly brought into this state for business use here. The decisions in Pope & Talbot v. Revenue does not apply to leased mobile property home based outside this state but regularly used here by a Washington located 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.

TAXPAYER REPRESENTED BY: . . . , Attorney[2]
. . . , Treasurer

HEARING CONDUCTED BY DIRECTOR'S DESIGNEES:
Garry G. Fujita, Assistant Director
Edward L. Faker, Sr. Administrative Law Judge

DATE AND PLACE OF HEARING: October 28, 1987; Olympia Washington

NATURE OF ACTION:

The taxpayer appeals from the findings and conclusions of Determination No. 87-171, 3 WTD 153 (1987), which was issued on May 22, 1987 after an original appeal conference conducted on September 23, 1986. That Determination sustained the assessment of business and occupation tax and retail sales tax measured by apportioned income from rentals of three barges used by the taxpayer's lessee, an Idaho corporation, in performing business in this state.

FACTS AND ISSUES:

The material facts of this case are not in dispute. Those facts, together with the audit and tax assessment details are fully reported in the Determination, 3 WTD 153 (1987), and are not restated here. Certain factual circumstances are emphasized later in the Taxpayer's Exceptions portion of this Final Determination.

There is a single, compound and complex issue for our resolution. Does this state's B&O tax and retail sales tax apply to the apportioned gross receipts of an out-of-state lessor from leases of mobile tangible personal property to an out-of-state lessee doing business and using

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[2] Because of contractual obligations by the lessee to assume all of the tax liability attendant to the transactions at issue here, the lessee was represented at the hearing by its attorney, with approval of the taxpayer.

the mobile property in this state, though the leased property was initially delivered to the lessee outside of this state?

As a collateral matter, the taxpayer is unsure whether the tax assessment imposes retail sales tax upon the apportioned lease income or requires the taxpayer to collect apportioned use tax from its lessee of the mobile property. Thus, use tax liability by the lessee is also in question.

TAXPAYER'S EXCEPTIONS:

To emphasize its argument that the B&O tax and sales tax have been improperly imposed, the taxpayer's petition to the Director restates the following:

> [The taxpayer][3] is an Oregon based marine equipment company with its corporate offices located in Portland, Oregon. [The taxpayer] leases three pulp barges to [Lessee] Corporation pursuant to a lease dated December 26, 1968. The barges are leased on a bare boat charter basis. The lease, as amended, runs for a total period of 26 years.
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> The three barges which are the subject of the lease between [the taxpayer] and [lessee] were constructed by [taxpayer] in the State of Oregon. Possession to the barges passed from [taxpayer] to [lessee] in the state of Oregon. The barges are based in . . . , Oregon, where [lessee] operates a pulp and paper mill. The barges are also maintained and repaired at [lessee]'s marine repair facility located at [Oregon].
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> The barges are used by [lessee] to transport pulp from its . . . , Oregon, mill to [lessee]'s plant located in . . . , Washington. Once the pulp is offloaded in [Washington], the barges are returned to . . . , Oregon.
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> [Taxpayer] has no control over the use to which [lessee] dedicates the barges. Nor is [lessee] obligated to report to [taxpayer] on any basis which would indicate the jurisdictions in which the barges operate. Finally, [lessee]'s obligation to make the lease payments required under the lease is unaffected by the degree to which the barges are used.
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> [Taxpayer] maintains no office nor any place of business in the State of Washington. It has no employees, agents or independent contractors operating within the State. Although [taxpayer] from time to time moors barges in Tacoma, Washington which are not in use or "laid up", [taxpayer] otherwise maintains no warehouse, inventory, stock of goods or other property in the State of Washington. Aside from the moorage of laid up barges, the only contact [taxpayer] has with the State of Washington results from the fact that barges leased to various business are used from from time to time by those business both within and without the boundaries of the State of

[3] Internal references to the taxpayer and its lessee by their corporate names have been deleted.

> Washington. Other barges leased to customers by [taxpayer] are used up and down the West Coast.

The taxpayer asserts that Determination 87-171 fails to properly apply the Department's own rule, WAC 458-20-193B (Rule 193B) under the established facts of this case. In short, the taxpayer argues that even in cases involving leases by out-of-state taxpayers there must be some nexus or activity within this state, other than the mere taking of the leased property into a taxing state by the lessee, in order for tax to apply to lease receipts. The Commerce Clause and Due Process Clause of the U.S. Constitution require a greater level of in-state activity by the lessor, according to the taxpayer. The taxpayer urges that Rule 193B properly expresses the necessary additional nexus required and sets forth examples of such nexus contacts, none of which apply in this case.

