

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

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment/Refund of)	
)	No. 95-244
)	
...)	...
)	Notice of Tax Due
)	
)	

- [1] RCW 82.32.300: RULES OF CONSTRUCTION. The rules of statutory construction apply to the construction of regulations. Citing: State of Washington v. Burke, 92 Wn.2d 474, 598 P.2d 395 (1979).
- [2] RULE 178; RCW 82.08.010(1), 82.12.010(1)(a): RETAIL SALES TAX -- BELOW MARKET LEASES. When the rental price of a product is below the true value, the Department adjusts the rental price to the true value based on the reasonable rental price of similar products of like quality, quantity, and character.

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:

The taxpayer challenges the Department's authority to assess uncollected retail sales tax on lease payments based on the fair rental value, and not the actual rental value.¹

FACTS:

Coffman, A.L.J. -- The taxpayer is a living trust established by . . . for estate planning purposes. The taxpayer is not registered with the Department of Revenue (Department). The taxpayer purchased a 55 foot custom watercraft, the [Watercraft]. The purchase was made in Oregon in 1976. The [Watercraft] is insured for \$250,000.

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

The taxpayer leased the [Watercraft] to (Lessee). The Lessee is a corporation formed by the taxpayer on May 15, 1992. The taxpayer is the Lessee's sole shareholder. The lease was entered into on July 31, 1992. The lease price is \$1,000 per year. The taxpayer did not collect retail sales tax and did not file excise tax returns with the Department.

The Department's Compliance Division mailed the taxpayer a notice of tax due on December 5, 1994. The notice consisted of a letter and completed Combined Excise Tax Returns for 1992 and 1993. The Department determined that the fair rental value of the [Watercraft] was \$60,000 per year and calculated tax on that basis. The total amount due (including interest and penalties) per the December 5, 1994 notice was \$ The taxpayer filed a timely appeal of the notice.

ISSUE:

Whether the proper measure of the retail sales tax is the fair rental value or the actual rental payments.

DISCUSSION:

Leases of tangible personal property are sales for the purposes of the retail sales tax. RCW 82.08.010(4) and 82.04.040. The taxpayer leased tangible personal property to the Lessee. Lessors of tangible personal property are sellers. RCW 82.08.010(2). When the seller makes a retail sale, it is obligated to collect retail sales tax. RCW 82.08.050. When a seller fails to collect the retail sales tax, the seller is personally liable for the tax. RCW 82.08.050. The taxpayer did not pay over the retail sales tax to the Department. Therefore, the taxpayer is liable for the retail sales tax.

The measure of the retail sales tax is the selling price. Selling price is defined in RCW 82.08.010(1) as:

the consideration, whether money, credits, rights, or other property except trade-in property of like kind, expressed in the terms of money paid or delivered by a buyer to a seller . . .

When tangible personal property is rented or leased under circumstances that the consideration paid does not represent a reasonable rental for the use of the articles so rented or leased, the "selling price" shall be determined as nearly as possible according to the value of such use at the places of use of similar products of like quality and character under such rules as the department of revenue may prescribe;

(Emphasis added.)

The [Watercraft] is valued at \$250,000. The lease payments are \$1,000 per year. The Department concluded that the lease payments charged by the taxpayer do not represent a reasonable rental value for the [Watercraft]. The Department, relying on the average lease rate for automobiles of two percent per month, determined that a reasonable rental value would be two percent (2%) of value per month. This calculates to \$5,000 per month or \$60,000 per year. The taxpayer claims that the

proper measure of the retail sales tax is \$1,000 per year.

The Department's rules concerning leases do not address the "reasonable rental" issue. The Department's rule specifically concerning leases is WAC 458-20-211 (Rule 211) which states:

(9) RETAIL SALES TAX. Persons who rent or lease tangible personal property to users or consumers are required to collect from their lessees the retail sales tax measured by gross income from rentals as of the time the rental payments fall due.

(Emphasis added.) This is a timing provision and does not address the issue of the selling price when the stated price is not a reasonable price. Further, the Department's rule concerning "Selling Price" (WAC 458-20-107) addresses the issue of advertising a price as including retail sales tax and does not address the issue of unreasonably low lease payments. We are unable to find a regulation that specifically addresses reasonable rental.

