

Cite as Det. No. 11-0009, 32 WTD 297 (2013)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For)	<u>D E T E R M I N A T I O N</u>
Correction of Assessment and Refund)	
)	No. 11-0009
...)	
)	Registration No. . . .
)	Document No. TAS # . . .
)	Docket No. . . .
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[1] RCW 82.12.020: USE TAX -- VESSEL-- ALTER EGO DOCTRINE. One situation in which it is proper to disregard a corporate entity is when the corporation is used merely as an instrumentality of the entities that own it in the conduct of their own business, generally referred to as the alter ego situation. In the present case, there is no evidence that the LLC was formed with the object of any gain, benefit, or advantage beyond avoiding the payment of Washington State use tax on yachts used solely by its Washington State resident owners.

[2] Rule 211: USE TAX – BAILMENTS – MEASURE OF TAX. The value of tangible personal property held or used under bailment is subject to use tax if the property was purchased or acquired under conditions whereby the retail sales tax was not paid by the bailor. The measure of the tax to the bailor is the fair market value of the article at the time the article was first put to use in Washington.

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.

Callahan, A.L.J. – The Department of Revenue (“Department”) issued use tax assessments on a vessel to an out-of-state limited liability company (LLC) and to its members as individuals. Both the members and the LLC protest the assessments. The LLC argues that it is an out-of-state

company and is exempt from the use tax¹ because its use in Washington was temporary and constitutes a nontaxable use. The members argue that the LLC owns the vessel and they only used it as “bailees.” We deny both petitions.²

ISSUES

1. Whether an out-of-state LLC owes use tax on a vessel its sole members used in Washington.
2. If the LLC bailed the vessel to its members, what is the measure of the use tax under WAC 458-20-211(7) (Rule 211)?

FINDINGS OF FACT

[A married couple (“Taxpayer” or “Taxpayers”)] are Washington residents who are the sole members of [Taxpayer LLC] (the “LLC”). On March 28, 2009, a law enforcement officer observed [Taxpayer] on a vessel, fishing The law enforcement officer informed the Department’s Compliance Division. That division investigated and sent letters to [Taxpayer] and to the LLC inquiring about the ownership of the vessel. [Taxpayer] neither individually nor as an LLC member, responded to the inquiry letters.

On July 16, 2009, the Department’s Compliance Division assessed use tax based on estimated values of the vessel and tender³ and issued two assessments with identical amounts against both the LLC and [Taxpayer]. . . . [Taxpayer] responded to the assessments by contacting the Compliance Division and subsequently submitting the Buyer Closing Agreement and Tender to [the vessel] which reflected the purchase price and the tender of the vessel. . . . Thereafter, the Compliance Division issued two amended assessments against both [Taxpayer LLC] and [Taxpayer]. The amended assessments were in the amount of \$. . . , which consisted of use tax of \$. . . , delinquent penalty of \$. . . , interest of \$. . . , and assessment penalty of \$. . . . [Taxpayer] did not pay the assessment issued him personally but instead petitioned the Department’s Appeals Division for correction of the assessment. The LLC paid the assessment and petitioned for a refund.

The LLC was registered with [State A] on . . . , 2006. The capital amount of the LLC was \$0 at the time of the registration. [38 days later,] [t]he LLC purchased the vessel from a corporation in [State B] The LLC owns the vessel. There is no evidence that the LLC paid [State B’s] sales tax when it purchased the vessel. The vessel was transported from [State B] to [a foreign country] [Taxpayer] took delivery of the vessel [in] Washington on . . . , 2006. [Six days later,] [Taxpayer] took the vessel [to another location in] Washington. According to the vessel log which [Taxpayer] provided, [Taxpayer] used the vessel for cruising [in] Washington on [one

¹ Watercraft Excise Tax is not included in this assessment.

² Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

³ The tender is the life boat, which value was not included in the vessel when it was purchased.

day in 2007 and one day in 2008]. The vessel log also indicated that [Taxpayer] used the vessel for fishing [in] Washington on [three days in 2009]. There is no evidence that the LLC provided any crew member to operate the vessel during the audit period, i.e. from . . . 2006 to . . . 2009. Only [Taxpayer] operated the vessel according to the vessel log.

