

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

In the Matter of the Petition        ) D E T E R M I N A T I O N  
for Correction of Assessment        )  
of                                        )  
  )       No. 89-375  
  )  
  )       Registration No. . . .  
  )       . . . /Audit No. . . .  
  )  
  )

[1] RULE 211 & RULE 178: USE AND/OR DEFERRED SALES TAX -- BAILMENT -- POSSESSION -- LACK OF USE. Equipment stored on taxpayer's premises which the taxpayer was temporarily prevented from using, because of a dispute with one of the owner/partners, was found to be not subject to use tax on a bailment theory.

[2]RULE 178: USE AND/OR DEFERRED SALES TAX -- VALUE OF ARTICLE USED -- RETAIL SELLING PRICE -- BLUE BOOK VALUATION. Previously untaxed capital assets transferred to the corporation from a partnership were found subject to use and/or deferred sales tax on the value of the article used. Value of article used was determined by retail selling price of similar products of like quality and character as listed in an auctioneer's blue book.

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 26, 1989

NATURE OF ACTION:

The taxpayer protests the imposition of use and/or deferred sales tax on capitalized assets and bailed equipment in an audit report.

FACTS:

Okimoto, A.L.J. -- The taxpayer's books and records were examined by a Department of Revenue (Department) auditor for the period January 1, 1982 through March 31, 1986. An audit resulted in additional taxes and interest owing in the amount of \$ . . . and Assessment No. . . . was issued in that amount on June 30, 1987. The taxpayer has protested the assessment in full, and it remains due.

The taxpayer operates a trucking, contracting and excavating business located in . . . , Washington. The issues on appeal concern the two following schedules:

Schedule VII - Use Tax Due on Bailed Equipment

In the audit report, the auditor assessed use tax on equipment as follows:

The equipment in question was owned by . . . , a partnership between the then two corporate officers of . . . . . needed the equipment and it was decided that it would be purchased by the partnership and rented exclusively to the corporation, as it was through 1981.

From January 1982 through March 1983, as the partnership was being dissolved, there was no formal recognition of rental expense by the corporation or rental income on the part of the partnership. Effective March 1983, after the close of the partnership, the corporation started recognizing \$10,000 per month rental expense relating to the equipment. The surviving partner also was recognizing corresponding income from rental of the equipment. Retail sales tax was neither charged by the surviving partner nor paid by the corporation as use tax. Use tax on those rentals is calculated on Schedule VIII.

Lacking accurate records of usage, the fair rental value of the equipment was estimated to be the \$10,000 per month that the corporation started recognizing in April 1983. Additional time was required by the taxpayer in order for them to obtain

usage records documenting a lesser fair rental value for the equipment. Those records could not be made available for examination.

The taxpayer makes two arguments. First, the taxpayer stated at the hearing that the auditor is not consistent in utilizing information obtained from the federal income tax return because the auditor used the information for valuation of equipment in Schedule X while rejecting the information on the federal tax return for Schedule VII.

The taxpayer also stated at the hearing that the equipment was not used by the taxpayer during the period in question because the two owners of the equipment were in a serious conflict at the time. Because of this conflict, the other partner would not let the taxpayer (whose president was one of the partners that owned the equipment) use the equipment. Consequently no rental income was accrued by the partnership or expensed by the taxpayer. The taxpayer also points out that there are no equipment repair expenses listed on the federal return of the partnership, which is consistent with the taxpayer's contention that the equipment was not used.

The taxpayer also stated that it has attempted to locate records which would establish its claim of non-use during this period, but has been unable to do so because they simply do not keep such records.

Second, the taxpayer argues that the Department should be estopped from assessing tax on the bailment issue because this issue was not disclosed when the auditor presented a waiver request for the year 1982. The taxpayer contends that at the time it signed the waiver, the auditor assured it that no other issues would be raised. The taxpayer stated that if it had known that signing the waiver would potentially expose it to further tax liability on undisclosed issues, it would not have signed the waiver.

#### Schedule X - Use Tax Due on Capital Equipment

In the audit report, the auditor assessed use and/or deferred sales tax on the capitalized value of two pieces of equipment which were transferred from a partnership to the corporation for the issuance of stock. Because the equipment had been previously purchased for resale no sales tax was paid, and the auditor asserted use and/or deferred sales tax on the book value of the capitalized equipment at the time the equipment was transferred.

