Cite as Det. No. 02-0139, 26 WTD 130 (2007)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 02-0139
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .

RCW 82.12.020; ETA 332.12.178: USE TAX – INTERVENING USE – FLOOR DEMONSTRATORS. Whether use tax is due on the use of a sample product for demonstration is determined on a case by case basis in light of the guidelines contained in ETA 332.12.178 and Det. No. 92-044R, 13 WTD 63 (1993). Such use generally is not subject to use tax if the product is used in the furtherance of its own sale or the sale of other like products, is carried on Taxpayer's books as inventory and not as a demonstrator, and does not experience use as a demonstrator so extensive that it cannot be sold as new. "New" does not mean brand-new, but rather with no substantial reduction in price or compromise of warranty because of wear and tear.

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.

INTRODUCTION:

Prusia, A.L.J. -- [Taxpayer] is a Washington corporation engaged in the business of selling and installing spas (tubs) and stoves (both gas stoves and wood stoves). It uses some stoves and spas as demonstrators before selling them.[1]

The issues to be determined in this appeal are:

1. . . .

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

2. . . .

3. Does use tax/deferred sales tax apply to spas and stoves Taxpayer installed in its showrooms and used as demonstrators prior to sale?

. . . . We find Taxpayer's use of stoves and spas as demonstrators was not subject to use tax.

FACTS:

Background -- audit examination, assessment, and objections thereto

The Audit Division of the Department of Revenue ("Department") examined the books and records of Taxpayer for the period January 1, 1997 through September 30, 2000. As a result of that examination, the Audit Division assessed Taxpayer additional taxes for the audit period. The total amount of the assessment, including statutory interest, was $ . . . . Taxpayer has paid $ . . . on the assessment. Taxpayer contests the following portions of the assessment:

1) . . .
2) . . .
3) The assessment, in Schedules 6A through 6E, totaling $ . . . , of use tax/deferred sales tax on spas and stoves [Taxpayer] purchased and used as demonstrators in its showrooms before selling, on which it did not pay retail sales tax to its suppliers. The schedules are not based on records of stoves and spas actually used (Taxpayer had no such records), but on the estimated value of usage of stoves and spas during the audit period. Taxpayer contends all spas and stoves used for demonstration in its showrooms remained inventory at all times, and were not subject to use tax.

Facts

. . .

. . .

In each store, Taxpayer had several stoves (as many as six) hooked up to gas pipes and exhaust piping, and several spas (typically two) hooked up to water pipes and electric lines, at any one time, so that it could operate them for demonstration purposes. Taxpayer displayed and demonstrated the items in furtherance of the items' own sale and the sale of similar items. It also used spas in making commercials.

Taxpayer does not dispute that it used some stoves and spas as demonstrators prior to sale. However, all stoves and spas were purchased with the expectation that they would be sold. Taxpayer carried all stoves and spas on its books as inventory, including those used as

demonstrators. All stoves and spas used as demonstrators were available for sale. The stoves are easily disconnected from the pipes. The spas are portable. All stoves and spas used as demonstrators were in fact sold. Demonstrators were not used so extensively that they could not be sold as new merchandise. They were sold with a full new product warranty; the serial numbers were not recorded for warranty purposes until a customer purchased the item. Demonstrator spas that were sold were taken to Taxpayer's . . . warehouse for cleaning and to make sure they were operating properly, before delivery to customers. Taxpayer states the demonstrators were generally sold at a discount in the range of 4-5 percent, as a way of keeping them from being on the floor too long, and to increase overall sales. . . .

. . . Taxpayer did an analysis of spas purchased for its showrooms from February to May of 2001. Taxpayer generally had an inventory of 35 spas, and during that period purchased 29 spas, which indicates an 85% turnover in four months. . . . Salespeople have some leeway in negotiating the price on any item.

ANALYSIS:

Under the Washington Revenue Act, a retail sales tax is levied on every "retail sale" in this state, including successive retail sales of the same property. RCW 82.08.020. "Retail sale" is defined in RCW 82.04.050, and means "every sale of tangible personal property to all persons irrespective of the nature of their business, other than . . . ." Only sales for a few specified purposes fall outside the definition. A merchant's purchases of consumable supplies are not specified exceptions; they are retail sales. "Purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person" is a specified exception to the definition of "retail sale." RCW 82.04.050(1)(a). There are no other specified exceptions that are relevant to this appeal.

In general, the use tax applies upon the use as a consumer within Washington of any tangible personal property the retail sale or acquisition of which has not been subjected to the Washington retail sales tax. It [complements] 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. . . .

Under the above statutes and rules, Taxpayer was liable for retail sales tax on purchases of stoves and spas it purchased, unless it purchased them for the purpose of resale as tangible personal property in the regular course of business without intervening use.[2] Taxpayer was liable for use tax on the value of any stoves and spas it put to "intervening use" before selling, on which it did not pay retail sales tax to its suppliers. We must address two issues with respect to the use as demonstrators. First, under what circumstances, if any, may a seller use merchandise for demonstration prior to sale without incurring use tax liability? Second, if some use as a

[2] If a seller is normally engaged in both consuming and reselling a type of tangible personal property, and is not able to determine at the time of purchase whether particular items acquired will be consumed or resold, it may be able to defer reporting and remitting retail sales tax. *See*, RCW 82.08.130 and WAC 458-20-102(11).

demonstrator is nontaxable, was use tax applicable to Taxpayer's use of stoves and spas as demonstrators?

Several use tax statutes specifically address display of tangible personal property for promotional purposes, and two statutes provide limited exemption from use tax for mere display.[3] No statute specifically addresses whether demonstration of articles held for sale is a taxable use.