ANALYSIS

[1] Washington imposes both a retail sales tax and a use tax. Retail sales tax is imposed on tangible personal property purchased by a consumer in this state. RCW 82.08.020; RCW 82.04.050. The use tax, complements the retail sales tax and is imposed "for the privilege of using within this state as a consumer . . . [a]ny article of tangible personal property purchased at retail, or acquired by lease, gift, repossession, or bailment . . ." on which Washington retail sales tax has not been paid unless there is an applicable statutory exemption, deduction or exclusion. RCW 82.12.020(1).

RCW 82.12.010(5)(a) broadly defines "use":

"Use," "used," "using," or "put to use" shall have their ordinary meaning, and shall mean: (a) With respect to tangible personal property, the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer), and include installation, storage, withdrawal from storage, distribution, or any other act preparatory to subsequent actual use or consumption within this state." (Emphasis added.)

RCW 82.04.190(1) defines "consumer" as:

Any person who purchases, acquires, owns, holds, or uses any article of tangible personal property . . . other than for purpose (a) of resale as tangible personal property in the regular course of business (Emphasis added.)

Thus, the tax applies to the use of watercraft in this state, whether for pleasure or for business, and whether by a resident or a nonresident, unless the use is statutorily excepted or determined to be otherwise exempt. *See* Det. No. 87-105, 3 WTD 1 (1987). Use tax liability arises at the time the property is first put to use in this state. WAC 458-20-178 (Rule 178). Based on the facts in this case, there is no dispute that the vessel was used in this state. We must decide whether the [Taxpayer LLC] or [Taxpayer] owes the use tax.

[Taxpayer] asserts that the vessel is owned by the [Taxpayer] LLC. A corporation is a separate entity or "person," under the law, from the persons or entities which comprise its membership. RCW 84.04.030; WAC 458- 20-203 (Rule 203). Washington courts and the Department generally will respect taxpayers' use of the corporate form. There are, however, circumstances in which the courts and the Department will not recognize a corporation as separate from its shareholders, and will employ the doctrine of disregard.

In order to apply the doctrine of disregard, two elements must be met. *Rogerson Hiller Corp., v. Port of Port Angeles*, 96 Wash. App. 918, 924, 982 P.2d 131 (1999). First, there must be an abuse of the corporate form to violate or evade a duty. Such abuse typically involves “fraud, misrepresentation, or some form of manipulation of the corporation to the stockholder’s benefit and creditor’s detriment.” *Truckweld Equip. Co. v. Olson*, 26 Wash. App. 638, 645, 618 P.2d 1017 (1980). Second, disregard of the corporate entity must be “necessary and required to prevent unjustified loss to the injured party.” *Rogerson*, 96 Wash. App. at 924. Washington courts have applied the doctrine on a case by case basis with each case being decided upon its own peculiar facts. *Harris, Washington’s Doctrine of Disregard*, 56 Wash. L. Rev. 253 (1981).

One situation in which it is proper to disregard a corporate entity is when the corporation is used merely as an instrumentality of the entities that own it in the conduct of their own business, generally referred to as the alter ego situation *Grayson v. Nordic Construction Co., Inc.*, 92 Wn.2d 548, 553, 599 P.2d 1271 (1979); *Garvin v. Matthews*, 193 Wash. 152, 74 P.2d 990 (1938); *Platt v. Bradner Co.*, 131 Wash. 573, 230 P. 633 (1924). . . .

