

Cite as Det. No. 99-132, 19 WTD 255 (2000)

BEFORE THE 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 of)	
)	No. 99-132
)	
...)	Registration No. . . .
)	FY. . . /Audit No. . . .
)	
)	

- [1] RULE 178; RCW 82.12.010: USE TAX--VALUATION—MIXED REAL AND PERSONAL PROPERTY TRANSACTION. The Department of Revenue is not required to accept a buyer and seller's written allocation of value between personal and real property as the market value of the personal property where the transaction was not an arms length one.
- [2] RULE 178; RCW 82.12.010(1), RCW 84.40.030: USE TAX—VALUATION—FAIR MARKET VALUE. Use tax is based on fair market value of an item at the time and place of the transaction based on comparable sales. The Personal Property Tax rolls are based on estimated statewide values that are annualized and include depreciation. Personal Property Tax rolls may not be an appropriate evidence of fair market value for use tax.
- [3] RULE 178; RCW 82.12.010(1): USE TAX—BURDEN OF PROOF. For use tax purposes, the party disputing the written allocation of value between real and personal property by a buyer and seller has the burden of producing evidence of market value based on comparable sales.

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 appeals an assessment of use tax on personal property included in the sale of a motel on the grounds that the allocation of value between personal property and real property on

the Real Estate Excise Tax Affidavit did not reflect the true market value of the personal property.¹

FACTS

Bianchi, Policy & Operations Manager.--On December 30, 1993, taxpayer purchased the [motel] located in . . . , Washington, on a Real Estate Contract through a tax-free exchange with . . . as the facilitator for the purchaser. The documents of sale were drafted by the seller. The sale was closed in the seller's office in . . . , Oregon. The purchaser was not a native speaker of English. Before he purchased the motel and personal property in Washington, he had never lived or worked in Washington. No independent closing agent was involved. The purchaser was not informed of its use tax obligation on the personal property. The Real Estate Excise Tax Affidavit drafted by the seller identified the land valued at . . . and the personal property transferred at . . . Seller paid the real estate excise tax in the amount of The seller did not collect or pay retail sales tax on the personal property.

The Department of Revenue (Department) issued a Notice of Use Tax Due on February 11, 1994. In response to this notice the taxpayer paid Based on the value of the personal property identified on the Real Estate Excise Tax affidavit, the Department sent the taxpayer a Notice of Balance Due on May 11, 1994, identifying the total tax due as . . . with a credit of . . . , leaving a balance of The taxpayer then filed an amended use tax return, alleging the true value of the property was . . . as reflected in the personal property records of the . . . County Personal Property Department as of January 1994. The total use tax on property so valued would have been [less than the amount of use tax reflected in the Notice of Balance Due]. The taxpayer submitted the Notice of Balance Due with the new value and tax inserted along with the remaining On August 31, 1994, the Miscellaneous Tax Division sent the taxpayer a letter notifying him that no additional tax was due "based on the information you supplied." Printed on the amended return was the following admonition, "If your account is selected for audit, the information reported on this return would be subject to verification by an auditor."

Subsequently, the taxpayer was audited for the period between December 30, 1993 and December 31, 1995. During this audit, the Department, for the first time, obtained access to the Contract of Sale between the seller and the taxpayer. The contract declared the value of the personal property to be [more than the amount reflected in the County Personal Property Department records]. Not only did the contract allocate the purchase price between real property and personal property as described, in it the Purchaser certified that the contract was accepted and executed on the basis of purchaser's own examination and personal knowledge of the value of the real property and the personal property. Based upon the contract, and this certification, Audit held that the true evidence of value was the amount identified in the contract.

ISSUES

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

1. Is the Department required to accept a buyer and seller's allocation of value between personal property and real property for use tax purposes?
2. If not, are the personal property tax rolls an adequate estimate of the true value of personal property for use tax purposes?
3. If not, on whom does the burden lie to produce an estimate of true value based on comparable sales?

