Cite as Det. No. 94-320ER, 23 WTD 307 (2004)

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

In the Matter of the Petition of	)	D E T E R M I N A T I O N
	)	
. . .	)	No. 94-320ER
	)	
	)	Use & Watercraft Excise Taxes
	)	

[1] RULE 178, RULE 211; RCW 82.12.020: USE TAX – CORPORATE OFFICER'S USE OF YACHT "LEASED" TO CORPORATION – PERSONAL LIABILITY FOR PERSONAL USE –POSSESSION AND CONTROL – "TRUE LEASE" – *ULTRA VIRES* ACT –INTERVENING USE. Officer of corporation is liable for use tax on a yacht purchased outside Washington where officer did not relinquish possession and control of yacht so as to create a "true lease" to the corporation. To impose personal liability for use tax against the officer, the Department need not prove that officer's action in using yacht was *ultra vires.*

[2] RCW 88.02.020, RCW 82.02.030: WATERCRAFT EXCISE TAX ("WET") – EXEMPTION – REGISTRATION REQUIREMENTS – USE IN COMMERCE REQUIRING UNITED STATES DOCUMENTATION. Yacht used for taxpayer's personal use and charters incidental to taxpayer's personal use is not exempt from registration requirements and is therefore subject to WET.

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:

Taxpayer challenges use and watercraft excise taxes assessed on a vessel he purchased and leased to a corporation. [1]

FACTS:

Danyo, A.L.J. -- Taxpayer's request for an executive level review of Determination No. 94-320 was granted because it raised an issue of first impression. The following is a restatement of the pertinent facts.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Taxpayer, . . . , is a resident of Washington, is engaged in business in this state as an attorney, and is the sole shareholder, officer, and director of . . . (the "Corporation"). The Corporation received its Certificate of Incorporation from Washington's Secretary of State on June 7, 1991 and registered with the Department of Revenue (Department) as a bare boat charter business on June 9, 1991.

On June 13, 1991, Taxpayer and his wife, . . . , purchased a . . . yacht (the "vessel") [outside Washington], and leased it to the Corporation on June 14, 1991. Taxpayer did not pay retail sales tax on the purchase. Taxpayer shipped [the yacht] to Washington. Taxpayer did not register or license the vessel in Washington.[2]

On September 27, 1993, the Tax Discovery Unit of the Department's Compliance Division, having observed the unregistered and unlicensed vessel moored in a marina in Washington, sent a letter to Taxpayer requesting confirmation that use tax and watercraft excise tax (WET) had been paid. On October 28, 1993, Taxpayer responded that neither tax had been paid. He claimed the use tax was not due because the vessel had been purchased for lease to the Corporation for its use in the bare boat charter business.[3] He claimed the vessel was exempt from the WET because it was used primarily in conducting interstate commerce.[4]

The Compliance Division disagreed, however, and on January 24, 1994 issued a notice of use tax assessment for $ . . . and a notice of WET for $ . . . against Taxpayer. Both assessments included interest and late-payment penalties.

In response to his petition for cancellation of the assessments, we issued Det. No. 94-320, which sustained both assessments. The determination concluded that Taxpayer's use of the vessel was not exempt from the use tax because Taxpayer and his wife did not relinquish possession and

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[2] See, generally, chapter 88.02 RCW for vessel registration requirements. See, RCW 88.02.030 for exceptions from vessel registration requirements.

[3] See, RCW 82.04.050 and WAC 458-20-178 for exemptions to use tax for tangible personal property purchased for resale or "re-lease" in the ordinary course of business.