The taxpayer challenges the reliance in Determination 87-171 upon the rationale of the Court from another jurisdiction in a state income tax case, in American Refrigerator Transit Co. v. State Tax Commission, 238 Ore. 340 (1964) as supporting the position that the mere physical presence of lease property in a state gives that state taxing jurisdiction over the lease receipts or any apportioned part thereof. The taxpayer asserts that the Oregon case law does not represent the accepted constitutional analysis and that the concept of "exploiting the economic milieu" of a state to realize a profit has not been accepted by other states as satisfying the Commerce Clause/Due Process Clause nexus tests. The taxpayer's petition to the Director refers to several other jurisdiction cases where attempts to assess tax based only upon the lessee's possession of the leased property in the taxing state were struck down by the highest Courts of those states.[4]

At the October 28, 1987 hearing the taxpayer emphasized that the property in question was mobile in nature (floating barges) and was manufactured for the precise purpose of easy movement from place to place. Under such circumstances the lessor of such property cannot be held tax accountable for a lessee's movement of the property from state to state, which is independent of the lease agreement. The taxpayer asserts that it had no knowledge or any reason to know where the lessee would transport the barges for its own business use. In fact, the lease contained a general tax indemnification clause by which the lessee agreed to pay all taxes which might be incurred.

The taxpayer concluded its oral testimony by stating, in the alternative and arguendo, that if the tax is sustained it can show by actual records that the barges were used by the lessee in Washington State less than 50% of the time. Thus, the apportioned tax measures (50/50%) should be adjusted further.

Regarding the collateral issue of use tax liability by the lessee, the petition to the Director includes the following:

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[4] We note here that the cases cited for our reference were all use tax cases in which the taxing states attempted to assert use tax directly upon the out-of-state lessor because of the lessee's possession of the property. These cases do not guide us here; are inapposite to B&O tax and retail sales tax questions, and are not further addressed herein.

At the hearing conducted September 23, 1986 in this matter, [lessee] appeared and presented evidence that its use of the barges in the State of Washington was, use in interstate commerce and not subject to a use tax. Obviously, if [lessee]'s use of the barges is not subject to the use tax, there can be no collection responsibility imposed on [lessor].

RCW 82.12.020 provides as follows:

> 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 article of tangible personal property purchased at retail, or acquired by lease, gift, repossession, or bailment, or extracted or produced or manufactured by the person so using the same, or otherwise furnish to a person engaged in any business taxable under RCW 82.04.280, subsections (2) or (7). This tax will not apply with respect to the use of any article of tangible personal property purchased, extracted, produced or manufactured outside this state until the transportation of such article has finally ended or until such article has become commingled with the general mass of property in this state . . . .
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> . . .

The determination apparently does not dispute that transportation of the barges by [lessee] in the State of Washington never "ends." However, the determination states, at page 8, that because the underscored portion of RCW 82.12.020 quoted above refers only to "purchased" articles of tangible personal property and not "leased" articles, [lessee] is not entitle (sic) to the benefit of that section. While the determination goes on to cite a number of cases concerning the construction of taxing statutes in the abstract, the determination offers no meaningful rational as to why property which is leased should not be subject to the same rule as property which is purchased.

The obvious import of the underscored portion of RCW 82.12.020 is to preclude imposition of the use tax on tangible personal property brought into the State of Washington until such time as it obtains a situs within the state. This rational should apply regardless of whether the property in question is purchased or leased.

[Lessee]'s use of the barges from time to time within the boundaries of the State of Washington is virtually identical to the use of an airplane by the taxpayer in Pope & Talbot v. Revenue, 90 Wn.2d 191, 580 P.2d 262 (1978). . . .

Finally, the taxpayer's petition and oral arguments stress the administrative impossibility of meeting the burden apparently imposed by the conclusions in Determination 87-171. That is, the taxpayer and other lessors similarly situated have absolutely no control over the place of usage of the leased mobile property by the lessees. Thus, such lessors can never know or project with any degree of certainty what the various state tax liabilities may be, which depends exclusively upon where and for how long the lessees independently choose to use the leased property. The due process question is thusly begged.

DISCUSSION:

As a matter of clarification, the tax issues in question before us results from the assessment of Retailing B&O tax and retail sales tax, measured by apportioned gross lease receipts. This is not a case involving a lessor's duty to collect use tax from its lessee. We are nonplussed by the taxpayer's stated confusion on this point, especially whereas its written and oral arguments so succinctly address the taxes in question.