DISCUSSION

1. Where conditions of the sale show otherwise, the allocation of value between personal property and real property made by buyer and seller may not be a true estimate of the value of personal property and the Department is not required to accept such allocation.

RCW 82.12.020 imposes a use tax for:

the privilege of using within this state as a consumer any article of tangible personal property purchased at retail . . . The tax shall be levied and collected in an amount equal to the value of the article used by the taxpayer multiplied by the rate in effect for the retail sales tax under RCW 82.08.020, as now or hereafter amended, in the county in which the article is used.

(Emphasis added.) RCW 82.12.010(1) defines the term "value of the article used" as:

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 In case the article used 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 and regulations as the department of revenue may prescribe.

(Emphasis added.) The only rule promulgated by the Department in accordance with this statute, WAC 458-20-178 (Rule 178)(13), similarly defines value for use tax purposes, as follows:

The [use] 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...

(Emphasis added.) The Department has not promulgated a rule that identifies the conditions when a purchase price does not represent true value or a methodology, other than by comparable sales of like quality, quantity, and character, for determining value if the consideration paid does not represent true value.

In several determinations, we have recognized that, in an arm's length sale, the value placed on the property by the parties to the transaction may be persuasive evidence of value. See, e.g., Det. No. 93-310, 14 WTD 063 (1994)(an itemized closing statement signed by both buyer and seller, which attributed a particular dollar amount to farm equipment, is evidence of value); Det. No. 92-156, 12 WTD 195 (1993)(use tax was properly imposed on the agreed price for personal property purchased in a real property transaction).

The case most directly on point is Det. No. 93-310. In that case the taxpayer purchased a farm and certain farm equipment. The REET affidavit listed the real property as valued as \$100,000 and the farm equipment as valued at \$38,500. The Department assessed additional use tax and late payment penalties on the farm equipment using the value declared on the REET affidavit and an Addendum to Sales Agreement. Taxpayer protested the amount of use tax assessed on the grounds that the price of \$38,500 of certain farm equipment did not reflect its actual value. He produced the county personal property tax rolls showing a value of only \$8,300. The county personal property tax rolls, however, listed only five items of farm equipment: two wind machines, a ladder, spray equipment and a tractor. The affidavit attached to the earnest money agreement listed 23 items including, among others, two tractors, one truck, forklift, 2 trailers, and irrigation pumps. In those circumstances the ALJ held that the best evidence of value was the closing statement that both parties acknowledged, which the buyer stated he "approved and received."

Where the transaction was not an arms length one, however, the conclusion that the allocated price is the true value does not hold. 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 a 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 because it is not an arms length sale.

2. The personal property tax rolls do not necessarily reflect the true value of personal property, but they may be evidence that the purchase price does not represent its true value.

The question then becomes whether the taxpayer's property tax valuation in and of itself provides a basis for the use tax assessment. With respect to property tax valuations, RCW 84.40.030 provides that, "[a]ll property shall be valued at one hundred percent of its true and fair value in money and assessed on the same basis unless specifically provided otherwise by law." RCW 84.40.040 requires certain property owners to file a "list and statement" of all personal property, and the Assessor to list and "determine the true and fair value of the property." RCW 84.41.090 provides that

The department of revenue shall make and publish such additional rules, regulations and guides which it determines are needed to supplement materials presently published by the department of revenue for the general guidance and assistance of county assessors. Each assessor is hereby directed and required to value property in accordance with the standards established by RCW 84.40.030 and in accordance with the applicable rules, regulations and valuation manuals published by the department of revenue.

In accordance with this statute, the Department provides assessors with Personal Property Valuation Schedules as a guide to personal property valuations. As stated in these schedules, the "valuation indicators are published as guides in estimating market values of equipment in average condition." 1999 Personal Property Valuation Schedules (January 19, 1999). (Emphasis added.) An assessor's valuation arrived at by using such a guide is presumed correct and can be overcome only by clear, cogent, and convincing evidence. RCW 84.40.0301.