[4] See, RCW 82.49.010, which imposes a watercraft excise tax (WET) for the privilege of using a vessel in Washington. RCW 82.49.020 exempts certain vessels from the WET if they are exempt under RCW 88.02.030, "Exceptions from Vessel Registration." Taxpayer claimed an exemption from WET because under RCW 88.02.030(10) "[v]essels primarily engaged in commerce which have or are required to have a valid marine document as a vessel of the United States" are excluded from Washington registration requirements.

control of the vessel when they leased it to the Corporation for use as a bare boat charter vessel. WAC 458-20-211 (Rule 211).[5]
This conclusion was based on the following facts:

> The Corporation did not make any lease payments to Taxpayer and his wife;
>
> The Corporation did not report or remit any retail sales tax on charters;
>
> The Corporation did not have any employees (not even Taxpayer), offices, or operating capital;
>
> Taxpayer made monthly "loans" of approximately $ . . . to the Corporation to cover repairs, maintenance, fuel, and moorage fees for the vessel;
>
> Taxpayer and his wife did not pay the Corporation for their charters of the vessel;
>
> Taxpayer's family members were on board the vessel during times when the vessel was not chartered;
>
> Taxpayer, not the Corporation, insured and financed the vessel;
>
> Taxpayer's insurance policy and the bank purchase financing agreement required that the owner or the owner's agent operate the vessel at all times; and,
>
> The vessel had been chartered only once (between July 1991 and December 1994), for a one-half day charter, to someone other than Taxpayer's family and for which Taxpayer and his wife were the crew.[6]

On these facts, we found that Taxpayer and his wife, as the owners of the vessel, used it in this state, and owed use tax. RCW 82.12.020. We also found that the vessel was not exempt from the registration requirements under RCW 88.02.030(10) because it was not a documented vessel

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[5]Rule 211 was amended effective July 1, 1996. The revised portions of this Rule do not affect Taxpayer's use tax assessment. But the amended rule does provide an example describing when use tax is applicable, which is appropriate to Taxpayer's facts. See Rule 211(8)(h), which states:

> John Doe purchased a vessel which will be rented to others as a bare boat rental. The rentals will be arranged through an agent at a marina. The marina receives a commission based on any usage of the vessel, including usage by the owner. The rental of the boat is a retail sale when the boat is rented to others. The usage of the boat by John Doe is not a rental. Since John Doe will be using the boat at times for his own use, he may not purchase the boat for resale.

[6]As of June 1995, there was one additional half-day charter to a third party who was not related to Taxpayer.

primarily engaged in commerce. Therefore, we found that WET was also due. RCW 88.02.030(4).

Taxpayer's petition for reconsideration assigned error to several factual statements contained in Det. No. 94-320, claiming that the decision was incorrect as a matter of fact and law. Taxpayer again argued that he did not use the vessel in any capacity other than as an officer of the Corporation or as a bona fide third-party charterer.

ISSUES:

1. Was the determination's conclusion based on erroneous facts?

2. Did Taxpayer's use of the vessel constitute intervening use, subject to use tax?

3. Did Taxpayer prove that the vessel qualified for an exemption from the watercraft excise tax?

DISCUSSION:

Issue 1: Errors of fact

Taxpayer's petition for reconsideration alleges several errors of fact and law. In Section 1 of the petition, Taxpayer alleges that we incorrectly stated that the "Declaration of Use Tax" form was filed on August 18, 1991. We agree that the form was filed on August 20, 1991. This, however, was harmless error.

Taxpayer also states we erred when we said that he completed the form. Taxpayer states that a Department employee completed the form and "had" him sign it. Since Taxpayer does not challenge the information contained on the form, we find that the error does not alter the basis for reaching our original conclusions.

Next, Taxpayer alleges that Det. No. 94-320 erred in stating that he was advised by the Department of Licensing and the Department "that he would not have to pay any excise taxes if he chartered the vessel." He claims he never made any such statement.

In a letter dated October 28, 1993, addressed to a Senior Revenue Officer at the Department's Tacoma office, Taxpayer wrote:

> I was very careful when [corporation], Inc. was incorporated and the boat purchased for charter that the corporation was in compliance with all governmental regulations and personally went to the Department of Revenue office and the Department of Licensing office to ascertain exactly what would be needed. I was assured in both places that neither sales tax or use tax was applicable and, in fact, obtained confirmation of the exemption of use tax in writing which I have attached. I frankly do not understand why

> your records do not disclose the Declaration of Use Tax executed by [Department employee] of your office.

(Emphasis added).

