Cite as Det. No. 00-150, 20 WTD 432 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 00-150[1]
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 102; RCW 82.08.130: RETAIL SALES TAX – RESALE CERTIFICATES – PURCHASES FOR DUAL PURPOSES – WITHDRAWAL FROM INVENTORY AND USE OUT OF STATE. A taxpayer who gives a valid resale certificate for articles it purchases, pursuant to RCW 82.08.130 and WAC 458-20-102(11) (purchases for dual purposes), and who subsequently withdraws some of the articles from inventory and distributes them outside the state as free samples, is liable for retail sales tax on the value of the samples distributed out of state.

[2] RULE 102; RCW 82.08.130: RETAIL SALES TAX; USE TAX – RESALE CERTIFICATES – PURCHASES FOR DUAL PURPOSES – WITHDRAWAL FROM INVENTORY AND USE OUT OF STATE. The term "deferred sales tax" as used in WAC 458-20-102 means retail sales tax, not use 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.

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NATURE OF ACTION:

A distributor of publications who gave valid resale certificates on all acquisitions of inventory pursuant to RCW 82.08.130 and WAC 458-20-102(11), protests assessment of "deferred sales tax" on publications it removed from inventory and distributed out of state as free samples.[2]

[1] The reconsideration determination, Det. No. 00-150R, is published at 20 WTD 442 (2001).
[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS:

Prusia, A.L.J. -- The taxpayer is engaged in business in Washington as a distributor of textbooks and educational materials (hereinafter referred to as "publications").[3] The taxpayer buys the publications at wholesale from a number of Washington-registered vendors, and resells the publications to school districts and other buyers, using a catalog distribution model. The taxpayer has customers both in and outside Washington. The taxpayer has its office and warehouse facilities in [Washington].

The taxpayer provides resale certificates to its vendors on 100% of purchased inventory. It resells the great majority of the publications it purchases. However, it distributes some as free samples. The samples are used to introduce products to the taxpayer's buyers. This occurs when a potential buyer of a publication requests a sample for purposes of comparing it with other publications. The samples are identical to the items the taxpayer sells in the regular course of its business. At the time it purchases the inventory, the taxpayer is not able to determine whether particular property purchased will be used as a sample or resold. For 1996, 1997, and 1998, samples as a percentage of purchased inventory were 8.79%, 9.02%, and 18.88% respectively.

The Audit Division of the Department of Revenue (Department) examined the taxpayer's business records for the period January 1, 1995 through December 31, 1998. As a result of this audit, the Department issued Tax Assessment No. FY. . . on November 17, 1999, in the amount of $. . . plus $. . . statutory interest. Schedule 7 of the assessment is for "deferred sales tax/use tax" on publications the taxpayer took from inventory and sent as free samples to potential buyers in Washington. Schedule 8 is for "deferred sales tax" on publications the taxpayer took from inventory and sent as free samples to potential buyers out-of-state.

The taxpayer contests Schedule 8 of the assessment, which assesses $. . . in additional tax, as well as statutory interest related to Schedule 8. The taxpayer agreed to the remainder of the assessment, including the Schedule 7 portion, and in December 1999 paid $. . . on the assessment.

The Audit Division based the Schedule 8 assessment upon its interpretation of RCW 82.08.130 and WAC 458-20-102 (Rule 102). It interprets those provisions as requiring that the taxpayer account for the value of any articles it purchased with a resale certificate that it subsequently used rather than resold, and to remit retail sales tax on the articles. The taxpayer also relies upon RCW 82.08.130 and Rule 102 in contesting the assessment. The taxpayer contends its purchases of publications were exempt from retail sales tax under RCW 82.08.130 and Rule 102, the only tax the Department can assess on the taxpayer's subsequent use of the samples is use tax, and use tax does not apply to samples distributed outside Washington.

[3] The taxpayer is a "publisher" in that it owns the copyrights or distribution rights to the materials. It generally is the sole source of titles it distributes. The taxpayer does not physically produce books. Most of the books and materials it distributes are for the elementary school level.

ISSUES:

If a taxpayer gives a valid resale certificate for articles it purchases, pursuant to RCW 82.08.130 and Rule 102(11), and subsequently withdraws some of the articles from inventory and distributes them out of state as free samples, is the taxpayer liable for sales tax on the samples?