The issue before us here, refined as it has now been, is a matter of first impression before the Director. Notwithstanding the impressions created by prior Determinations and precedents explained in ETB 384.08.211 and ETB 447.04.211, before Determination 87-171 the Department has not ruled upon the precise question whether the mere presence of leased property in this state, and nothing more, incurs B&O tax and sales tax liability by the out-of-state lessor. The issue presents a close question of law, tightly controlled by the prevailing facts. Determination 87-171 concludes that the issue is governed by Rule 193B, " . . . which defines the constitutional limits upon the state's ability to impose its excise tax upon sales of goods originating in other states to persons in Washington." (Determination 87-171, p. 4, para. 3). The Determination further explains that leases of tangible personal property are retail sales under this state's statutory law (RCW 82.04.050) and that the "sale" takes place when the leased property is used in this state by the lessee, citing WAC 458-20-103. After considerable discussion of pertinent case law, the Determination reaches the seemingly logical conclusion that the taxpayer has made taxable retail sales in this state merely by virtue of owning leased property which is located and used here by the lessee. However, a close reading of the rules and ETBs referenced and the case law cited as authority for their propositions does not support that conclusion. After thorough review, we cannot concur with the dispositive proposition stated in Determination 87-171 that Rule 193B clearly provides that "(t)he ownership of income producing lease property in this state itself constitutes a commercial or business situs sufficient to support imposition of this state's B&O and retail sales tax."

Washington State imposes no income tax. Rather, the B&O tax is a gross receipts tax imposed upon the act or privilege of engaging in business activities in this state (RCW 82.04.220). Absent a finding of some business activity here -- some conduct or behavior by which a business approaches or touches the marketplace in this state -- the business privileges tax cannot apply. Rule 193B respects this distinction and properly provides the nexus requirements for taxation of out-of-state located businesses. These requirements are equally applicable for leases of tangible personal property as for outright sales of such property. Moreover, the rule applied the same nexus guidelines for sales tax collection

liability as it does for B&O tax liability. Thus, in order for B&O tax and retail sales tax to apply to any gross receipts derived by an out-of-state business, it must be found that that business has, itself, knowingly and purposely approached the economic marketplace in this state. The general nexus propositions and examples of nexus contained in Rule 193B explain how this is done. The rule expresses the collective rationale of the courts concerning states' authority to tax activities and transactions which involve interstate aspects or elements.

When the interstate activity or transaction results from the leasing of tangible personal property originating outside this state which is used by the lessee in this state, Rule 193B still requires some minimum connection with this state by the out-of-state lessor. This kind of transaction is further discussed in the Excise Tax Bulletins relied upon in Determination 87-171. ETB 447.04.211 relies for its authority upon the decision in Stoen v. Stapling Machines Co., 71 S.2d 205, and Longview Tugboat Company v. State, 64 Wn.2d 323 (1964). The latter case is the same decision cited in Determination 87-171 as Smith v. State. (See Determination 87-171, p.7, footnote 3).

The Stoen case, often cited in the Department's previous Determinations as authority for taxing interstate leases, involved three questions; a) the meaning of "doing business" under Mississippi statutes; b) the situs of property for taxation; and c) the restrictions upon state taxation under the Commerce Clause of the U.S. Constitution. The Mississippi Supreme Court's decision, sustaining the tax assessment, was dismissed by the U.S. Supreme Court on appeal, thus approving the decision on its merits; 383 U.S. 802.

Stapling Machines Co. leased and delivered patented box making machines to Mississippi resident businesses at a point outside Mississippi. The lessees had the right to use the machines exclusively in Mississippi to make and sell patented boxes. The lease provided for lessees to pay the lessor the cost of production of the machines, plus four percent of its gross sales receipts from sales of patented boxes and an additional two percent of gross sales receipts from sales of unpatented boxes. The Court ruled that Stapling Machines Co. was taxable under Mississippi's gross receipts business privileges tax on sales because, under its lease agreement, it maintained personal property in Mississippi and thus did business there. The Court cited Curray v. McCanless, 307 U.S. 357 as follows:

> "But when the taxpayer extends his activities with respect to his intangibles, so as to avail himself of the protection and benefit of the laws of another state, in such a way as to bring his person or property within the reach of the tax gatherer there, the reason for a single place of taxation no longer obtains, and the rule is not even a workable substitute for the reasons which may exist in any particular case to support the constitutional power of each state concerned to tax."

