

Cite as Det. No. 99-280R, 20 WTD 20 (2001)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of	)	<u>F I N A L</u>
Assessment of	)	<u>D E T E R M I N A T I O N</u>
	)	
	)	No. 99-280R
...	)	
	)	Registration No. . . .
	)	FY. . . /Audit No. . . .

RULE 102, RULE 112, RULE 178; RCW 82.04.050, RCW 82.010: USE TAX – DEFERRED SALES TAX --VALUE – GIFT – CELLULAR PHONES: Use tax on cellular phones given away to promote cellular service commissions is measured by the donor's arm's length purchase price of the phones.

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.

NATURE OF ACTION:

A retailer protests the measure of use tax on phones given away to promote sales of cellular phone services.<sup>1</sup>

FACTS:

M. Pree, A.L.J. -- . . . (taxpayer) operates several retail stores in Washington. The taxpayer sells and installs such items as car audio equipment, cellular phones, vehicular security devices, and satellite dishes. The taxpayer also sold cellular phone services on behalf of an area provider of cellular phone service. The area provider paid the taxpayer commission income to solicit orders.

The Department of Revenue (Department) reviewed the taxpayer's books and records for the period from January 1, 1995 through December 31, 1997. On December 4, 1998, the Department's Audit Division issued the assessment referenced above. The taxpayer disputed the measure of use tax on the cellular phones given away. The taxpayer also questioned the Audit Division's computation of the number of phones given away.

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

On September 30, 1999 we issued Determination No. 99-280, which denied the taxpayer's petition in part. We denied the taxpayer's request to measure the use tax based upon the phone prices competitors charged customers who purchased cellular service from the taxpayer. However, we remanded the assessment to the Audit Division to review additional records. Based upon its review, the Audit Division will issue a post audit adjustment (PAA) reducing the assessment substantially. The number of phones is no longer in dispute.

The taxpayer petitioned for reconsideration of our determination, stating we erred by holding that the proper measure for use tax was the taxpayer's cost (wholesale purchase price), rather than using comparable retail sales of phones that competitors provided to customers who purchased cellular service. The taxpayer does not dispute that use tax was due, only the measure of use tax.

The Audit Division and the taxpayer agree that during the audit period the taxpayer paid on average \$100 for every phone, which was not resold, but given to its cellular customers. The taxpayer gave the phones to customers provided the customers signed cellular telephone agreements. The cellular telephone companies paid the taxpayer a commission of several hundred dollars for each contract. Rather than give the phones away, many of the taxpayer's competitors resold the phones at nominal prices ranging from 1¢ to \$1 to customers who signed their cellular telephone contracts. The taxpayer contends these were comparable sales, and the measure of its use tax should be 1¢ to \$1 per phone rather than its cost of \$100 per phone. The taxpayer's customers who purchased phones only without signing cellular contracts, were charged over \$100 per phone.

#### ISSUE:

What is the proper measure of use tax on phones given to customers who sign cellular telephone contracts: The donor-taxpayer's purchase price; or the sales price charged by competitors to customers who also purchased cellular service?

#### DISCUSSION:

Use tax is imposed on the privilege of using as a consumer any article of tangible personal property. RCW 82.12.020(1). Cellular phones are tangible personal property. RCW 82.12.010(5) includes in the definition of consumer, any person who distributes any article of tangible personal property, the primary purpose of which is to promote the sale of services (such as the cellular telephone service). It is important to note, under this definition, the taxpayer is the consumer upon whom use tax is imposed. The taxpayer and the Audit Division agree when the taxpayer withdrew the phones from inventory by giving them away, the taxpayer should have reported the phones under the use tax classification on the taxpayer's excise tax return. *See* WAC 458-20-102(11)(a).

The amount of use tax is an amount equal to the value of the article used by the taxpayer multiplied by the rate of tax. RCW 82.12.020. The taxpayer and the Audit Division dispute the value used to determine the tax. RCW 82.12.010(1)(a) provides:

**"Value of the article used" shall mean the consideration, whether money, credit, rights, or other property except trade-in property of like kind, expressed in terms of money, 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.** The term includes, in addition to the consideration paid or given or contracted to be paid or given, the amount of any tariff or duty paid with respect to the importation of the article used. In case the article used is acquired by lease or by gift or is extracted, produced, or 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 as the department of revenue may prescribe.

(Emphasis added.) The taxpayer is the consumer. The taxpayer purchased the phones for \$100 each.<sup>2</sup> There is no indication the taxpayer's purchases of the phones were anything but arm's length transactions. Therefore, under the first sentence of RCW 82.12.010(1)(a), the amount the taxpayer paid the seller of the phones equals the "value of the article used."

