BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	F I N A L D E T E R M I N A T I O N
	No. 86-35A
. . .	Registration No. . . . Tax Assessment No. . . .

[1] **RCW 82.08.100 and RULE 196:** RETAIL SALES TAX -- DEDUCTION -- BAD DEBTS -- FAILURE OF CONSIDERATION.
The bankruptcy of a construction work customer and the failure of the construction contractor/seller to collect payment for the work performed does not excuse the sales tax liability on the agreed selling price. Buyer's bankruptcy does not result in total failure of consideration for taxation purposes; the requirements of RCW 82.08.100 and Rule 196 must still be met for bad debts deductions.

[2] **RCW 82.08.0269 and RULE 193A:** RETAIL SALES TAX -- EXEMPTION -- NONCONTIGUOUS STATES -- LOCAL DELIVERY --BUYER'S OWN RECEIVING TERMINAL. The sales tax exemption for goods sold for use in noncontiguous states is not available for buyers who take delivery in this state at their own warehouse/receiving terminal and then act as their own forwarding agent, carrying some goods themselves and hiring common carriers for other deliveries to Alaska. In such cases there is no reasonable certainty that the goods are going to Alaska at the time of the taxable transaction--the sale. Strict adherence to the statute and rule are required for exemption.

Headnotes are provided as a convenience for the reader and are not in anyway a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

. . .

DEPARTMENT REPRESENTED BY DIRECTOR'S DESIGNEES:
Sandi Swarthout, Assistant Director
Garry G. Fujita, Assistant Director
Edward L. Faker, Sr. Administrative Law Judge

DATE AND PLACE OF HEARING: July 8, 1987; Olympia, Washington

NATURE OF ACTION:

Appeal to the Director from the findings and conclusions of Determination No. 86-35 which was issued on January 29, 1986. The taxpayer appeals three of many issues involved in the original hearing and Determination and raises one new matter which was not originally appealed or addressed in Determination 86-35.

FACTS AND ISSUES:

Faker, Sr. A.L.J. -- The audit and tax assessment details are fully and properly set forth in Determination No. 86-35 and are not restated here. Moreover, the operative facts pertinent to the three repetitive issues on appeal are contained in that Determination and are included here only as necessary for perspective of these issues.

The new matter appealed to the Director involves the assessment of deferred retail sales tax upon purchases of lumber used by the taxpayer as form lumber in construction work performed in this state which the taxpayer claims to have then incorporated into the substructure of the buildings being constructed. The taxpayer claims the exemption of RCW 82.08.0274.

The issues for our resolution are:

1) As matters for factual adjustment, a) whether business and occupation tax and retail sales tax in connection with three construction jobs was reported and paid one month late and was again assessed for payment under Schedule V of the audit; and b) whether sales tax has been assessed under this same schedule upon two construction jobs upon which there was a complete failure of consideration, the taxpayer was not paid, and the accounts were written off as bad debts.

2) Whether the taxpayer can be held accountable for retail sales tax which it failed to collect from retail construction

customers who claimed to have reported and paid the tax directly to the state.

3) Whether the taxpayer was entitled to the sales tax exemption of RCW 82.08.0269 on its purchases of construction materials and equipment in this state which were delivered to the taxpayer in this state for its transportation to, and use in Alaska.

4) Whether the taxpayer was entitled to the sales tax exemption of RCW 82.08.0274 for purchases and construction uses of form lumber.

TAXPAYER'S EXCEPTIONS:

The taxpayer argues that its regular books and records reflect that it paid the taxes assessed upon the three construction jobs referred to in issue 1-a above, but that the payment was made one month after the jobs were recorded on its books. The taxpayer's petition to the Director states:

> The items on lines 11, 18, and 22 [of Schedule V] were not included on the excise tax returns in the month that the sale was recorded. All three items were, however, reported in the following month, and the tax was paid at that time. The taxpayer will present documentation of this fact at the hearing. (Bracketed inclusion provided).