Based on this written statement from Taxpayer, we do not find that our paraphrased statement amounts to a factual error.[7]

In Sections 2, 3, and 4 of the petition, Taxpayer challenges our conclusion that he was liable for the use tax and the WET. He states: ". . . contrary to the findings of fact of the administrative law judge, the vessel was not used for personal use of [Taxpayer] and his family."

Issue 2: Use Tax Exemption

[1] In Det. No. 94-320, we concluded that Taxpayer was not entitled to the use tax exemption because Taxpayer and his wife had not relinquished possession and control of the vessel so as to create a "true lease" with the Corporation.[8] Rule 211. We held that Taxpayer exercised dominion and control over the vessel the entire time it was in Washington and therefore used the vessel as the owner and not just as a corporate officer.

On reconsideration, Taxpayer contends that the Department could not impose the taxes against him personally unless it had shown that he "had somehow `pierced the corporate veil' by exceeding [his] authority as an officer and director of" the Corporation. Taxpayer states that the Department made no such finding. In essence, Taxpayer asserts that the burden is on the Department to prove that he is not entitled to the exemption from use tax and cannot impose tax liability against him individually unless it meets that burden.

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[7] In Taxpayer's petition for reconsideration, he wrote the following:

> I personally went to the department of Revenue and spoke with a [Department employee] on the 20th day of August, 1991, and I simply asked her whether I would have to pay any taxes to the State of Washington concerning the charter boat that was being leased to [corporation].

[8] Prior to the July 1, 1996 amendment, Rule 211 did not define a "true lease." Instead it explained that

> A true lease . . . of personal property does not arise unless the lessee . . . or employees or independent operators hired by the lessee . . . actually takes possession of the property and exercises dominion and control over it. Where the owner/lessor of the equipment or the owner's/lessor's employees or agents maintain dominion and control over the personal property and actually operate it, the owner/lessor has not generally relinquished sufficient control over the property to give rise to a true lease, . . . of the property.

The amended rule provides the following definition:

> (f) The term "true lease" (often referred to as an "operating lease") refers to the act of leasing property to another for consideration with the property under the dominion and control of the lessee for the term of the lease with the intent that the property will revert back to the lessor at the conclusion of the lease.

Generally, "piercing the corporate veil is a judicial process used by the courts to disregard the usual immunity of corporate officers or entities from liability for corporate activity."[9]

> . . . [C]ourts have pierced the corporate veil and imposed personal liability where the corporate entity has been disregarded by the principals themselves so that there is such a unity of ownership and interest that the separateness of the corporation has ceased to exist [citations omitted].

McCombs Construction v. Barnes, 32 Wn.App. 70, 76, 645 P.2d 1131 (1982).

In Taxpayer's case, the use tax assessment was not issued against the Taxpayer for corporate liabilities, but against Taxpayer for his use of the vessel in Washington.[10] It is not the Department's burden to prove that Taxpayer "violated a corporate duty" or acted "ultra vires" to find that he is liable for the use tax. The Department is only required to show that Taxpayer used the vessel in a manner that triggered use tax liability.[11] Taxpayer has the burden to show that he is entitled to the tax exemptions he claims.[12]

The legislature, in promulgating RCW 82.04.050(1), defined a "sale at retail" as every sale of tangible personal property to all persons including "the renting or leasing of tangible personal property to consumers." RCW 82.04.050(4). But, the legislature also provided that a sale at retail does not include

> a sale to a person who (a) purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person . . . .

This exemption applies only to the person who purchases for the purpose of leasing to a third party in the regular course of business, and who does not use the property for his or her own purposes. RCW 82.04.050. Use tax is imposed "for the privilege of using within this state as a consumer any article of tangible personal property purchased at retail, or acquired by lease . . . ." RCW 82.12.020. "Use" is defined as having its ordinary meaning and as "the first act within this

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[9]Black's Law Dictionary 1147-48 (6th Edition 1990).