Although the use tax and property tax provisions share the common goal of arriving at an estimation of "true value," there are problems in using the property tax valuation methodology by itself in use tax cases. First, property tax valuations are done to arrive at a true value on an annualized basis (RCW 84.36.010), with the valuation schedules applying statewide. In contrast, the use tax provisions require valuation as nearly possible in relation to similar products at the place of use of the products. More importantly, the use tax provisions do not explicitly provide for a depreciation method of valuation. Rather, value for use tax purposes is to 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." Rule 178(13).

In general, "fair market value is a matter of opinion." Northwest Chem. Sec. Co. v. Chelan Co., 38 Wn. 2d 87, 94, 228 P.2d 129 (1951). In Northwest Chemical, the court discussed various valuation methods, including comparable sales, and concluded as follows:

Whatever factors are taken into consideration, it is important to bear in mind that the ultimate question for determination is always the same--what is the reasonable market value of the property at the time the assessment is made? As this court said, in Bellingham Community Hotel Co. v. Whatcom County, supra:

"The original cost of construction or the estimated cost of reproduction, less depreciation, may be considered, but only as an aid in arriving at the market value of the building." (p. 612.)

Id. at 91.

For use tax purposes, a depreciation method of valuation may also be an aid in arriving at an opinion of market value, but this evidence must be supplemented by a valuation of comparable sales as envisioned under Rule 178. That information is lacking here.

A serious disparity between the value as alleged on the REET affidavit and personal property tax rolls might also be persuasive evidence that the sale occurred under circumstances indicating that there was not an arms length transaction.² In the instant case, however, the disparity between the allocated value and the personal property tax rolls is not the only evidence the transaction lacked truly informed buyers and sellers. A close comparison of the two lists reveals that the personal property tax rolls identified far more property than did the exhibit attached to the contract, but at a substantially lower value. The sale closed in the office of the seller through documents drafted by the seller, without a closing agent present. The purchaser lacked facility in English and familiarity with Washington State retail sales tax. From these factors we draw the conclusion that this personal property was sold under conditions where the purchase price allocated to the personal property may not have represented its true value.

3. The party disputing the buyer and seller's allocation of value between personal property and real property has the burden of proving the value by providing an estimate based on comparable sales.

Where neither the taxpayer nor the Department contests the allocation of value declared on the REET affidavit, that allocation is prima facie evidence of the market value of the personal property. If the Department disputes the value declared on the REET affidavit or Contract of Sale, the burden then is on the Department to provide a valuation that shows the true market value of the property based on comparable sales. If the Taxpayer disputes the value stated on the REET affidavit or in the Contract of Sale the taxpayer itself signed, the burden is on the taxpayer to provide a valuation demonstrating the market value of the goods at the time of sale based on comparable sales.

DECISION AND DISPOSITION:

² The allocation between real property and personal property may have been directly bargained for and reflect an arms length transaction even though it seriously differs from the contemporaneous personal property tax rolls. The higher the value of the personal property, the more a taxpayer may depreciate it over a shortened period of time on federal tax returns. I.R.C. §§167-168. One aid to determine whether the allocation in fact reflected an arms length transaction would be to review the purchaser's federal income tax return to see if taxpayer took shortened depreciation schedule for personal property on the returns. This return may not be available, however, at the time of the assessment of use tax.

This matter is remanded to the Audit Division. The Appeals Division will retain jurisdiction over the matter for 45 days to allow the taxpayer an opportunity to provide an appraisal of the personal property based on a comparable sales method. If the taxpayer fails to provide Audit with such a valuation within 45 days of the issuance of this determination, then this case shall be dismissed with prejudice, and the taxpayer's right to appeal shall commence upon dismissal.

If Audit accepts the taxpayer's valuation it shall assess use tax based upon the accepted new value. In the event that Audit continues to disagree with the valuation produced by the taxpayer, the Audit Division must provide its own valuation of the property based on comparable sales. Provided that the taxpayer has timely provided an appraisal based on comparable sales, the taxpayer may, if necessary, petition for correction of any action (including a no-change finding) taken on remand by the Department.

DATED this 14th day of May, 1999.