Cite as Det. No. 99-104, 19 WTD 76 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 99-104
	)	
. . .	)	Registration No. . . .
	)	FY . . ./Audit No. . . .
	)	

[1] RULE 178; RCW 82.12.035: USE TAX -- CREDIT FOR TAX PAID TO ANOTHER STATE. The use tax credit in 82.12.035 is available to a taxpayer only if it has paid a retail sales or use tax with respect to such property to another state, and has done so prior to using the property in Washington.

[2] RULE 211: DEFERRED SALES TAX -- USE TAX -- SALE/LEASEBACK. A taxpayer does not incur retail sales tax on the purchase of equipment it purchases with the intent to execute a sale/leaseback, when it has presented a resale certificate and, prior to the purchase, the lender has executed a commitment to purchase and lease back such equipment.

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 Taxpayer protests use tax imposed on carpet it purchased in another state and subsequently used in Washington; use tax imposed on equipment it purchased with the intent to execute a sale/leaseback; and retail sales tax assessed in the amount of retail sales tax it over-collected from customers and did not remit to the Department.[1]

FACTS:

Prusia, A.L.J. -- . . . ("Taxpayer") is a [State A] corporation that operates eighteen . . . restaurant franchises in the state of Washington.

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

The Audit Division of the Department of Revenue (Department) examined Taxpayer's books and records for the period January 1, 1991 through June 30, 1995. On June 21, 1996, the Department issued an assessment for additional taxes and interest, Document No. FY . . . , in the total amount of $ . . . Taxpayer paid the assessment, and with its payment requested refund of amounts it was paying under protest.

Taxpayer disputes three parts of the assessment: 1) Use tax imposed on carpet it purchased in [State A] and used in a restaurant in Washington. 2) Use tax imposed on approximately $. . . of used equipment it acquired as part of the purchase of a restaurant in [Washington]. 3) Retail sales tax assessed in the amount of retail sales tax it over-collected from customers and did not remit to the Department.

Use tax assessed on carpet

Taxpayer made a bulk purchase of carpet in [State A] which, after a period of storage in [State A], it used in a restaurant in Washington.

[State A] sales or use tax applies to the purchase. Taxpayer did not pay [State A] sales tax at the time of purchase, and has not paid [State A] use tax. On its books, Taxpayer accrues [State A] use tax in the amount of six percent on carpet it purchases for storage in [State A]. It pays the tax periodically, when audited by [State A]. It has not yet been audited by [State A] for the period in which it purchased the carpet.

Taxpayer argues that because it accrues [State A] tax on all bulk purchases of carpet, the Department should assess it only the difference between the [State A] tax rate and the Washington tax rate for this purchase. It states that with respect to other purchases in [State A], the Department assessed only the difference between [State A] and Washington tax.

Use tax assessed on used equipment

It is Taxpayer's policy to finance all equipment transactions as a sale-leaseback. Pursuant to its policy, Taxpayer solicited and accepted a proposal by . . . ("Lessor") to finance up to $ . . . in equipment acquisitions by Taxpayer during 1993 and 1994, in a sale-leaseback arrangement. Taxpayer agreed to Lessor's proposed terms on June 18, 1993. The proposal specified the equipment covered -- new and/or used furniture, trade fixtures, and equipment for restaurants operated by Taxpayer. It specified the equipment cost, the term of the base lease, rental payments, and other terms of the base lease. It provided that final terms and conditions would be established by Lessor and subject to mutually satisfactory documentation. The agreement required a deposit from Taxpayer upon execution. Taxpayer paid a deposit in the amount of $ . . . on June 22, 1993.

On January 25, 1994, Taxpayer entered into an agreement with a [Washington] restaurant to purchase the restaurant's leasehold and equipment. It promptly sought its tax advisor's

recommendation on the proper handling of the transaction consistent with the equipment financing agreement with Lessor. In a memorandum dated February 9, 1994, the advisor recommended that Taxpayer issue the restaurant a resale certificate and request a retail exemption from Lessor.

Taxpayer gave the restaurant a resale certificate, on which it stated it was purchasing the equipment "for resale in the regular course of business without intervening use in the regular course of business." The resale certificate had a stated effective date of January 1, 1994 through June 30, 1994. Taxpayer then made improvements to the leasehold and equipment, and opened the location for business on March . . ., 1994.