The taxpayer protests on the grounds that the valuation used on its books utilizes a stepped-up basis allowed under federal income tax law under section 731. The taxpayer argues that a stepped-up basis, for purposes of federal income tax law, has no bearing on the valuation of the property for purposes of state excise tax law. Instead the taxpayer argues that the original cost of the equipment less the accelerated depreciation should be used to determine the value of the equipment.

In the alternative, the taxpayer argues that the fair market value of the equipment at the time of transfer to the corporation should be the value upon which use tax is computed.

#### DISCUSSION:

##### Schedule VII - Use Tax Due on Bailed Equipment

[1] WAC 458-20-211 states:

(2) The term "bailment" refers to the act of granting to another the temporary right of possession to and use of tangible personal property for a stated purpose without consideration to the grantor.

(3) A true lease, rental, or bailment of personal property does not arise unless the lessee or bailee, or employees or independent operators hired by the lessee or bailee actually takes possession of the property and exercises dominion and control over it. (Emphasis ours.)

Keeping the above principals in mind, we believe that in order for use tax to be sustained in this case, the auditor must establish the following:

1. The taxpayer received the temporary right of possession to and use of the equipment without consideration being paid to the grantor, and
2. The taxpayer exercised both dominion and control over the equipment during the period in question.

We believe that the facts fail to establish a bailment situation. Although the taxpayer had possession of the equipment and no consideration was paid, we believe that the auditor has failed to establish the requisite use of the equipment by the taxpayer during the period in question. The

taxpayer testified that it was prevented from using or exercising control over the equipment by the partner/owner of the equipment with whom the taxpayer's president (who was also a partner/owner) was having a dispute. This statement is supported by the information contained on both the partnership and the corporation's federal income tax returns. We further note the total absence of any repairs or maintenance charges attributable to the equipment in question on either the partnership or corporation's books. Although the fact that two pieces of expensive construction equipment remained idle for the period in question may have seemed unlikely to the auditor, we find that possibility both plausible, (in light of the tumultuous, and disputed partnership dissolution that was going on at the time), and consistent with the taxpayer's own bookkeeping. Therefore, absent objective evidence that the taxpayer actually did use the equipment during the period when no rental income was accrued by the partnership or expensed by the corporation, we cannot sustain the use tax assessed. Accordingly, the taxpayer's petition is granted on this issue. Because we have already ruled in favor of the taxpayer on substantive grounds, we do not have to address the estoppel issue.

#### Schedule X - Use Tax Due on Capital Equipment

[2] RCW 82.12.020 imposes a use tax "... for the privilege of using within this state as a consumer any article of tangible personal property purchased at retail, ... or manufactured by the person so using the same,.... The tax shall be levied and collected in an amount equal to the value of the article used by the taxpayer ..."

RCW 82.12.010 defines 'value of the article used' to mean:

... the consideration, ..., paid or given or contracted to be paid or given by the purchaser to the seller for the article of tangible personal property, the use of which is taxable under this chapter. ... In case the article used is ... manufactured by the person using the same or is sold under conditions wherein the purchase price does not represent the true value thereof, the value of the article used shall be determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character under such rules and regulations as the department of revenue may prescribe. (Emphasis ours.)

The statute clearly states that the value upon which use tax is to be computed is the retail selling price at place of use of similar products of like quality and character. Because neither the stepped-up basis per the federal income tax return nor the accelerated depreciated book value of the assets at the time of transfer has any particular relationship to the retail selling price at place of use, we reject both methods of valuation.

Instead, we adopt the taxpayer's last proposal of fair market value (or retail selling price) at the time of transfer to be the value upon which use tax is to be computed. To determine the fair market value of the equipment at time of transfer, the taxpayer has submitted a 1985 copy of Forke Brothers, The Auctioneers Blue Book. The book lists two actual sales of equipment similar to the 225 excavator that were made during the year 1985 for \$46,000 and \$70,000. Accordingly, by taking the average of the two sales, we find the retail selling price of the 225 excavator to be \$58,000. Although there were no sales of 1980 D-8k's listed in the book, three 1979 D-8k's were sold for \$62,500, \$61,500, and \$55,000. Accordingly, by taking the average of these three sales, we find the retail selling price of the 1980 D-8k to be \$59,666. The taxpayer's petition is granted on this issue.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of assessment is substantially granted. The file will be referred to Audit so that the proper adjustments can be made and a revised assessment issued.

DATED this 20th day of July 1989.