

Cite as Det. No. 07-0178, 27 WTD 26 (2008)

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. 07-0178
...)	
)	Registration No. . . .
)	Doc. No. . . . /Audit No. . . .
)	Docket No. . . .

- [1] RULE 102: RESALE CERTIFICATE – DUAL PURPOSES – ELIGIBILITY TO USE. The test of whether a resale certificate for dual purposes may be used must be applied against the “certain types of tangible personal property” involved – in this case, the equipment that a taxpayer purchased with the use of resale certificates. In accordance with Rule 102(11), we must look to the general nature of a buyer’s business: If a buyer consumed more than 50% of the articles in question, then the buyer “principally” purchased this type of tangible personal property (*i.e.*, equipment) for its own consumption/use in its construction business and would be ineligible to use a resale certificate for dual use on any of these purchases; if a buyer resold more than 50% of the articles in question without any intervening use, the buyer would be entitled to use a resale certificate for those purchases in which it did not know whether it would be consuming or reselling the article.
- [2] RULE 102; RCW 82.32.291: – RESALE CERTIFICATE – DUAL PURPOSES – 50% PENALTY FOR IMPROPER USE. The 50% penalty for improper use of a resale certificate was properly imposed when the buyer was not entitled to use a resale certificate for dual purposes because it did not resell, without intervening use, more than 50% of the equipment it purchased. Even if it had been entitled to use a resale certificate, the buyer did not discover and remit, as required, a minimum of 80% of its deferred sales/use tax liability within 120 days of the property’s first use or demonstrate by other facts and circumstances that it made a good faith effort to remit its tax liability.

- [3] RULE 102; RCW 82.32.291: RESALE CERTIFICATE – DUAL PURPOSES – 50% PENALTY FOR IMPROPER USE – PENALTY WAIVER. The penalty for improper use of a resale certificate may be waived when the use was due to circumstances beyond the control of the buyer. One situation in which waiver is appropriate is when a buyer makes a good faith effort to discover all of its deferred sales tax liability within 120 days of purchase and remits the discovered tax liability upon the next excise tax return.

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.

Bauer, A.L.J. – A contractor who buys equipment to use in its business and also buys equipment for resale objects to the imposition of the 50% penalty for its improper use of a resale certificate. We hold that it was ineligible to use a resale certificate for dual purposes, that the penalty for its misuse was properly imposed, and there are no grounds for its waiver.¹

ISSUES

1. Was a contractor eligible to use resale certificates for dual purposes on its purchases of equipment in accordance with RCW 82.08.130 and WAC 458-20-102(11) (Rule 102(11)) when, under the general nature of its business, it did not principally resell those articles without intervening use.
2. Was the 50% penalty for improper use of a resale certificate properly imposed in accordance with RCW 82.32.291 and Rule-102(6) when a contractor resold, without intervening use, less than 50% of the equipment it purchased?
3. If so, may the penalty for improper use of a resale certificate be waived in accordance with the provisions of RCW 82.32.291 and Rule 102(12) because of the inexperience of the controller?

FINDINGS OF FACT

The books and records of [Taxpayer] were audited by the Audit Division (Audit) of the Department of Revenue (Department) for the period of January 1, 2000, through June 31, 2003 (audit period). As a result, the first audit assessment was issued on September 1, 2004, and was adjusted three more times based on additional records that were supplied by Taxpayer. Taxpayer has now timely appealed for correction of the above-referenced assessment, the final of which was issued on August 12, 2005, in the total amount of \$. . .

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

Schedules 5 and 6 of the audit assessed deferred retail sales/use tax² upon assets and consumables that were purchased using a resale certificate for dual purposes and without payment of retail sales tax. A 50% penalty in the amount of \$. . . was imposed for the improper use of a resale certificate, and Taxpayer requests that this penalty be cancelled.

Taxpayer was a contractor and, as such, performed site preparation and clearing. Taxpayer also purchased, rented, and sold heavy construction equipment and vehicles (equipment).