[10]Although the Department did not assess use tax against the Corporation for its use of the vessel, we noted in the original determination that the Corporation would also owe use tax on its use of the vessel for purposes other than leasing it to third parties. In addition, it is required to collect retail sales tax from charterers. We also noted that the Corporation would owe retail sales tax the measure of which would be the rental charged under the lease; or, the fair rental value, if the parties did not designate a rental charge under the lease. See, Rule 211(13).

[11]See, WAC 458-20-178 (Rule 178) and RCW 82.04.050.

[12]Exemptions to a tax are narrowly construed, and the burden is upon the party who seeks the benefits of the exemptions. See, Budget Rent-A-Car v. Department of Rev., 81 Wn.2d 171, 500 P.2d 764 (1972).

state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer) . . . ." RCW 82.12.010(2). A "consumer" is

> [a]ny person who purchases, acquires, owns, holds, or uses any article of tangible personal property irrespective of the nature of the person's business . . . other than for the purpose (a) of resale as tangible personal property in the regular course of business . . . .

RCW 82.04.190.

In Excise Tax Bulletin 481.12.178, the Department explains that:

> [a] person who purchases an article of tangible personal property for resale or lease without intervening use need not pay the sales or use tax. However, no such exemption exists for a purchaser who both leases the article and uses it for personal purposes.

WAC 458-20-178 (Rule 178) is the administrative rule that explains the use tax application in various situations. In subsection (6) it states:

> (6) Lessors and lessees. Any use tax liability with respect to leased tangible personal property will be that of the lessee and is limited to the amount of rental payments paid or due the lessor. However, when boats, motor vehicles, equipment and similar property are rented under conditions whereby the lessor itself supplies an operator or crew, the lessor itself is the user and the use tax is applicable to the value of the property so used.[13]

(Emphasis added).

Taxpayer contends that he did not use the vessel for his own purposes but only as an officer of the Corporation. In Higgins v. Smith, 308 U.S. 473, 477 (1940) the U.S. Supreme Court acknowledged that a person may choose to do business as a corporation but,

> . . . the government may not be required to acquiesce in the taxpayer's election of that form of doing business which is most advantageous to him [the taxpayer]. The government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purpose of the tax statutes. To hold

[13] In a lease, the sales tax is to be collected on the rental payments, in a sum measured by the amount of each such lease payment, at the time the lease payment is made. The lease transaction is regarded as a series of periodic sales. Gandy v. State, 57 Wn.2d 690, 359 P.2d 302 (1961).

> otherwise would permit the schemes of taxpayers to supercede the legislation in the determination of the time and manner of taxation.

In this case, the "actualities" are that Taxpayer, not the Corporation, used the vessel for various purposes, including promoting the business of chartering the vessel. There is no evidence that the Corporation actively engaged in the bare boat charter business or leased the vessel for re-lease in the regular course of business. Rule 178. In four years, the Corporation documented only two charters to third parties other than Taxpayer.

Taxpayer claims his personal use of the vessel was limited to those times covered by charter agreements with the Corporation and, therefore, use tax is owed only on the rental price for the use of the vessel. The Department addressed a similar argument in Det. No. 90-397, 10 WTD 341 (1990), where the taxpayer owned an airplane and leased it to a third-party leasing company which, in turn, leased the airplane back to the taxpayer, as a third-party lessee. In that case, we acknowledged that:

> . . . under certain limited circumstances, we would agree that two separate and independent leases between the owner and a leasing company may exist. The first lease would involve the owner leasing the airplane to the leasing company (in this case, [the flying service]) for a fixed amount and the second lease would involve [the flying service's] sublease to users of the aircraft (which could include the lessor/owner).

(Brackets added.) Further, we recognized that:

> [i]f, under the agreement between the lessor/owner and the leasing company, the lessor/owner only has the right to use the plane on a rental basis in the same manner and conditions of use as the general public and subsequently pays the full rental price for the use of its own aircraft, we would agree that no intervening use by the owner has occurred.

But, we emphasized that:

> [i]t is important to note that the foregoing is limited to circumstances where the lessee (leasing company) is formally engaged in a regular leasing business and charges competitive rental rates to its retail customers. In addition, lessor/owner must relinquish all scheduling control to the leasing company which in turn must collect the retail sales tax and report the business tax upon the full rental charges paid by the lessor/owner for use of its own plane.