RELEVANT STATUTES AND RULES:

RCW 82.08.020 imposes a retail sales tax on each retail sale in this state. RCW 82.04.050 defines the term "retail sale" for excise tax purposes. Subsection (1)(a) of RCW 82.04.050 excludes from the definition of "retail sale" a sale to a person who presents a resale certificate under RCW 82.04.470,[4] and who "[p]urchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person."

There is no exemption from the sales tax for Washington residents who purchase articles in this state for their own use outside the state.

RCW 82.12.020(1) imposes a use tax "for the privilege of using within this state as a consumer" any article of tangible personal property purchased at retail on which retail sales tax under Chapter 82.08 was not paid. WAC 458-20-178 explains the use tax. Subsection (3) of Rule 178 provides that tax liability under the use tax arises "at the time the property purchased . . . by the person using the same is first put to use in this state."

RCW 82.08.130, entitled "Resale certificate--Purchase and resale--Rules," provides tax alternatives to buyers who engage in both consuming and reselling certain types of tangible personal property, as follows:

> If a buyer normally is engaged in both consuming and reselling certain types of articles of tangible personal property and is not able to determine at the time of purchase whether the particular property acquired will be consumed or resold, the buyer may use a resale certificate for the entire purchase if the buyer principally resells the articles according to the general nature of the buyer's business. The buyer shall account for the value of any articles purchased with a resale certificate that are used by the buyer and remit the sales tax on the articles to the department.
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> A buyer who pays a tax on all purchases and subsequently resells an article at retail, without intervening use by the buyer, shall collect the tax from the purchaser as otherwise provided by law and is entitled to a deduction on the buyer's tax return equal to the cost to the buyer of the property resold upon which retail sales tax has been paid. The deduction is allowed only if the taxpayer keeps and preserves records that show the names of the persons from whom the articles were purchased, the date of the purchase,

[4] RCW 82.04.470 sets out the information required in a resale certificate, and absolves a seller who has accepted a resale certificate in good faith from the burden of proving a sale was not a sale at retail.

> the type of articles, the amount of the purchase, and the tax that was paid. The department shall provide by rule for the refund or credit of retail sales tax paid by a buyer for purchases that are later sold at wholesale without intervening use by the buyer.

WAC 458-20-102 (Rule 102) is the administrative rule governing the issuance of resale certificates. It explains the conditions under which a buyer may furnish a resale certificate to a seller, provides tax reporting information to persons who purchase articles for resale and subsequently withdraw them from inventory for their own use, and provides information to persons who purchase types of articles for dual purposes (i.e., for both resale and consumption).

With respect to persons who purchase articles for resale and subsequently withdraw them from inventory for their own use, examples in Rule 102 explain that the taxpayer must report "deferred sales tax or use tax" on such items.[5]

Regarding purchases that are for both consumption and resale, Rule 102 states, in pertinent part:

> (11) **Purchases for dual purposes.** A buyer normally engaged in both consuming and reselling certain types of tangible personal property, and not able to determine at the time of purchase whether the particular property purchased will be consumed or resold, must purchase according to the general nature of his or her business. RCW 82.08.130. If the buyer principally consumes the articles in question, the buyer should not give a resale certificate for any part of the purchase. If the buyer principally resells the articles, the buyer may issue a resale certificate for the entire purchase. For the purposes of this subsection, the term "principally" means greater than fifty percent.
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> (a) **Deferred sales tax liability.** If the buyer gives a resale certificate for all purchases and thereafter consumes some of the articles purchased, the buyer must set up in his or her books of account the value of the article used and remit to the department of revenue the applicable deferred sales tax. The deferred sales tax liability should be reported under the use tax classification on the buyer's excise tax return.

[5] Rule 102(7)(d)(i) and (ii) state:

> (i) ABC is an automobile repair shop purchasing automobile part for resale and tools for its own use from DE Supply. ABC must provide DE Supply with a resale certificate limiting the certificate's application to automobile part purchases. However, should ABC withdraw parts from inventory to install in its own tow truck, deferred retail sales tax or use tax must be remitted directly to the department of revenue. The buyer has the responsibility to report deferred retail sales tax or use tax upon any item put to its own use, including items for which it gave a resale certificate and later used for its own use.
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> (ii) X Company is a retailer selling lumber, hardware, tools, automotive parts, and household appliances. X Company regularly purchases lumber, hardware, and tools from Z Distributing. While these products are generally purchased for resale, W Company may occasionally withdraw some of these products from its inventory for its own use. X Company may provide Z Distributing with a resale certificate specifying "all products purchased" are purchased at wholesale. However, whenever X Company removes any product from inventory to put to its own use, deferred retail sales or use tax must be remitted to the department of revenue.