In its many years of administration of the Revenue Act, the Department has recognized the necessity of demonstration of articles held for sale. Excise Tax Advisories (ETAs) and published determinations address the question.

ETA 61.12.178 (ETA 61), first issued as an Excise Tax Bulletin in 1966, concluded that use tax was not applicable to use of a specific machine for demonstration purposes only in connection with efforts to sell the same machine.[4] That does not describe Taxpayer's situation. Taxpayer used representative stoves and spas as demonstrators in furthering their own sale and the sale of other like products. It does not appear to be practical for Taxpayer to demonstrate its merchandise in a manner that would bring it under ETA 61.

ETA 332.12.178 (ETA 332), first issued as an Excise Tax Bulletin in 1968, provides more extensive guidelines. It states:

> The Use Tax applies to articles which are substantially used for sales promotion purposes. This includes automobiles, boats or appliances regularly used as demonstrators, display advertising materials, samples or advertising material given away to customers, and samples carried by salesmen.
>
> The tax is not applicable to the brief and superficial use which occurs when articles held for sale are displayed in single trade shows (boat shows, home shows, auto

[3] For use tax purposes, "consumer" is specially defined in RCW 82.12.010(5) as including "any person who distributes, displays, or causes to be distributed or displayed, any article of tangible personal property . . . the primary purpose of which is to promote the sale of products and services." RCW 82.12.0271 exempts from use tax the use of wearing apparel only as a sample for display for the purpose of effecting sales of goods represented by the sample. RCW 82.12.0272 exempts the use of tangible personal property held for sale and displayed in single trade shows for promotional purposes, for a period not to exceed thirty days.

[4] ETA 61 states:

> Are machines which are a part of the regular stock of goods available for sale, but which are also used for demonstration purposes by company salesmen subject to Use Tax liability?
>
> Taxpayer employed salesmen who were provided with a stock of goods for sale. None of the machines was issued to the salesmen for the particular purpose of serving as demonstration models and all machines were available for sale in the regular course of business. The company policy was to sell the machine displayed and demonstrated.
>
> The taxpayer was using a specific machine for demonstration purposes only in connection with efforts to sell that same machine. As such the Use Tax was not applicable as the demonstration was part of the retail sales process, and not a separate use of the product by the taxpayer.

> shows, agricultural fairs, conventions, etc.) for short periods, or are used in floor or window displays, and are thereafter sold as new merchandise.
>
> As a general guide, such articles will be deemed to have been substantially used. and subject to the Use Tax, when carried in the taxpayer's books of account as demonstrator or display merchandise, or when so extensively used for demonstration or display purposes that they can no longer be sold as new merchandise.

The Department has addressed when use of merchandise as a demonstrator is use-taxable in at least three published determinations: Det. No. 86-251, 1 WTD 167 (1986); Det. No. 92-044R, 13 WTD 63 (1993); and Det. No. 01-101, 21 WTD 123 (2002).[5] The latter summarized the Department's interpretations of ETA 332, as follows:

> Therefore, according to Det. No. 92-044R, for a sample product to be "used" [as a demonstrator] and not trigger use tax liability the product must:
>
> - Be used in the furtherance of its [own] sale or the sale of other like products.
> - Not be carried on Taxpayer's books as a demonstrator.
> - Not experience use [as a demonstrator] so extensive that the product cannot be sold as new.
>
> Thus, whether use tax is due on the use of a sample product used for demonstration is determined on a case by case basis in light of the guidelines contained in ETA 332.12.178 and Det No. 92-044R, 13 WTD 63 (1993). Accordingly, in this case, if the sample home is carried on Taxpayer's books as inventory and not as a demonstrator, and if the home is sold as new with no substantial reduction in price or compromise of warranty because of "wear and tear," then the Taxpayer is not required to pay retail sales tax or use tax on its intervening display use of the home before sale.

(Emphasis in the original.) Taxpayer's use of stoves and spas as demonstrators was as described in Det. No. 92-044R and Det. No. 01-101, and therefore its taxability is to be determined by application of the general guide in ETA 332. The determinative question is whether the stoves and spas were "substantially used" for sales promotion purposes, *i.e.*, were they so extensively used for demonstration purposes they could no longer be sold as new merchandise? ETA 332. "New" does not mean brand-new, but rather "with no substantial reduction in price or compromise of warranty because of 'wear and tear.'" Det. No. 92-044R; Det. No. 01-101.

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[5] Det. No. 86-251 held that a taxpayer who held a vessel for over two years for demonstration purposes had made more than limited use for demonstration purposes. Det. No. 92-044R held that a seller who carried items used for demonstration on its own books and records as demonstrators, and who highly discounted them upon their sale because of use and age, was liable for use tax. Det. No. 01-101 held that if a seller of manufactured homes carried a sample home on its books as inventory and not as a demonstrator, and if the home was sold as new with no substantial reduction in price or compromise of warranty because of "wear and tear," then the display use was exempt from use tax.

Applying the above guidelines to the facts before us,[6] we conclude that Taxpayer's use of stoves and spas during the audit period was not subject to use tax. Our conclusion is based on the following facts. The items were held in sales inventory. They were not depreciated for federal income tax purposes. The items were at all times available for purchase. The items were sold with new product warranties. There was not a substantial reduction in price because of wear and tear.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and remanded in part. The assessment of additional use tax under audit Schedules 6A through 6E is cancelled. . . .

Dated this 28th day of August, 2002.

[6] We emphasize that whether use tax is due on the use of a sample product used for demonstration is determined on a case by case basis, and assessment of use tax depends upon the facts uncovered in a particular audit.