On June 6, 1994, Taxpayer and Lessor entered into a "Master Equipment Lease Agreement." The master agreement sets out terms applicable to purchase/leaseback transactions between Taxpayer and Lessor. It provides that the parties will enter into written agreements in the form of "Request to Purchase Addenda" for the purchase by Lessor of equipment, and the leasing of such to Taxpayer, and the terms of the master agreement will be incorporated by reference into each Request to Purchase. It provides that Taxpayer may order or purchase the equipment and thereafter assign to Lessor the purchase order or agreement, or Lessor may issue purchase orders to the suppliers.

On August 11, 1994, Taxpayer and Lessor entered into an addendum to the master agreement covering the equipment at the [Washington] restaurant.

The Auditor's Detail of Differences and Instructions to Taxpayers accompanying the assessment states the following reason for the assessment of use tax on the equipment acquisition:

> This schedule asserts deferred sales or use tax on capital assets and/or other acquisitions which were not made on a routine or recurring basis. The tax is assessed since sales or use tax was not paid on these acquisitions.
>
> [Taxpayer] disagrees with the assessment of use tax on the $ . . . asset acquisition for [the restaurant location]. You argue that it was the intent of the Company to finance the equipment prior to the purchase and therefore, should be exempt from tax.
>
> No retail sales tax would have been due on the initial purchase if there was an intent to finance and no intervening use had occurred. Taxable use in accordance with WAC 458-20-178, includes any act by which a taxpayer assumes dominion or control, including storage, installation, or any act preparatory to subsequent use in this state.

Taxpayer contends that given the fact it was Taxpayer's intent from the onset to treat the equipment acquisition as a sale-leaseback, and the documents described above evidence this intent, the initial purchase by it from the restaurant should not be subject to the retail sales tax.

Taxpayer adds that when it renovates an existing unit, renovation usually takes approximately 90-120 days to complete. Taxpayer has the option of having the lender pay the contractors and vendors, but instead chooses to pay the vendors, because this allows it more control and strengthens relationships with suppliers. Once renovation of a unit is completed, a close-out package is prepared to be sent to the lender. This finalizing of the outstanding invoices and preparation of the package for the lender can take another 30-60 days, depending on how quickly the contractors and vendors complete their billing. Once the package is submitted to the lender, it typically takes the lender 45-60 days to grant approval. This time can vary depending on UCC filing, incorrect/illegible documents, a change of personnel handing Taxpayer's account, and down time waiting for signatures and landlord waivers. The transaction in question followed the above process and timelines.

Over-collected sales tax

The amount of sales tax Taxpayer collected from its customers in Washington during the audit period varied from the amount of sales tax due on its total sales, in some months resulting in an over collection, and in other months resulting in an under collection. Taxpayer did not refund the over collections to customers, or remit them to the Department. Rather, it accrued the over collections and under collections in a miscellaneous income account. The Department assessed retail sales tax in the amount of the over-collected retail sales tax.

The Auditor's Detail of Differences and Instructions to Taxpayers, which accompanied the assessment, states the following reason for the assessment

> Sales tax collected is deemed held in trust for the State and amounts over collected must be remitted unless refunded to the customer. Refer to the attached ETBs 307.08.237 and 299.32.229.

The petition "submits" that the cause of the sales tax over-collections was "breakage." The petition argues that under Excise Tax Bulletin (ETB) 307.08.237, taxpayers are not required to account for tax over-collected in this manner.

The Audit Division explains that "breakage" refers to the difference between the tax due under an approved tax chart which rounded up to the nearest whole cent on each sale, and the actual tax due based on the gross sale amount times the tax percentage (which was not rounded). With pre-computerized cash registers, it was possible, depending on the product pricing, to have a majority of the sales collect a half cent more tax on each individual sale due to rounding. With advancements in cash register technology, cash registers now round both up and down, which largely eliminates true "breakage."

The Audit Division states it has seen nothing that shows the overage was caused by breakage. It would need to see an analysis of the tax accrual account for a test period by each store (restaurant) which allows the auditor to track the tax from the cash registers to the accrual, and

also would need journal entries related to the tax account. It contends it is unrealistic to believe all overage is due to breakage, and not some portion due to employee errors in making change. Such errors are not excluded from the gross income subject to tax. We provided Taxpayer with the Audit Division's response, and allowed it an opportunity to respond.