Clearly, in Stoen, the lessor elected to introduce its personal capital assets into the taxing state and to derive income from its business use there. This was clear from the very recitations of the lease agreement and "an exhaustive and diligent examination of all available information" by the Mississippi taxing agency. Supra, pp. 210. In short, Stapling Machine Co. knowingly and purposefully entered the state of Mississippi with its rental

machines for the express purpose of deriving income there. This resulted directly from the lease agreement and was directly dependent upon that agreement. Moreover, the box making through the use of the machines by the lessees was found to be inherently local business, not involving interstate commerce.

This case, cited as authority for ETB 447.04.211, does not stand for the proposition or support the conclusion that the mere presence of leased property within this state gives this state jurisdiction to tax any part of the gross receipts from the lease (rental payments). Though statements in the ETB, read out of context, can lead to such a conclusion, the entire meaning of the ETB's text is contrary to this result. The ETB concludes, in conformity with provisions of Rules 193B and 211, that "persons who lease or rent tangible personal property for use both within and without Washington are taxable upon that portion of gross income derived from its use by the lessee in Washington . . . " If the lease of property delivered to the lessee outside this state does not contemplate or provide for use of the property in this state by the lessee, then the movement and presence of the leased property here, at the sole discretion of the lessee, cannot attribute any purposeful entry into this state by the lessor for the purpose of doing any business here. Such a situation is totally independent from the leasing transaction. It would place the tax liability of a lessor completely at the whim of its lessee and would force the conclusion that lessors can approach the marketplace in this state unknowingly and even if they did not want such exposure. Neither Rule 193B nor Rule 211 provides for such happenstance tax liability. In fact, Rule 211 does not address this subject at all. It deals exclusively with in-state lessors and lessees. Rule 193B contains provisions under both the B&O tax section and the sales/use tax section entitled "JURISDICTION STANDARD" which clearly specify that in order to be taxable in this state the property must be leased "for use in this state." The rule provides in pertinent parts as follows:

> BUSINESS AND OCCUPATION TAX
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> . . .
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> RENTING OR LEASING OF TANGIBLE PERSONAL PROPERTY. Persons outside this state who rent or lease tangible personal property for use in this state are subject to tax upon their gross proceeds from such rentals, irrespective of the fact that possession to the property leased may have passed to the lessee outside the state or that the lease agreement may have been consummated outside the state.
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> . . .
>
> SALES AND USE TAX
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> . . .
>
> JURISDICTION STANDARD. A vendor is required to pay or collect and remit the tax imposed by chapter 82.08 or 82.12 RCW if within this state he directly or by any agent or other representative:

> (1) Has or utilizes an office, distribution house, sales house, warehouse, service enterprise or other place of business; or
> (2) Maintains a stock of goods; or
> (3) Regularly solicits orders whether or not such orders are accepted in this state, unless the activity in this state consists solely of advertising or of solicitation by direct mail; or
> (4) Regularly engages in the delivery of property in this state other than by common carrier or U.S. mail; or
> (5) Regularly engages in any activity in connection with the leasing or servicing of property located within this state. (Emphasis supplied.)

Both of the highlighted provisions above make it clear that there must be something more than the mere presence of leased property here in order for tax liabilities to attach to the out-of-state lessor. The property must be leased for use in Washington and the lessor must engage in some in-state activity in connection with that leased property.

We have thoroughly researched the Department's established position with respect to these rule provisions. Eighteen written Determinations have been issued in the last twenty years dealing in whole or part with out-of-state lessors of property used by consumer lessees in this state. Without exception the findings and conclusions in these cases have been controlled by the actual facts involved in each. Without exception the evidence revealed a knowledgeable, purposeful entry into this state by the lessor through its leased tangible personal property, either recited in the lease agreement or established by other related activities undertaken by the lessor in this state. While none of these Determinations established a clear, uniform rule applicable in all cases, a relatively bright line test has evolved. It comports with the prevailing case law cited in Determination 87-171, both by the taxpayer and by the Administrative Law Judge. The test is this.

[1] Washington State has jurisdiction to tax lease receipts under the B&O tax and retail sales tax where the property is leased to a consumer for use in this state during any of the lease period, on an apportioned basis as appropriate, where the lease agreement or the parties to the lease contemplate such use in this state.