Regarding issue 1-b above, the taxpayer argues that it need not comply with the requirements of WAC 458.20.196 (Rule 196) concerning bad debt deductions in connection with construction jobs for persons who became bankrupt and made no payment whatever for the work performed. In such cases, according to the taxpayer, there is a total failure of consideration and no sale actually occurs. The taxpayer's petition includes the following, which was reiterated orally at the hearing on July 8, 1987:

> Rule 196 is derived from the statute at 82.08.037, which merely states that:
>
> > A seller is entitled to a credit or refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes.
>
> The statute was enacted in 1982, effective January 1, 1983. Neither the statute nor the rule states

> that bad debts prior to that time were not deductible. Therefore, to determine the proper treatment of debts in 1980 and 1981 we must look to the statutes in effect at that time.
>
> The sales tax is applied on "each retail sale" based upon the "selling price." RCW 82.08.020. The sales at issue were clearly retail sales per RCW 82.04.050. "Selling price" is defined at 82.08.011 as "the consideration, whether money, credits, rights, or other property, expressed in terms of money paid or delivered by a buyer to a seller... ." . . . did not ever receive any consideration of value or any payment from McGovern or Trus Span. The selling price was actually $0.00. When that fact was determined a credit was properly taken.
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> Applying the laws as they existed in 1980 and 1981, . . . is entitled to the credit claimed. The adoption of the statute and the rule in 1982 was merely a codification and clarification of the proper treatment.

As to the second issue outlined above, the taxpayer asserts that it performed construction work upon a Baskin-Robbins store at the Tacoma Mall in 1981, for $ X. Alpenrose Dairy, Inc., allegedly paid use tax on the construction directly to the state in October, 1981. The taxpayer argues that the assessment is for a duplicative sales tax. Moreover, the taxpayer asserts that it reported and paid retailing b&o tax on this contract, but that this tax has been assessed again.

Regarding the third and most pressing issue, the taxpayer claims entitlement to the sales tax exemption of RCW 82.08.0269 for its in state purchases of materials and equipment delivered to the taxpayer in this state for immediate transportation and use in Alaska, where approximately 75% of the taxpayer's construction is done. The taxpayer's petitions to the Director include the following:

> Some of the items purchased for use in the state of Alaska are large items, or large quantities of construction materials, that are being shipped to an accessible location in Alaska. Such items are delivered to a common carrier in Seattle for shipment to Alaska without . . . ever taking possession of the goods. In many cases, however, the supplies, construction materials or capital assets to be used in Alaska are going to locations

that are not readily accessible; the shipments are small and sometimes must be made immediately by the most expedient method. For this reason . . . frequently acts as its own carrier for a significant number of goods. . . . also acts as a freight forwarder/consolidator, crating numerous small items together for shipment to Alaska on a common carrier.

The Auditor's Report detailed on Schedules VII, VIII, and X certain sales upon which the Washington sales tax was not paid at the time of purchase, and upon which the auditor asserted either the Use Tax or the Deferred Sales Tax on the theory that the items were purchased in Washington and did not meet the specific requirements for the noncontiguous state exemption. Schedule VII concerned the purchase of consumable supplies subject to the Use Tax and/or Deferred Sales Tax on the premise that the supplies were purchased in Washington and used in Washington. The auditor used a test period in 1982 and applied the resultant factor to the gross sales for the four-year period in order to determine the amount subject to tax. A significant number of the items on Schedule VII were immediately shipped to and used in Alaska. . . . will present documentation of the fact at the hearing.

On Schedule VIII the auditor again used a 1982 test period to estimate the total amount of purchases of consumable supplies that were shipped to Alaska. The auditor assessed the Deferred Sales Tax on these items. Schedule IX also used a 1982 test period in calculating the amount that . . . expended to purchase shipping supplies used for crating and shipping consumables, construction materials, and capital assets to Alaska. On Schedule X the auditor assessed the Deferred Sales Tax on specific capital assets purchased in Washington and shipped to Alaska in 1982 and 1983.

. . . concedes that the shipping supplies subjected to tax to the Deferred Sales Tax on Schedule IX are properly taxable in the State of Washington. . . . purchased the supplies to be used in its shipment of goods to Alaska. The shipping supplies, however, were used in Washington and are therefore subject to the Washington tax.

The remaining items on Schedules VII, VIII, and X were shipped to Alaska and are not subject to Washington Use Tax or Deferred Sales Tax.

. . .