The taxpayer contends the measure of tax should be determined from comparable retail sales of like quantity, quality and character. The taxpayer suggests that recently published Det. No. 99-102, 19 WTD 236 (2000), supports its contention: Rather than using the purchase price for use tax purposes, the Department should allow third party comparable sales to determine use tax. The taxpayer applies RCW 82.12.010(1)(a) and Det. No. 99-102 incorrectly under its facts for two reasons.

First, the taxpayer's purchase price of \$100 per phone does in fact represent the true value of the phones. The third sentence of RCW 82.12.010(1)(a) applies only under conditions wherein the purchase price does not represent the true value of the article. The taxpayer does not suggest it acquired the phones under anything but arm's length circumstances. In fact the taxpayer acknowledges that its competitors purchased similar phones at or near \$100 per phone.<sup>3</sup> Because the taxpayer's \$100 purchase price per phone represented the true value of the phones, we need not compare sales of similar products.

Second, the "comparable sales" offered by the taxpayer were combined sales of phones and cellular telephone services. Customers could not purchase the phones for 1¢ to \$1 without agreeing to pay a much greater amount over time for cellular telephone service. Competitors' customers paid a much higher price if they purchased the phones only. The commission income on each of these transactions

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<sup>2</sup> The taxpayer and the Audit Division agree the \$100 price was a reasonable average of the amount the taxpayer paid its vendors for the phones.

<sup>3</sup> The taxpayer has not offered any evidence its competitors' purchase prices varied from \$100 per phone. The taxpayer acknowledges any variance from the \$100 price would have been minor (compared to the 1¢ to \$1 value sought by the taxpayer), and due to volume and timing differences. We acknowledge some of the taxpayer's competitor's sold the phones for 1¢ to \$1 to their customer's on the condition that each customer purchasing the phones at the low price contract for cellular telephone service.

alone exceeded the taxpayer's \$100 phone cost, which indirectly subsidized<sup>4</sup> the customers' 1¢ to \$1 charges. The taxpayer may not isolate these nominal charges as the comparable sales price.

Det. No. 99-102, 19 WTD 236 (2000) involved a combined sale of real estate and personal property upon which use tax was assessed. The taxpayer initially relied upon the allocation of values provided by the seller. The Audit Division depreciated the original cost of the personal property. Neither method offered sufficient evidence to determine the value of the personal property. Det. No. 99-102, 19 WTD 236 (2000), recognized the problems of using combined sales as comparable sales:

In general, an arm's length sale involves a "a transaction negotiated by unrelated parties, each acting in his or her own self interest; the basis for a fair market value determination." Black's Law Dictionary 100 (5th ed. 1979); see also Washington v. Kleist, 126 Wash. 2d 432; 434, 895 P.2d 398 (1995) ("Market value" is defined in this state as the price which a well-informed buyer would pay to a well-informed seller, where neither is obliged to enter into the transaction"). The transaction at issue involved an arm's length, combined sale of tangible personal property and real property, and the total purchase price would presumably represent a fair market value for the real and personal property. Because use tax is imposed only on the personal property, the value allocated to the personal property may not in and of itself represent the fair market value for the personal property. In other words, such a transaction may present a condition where the allocated purchase price does not represent true value for the personal property even though the transaction as a whole was an arm's length sale.

*Id.* at 238. The "comparable sales" offered by the taxpayer are combined sales of cellular telephone service and each phone. While the total purchase price of both the service and the phone represents fair market value of the combination in an arm's length transaction, the value allocated to the personal property (the phone) does not in and of itself represent the fair market value of the phone. Arm's length sales of the phones only, without the service, would offer better evidence as comparable sales.

However, we measure the tax using the taxpayer's purchase price, not comparable sales. By giving the phones away to promote cellular service sales, the taxpayer used the phones as a consumer under RCW 82.12.010(5). As a consumer, use tax is first imposed upon the taxpayer, not the taxpayer's customers. The taxpayer acquired the phones by purchasing them, not by gift. Because the taxpayer acquired the phones by purchase, the taxpayer's purchase price establishes the value of the phones under RCW 82.12.010(1)(a). The Audit Division properly used the taxpayer's purchase price to measure the tax.

#### DECISION AND DISPOSITION:

We deny the taxpayer's petition.

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<sup>4</sup> The Department's Rule 112 (WAC 458-20-112) provides in subsection (3) when comparable sales are used to measure tax, subsidies and bonuses should be included in the gross proceeds measure. The cellular telephone contracts represent consideration necessary for customers to purchase the phones at the reduced rates. We consider a portion of the customer's obligation under these contracts to be a subsidy to their phone cost includable in the gross proceeds received for the phones. However, because the taxpayer's purchases represent arm's length purchases by which the tax is measured, we need not reconcile or determine the actual amount subsidized in the competitors' sales.

Dated this 27<sup>th</sup> day of June, 2000.