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

In the Matter of the Petition for Refund of	) D E T E R M I N A T I O N)) No. 89-309)
. . .	)Registration No. . . .)Doc. No. . . .) Audit No. . . .)

[1] RULE 231: INTERNAL DISTRIBUTIONS TAX -- RETAIL OUTLET -- WAREHOUSES WHICH MAKE RETAIL SALES. Warehouses which also make retail sales were found to be retail outlets within the meaning of WAC 458-20-231, (Rule 231). The term retail outlet under Rule 231 means "a place from which retail sales are made... ."

[2] RULE 231: INTERNAL DISTRIBUTIONS TAX -- TWO OR MORE RETAIL STORES -- MEANING OF. The phrase which excludes from the definition of "two or more of their own retail stores or outlets", "a retail store or retail outlet, a part of which is operated as a warehouse from which distribution is made" is applicable only in determining whether the initial threshold requirement of a warehouse serving "two or more... outlets" is satisfied.

[3] RULE 102 AND RULE 231: INTERNAL DISTRIBUTIONS TAX -- DEFINITION OF WHOLESALE -- RESALE CERTIFICATE. The acceptance in "good faith" of a valid resale certificate does not conclusively determine the character of a sale, (ie. wholesale or retail), but only relieves the vendor from the responsibility of collecting retail sales tax on the transaction. The actual test is whether the item was in fact purchased for resale in the regular course of business without intervening use.

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: May 11, 1989

NATURE OF ACTION:

The taxpayer protests the imposition of Internal Distributions tax assessed in an audit report.

FACTS & ISSUES:

Okimoto, A.L.J. -- The taxpayer's books and records were examined by a Department of Revenue (Department) auditor for the period April 1, 1984 through December 31, 1987. An audit resulted in additional taxes and interest owing in the amount of $ . . . and Assessment No. . . . was issued in that amount on October 18, 1988. The taxpayer has paid the assessment in full, and now petitions for a refund.

The taxpayer operates a beauty supply distribution business with warehouses located in . . . . . Although all of taxpayer's stores are of the warehouse format, each warehouse makes both wholesale and retail sales. Taxpayer's main warehouse which is also the central receiving point for the majority of merchandise ordered from out-of-state manufacturers, is located in . . . , Washington. The taxpayer also has warehouses in . . . . The taxpayer stated at the hearing that a portion of the taxpayer's purchases are shipped directly from the supplier to their respective warehouses. Because virtually all merchandise destined for . . . is shipped direct and because the taxpayer makes only minimal retail sales from its . . . warehouse, the auditor did not assert Internal Distributions tax on merchandise destined for those locations. Tax was only asserted on distributions from the taxpayer's . . . warehouse to the . . . warehouses. The auditor asserted the tax based on the cost of the merchandise per Rule 231.

The taxpayer protests the assertion of Internal Distributions tax for the following reasons:

1. The taxpayer argues that all of the taxpayer's stores are warehouses and only incidentally make retail sales, and

therefore are not retail outlets. The taxpayer also contends that it is "only a wholesale operation, open only to bona fide state registered businesses" and that "Any item sold with sales tax has been for [the] convenience of . . . 's business customers..."

2. In the alternative, if the warehouse is found to be a retail outlet, then it is part of a warehouse from which distributions are made, and is excluded from the definition of a retail outlet. The taxpayer states that Rule 231 specifically excludes from the definition of "two or more of their own retail stores or outlets"... "a retail store or retail outlet, a part of which is operated as a warehouse from which distribution is made."

3. The taxpayer also states that a certain percentage of the taxpayer's purchases of goods are shipped directly from the supplier's plant to the taxpayer's individual stores and never enter taxpayer's central warehouse in . . . . The taxpayer states that these purchases should not be included in the Internal Distributions tax computations.

4. The taxpayer also argues that it has not been given the opportunity to verify and establish that Wholesaling B&O tax has been paid by its vendors, as Rule 231 allows.

DISCUSSION:

[1] Although the taxpayer argues that all of the taxpayer's stores are warehouses and only incidentally make retail sales, and therefore are not retail outlets, we must disagree. The Department and the courts have consistently adopted the definition of a retail outlet for purposes of Internal Distributions tax, as being "a place from which retail sales are made...." Standard Oil v. State, 57 Wn.2d 56, 355 P.2d 349 (1960). Similarly, we reject the taxpayer's contention that its business is strictly a "wholesale operation" because of its policy to sell only to beauty and barber shops duly registered with the Department of Revenue.