. . . does act as its own carrier on many of its own shipments to Alaska. It has a warehouse at its Washington facility where it receives small shipments which are then repackaged and forwarded immediately to Alaska without any intervening use. The Auditor's Report reflects on Schedule IX that the taxpayer spent nearly $ X for shipping supplies used to crate items that were shipped immediately to Alaska.

A carrier is any person who undertakes to transport or convey goods, property, or persons from one place to another, either gratuitously or for hire, and may be classified as a private or special carrier, or a common public carrier. Cushing v. White, 101 Wn. 172 (1918). A common carrier is one who transport persons or goods for hire and holds itself out to serve the public. A single undertaking is that of a private and not a common carrier. Thus, . . . meets the requirements of a private carrier as to those goods that it packages and ships or delivers itself to Alaska.

. . .

. . . asserts that it is of paramount consequence that it shipped the items to Alaska for use there. . . . met all the requirements of RCW 82.08.0269. It purchased goods in the state of Washington for use in a noncontiguous state; the seller of those goods delivered the goods to the purchaser at its normal receiving terminal for shipment; the taxpayer acted as its own carrier and used its own facilities as a shipping terminal; the documentation in the taxpayer's files, as verified by the auditor and affirmed by the Administrative Law Judge, provide more than reasonable certainty that the goods were transported directly to an Alaska location.

. . .

> The Washington Supreme Court, when considering taxes in light of the Equal Protection and the Privileges and Immunities Clauses of the federal and Washington constitutions, has upheld excise tax differences based upon a classification by type of property. Black v. State, 67 Wn. 2d 97 (1965). Courts have stated, however, that the discretion in making classifications is allowed only if the classification is neither arbitrary nor capricious, and if it rests upon a reasonable consideration of policy differences. Clifford v. State, 78 Wn. 2d 4 (1970). The type of policy differences that justify a difference in taxation are precisely the policy considerations that the Washington State Tax Commission and the legislature had in mind when they originally enacted the exemption for sales of products being shipped for use in Alaska. The distinction between sales of this type, and sales of goods that are to be used in the state of Washington, clearly is not an arbitrary or capricious distinction, and is based upon sound policy consideration.
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> The distinction that the Department of Revenue is attempting to apply in the instant case, however, is clearly contrary to the underlying policy and intent of the statute. The Department's rigid insistence upon using a certain type of carrier, or a certain loading facility, unduly emphasized the form of the transaction over its basic substance. The strict procedural requirements being imposed now by the Department of Revenue's auditor go beyond a reasonable classification and superimpose an unreasonable formalism. This emphasis on procedure places an undue burden on the interstate commerce at issue here. The Equal Protection Clause requirements are not satisfied when the statute is so rigidly applied. The Department of Revenue has conceded that the purpose of the statute has been met, that the goods were immediately shipped to Alaska. The Constitution therefore mandates that . . . be treated comparably to those taxpayers who met the formal procedural requirements.

At the Director's level hearing on July 8, 1987 the taxpayer proposed to submit additional documentation proffering to show a breakdown between items shipped to Alaska via common carrier and via its own transportation equipment. Other documentation

in support of the factual presentations made was also to be submitted.
As of this writing there have been no such submittals.

Regarding the fourth and final issue, for the first time at the Director's level hearing the taxpayer protested the assessment of deferred retail sales tax upon lumber purchased in this state and used here as form lumber in construction projects performed locally. The taxpayers seeks to excuse its tardiness in raising this issue by explaining that before Determination No. 86-35 was issued the taxpayer had no legal representation and was not aware that it had to expressly plead all items of the audit assessment with which it had disagreement. It now seeks to amend any pleadings to include this assessment item. The taxpayer relies upon the provisions of WAC 458-08-070(6) concerning amended pleadings and urges the application Superior Court Civil Rules 15 (a) and (c).

On the merits of this issue, the taxpayer submitted affidavits by its former construction project supervisors and siding/flooring subcontractors to the effect that as much as 35% of the materials
purchased became a permanent part of the structures built. The taxpayer testified that, regarding the form lumber, approximately
$ X worth of the total lumber purchases of $ X was actually incorporated into the substructure of the buildings. Additional documents and work orders were to be presented but have not been made available.