In the present case, there is no evidence that the LLC was formed with the object of any gain, benefit, or advantage beyond avoiding the payment of Washington State use tax on yachts used solely by its Washington State resident owners. . . . The manner in which the LLC is operated demonstrates a lack of business purpose, and only benefits the LLC members as individuals. The evidence before us demonstrates that the LLC was formed with [Taxpayers] as the sole members with the vessel at issue as the sole asset of the LLC. The LLC purchased the vessel less than two months after the LLC was formed. The LLC has no business activities. There is no income generated by the LLC. No substantial nontax reasons exist for [Taxpayers] to register the vessel under the LLC. The LLC allowed [Taxpayer] to use the vessel at no cost. There is no evidence that [Taxpayer] used the vessel as a member of the LLC. During the audit period, [Taxpayer] exercised dominion and control over the vessel evidenced by the fact that the LLC does not have any crew member to control the vessel. The weight of evidence does not support [Taxpayer’s] claim that the LLC was formed with a business purpose.

As we stated above, Washington courts have applied the corporate disregard doctrine on a case by case basis, with each case being decided upon its own peculiar facts. *See* Det. No. 05-0020, 25 WTD 12 (2006), Det. No. 00-036, 19 WTD 723 (2000), and Det. No. 90-397, 10 WTD 341 (1990). Based on the facts in this case, we find that the LLC is the mere alter ego of [Taxpayers]. *See*, Det. No. 05-0020, 25 WTD 12 (2006), where we upheld use tax assessments on a motor home, owned by a corporation but operated exclusively by the corporation’s sole shareholders, a married couple, on the basis that the corporation was the “alter ego” of the couple. As in Det. No. 05-0020, the LLC here is the alter ego of its sole members, who were the users of the vessel. We conclude, therefore, that [Taxpayer] LLC is the alter ego of its sole members, [Taxpayers]. Because the LLC did not pay retail sales tax, the Department had the option of assessing use tax on any subsequent use as a consumer. 25 WTD 12.

If [Taxpayers] used the vessel as consumers, i.e., purchased, acquired, owned, held, or used it other than to resell the vessel in the regular course of business, they are subject to the use tax on the vessel. RCW 82.04.190; RCW 82.12.020. The evidence before us indicated that

[Taxpayers] did not purchase the vessel for resale in the regular course of business. Rather, from the cruising logs provided, there is strong evidence that [Taxpayers] used the vessel for personal pleasure This evidence was sufficient to prove that [Taxpayers] exercised dominion and control over the vessel by using the vessel for cruising in Washington waters. It does not matter if the use was of short duration. Use tax is not determined by the amount of use or the length of time the vessel was used. *See* Det. No. 87-109, 2 WTD 463 (1987) (where the Department concluded that the vehicle, according to the taxpayer, was not used very much in Washington from February to July or that it was repeatedly in and out of the shop does not prevent imposition of the use tax.) We conclude that the Department properly assessed use tax against [Taxpayers] on the purchase value of the vessel. RCW 82.08.020. Accordingly, [Taxpayers] are liable for the use tax on the fair market value of the vessel as consumers under RCW 82.08.020; RCW 82.04.050; and RCW 82.12.010(5). Therefore, we sustain the assessment against [Taxpayers].

[2] [Taxpayer] also claims his personal use of the vessel was limited to those times covered by the bailment agreement with the LLC and, therefore, use tax is owed only on the rental price for the use of the vessel. Assuming *arguendo* this was the case here, the LLC as the bailor would then owe the tax. As provided in Rule 211(7)(a):

Bailment. The value of tangible personal property held or used under bailment is subject to use tax if the property was purchased or acquired under conditions whereby the retail sales tax was not paid by the bailor. Tax liability is that of the bailor, or of the bailee if the bailor has not paid the tax. The measure of the tax to the bailor is the fair market value of the article at the time the article was first put to use in Washington (Emphasis added).

When the vessel was used in [Washington waters] as indicated by the log, it constitutes its first use in Washington. RCW 82.12.010(5)(a). Retail sales tax was not paid on the vessel. The LLC, to the extent it was a bailor, which did not pay retail sales tax when it purchased the vessel, owes use tax on the “fair market value of the article at the time the article was first put to use in Washington.” Rule 211. Therefore, we sustain the assessment against the LLC.

DECISION AND DISPOSITION

[Taxpayers’ and Taxpayer LLC’s] petitions are denied. We affirm both assessments. Nothing is due because [Taxpayer LLC] paid the assessment.

Dated this 10th day of January, 2011.