Audit noted that Taxpayer's general ledger reflected that the revenue account for bare rentals of equipment³ constituted [a very small amount compared with Taxpayer's non-revenue account titled "owned equipment rental," and with the total amount of revenue]. Audit found no accounting records supporting Taxpayer's intent to resell the equipment it purchased. The equipment at issue was listed as assets, and not as inventory.⁴ Audit found no general ledger accounts for the sale of equipment, and sales revenue for the equipment was instead reflected under sales of assets. Taxpayer kept no accounting records or separate inventory of equipment and parts held for sale.

Audit therefore determined that Taxpayer was not eligible to use a resale certificate for its purchase of equipment for sale. Audit reasoned that, while Taxpayer might have been engaged in renting its equipment, this was not a separate or significant part of its business activity. Audit contends that Taxpayer was not entitled to use resale certificates for dual [purposes] because the nature of Taxpayer's business was construction, and the "rental and sale of equipment" was merely a "by product" of the business that made good use of idle equipment. Audit based its rationale on the fact that Taxpayer's accounting records – particularly the absence of an inventory account -- did not indicate that Taxpayer "determined at the time of purchase" that this equipment was for resale.

Beginning in March 2002 through the end of the audit period, Taxpayer completely ceased reporting use tax, except for a small amount paid in May 2003. During this period, Taxpayer increased its use of resale certificates, crossed off and did not pay sales tax amounts billed by vendors, and registered its trucks without payment of use tax.

Taxpayer explains that during the audit period it had three different controllers. [Controller A] was the controller until February 2002. According to Taxpayer, resale certificates under [Controller A] were properly used and deferred retail sales/use taxes paid on a timely basis. [Controller B] took over as controller in March 2002. [Controller B] did not understand the

² Because the Combined Excise Tax Return does not have a special line for reporting deferred or unpaid sales taxes on purchases, taxpayers are instructed to report these amounts on the use tax line of the return.

³ Taxpayer stated that its "bare equipment rental" account reflected income from the rental of equipment that was purchased for rent and/or sale and was not used in the construction division of the business. Although only a small portion of Taxpayer's total income was from the rental of bare equipment, Taxpayer asserts it was not a traditional rental business, and all of the equipment at issue was held for sale or rental purposes.

⁴ Taxpayer states that equipment held for bare rental is correctly booked as assets.

proper procedures for reporting deferred sales/use tax, nor did he educate himself. [Controller C] became controller in June 2003 and immediately started properly remitting use tax.

Taxpayer has submitted the following documentary evidence in support of its argument that its buying and reselling equipment was a valid business activity and therefore was entitled to provide resale certificates at the time it purchased the equipment:⁵

- A photograph of an old sign on one of Taxpayer's buildings stating [the company name, and the words "rentals and sales"];
- Several photographs of a fenced-in area containing equipment and trucks, and one picture of a sign outside that fenced area stating [that there was equipment for sale];
- A copy of a heavy equipment advertisement, with pictures from [a] catalogue listing some of Taxpayer's equipment for sale;
- Excerpts from financial statements that Taxpayer believes support its contention that it is a purchaser of used equipment and vehicles for resale. These notes indicate that Taxpayer depreciates all of its equipment, and charges maintenance, repairs, and minor renewals to expense when such charges are incurred;
- Workpapers documenting "Assets Purchased," beginning January 15, 2000 through May 3, 2003, listing the dates, source, purchase amounts, and whether (and, if so, when and how much) use and DOL taxes were paid; and
- Workpapers documenting use taxes paid, by month, for years 2000, 2001, 2002, and 2003, on "consumables" and "other assets." This demonstrates that almost no use taxes were paid during 2002 and 2003. Purchases in 2002 include computer systems.

Taxpayer submitted this information in support of its assertion that its use of resale certificates for dual purposes was lawful because it had always intended to have two lines of business – construction site preparation and clearing and reselling and/or renting bare equipment. Taxpayer contends that it purchased all of its heavy equipment for resale, and it was therefore entitled to use a resale certificate. Taxpayer asserts that it purchased used equipment (which it restored, as needed) in order to rent or sell it for a profit.