[2] This is so, even though the lessee originally takes delivery of the leased property at a point outside this state. If there is no written lease agreement or the agreement is silent with respect to the lessee's place of use of the property, then the circumstances surrounding the lease transaction will be weighed to determine the place of use contemplated by the parties. If the lessee is a Washington located business, or billings go to a Washington location or lease payments are made from a Washington location, such circumstances among others, are supportive of this state's taxing jurisdiction. The nexus contact is clear. In such cases the lessor knows and agrees to have its lease property maintained in this state as income producing property. Neither the Commerce Clause nor the Due Process Clause requires more. Conversely, Washington does not assert taxing jurisdiction upon lease receipts where an out-of-state lessor, without other presence or activity in this state delivers the leased, mobile property, at a point outside this state, to an out-of-state lessee and where the

subsequent movement of the mobile property into Washington and use of the property here is at the sole discretion of the lessee.

The case before us here fails to meet this test. It is distinguishable from cases such as Stoen, supra, where the use under the lease was exclusively in the taxing state (Mississippi), and Longview Tugboat v. Washington, supra, where the leases were exclusively to Washington located lessees.

[3] Regarding the Oregon Court's ruling in American Refrigerator Transit, supra, relied upon for support in Determination 87-171, we neither approve nor reject its applicability. It is a case which deals with Oregon's net income tax and, except for its general tax rationale, it does not appear to be germane. It may well be that under an income taxing system with its attendant three factor apportionment formula of the Uniform Division of Income for Tax Purposes Act, the mere physical presence of income producing leased property in Oregon, even though unintended by its owner, could support apportioned tax liability. Under Washington State's taxing system, however, something more is required by which the owner/lessor knowingly and purposefully approaches the marketplace. See General Motors v. Washington, 377 U.S. 436 (1964). In short, the same nexus standards apply to interstate leases of tangible personal property as to outright interstate sales of tangible personal property. Even under the rationale of the Oregon Court in American Refrigerator, basic due process would require that a taxpayer must have some knowledge or notice that it was somehow using the economic resources of the taxing state and was, somehow, taking advantage of the "economic milieu within the state to realize a profit." 283 Ore. 340 at pp. 346-347. Not surprisingly, other states have not viewed this "economic milieu" approach with favor.

An application of the concept which has evolved in Washington State to the facts in this case reveals no provision of the lease agreement and no contemplation by the taxpayer that the barges would be used in Washington State by the lessee. Most importantly, the record reflects no activity whatever in this state by the taxpayer respecting the leased barges. The audit report indicates that the taxpayer rented some moorage space in Tacoma to be available if other of its leased vessels were "laid up." However, there is no evidence that such a space rental was in any way related to the barges manufactured in Oregon and delivered in Oregon to the taxpayer's lessee in this case. The taxpayer now stipulates that after the audit in question here it leased vessels to other lessees for use in this state and has now reported tax on these other transactions. We hereby confirm that, under the test explained in this Final Determination, such tax liability on these other lease transactions is proper. The leases in question in the case before us here, however, are completely dissociable from the taxpayer's latent nexus activities respecting other barge leasing and moorage space rental activities. Accordingly, the B&O tax and sales tax, even as apportioned, do not apply.

Though no use tax has been assessed upon the apportioned lease income, either against the taxpayer or its lessee, this question is placed in doubt by the taxpayer's petition and representation.

[4] For all of the reasons stated in Determination 87-171, we agree that the decision in Pope & Talbot v. Revenue, supra, is distinguishable from this case. (See Determination 87-171 at pp.5-6). For use tax purposes "leases" of tangible personal property are not the same as "purchases" of such property. When the statutory law (RCW 82.12.020) addresses purchases and leases separately, the intent is clear and unambiguous that such transactions are distinct. The exclusionary language construed by the Court in Pope & Talbot does not include property "acquired by lease." It expressly includes "property purchased." Thus, it is clearly the result of direct statutory provision that uses of leased tangible personal property by Washington consumers are not excluded under the tax imposing provisions of RCW 82.12.020. Throughout Chapter 82.12 RCW, when the law means to include both purchased and leased property within its specific provisions, it expressly says so. Determination 87-171 properly explains the applicable rules of statutory construction.

We recognize that no use tax has yet been assessed. Also, the taxpayer's lessee now claims to have tugboat logs available which will reflect the use of the barges in Washington waters and at its Vancouver mill considerably less than the 50% of time apportioned by the auditor for the taxpayer's assessment. Accordingly, this use tax matter is referred to the Audit Section for its consideration. Any use tax assessment which may now be issued must be limited to the statutory period for auditing under RCW 82.32.050.

DECISION AND DISPOSITION:

The taxpayer's petition is sustained. To the extent that Determination 87-171 conflicts with this Final Determination, it is hereby overturned. The Retailing B&O tax and retail sales tax assessed under Tax Assessment No. . . . pertinent to barge lease receipts will be deleted.

DATED this 31st day of March 1988.