DISCUSSION:

With respect to issue 1-a, concerning the reporting and payment of taxes one month after the income was recorded on the taxpayer's books, this matter is strictly factual and completely susceptible to verification by the department's Audit Section. The assessment is remanded for that purpose. If payment can be verified, the tax assessment will be adjusted downward proportionately. The taxpayer will be extended an additional period of thirty days from the date of this Final Determination within which to submit corroborating records and documents. Failure to do so will cause the tax assessment to be final on this matter and the taxpayer's only recourse will be to pay the tax and pursue a refund if such records are eventually available. See RCW 82.32.170.

With respect to issue 1-b, Determination No. 86-35 contains the proper resolution of the bad debts question. This matter

is controlled by the provisions of WAC 458-20-196, which, in pertinent part, implements the statutory exemption provided by RCW 82.08.100.

The statute, which allows the exemption for bad debts which are deductible as worthless for federal income tax purposes, had an effective date of January 1, 1983. It has been the consistent and uniformly applied position of the department that bad debts were not deductible for retail sales tax purposes prior to that effective date. Moreover, there is no evidence or other information from which it could be concluded that the enactment of the sales tax exemption for bad debts was merely a clarification of legislative intent that such bad debts were always tax exempt.

In fact, before the 1983 effective amendment, Rule 196 expressly forbad the exemption for sales tax purposes. That provision of the rule was upheld by the State Supreme Court in Olympic Motors Inc. v. McCroskey, 15 Wn. 2d 665 (1942).

[1] Concerning the taxpayer's alternative argument on this issue, that there was a total failure of consideration when its customers claimed bankruptcy before paying for the work completed, there is simply no judicial or other legal support for this imaginative position. See again, Olympic Motors Inc., supra. The fact that the taxpayer could not effect payment from its customers does not mean that there was no "selling price" for the work performed. RCW 82.08.010 defines the term "selling price" to include money, credits, rights, or other property expressed in terms of money. Certainly the taxpayer received the right to be paid when it performed the construction work and accrued the income on its books and records. Moreover, as an unpaid creditor, it retained the right to assert a creditor's claim in bankruptcy. Thus, there was consideration from both parties to the transactions which constituted "retail sales" before there was any legal exemption for retail sales tax on bad debts. The taxpayer's petition regarding the second issue is denied.

Respecting issue no. 2, we have received no documentation or other evidence going to establish that any of the taxpayer's customers actually paid sales or use tax directly to the state covering any of the construction work performed by the taxpayer.

Neither the provisions of the Revenue Act, nor any of the rules relating thereto authorize the direct payment of tax by such customers. Moreover, it is not the responsibility of the department to track down customers to see if they have

satisfied the duty of their sellers to collect and report retail sales tax.

The treatment of these questions included in Determination No. 86-35 is the proper expression of the department's position under the law. If the taxpayer later submits records or documents from which it can be determined that the sales tax has been paid more than once upon the same amounts, it may seek refund of these taxes paid under tax assessment no. 4776100. The taxpayer's petition on this issue is denied.

[2] Respecting the third issue before us, we have included the taxpayer's arguments at considerable length in the TAXPAYER'S EXCEPTIONS portion of this Final Determination to clearly reflect that we have thoroughly reviewed and weighed them. In our view, however, not all of those positions require further discussion. The taxpayer has failed in significant and material ways to meet the substantive requirements of RCW 82.08.0269 and Rule 193A for entitlement to sales tax exemption.

The statute expressly provides that the sales tax shall not apply to sales for use in noncontiguous states, "but only when ... the seller delivers the subject matter of the sale to the purchaser or his designated agent at the usual receiving terminal of the carrier selected to transport the goods"...where it is reasonably certain that the goods will be directly taken to the noncontiguous state. Rule 193A which implements the statute and has the force and effect of the statute unless overturned by a court of record not appealed, provides in pertinent part as follows:

> Where the buyer is also the carrier, delivery may be to a warehouse receiving terminal or other facility maintained by the buyer when the circumstances are such that it is reasonably certain that the goods will be transported to their place of ultimate use. (Emphasis supplied.)