Taxpayer contends its purchases were not based on its contracting needs. According to Taxpayer, the heavy equipment was held for rent or sale from the time it was purchased and, if rented or sold, retail sales taxes were collected and remitted as necessary. Further, Taxpayer acknowledges that when it used the equipment in a construction job, it owed the deferred sales/use tax. Taxpayer asserts that for tax years 2000 and 2001 it paid the deferred or use tax on such equipment and as evidence of this directs our attention to the fact that the audit for those

⁵ By October 17, 2006 letter.

years resulted in a credit for consumables.⁶ Thus, Taxpayer argues that the resale certificates were properly used because “[it held] equipment out for rental and/or sale purposes,” even if that equipment was not in fact sold before being used by Taxpayer. Although Taxpayer admits that appropriate deferred sales/use taxes were not remitted during the tax years 2002-2003, Taxpayer asserts that its use of resale certificates for the equipment purchased for resale was correct.

On appeal, Taxpayer’s representative claims that the audit in this case was confusing from the beginning. When Taxpayer first received the audit notice, [Controller B] had just been hired as controller. [Controller B] asked for some time to get acquainted with the company before the audit. Therefore, the audit was delayed several times at [Controller B’s] request. Before the audit could be accomplished, however, [Controller B] left the company and then died. [Controller B] was, therefore, never available for the audit. [Controller C] became the new controller in June 2003. He thought that the company only rented out idle equipment, and passed this incorrect information on to Taxpayer’s representative, who then passed it on to Audit. Taxpayer’s representative asserts that he tried to correct this misinformation during the audit, but felt Audit did not believe him and felt the audit had become contentious.

ANALYSIS

1. Was a contractor eligible to use resale certificates for dual purposes on its purchases of equipment in accordance with RCW 82.08.130 and Rule 102(11) when, under the general nature of its business, it did not principally resell those articles without intervening use.

RCW 82.08.130 provides:

If a buyer normally is engaged in both consuming and reselling certain types of articles of tangible personal property and is not able to determine at the time of purchase whether the particular property acquired will be consumed or resold, the buyer may use a resale certificate for the entire purchase if the buyer principally resells the articles according to the general nature of the buyer's business. The buyer shall account for the value of any articles purchased with a resale certificate that are used by the buyer and remit the sales tax on the articles to the department.

(Emphasis added.) Rule 102(11) provides:

Purchases for dual purposes. A buyer normally engaged in both consuming and reselling certain types of tangible personal property, and not able to determine at the time of purchase whether the particular property purchased will be consumed or resold, must purchase according to the general nature of his or her business. RCW 82.08.130. If the buyer principally consumes the articles in question, the buyer should not give a resale certificate for any part of the purchase. If the buyer principally resells the articles, the

⁶ It is not clear on what items use tax was reported. Taxpayer nonetheless claims that the credit resulted because the controller at that time paid deferred sales tax on the heavy equipment when due.

buyer may issue a resale certificate for the entire purchase. For the purposes of this subsection, the term "principally" means greater than fifty percent.

(Emphasis added.) As an initial matter, we do not dispute that Taxpayer, a contractor, also purchased and resold articles of equipment constituting another business activity. The general nature of Taxpayer's business was contracting, based not only on the income generated from that activity, but also based on the use of the equipment purchased.

Under Rule 102, if the taxpayer knew at the time of purchase that the equipment would be used in contracting, it should not have used a resale certificate but [should have] paid the retail sales tax. If Taxpayer did not know at the time of the purchase whether the equipment would be resold or consumed, then it should have purchased according to the general nature of its business – contracting.

The test of whether a resale certificate for dual purposes may be used must be applied against the “certain types of tangible personal property” involved – in this case, the equipment that Taxpayer purchased with the use of resale certificates. In accordance with Rule 102(11), if Taxpayer -- according to the general nature of its business -- consumed more than 50% of the articles in question, then we must conclude that Taxpayer “principally” purchased this type of tangible personal property (*i.e.*, equipment) for its own consumption/use in its construction business and was ineligible to use a resale certificate for dual purposes on any of its purchases.⁷ On the other hand, if Taxpayer, according to the general nature of its business, resold more than 50% of the articles in question without any intervening use, Taxpayer would have been entitled to use a resale certificate for those purchases in which it did not know that it would be consuming the article before its resale.