(Emphasis added).

Further, in Det. No. 90-397, supra, we explained "the underlying reasoning for this policy," as follows:

> . . . the Department does not believe that the actual lessor/owner should be precluded from renting (or else be subject to tax on the full purchase price) when it rents the airplane on the same basis as the general public. Fundamental to this policy is the presumption that over the life of the rental equipment, the value of sales taxes paid on subsequent rental receipts will equal or exceed the original sales tax that was due, and that the State will eventually receive its fair share of taxes. This policy was not adopted to allow taxpayers to defer or avoid 90% of their sales or use tax liability.

Thus, in that case, we examined the substance of the taxpayer's lease arrangement, rather than merely accepting the form. Higgins, supra. As a result, we found that the taxpayer purchased the airplane

> primarily for its own personal use and enjoyment. That it placed the plane with [the flying service] primarily for maintenance, and scheduling purposes and not for renting the airplane to outside parties. And, that any outside rentals which did occur were not the primary purpose of the acquisition, but were merely incidental to the personal use by the taxpayer.

Likewise, in this case, we examined the substance of Taxpayer's lease arrangement with the Corporation. We find that the Corporation was not "formally engaged in a regular leasing business." See, Det. No. 90-397, supra. It had only two charters in addition to Taxpayer's. It did not report the rental charges as income subject to B&O tax. It did not charge and collect retail sales tax. Further, the Corporation did not make any payments under its lease agreement with Taxpayer and his wife for the vessel; and Taxpayer did not pay the Corporation the rental price for his use of the vessel under the charter agreements. According to Taxpayer, the charter costs were offset against outstanding debts the Corporation owed Taxpayer. Thus, the Corporation did not charter the vessel to Taxpayer and his wife under the same terms and conditions as it did the general public. See, Det. No. 90-397, supra. We find, under these facts, the outside rentals were merely incidental to Taxpayer's personal use.

Further, at the reconsideration hearing, Taxpayer advised that his wife used the vessel during the charters to others. Taxpayer's wife was neither a corporate officer nor an employee of the Corporation. She was, however, an owner of the vessel. Thus, there was personal use of the vessel in Washington by Taxpayer's wife.

We conclude that Taxpayer and his wife did not relinquish possession of the vessel, and they exercised dominion and control of the vessel in Washington. See, Rule 211. Accordingly, we hold that Taxpayer and his wife put the vessel to intervening use and is subject to use tax on the full price of the yacht purchased on June 13, 1991. See, Rule 178.

Issue 3: WET exemption

[2] We find that Taxpayer was required to register the vessel in Washington and was subject to WET. RCW 88.02.020 states:

> Except as provided in this chapter, no person may own or operate any vessel on the waters of this state unless the vessel has been registered and displays a registration number and a valid decal in accordance with this chapter, . . .

RCW 88.02.030 lists certain vessels that are not required to register in Washington. Included in this list is a "vessel primarily engaged in commerce which has or is required to have a valid marine document as a vessel of the United States."

Taxpayer has provided no evidence to support a conclusion that the vessel was primarily engaged in commerce. In his Memorandum submitted in December 1994, Taxpayer explains his position:

> The logs for the vessel in question were produced to the Department of Revenue as well as copies of the charter contracts. The testimony of Appellant will be that during charter operations, the vessel was operated in British Columbia more than fifty percent of the actual charter time. Therefore, the exemption of watercraft used in foreign commerce outside the territorial waters of the state would be applicable.

The "actual charter time" in British Columbia was when Taxpayer and his family used the vessel for recreational purposes. The other two, one-half day charters were incidental to Taxpayer's personal use. The other times the vessel was used were either to promote the charter business, or to check the condition of the vessel.

We find, therefore, that the vessel is not exempt from watercraft excise tax because it was not a vessel properly excepted from Washington's registration requirements under RCW 88.02.030. Taxpayer has not provided any other basis for canceling the watercraft excise tax.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 5th day of November 1996