(i) Buyers making purchases for dual purposes under the provisions of a resale certificate must remit deferred sales tax on all products or services they consume. If the buyer fails to make a good faith effort to remit this tax liability, the penalty for the misuse of resale certificate privileges may be assessed. This penalty will apply to the unremitted portion of the deferred sales tax liability.

RCW 82.04.190 defines the term "consumer" for excise tax purposes as "[a]ny person who purchases . . . any article of tangible personal property . . . other than for the purpose (a) of resale as tangible personal property in the regular course of business . . . ."

ARGUMENTS OF AUDIT DIVISION AND TAXPAYER:

The Audit Division's position is as follows. The taxpayer took delivery of samples in Washington from registered vendors and did not resell the items. Therefore, under RCW 82.04.130 and the dual-purpose section of Rule 102, deferred sales tax is due. Under deferred sales tax, the sales tax is due when the buyer takes delivery of the item, but is deferred until the buyer determines which particular items will not be sold. Because the tax due is deferred sales tax and not use tax, it does not matter whether the samples were distributed in-state or outside the state.

As refined at the hearing, the taxpayer's argument is as follows. The taxpayer purchased the publications with valid resale certificates. Therefore, no sales tax was due on the sales transactions. It did not use the samples in Washington prior to distributing them outside the state. Therefore, it did not incur a use tax liability on samples it distributed in other states. It contends that, through the guise of "deferred sales tax," the Audit Division improperly imposed use tax upon exempt out-of-state use.

The taxpayer analyzes relevant statutes and rules as follows. The retail sales tax is a transactional tax. It is to be collected on each "retail sale" in the state. RCW 82.08.020(1). If a sales transaction is exempt from retail sales tax, retail sales tax is never owed on the transaction. There was no taxable sales event.

Purchases for the purpose of resale, without intervening use by the purchaser in Washington, generally are excluded from the definition of "retail sale," and no retail sales tax is due on the transaction. RCW 82.04.050. RCW 82.08.130, which applies to the taxpayer's situation, expressly authorizes the taxpayer to use a resale certificate for the entire purchase if the buyer principally resells the articles. Rule 102(11) requires a taxpayer in the taxpayer's situation to give a resale certificate for the entire purchase.

Thus, the taxpayer gave valid resale certificates for its purchases. No sales tax was due on the sales transactions. There being no incidents of a retail sale, the only possible tax that could be due is use tax.

Use tax is not a transactional tax. It is a tax assessed on the privilege of using property "within this state as a consumer." RCW 82.12.020. The taxpayer's distribution of the samples to out-of-state users was not "use within this state as a consumer." The Department has interpreted such use as not subject to Washington's use tax. E.g., in Det. No. 86-20A, 1 WTD 415 (1986), the Department held that when a vessel was moored in this state preparatory to actual use in interstate commerce, there was no use in Washington. In Excise Tax Bulletin (ETA) 259.12.171 (1966), the Department's predecessor agency held that persons performing public road construction contracts outside the state do not owe use tax on materials purchased within the state and incorporated into the out-of-state projects.

The taxpayer argues the term "deferred sales tax" cannot be found in Washington's tax statutes. The Department has used the term in a number of its decisions, and uses it in Rule 102. What does the Department mean by the term? Often it is used interchangeably with use tax, perhaps because it doesn't make any difference which tax is assessed. When the Department has been careful about distinguishing between deferred sales tax and use tax, it has used the term "deferred sales tax" for situations where retail sales tax was due at the time of the transaction, but for some reason sales tax was not paid. E.g., if the seller did not bother to collect sales tax that was due, or the buyer tendered an invalid resale certificate, the Department may later collect the sales tax that was due on the transaction, as "deferred sales tax." In those instances, the Department has discretion to proceed against either the seller or the buyer for the unpaid sales tax. In such situations the Department may assess use tax against the buyer instead of assessing deferred sales tax.