In 2000 and 2001 -- years in which it asserts that it complied with the law – Taxpayer paid deferred retail sales tax or use tax almost immediately after purchase on [more than 50%]⁸ of the equipment. We interpret this to mean that this percentage of equipment was put to use almost immediately in its contracting business for these years. Thus, Taxpayer did not “resell more than 50%” of the equipment purchased without intervening use during 2000 and 2001. In accordance with Rule 102(11), Taxpayer was not eligible to use a resale certificate for dual purposes, even though the buying and reselling of heavy equipment was a legitimate part of its business. The fact that Taxpayer overpaid the total use tax it owed (which included taxes paid on consumables), and was thus given a credit, is irrelevant, although we note that because of the overpayment, no penalty was assessed for those periods.

During 2002 and 2003, Taxpayer did not keep records, and thus cannot demonstrate that more than 50% of the articles of equipment it purchased were not used in its construction business.

⁷ We reject Taxpayer's notion that equipment being “available” for sale, without being actually sold before use in its construction business, qualified it as being used in its resale business.

⁸ In 2000 and 2001, [more than 50% of the] vehicles or pieces of heavy equipment were used in Taxpayer's construction business, and use tax was paid soon after their purchase. . . .

Taxpayers have the responsibility to “keep accurate and complete business records.” RCW 82.32A.030. See also RCW 82.32.070(1)(a), which provides:

Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue. Any person who fails to comply with the requirements of this section shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

Because of the lack of adequate business records in 2002 and 2003 documenting what equipment was used in Taxpayer’s construction activity, and what equipment was not used but was resold without intervening use, Taxpayer cannot carry its burden of proof that there was no use and that deferred retail sales tax/use tax was not owed. Because all equipment during these years was therefore subject to tax, Taxpayer’s use of the resale certificate for dual purposes was not allowable during 2002 and 2003.

We conclude that Taxpayer was ineligible to use resale certificates for dual purposes on its purchases of articles of equipment during the audit period. Taxpayer thus should have paid the retail sales/use taxes at the time of purchase, and applied for a tax paid at source credit or refund⁹ when it sold [or rented] equipment without intervening use.

Taxpayer’s petition is denied; Taxpayer was not eligible to use a resale certificate for its purchase of heavy equipment during the audit period.

2. Was the 50% penalty for improper use of a resale certificate properly imposed in accordance with RCW 82.32.291 and Rule 102(6) when a contractor resold, without intervening use, less than 50% of the equipment it purchased?

Taxpayer argues that it had no desire to misuse its resale certificate. Taxpayer asserts that it had, for a short period, a controller that simply didn't know what he was doing. Taxpayer admits the accounting is not what it should have been, and this has been corrected for the future.

⁹ RCW 82.08.130 provides for this situation:

A buyer who pays a tax on all purchases and subsequently resells an article at retail, without intervening use by the buyer, shall collect the tax from the purchaser as otherwise provided by law and is entitled to a deduction on the buyer’s tax return equal to the cost to the buyer of the property resold upon which retail sales tax has been paid. The deduction is allowed only if the taxpayer keeps and preserves records that show the names of the persons from whom the articles were purchased, the date of the purchase, the type of articles, the amount of the purchase, and the tax that was paid. The department shall provide by rule for the refund or credit of retail sales tax paid by a buyer for purchases that are later sold at wholesale without intervening use by the buyer.

RCW 82.32.291 provides:

Any person who uses a resale certificate to purchase items or services without payment of sales tax and who is not entitled to use the certificate for the purchase shall be assessed a penalty of fifty percent of the tax due, in addition to all other taxes, penalties, and interest due, on the improperly purchased item or service. . . .

Rule 102(6) provides:

Penalty for improper use. Any buyer who uses a resale certificate to purchase items or services without payment of sales tax and who is not entitled to use the certificate for the purchase will be assessed a penalty of fifty percent of the tax due on the improperly purchased item or service. . . .

(a) Deferred sales tax liability. If the buyer gives a resale certificate for all purchases and thereafter consumes some of the articles purchased, the buyer must set up in his or her books of account the value of the article used and remit to the department the applicable deferred sales tax. The deferred sales tax liability should be reported under the use tax classification on the buyer's excise tax return.

Rule 102 11(a)(i) further provides:

Buyers making purchases for dual purposes under the provisions of a resale certificate must remit deferred sales tax on all products or services they consume. If the buyer fails to make a good faith effort to remit this tax liability, the penalty for the misuse of resale certificate privileges may be assessed. This penalty will apply to the unremitted portion of the deferred sales tax liability.