Under the facts of this case, as affirmed by the taxpayer itself, the materials and equipment were not delivered by the in state seller to any designated carrying agent's receiving terminal. The goods were delivered to the taxpayer's (buyer's) own facility. However, the taxpayer was not the carrier for most of the goods. Rather, it performed its own freight forwarding services at this facility, sometimes shipping materials via other land, air, and water carriers. It is simply not the purpose of the statutory law or the rule's

provisions to extend the tax exemption under these facts. This is clear from the limiting and qualifying words in the law, "but only when". It is simply insufficient to establish that the goods were all eventually shipped to Alaska. If that were all that was necessary to perfect the entitlement to exemption, the law could simply provide for a sales tax exemption for goods sold here for use in noncontiguous states, without adding the caveat, "but only when". Such qualified exemption provisions must be strictly construed against the person claiming exempt status. See Budget Rent a Car v. Dept. of Revenue, 81 Wn.2d 171 (1972).

Moreover, the Washington State Legislature has considered expanding or liberalizing this exemption on several occasions and has refused to do so. Importantly, this sales tax exemption has nothing whatever to do with interstate sales and is not circumscribed by Commerce Clause or other constitutional controls.

It is not a meritorious argument to plead that all taxpayers who purchase goods in this state must be treated precisely the same whether or not they comply with the express requirements for exemption under the statute. There is no such litmus test for determining whether a statute is discriminatory as enacted or as administered. Simply put, persons who take delivery under the conditions spelled out in the statute are entitled to the exemption; those who don't aren't.

In the case before us here, the taxpayer took delivery of the goods at it's own warehouse and processed them for it's own convenience. It then decided whether and how to get the goods to Alaska. This is clearly not the in state delivery circumstances contemplated under the statute for sales tax exemption. The department's strict adherence to the statutory requirements in cases such as this has been consistent and uniform. In such cases there is absolutely no reasonable certainty that the goods or any part thereof will be shipped to a noncontiguous state. The buyer cannot overcome this uncertainty by an attempt to show, after the fact, that the goods ended up in Alaska. Contrary to the taxpayer's assertion, the department does not concede that the purpose of the statute has been met in this case.

Concerning the Orders of the State Board of Tax Appeals cited and relied upon by the taxpayer, we find them to be distinguishable on their facts in very significant and dispositive ways. In the Trident Seafoods case, supra, the fishing nets were actually delivered to the buyer's fishing

vessels in this state upon which they were immediately carried from this state. In Savage Wholesale Building Materials, Inc., supra, the goods were locally delivered to common carriers or freight forwarders for delivery processing on to Alaska. In neither case were the goods delivered to a warehouse at which the buyer personally took possession, dominion, and control over the goods and then decided how much and by what means any of the goods would be transported to a noncontiguous state. Yet, this is precisely what the taxpayer did in this case and it is precisely the action proscribed by the "but only when" language in the statute. Again, RCW 82.08.0269 is not a blanket sales tax exemption for all goods sold to buyers who take delivery in this state and then ship all or some of the goods to a noncontiguous state. To the extent that the Board of Tax Appeals Order in Savage, supra, appears to rule otherwise, the department does not accede to that decision. The taxpayer's petition is denied on this issue.

Concerning the fourth and final issue, there is no evidence whatever to indicate that the lumber purchased by the taxpayer was not incorporated into the substructure of buildings after having been used as form lumber for cement or concrete laying. Any assumption on the part of the department to the contrary has been overcome by the only evidence and testimony in this case -- the affidavits of job foremen and supervisors. Moreover, it now appears that it would be physically impossible to determine whether or what part of lumber was used as mandated by RCW 82.08.0274 for entitlement to sales tax exemption. There is no reasonable basis for refuting the taxpayer's testimony that 75% of the lumber purchased was used in the statutorily exempt manner. We will resolve any doubt in the taxpayer's favor on this question. As to this issue the taxpayer's petition is sustained.

DECISION AND DISPOSITION.

The taxpayer's petition is sustained in part and denied in part. Tax Assessment No. . . . will be adjusted to delete deferred sales tax and interest upon 75% of lumber purchases during the test period audit.

The taxpayer has not been forthcoming with records or documents to support its positions with respect to overpayment of tax or double assessment of tax in connection with issues no. 1-a and 2. Thus, after the adjustment for issue no. 4 and the additional thirty days extension ordered above for the

presentation of records, the taxpayer must pay the entire adjusted assessment.

Dated this 29th day of November, 1988.