The taxpayer relies on several provisions of WAC 458-20-178 (Rule 178) to support its claim that the measure of the retail sales tax is the actual rental charged. This reliance is based on the fact that the use tax is a compensating tax. That is, if retail sales tax is not paid, then use tax, in the same amount as the retail sales tax, is generally due. Rule 178(1) and (2). The measure of the use tax is the value of the article used. RCW 82.12.020. RCW 82.12.010(1)(a) defines the value of the article used as:

In case the article used is acquired by lease . . . 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.

This language is identical in all material aspects to RCW 82.08.010 quoted above. The taxpayer quotes Rule 178(6) which provides:

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.

(Emphasis added.) The taxpayer also relies on Rule 178(13) which provides:

Value of the article used. The tax is levied and collected on an amount equal to the value of the article used by the taxpayer. The term "value of the article used" is defined by the law as being the total of the consideration paid or given by the purchaser to the seller for the article used plus any additional amounts paid by the purchaser as tariff or duty with respect to the importation of the article used. In case the article used was extracted or produced or manufactured by the person using the same or was acquired by gift or was sold under conditions where the purchase price did not represent the true value thereof, the value of the article used must be determined as nearly as possible according to the retail selling price, at

the place of use, of similar products of like quality, quantity and character. In case the articles used are acquired by bailment, the value of the use of the articles so used shall be in an amount representing a reasonable rental for the use of the articles so bailed, determined as nearly as possible according to the value of such use at the places of use of similar products of like quality and character. In case the articles used are acquired by lease or rental, use tax liability is measured by the amount of rental payments to a lessor who has not collected the retail sales tax.

(Emphasis added.) The emphasized parts of Rule 178 appear to support the taxpayer's claim. But upon close examination, they do not.

[1] "Rules of statutory construction apply to administrative rules and regulations." State of Washington v. Burke, 92 Wn.2d 474, 478, 598 P.2d 395 (1979). See, also; e.g., Det. No. 87-143, 3 WTD 91 (1987); Det. No. 88-155, 5 WTD 179 (1988); and Det. No. 89-524, 8 WTD 407 (1989) where the rules of statutory construction were used to interpret the Department's regulations.

[2] "Statutes should be construed to effect their purpose and unlikely, absurd or strained consequences should be avoided." State v. Stannard, 109 Wn.2d 29 at 36, 742 P.2d 1244 (1987). "Rules should also be interpreted in a manner consistent with the legislative purpose of the underlying statute." Boise Cascade Corp. v. Huizar, 76 Wn.App. 676, 684, 887 P.2d 417 (1994).

The statute at issue in this appeal is RCW 82.08.010(1). This statute states that the Department "may" issue rules specifying the methodology for determining value of use of an item. The use of the word "may" is generally permissive. State v. Onefrey, 119 Wn.2d 572, 835 P.2d 213 (1992), Scannell v. Seattle, 97 Wn.2d 701, 648 P.2d 435 (1982), State v. Burri, 87 Wn.2d 175, 550 P.2d 507 (1976). Thus, the absence of a regulation directly addressing the issue of inadequate rental payments is not a violation of statute.

Further, "an administrative agency may not, by means of an interpretative or clarifying regulation, actually modify or amend the statute in question." Fisher Flouring Mills Co. v. State of Washington, 35 Wn.2d 482, 492, 213 P.2d 938 (1950). If Rule 178 is a regulation addressing unreasonable rental payments, it is contrary to the statutory language. The regulation would have to consider the value of "similar products of like quality and character". Rule 178 does not.

Further, the definition of a sale found in RCW 82.04.040 includes leases. Rule 178(13) states, in part:

In case the article used was . . . sold under conditions where the purchase price did not represent the true value thereof, the value of the article used must be determined as nearly as possible according to the retail selling price, at the place of use, of similar products of like quality, quantity and character.

The only consistent interpretation of Rule 178, RCW 82.08.010(1), and RCW 82.12.010(1)(a) is for Rule 178 to govern cases where the rental charged is reasonable. When the rental charged is

unreasonable, the Department may rely on RCW 82.08.010(1) and 82.12.010(1)(a) to determine the reasonable rental value. The taxpayer's interpretation of Rule 178 contradicts the expressed purpose of RCW 82.08.010(1) and 82.12.010(1)(a) which is to determine the tax based on reasonable values. It is also absurd to think that the legislature would have authorized such a tax avoidance scheme.

DECISION AND DISPOSITION:

The taxpayers' petition is denied.

DATED this 26th day of December, 1995.