A buyer will generally be considered to be making a good faith effort to report its deferred sales tax liability if the buyer discovers a minimum of eighty percent of the tax liability within one hundred twenty days of purchase, and remits the full amount of the discovered tax liability upon the next excise tax return. However, if the buyer does not satisfy this eighty percent threshold and can show by other facts and circumstances that it made a good faith effort to report the tax liability, the penalty will not be assessed. Likewise, if the department can show by other facts and circumstances that the buyer did not make a good faith effort in remitting its tax liability the penalty will be assessed, even if the eighty percent threshold is satisfied. . . .

Taxpayer asserts that the reporting errors relate only to the underpayment of deferred sales/use tax, and not to the use of the resale certificates which were used properly. The penalty, however, was issued because of the misuse of the resale certificate, and the underpaid tax served only as the penalty's measure.

During the audit period, Taxpayer was not entitled to use a resale certificate for dual purposes because it did not resell, without intervening use, more than 50% of the equipment it purchased. Further, even if Taxpayer had been entitled to use the resale certificate for dual purposes, it did not discover and remit, as required, a minimum of 80% of its deferred sales/use tax liability within 120 days of the equipment's first use. Taxpayer has not shown by other facts and circumstances that it made a good faith effort to remit its tax liability. Thus, we uphold the imposition of the penalty for misuse of a resale certificate.

Taxpayer's petition is denied as to the imposition of the penalty for misuse of a resale certificate.

3. If so, may the penalty for improper use of a resale certificate be waived in accordance with the provisions of RCW 82.32.291 and Rule 102(12) because of the inexperience of the controller?

Because there was a consistent pattern of not paying retail sales tax at the time of purchase throughout the audit period, Audit believes Taxpayer was not entitled to the waiver of the penalty on the grounds that the use of the resale certificate was inadvertent or unintentional. Audit asserts that there was a deliberate, systematic, and ongoing process of not paying retail sales taxes to its vendors for the purchase of its heavy construction equipment and parts.

Taxpayer points out that the only time there was underpayment of its deferred retail sales/use tax liability was during the tenure of [Controller B], who did not understand how the tax worked.

RCW 82.32.291 provides:

The department may waive the penalty [for misuse of a resale certificate] . . . if it finds that the use of the certificate was due to circumstances beyond the taxpayer's control or if the certificate was properly used for purchases for dual purposes. The department shall define by rule what circumstances are considered to be beyond the taxpayer's control.

Rule 102(12) provides:

Waiver of penalty for resale certificate misuse. The department may waive the penalty imposed for resale certificate misuse upon finding that the use of the certificate to purchase items or services by a person not entitled to use the certificate for that purpose was due to circumstances beyond the control of the buyer. . . . The penalty will not be waived merely because the buyer was not aware of either the proper use of the resale certificate or the penalty. In all cases the burden of proving the facts is upon the buyer.

(a) Considerations for waiver. Situations under which a waiver of the penalty will be considered by the department include, but are not necessarily limited to, the following:

(i) The resale certificate was properly used to purchase products or services for dual purposes; or the buyer was eligible to issue the resale certificate; and the buyer made a good faith effort to discover all of its deferred sales tax liability within one hundred twenty days of purchase; and the buyer remitted the discovered tax liability upon the next

excise tax return. (Refer to subsection (11)(a)(i) of this rule [above] for an explanation of what constitutes "good faith effort.") . . .

(Emphasis added.) Taxpayer cannot demonstrate a "good faith effort" to discover all of its tax liability because 80% of its deferred sales/use tax liability for the audit period was not paid within the parameters of the Rule 102(11)(a)(i) "good faith" test. We do not find Taxpayer's reliance on [Controller B's] misunderstanding of the tax system over a two year period to be persuasive or within the parameters described in RCW 82.08.130 and Rule 102(12). Evidence does not support that the deficiency was due to circumstances beyond the taxpayer's control or that the certificate was properly used. As Rule 102(12) states, "[t]he penalty will not be waived merely because the buyer was not aware of either the proper use of the resale certificate or the penalty."

In this case, we find that Taxpayer has not offered sufficient evidence to support a penalty waiver. Taxpayer's petition as to this issue is denied.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 29th day of June, 2007.