The taxpayer cites as one case in which the Department carefully distinguished between "deferred sales tax" and use tax, Det. No. 89-480, 8 WTD 283 (1989). It quotes the following passage from the decision:

> The terms are often used interchangeably, as the rates are the same, but they are not identical concepts. Sales taxes are generally a liability of the buyer; they are imposed on the transaction, which is the purchase of tangible personal property in Washington. Use taxes are generally the liability of the person using the property, and are imposed on the use of the property in Washington, rather than the purchase, when sales tax was not paid at the time of purchase.

The taxpayer contends the Department has clearly indicated that in situations where sales tax was not due on the sales transaction, it would be inappropriate to apply "deferred sales tax." Rather, the appropriate tax to apply is use tax. It cites Det. No. 83-283, 11 WTD 9 (1983), and Det. No. 87-340, 4 WTD 221 (1987).

The taxpayer argues the drafter of Rule 102 did not use "deferred sales tax" in a technically correct manner. The drafter was using the term interchangeably with use tax, not referring to what is really meant by "deferred sales tax." The rule's requirement that the taxpayer report the "deferred sales tax" liability "under the use tax classification on the buyer's excise tax return" indicates what tax the Department considers to be due -- use tax.

ANALYSIS:

After fully considering the facts and the arguments of the Audit Division and the taxpayer, we conclude the assessment correctly assessed retail sales tax against the taxpayer on the samples it distributed out of state.

We find that the taxpayer is normally engaged in both consuming (using as samples) and reselling the publications. We find that it is not able to determine at the time of purchase whether particular items acquired will be consumed or resold. We conclude the taxpayer's circumstances bring it within the provisions of RCW 82.08.130 and Rule 102(11).

[1] RCW 82.08.130 does not provide an exemption from the retail sales tax. Rather, it permits a taxpayer in the taxpayer's situation to defer determination of which items are subject to sales tax and defer payment of sales tax until it is certain which items it acquired will not be resold. We note the statute is not labeled or identified as providing an exemption, and Rule 102 does not interpret it as providing an exemption. The statute expressly provides that when the buyer subsequently uses articles it purchased with a resale certificate, it shall account for the value of any such articles "and remit the sales tax."

The Department addressed the very issue the taxpayer presents in Det. No. 88-311A, 9 WTD 293 (1990). The Department stated in that determination:

> Rule 102 sets forth a method whereby persons, such as the taxpayer, may purchase items without paying sales tax on the initial transaction because they are not sure whether the item will be resold or used. Referring to the tax assessed as "deferred sales tax," simply means the payment of the sales tax is "deferred" until it can be determined whether the property is resold. The sales tax is a transaction tax and does not depend on use in Washington. If delivery takes place in Washington and the items are not purchased for resale, or are otherwise exempt from sales tax, the retail sales tax is due.[6]

See also Det. No. 89-309, 8 WTD 13 (1989).

RCW 82.08.130 is a statute that, for the mutual convenience of the Department, vendors, and dual-purpose buyers, allows dual-purpose buyers to present resale certificates for all the articles purchased and defer payment of retail sales tax until the final status of the goods is known. In the absence of the statute, vendors would be uncertain whether to accept a resale certificate. In the absence of the statute, the dual-purpose buyer would have to correctly guess which goods it would actually use rather than resell. In the absence of a statute, the Department's only remedy when a buyer has presented a resale certificate but has subsequently used rather than resold the goods would be to catch the failure in a subsequent audit, and assess additional retail sales tax plus statutory interest. The statute does not change the fact that sales tax was due at the time of

[6] Det. No. 88-311A differs somewhat factually from the taxpayer's situation, but we believe it correctly interprets the statute and Rule 102, and provides the interpretation that applies in this case.

purchase, or convert the tax that is due when the ultimate status of the articles is known into use tax.

The above interpretation of RCW 82.08.130 is supported by a comparison of the statute's two paragraphs. The paragraphs set out alternatives that should lead to the same result. The second paragraph provides that if a buyer pays sales tax on all its purchases, and subsequently resells some of them without intervening use, it is entitled to a deduction on its tax return equal to the value of the property resold upon which it paid sales tax. Under that paragraph, if the taxpayer had paid sales tax on all its purchases, it would not be entitled to a deduction for the value of articles it consumed out of state. I.e., it could not recover the sales tax it paid on those samples. To adopt the taxpayer's interpretation of the first paragraph would result in the taxpayer avoiding paying sales tax on those samples, which would result in a lack of parallelism between the two paragraphs.