In response, Taxpayer argues that if it were over-collecting due to an incorrect rate in the registers or any variety of other reasons, the amounts would be much larger. Taxpayer contends that given the number of stores and the smallness of the amount, it is likely the overage was due to the "breaks" that occur when using Washington's tax brackets. Under ETB 307.08.237, the amount should not have been assessed. Taxpayer states the auditor examined the sales tax accrual account during the audit, and had the opportunity to see whatever information it needed.

Taxpayer has remitted sales tax over-collections since the close of the audit.

ISSUES:

1. Is a use tax credit available when the purchase occurs in a state that imposes a use tax, but the use tax in that state has not been paid when the taxpayer subsequently uses the item in Washington?

2. When a taxpayer buys equipment with the intention of reselling it through a sale/leaseback financing arrangement, does the taxpayer incur use tax liability when it puts the equipment to intervening use for a period of months before execution of the sale/leaseback agreement, but after the lender/lessor has executed a commitment to purchase and lease back equipment ordered by or for the taxpayer?

3. Did the Department correctly assess retail sales tax in the amount of Taxpayer's sales tax over-collections?

DISCUSSION:

All sales of tangible personal property to consumers in the state of Washington, including successive retail sales of the same property, are subject to retail sales tax, unless there is a specific exemption. RCW 82.08.020 and 82.04.050. The tax, required to be collected by the seller, is deemed to be held in trust by the seller until paid to the Department. RCW 82.08.050.

The term "retail sale" includes the renting or leasing of tangible personal property to consumers. RCW 82.04.050(4). "Purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person" are expressly excepted from the definition of "retail sale." (Emphasis added). RCW 82.04.050(1)(a). The exception is treated as an exemption from the sales and use tax. See Duncan Crane v. Dept. of Revenue, 44 Wn. App. 684, 723 P.2d 480 (1986).

In general, the use tax applies upon the use within Washington of any tangible personal property the sale or acquisition of which has not been subjected to the Washington retail sales tax. It supplements the retail sales tax by imposing a tax of like amount. WAC 458-20-178 (Rule 178); RCW 82.12.020; RCW 82.12.0252.

Use tax credit issue

RCW 82.12.035 generally allows the present user of property a credit for any retail sales tax or use tax he or she has paid to another state prior to using the property in Washington. The statute provides as follows, in relevant part:

> A credit shall be allowed against the taxes imposed by this chapter [use tax] upon the use of tangible personal property . . . in the state Washington in the amount that the present user thereof or his or her bailor or donor has paid a retail sales or use tax with respect to such property to any other state . . . , prior to the use of such property in Washington. (Bracketed inclusion and emphasis ours.)

The statute is substantially repeated in WAC 458-20-178 (Rule 178).

[1] The use tax credit in 82.12.035 is available to a taxpayer only if it has paid a retail sales or use tax with respect to such property to another state, and has done so prior to using the property in Washington. Taxpayer did not pay use tax to [State A] prior to using the property in this state. Accordingly, Taxpayer is not entitled to the credit. See Det. No. 88-273, 6 WTD 201 (1988); Det. No. 88-339, 6 WTD 349 (1988); Det. No. 90-279, 10 WTD 75 (1990).

It appears Taxpayer's only remedy, if any, lies with [State A]. Taxpayer will not be entitled to a refund from Washington if, later, it is assessed use tax by [State A] and pays such tax. See Det. No. 88-273, 6 WTD 201 (1988).

Sale-leaseback issue

There were successive sales of the used equipment in question, first by the [Washington] restaurant to Taxpayer, and then by Taxpayer to Lessor. If the original purchase by Taxpayer was for the purpose of resale in the ordinary course of business, without intervening use, it is exempt from retail sales and use tax.

The phrase "for the purpose of resale" may be paraphrased as "purchases with the intent to resell." Based upon the documentary and other evidence provided, we find that Taxpayer purchased the equipment of the restaurant for the purpose of reselling it in the ordinary course of business.

However, it is not enough that Taxpayer intended to resell the equipment at the time of purchase. Taxpayer must additionally meet the "without intervening use" condition.