[2] In the alternative, the taxpayer argues that its warehouses are specifically excluded from the definition of a retail outlet by Rule 231. The taxpayer places its reliance upon an isolated portion of the rule's definition taken out of context to wit:

> ... the term does not include a retail store or retail outlet, a part of which is operated as a warehouse from which distribution is made...

The taxpayer has failed to appreciate that this exclusion has a very limited application. It is useful only for determining whether the threshold requirement of "two or more of their own retail stores or outlets" is initially satisfied. This is clear when the provision is read in toto, and in context. The rule provides:

> The term "two or more of their own retail stores or outlets" means two or more retail stores operated within this state separate and apart from any "warehouse or other central location." The term does not include a retail store or retail outlet, a part of which is operated as a warehouse from which distribution is made. However, a retail store or outlet will be counted as separate and apart, even though it may be located within the same premises or under the same roof as a warehouse or central location, if it is operated separately, ... (Emphasis ours.)

In fact, the Washington Supreme Court addressed this very issue in Air Mac v. State, 78 Wn.2d 319, 747 P.2d 261 (1970). In rejecting the taxpayer's argument that the above language excluded retail stores which also served as warehouses from the definition of a retail outlet for purposes of imposing the Internal Distributions tax, the court stated:

> Air-Mac's interpretation is too narrow. The statute and this rule merely prevent the Tax Commission from treating a retail outlet physically attached to a warehouse as one of the two retail outlets which receives goods from the warehouse. Under RCW 82.04.270 this becomes important only when it is necessary to determine whether, for the purpose of taxation, a warehouse serves two or more stores or outlets under the same ownership. For example, if a taxpayer has only two retail store-warehouse combinations that serve each other, the tax does not apply because the taxpayer does not possess the requisite "two or more ... outlets" inasmuch as the retail store connected with the distributing warehouse cannot be counted. The addition of a third such unit, however, places the taxpayer within

> the ambit of the tax. (Emphasis theirs.) Air Mac v. State, supra at 324.

[3] We also do not agree with the taxpayer's reasoning when it states in its petition:

> "Any item sold with sales tax has been for [the] convenience of . . . 's business customers, for the customers' internal use. If this transaction results in an additional tax on . . . , it will discontinue this practice and request the customer to report the use of tax on the customer's own returns."

We assume that the taxpayer intends to acquire signed resale certificates under WAC 458-20-102, (Rule 102) in order to establish the status of these sales as wholesale. Rule 102 states:

> ... all sales are deemed to be retail sales unless the seller takes from the buyer a resale certificate signed by and bearing the registration number and address of the buyer, to the effect that the property purchased is:
>
> (1) For resale in the regular course of business without intervening use, or
> (2) To be used as an ingredient or component part of a new article of tangible personal property to be produced for sale, or
> (3) A chemical to be used in processing an article to be produced for sale.
>
> When a vendor receives and accepts in good faith from a purchaser a resale certificate as described in this rule, the vendor is relieved of liability for retail sales tax with respect to the transaction.

We find the taxpayer's reasoning faulty for two reasons. First, Rule 102 requires that the certificates be accepted in "good faith." Where the taxpayer solicits resale certificates from customers involving purchases that it knows are not for "resale in the regular course of business" such certificates would not have been accepted in "good faith." Second, the acceptance in "good faith" of a valid resale certificate does not conclusively determine the character of a sale, (ie. wholesale or retail), but only relieves the vendor from the

responsibility of collecting retail sales tax on the transaction. In other words, the resale certificate merely serves as an affidavit from the purchaser to the vendor that it is buying for resale. As a matter of policy, the Department relieves the vendor from the liability of collecting sales tax on the transaction provided it has accepted the certificate in "good faith." The actual test for determining whether a sale is wholesale or retail, however, is whether the item was in fact purchased for resale in the regular course of business without intervening use. If the Department in a subsequent audit of the purchaser should later find that the affidavit was incorrect, then it can and does routinely assess deferred sales tax on the transaction.

As to the taxpayer's contention that the Internal Distributions tax does not apply to purchases of goods shipped directly from the supplier to a warehouse, we agree with the taxpayer. WAC 458-20-231 clearly states:

> ... Articles distributed from independent manufacturers or distributors directly to the taxpayer's retail stores or outlets are not taxable distributions by the taxpayer.

If and when the taxpayer presents sufficient documentation to the audit section to substantiate the amount of direct shipments, the assessment shall be adjusted.

Similarly, if and when the taxpayer presents the appropriately completed "Internal Distributions Exemption Certificates," to the audit section, the tax assessment shall be adjusted.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of assessment and petition for refund is denied in part and granted in part. The taxpayer's petition is remanded to the audit section for adjustment consistent with this determination.

DATED this 14th day of June 1989.