We also disagree with the taxpayer's more general contention with respect to purchases for resale that if a taxpayer has given a valid resale certificate at the time of purchase, sales tax is never due on the sales transaction regardless of what the taxpayer later does with the articles purchased. We addressed this issue in Det. No. 89-309, *supra*, as follows:

> Second, the acceptance in "good faith" of a valid resale certificate does not conclusively determine the character of the sale, (i.e., 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 <u>in fact</u> 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. (Emphasis in the original.)

The Department audits taxpayers after the fact. It bases its assessments on the taxpayer's actual business transactions, not what the taxpayer anticipated, or intended, when it entered into particular transactions. If a taxpayer purchased articles using a resale certificate, and later used or consumed the articles instead of reselling them, the nature of the original transaction is a purchase that was not in fact for resale. The Department may properly assess and collect the unpaid retail sales tax. In the alternative, the Department may collect use tax if the taxpayer used the articles in Washington, for use tax would also be applicable under that scenario.

The authority upon which the taxpayer relies is distinguishable. Det. No. 83-283 dealt with an exemption from retail sales tax for sales of tangible personal property for use by the purchaser in connection with the business of operating as a private or common carrier in interstate or foreign commerce, with the proviso that any actual use of the property in this state was subject to use tax. The sales met the requirements of the statute. The Audit Division assessed "deferred sales

tax" on all the purchases, even those where the use was outside the state. Det. No. 83-283 held that "deferred sales tax" was clearly inappropriate, and concluded there was no taxable use. The case is distinguishable from the present one in that the requirements for the exemption did not subsequently turn out not to be met. Det. No. 87-340 addressed the issue of whether a doctor who purchases drugs to administer to patients is purchasing for resale, or for the doctor's own use. The Audit Division had assessed "deferred sales tax or use tax" on the purchases on which the taxpayer did not pay sales tax. Det. No. 87-340 held that the purchases were for resale. While it directed the taxpayer to heed Rule 102 and to report use tax on drugs purchased with a resale certificate that the taxpayer later consumed, it did not address or decide whether the tax due if there was subsequent consumption was sales tax or use tax. As Rule 102 requires the tax to be reported under the use tax classification, it is unlikely Det. No. 87-340 intended more than to reference that requirement.

We agree with the taxpayer that use of the term "deferred sales tax" can be confusing, and it is inappropriate to use the term interchangeably with use tax. The tax that is owed is either retail sales tax or use tax. The Department often uses the phrase "deferred retail sales tax or use tax" in assessing tax in situations where both sales tax and use tax are due, but only one or the other need be paid. Sales tax is owed because it was not collected or paid on a taxable transaction, and use tax also is owed because there has been use of property in the state on which retail sales tax has not been paid. The word "deferred" is superfluous, but is a handy term for referring to unpaid sales tax in such situations. A situation in which the term "deferred" sales tax is appropriate is the RCW 82.08.130/Rule 102(11) situation. By statute, determination of the appropriate taxation of the transaction, and payment of any retail sales tax due, is deferred.

[2] In Rule 102(11), the term "deferred sales tax" is not intended as a synonym of use tax, and should not be so read. The term means unpaid sales tax. In the examples in Rule 102(7)(d), the expression "deferred retail sales tax or use tax" should not be read as equating "deferred sales tax" with use tax. The examples describe situations in which sales tax was not paid on the sale, but with the benefit of hindsight we can see sales tax should have been paid because the purchases turned out not to be for resale. Because sales tax was not paid, use tax also is due, on the use in Washington. Because both taxes are due, and payment of one generally satisfies liability for both, requiring the taxpayer to pay one or the other avoids issues that are unique to one tax.

In sum, the Audit Division correctly assessed sales tax on the publications the taxpayer distributed as samples outside the state. When the taxpayer consumed the publications for which it had given a resale certificate, rather than reselling them, it was required by statute and rule to account for the value of the articles consumed and to pay the retail sales tax on them. It did not do so, and thus became liable for the unpaid retail sales tax.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of assessment is denied.

Dated this 31st day of July, 2000.