In Det. No. 87-4, 2 WTD 127 (1986), we stated with respect to the "intervening use" condition:

> Accordingly, if a person purchases property, uses it, and then executes a sale/leaseback, the retail sales tax applies to the initial retail purchase and the subsequent lease payments. Pursuant to [RCW 82.08.020 and 82.04.050], the two transactions are separate and independent taxable events. . . .
>
> A purchaser can avoid payment of the sales tax on the first transaction where property is purchased with the intent to execute a sale/leaseback if there is no intervening use of the property between the time of the initial purchase and execution of the sale/leaseback or a commitment to lease the property is executed at the time of the initial transaction. The retail sales tax is then collected from the lessee as the rental payments fall due. WAC 458-20-211.[2]

Taxpayer and Lessor executed the sale/leaseback in August 1994, seven months after Taxpayer purchased the equipment, and after Taxpayer refurbished the equipment and put it to use in the restaurant. Thus, there was intervening use by Taxpayer between the initial purchase and execution of the sale/leaseback.

[2] However, the initial purchase and the use occurred after Taxpayer had solicited and accepted Lessor's equipment financing proposal. Under the holding in Det. No. 87-4, the "no intervening use" condition is met if there is no intervening use between the time of the initial purchase and the execution of a commitment to lease the property. While the June 1993 financing agreement between Taxpayer and Lessor was subject to agreement on final terms and conditions, we believe it was sufficient for the "purchases for the purpose of resale" exemption. Clearly, Lender and Taxpayer intended that Taxpayer would resell and lease back equipment it purchased subsequent to June 18, 1993, and this was the type of acquisition contemplated by the agreement. The documentary evidence detailed above establishes that as soon as Taxpayer agreed to purchase the restaurant, it commenced the process for financing the purchase of the equipment under its agreement with Lender. Accordingly, we grant Taxpayer's request for refund of the use tax assessed and paid on the $ . . . purchase price of the Seattle restaurant equipment.

Sales Tax Over-collections

Taxpayer relies upon ETB 307.08.237 in requesting refund of the sales tax it over-collected. As an aid in interpreting the law, the Department began converting Tax Commission rulings into published Excise Tax Bulletins in 1966.[3] ETB 307.08.237, issued in 1967 and cancelled January 31, 1996, addressed whether the amount of sales tax charged and collected by a seller must be match the amount remitted to the state.

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[2] Det. No. 87-4 concluded that under the facts and circumstances presented, retail sales tax was due because the decision to lease was made after the equipment was acquired.

[3] On July 1, 1998, the Department reissued existing ETBs as Excise Tax Advisories (ETAs).

ETB 307.08.237 clearly stated that "improperly collected Sales Tax," i.e., tax collected on exempt transactions or in excess of the rate prescribed by law, should be refunded to the customer, and if not so refunded, must be paid to the state. It provided somewhat conflicting advice on the appropriate handling of excess sales tax properly collected. It stated that it follows from the language of RCW 82.05.050 that "this tax, whether illegally collected, collected at the statutory rate, or at a rate in excess of that provided by law, is collected by the taxpayer as an agent of the state and is at all times held in trust for the state until paid." However, it also stated the following:

> Sellers making collections in accordance with the approved Sales Tax schedule may collect slightly more or slightly less on aggregate collections than the tax due on total sales. However, the Tax Commission does not require the accounting of tax over-collected in this manner because of "breakage".

Taxpayer contends the circumstantial evidence suggests the over-collections must have been due to breakage, and that it provided the Audit Division with sufficient records to determine the cause. The Audit Division's response to Taxpayer's petition contends it did not see sufficient records to enable it to determine the cause. However, upon closer examination of the records, it appears that the cause of the over-collections was not actually investigated or considered.

This remains an unresolved factual issue. To the extent the cause was not "breakage," there is no exception to the requirement that Taxpayer remit the over-collections. The burden rests upon Taxpayer to support its allegation. We will remand this issue to the Audit Division, to give Taxpayer an opportunity to show the extent to which the over-collections were due to "breakage."

DECISION AND DISPOSITION:

The request for refund of use tax paid on carpet purchased in [State A], and interest related thereto, is denied.

The request for refund of use tax paid on the used equipment acquired as part of the purchase of a restaurant in [Washington], and interest related thereto, is granted.

Taxpayer will be allowed until May 31, 1999, or such later date as it and the Audit Division may agree upon, to consult with the Audit Division concerning what records the Audit Division needs to examine in order to determine the cause of the sales tax over-collections, and to provide the records the Audit Division requests. Based upon the records Taxpayer provides as of that date, the Audit Division will grant this portion of the refund request, to the extent it determines the cause of the over-collections was "breakage." It will amend, if necessary, and reissue its denial of this portion of the refund request, if the request is not fully granted.

Dated this 27th day of April 1999.