

Cite as Det. No. 14-0301, 34 WTD 120 (2015)

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. 14-0301
))	
...)	Registration No. . . .
))	

[1] RULE 267; RCW 82.32.545; RCW 82.32.534: B&O TAX – AEROSPACE MANUFACTURER’S PREFERENTIAL RATE – ANNUAL REPORT REQUIREMENT – DEADLINE FOR SUBMISSION OF ANNUAL REPORT. Taxpayer was precluded from reporting its business activity under the Aerospace Manufacturer’s preferential B&O tax rate because it failed to file the required annual report by the deadline under the requirements of both former RCW 82.32.545, and its replacement, RCW 82.32.534.

[2] RCW 82.08.975; RCW 82.12.975: RETAIL SALES TAX – USE TAX – AEROSPACE PRODUCTS AND SERVICES – PURCHASE AND USE OF COMPUTERS. Taxpayer claimed that certain computers it purchased were exempt from retail sales tax and use tax because they were used primarily in the development, design, and engineering of aerospace products or in providing aerospace services. However, Taxpayer failed to produce documentation supporting its claim, and, therefore, failed to meet its burden of proving it was entitled to the exemption.

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.

Yonker, A.L.J. – A software development company (Taxpayer) that serves certain customers in the aerospace industry protests the Audit Division’s reclassification of its income from various classifications to the service and other activities business and occupation (B&O) tax classification. Taxpayer argues that its business activity is properly classified under one of the preferential tax rates offered for certain aerospace-related activities. Taxpayer further protests the Audit Division’s assessment of use tax and/or deferred sales tax on certain purchases of computers, arguing that those purchases are exempt from retail sales tax and use tax under an aerospace-related exemption. We deny Taxpayer’s petition.¹

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

ISSUES

1. [Under former RCW 82.32.545 and its replacement, RCW 82.32.534(1)(a), did Taxpayer in 2007, 2008, and 2009] qualify for the aerospace-related B&O preferential tax rates under either RCW 82.04.260(11)(a) or RCW 82.04.290(3) where Taxpayer did not file the required annual reports for those years until April 30, 2011?
2. Did Taxpayer establish that computers it purchased were “used primarily in the development, design, and engineering of aerospace products or in providing aerospace services” and, therefore, exempt from retail sales tax or use tax under RCW 82.08.975 and RCW 82.12.975?

FINDINGS OF FACT

[Taxpayer] is an [out of state] corporation that provides technology solutions, consulting services, and software development services for the aerospace and other industries. Taxpayer maintains an office in . . . Washington, from which it serves its Washington aerospace customers.

In 2010, the Department’s Audit Division began a review of Taxpayer’s books and records for January 1, 2007 through June 30, 2010. During its review, the Audit Division found that Taxpayer had reported its gross income under a variety of Business and Occupation (B&O) tax classifications, including retailing, wholesaling, and service and other activities. The Audit Division concluded that all of Taxpayer’s gross income should have been reported under the service and other activities B&O tax classification because of the nature of Taxpayer’s business activity. The Audit Division also found that Taxpayer had not paid retail sales tax or use tax on computers that Taxpayer used in its business activity in Washington.²

During the review process, on April 30, 2011, Taxpayer sent an email to the Audit Division, stating the following:

We recently discovered that [Taxpayer] is eligible to claim various Washington aerospace tax incentives.

[RCW] 82.32.545 requires that a company claiming these incentives must submit Annual Reports electronically to the Department of Revenue by March 31st following **any year in which the incentive is taken**. Since [Taxpayer] will be making adjustments to its tax reporting through the audit to take the incentives for the years of 2007 – 2010 during 2011, the Annual Reports for these years . . . would not technically be due until March 31st 2012. However with the repeal of this statute, we believe the due date for submittal of these Annual Reports is April 30, 2011. . . .

(Emphasis in original). Taxpayer attached to this email its annual reports for claiming the aerospace tax incentives for 2007 through 2010. The Audit Division found that the annual reports for 2007, 2008, and 2009 were untimely and, therefore, Taxpayer could not be eligible

² The Audit Division made other findings, including assessing for collected retail sales tax that Taxpayer failed to remit to the Department. However, Taxpayer on appeal has not asserted any argument related to the other findings and we, therefore, consider the other findings to be outside the scope of Taxpayer’s appeal.

for the aerospace tax incentive programs for those years. However, the Audit Division found that Taxpayer's annual report for 2010 was timely, and, therefore, Taxpayer was potentially eligible for the aerospace tax incentive programs for that year only. The Audit Division decided to separate the 2010 tax year from the rest of the review period and complete a separate review of that year to determine the portion of Taxpayer's 2010 income, if any, which qualified for the aerospace tax incentive programs.³

On September 25, 2013, as a result of the Audit Division's review, the Department issued a tax assessment totaling \$. . . , which included a \$. . . five percent penalty assessment, and \$. . . in interest relating to the Audit Division's review of Taxpayers records from January 1, 2007 through December 31, 2009 (audit period).⁴ Taxpayer timely appealed the full amount of the tax assessment.

On appeal, Taxpayer submitted an "appeal package" consisting of a legal brief and various supporting exhibits, and argued that it was eligible for various aerospace tax incentive programs because it timely filed its annual reports for 2007, 2008, and 2009. In addition, Taxpayer argued that certain computer purchases it made during the audit period were exempt from retail sales tax and use tax. Taxpayer did not provide any additional documentation beyond its "appeal package" on appeal.

ANALYSIS

Washington imposes a B&O tax "for the act or privilege of engaging in business activities" in Washington. RCW 82.04.220. The measure of the B&O tax is the appropriate tax rate multiplied by the "value of products, gross proceeds of sales, or gross income of the business, as the case may be." *Id.* The specific tax rate is determined by the nature of the business activity in which a taxpayer is engaged. *See generally* Chapter 82.04 RCW. Income from any business activity that is not expressly classified in Chapter 82.04 RCW is taxed under the service and other activities B&O tax classification. RCW 82.04.290(2).

Here, Taxpayer originally reported its business activity under various B&O tax classifications. During its review, the Audit Division reclassified Taxpayer's income originally reported as wholesaling and retailing income to the service and other activities B&O tax classification pursuant to RCW 82.04.290(2). On appeal, Taxpayer conceded that its business activity was not properly taxable under the wholesaling or retailing B&O tax rate, but argued that it qualified to report its business activity under either of two different preferential tax rates, as opposed to the catchall service and other activities B&O tax rate.

RCW 82.04.260(11)(a) provides a preferential tax rate for manufacturing of commercial airplanes, components, or aerospace tooling:

³ The Audit Division conducted a separate review of Taxpayer's books and records for January 1, 2010 through June 30, 2010, which ultimately resulted in the Department issuing a separate tax assessment on July 21, 2014 based on the findings of that separate review. Those findings are not at issue in this appeal, and, accordingly, we do not address those finding in this determination.

⁴ The additional tax liability assessed in the tax assessment, which totaled \$. . . , included \$. . . in retail sales tax reconciliation, \$. . . in service and other B&O tax, \$. . . in use tax and/or deferred sales tax on computers, and two credits against that tax liability totaling \$. . . from retailing B&O tax and wholesaling B&O tax, which Taxpayer incorrectly reported and paid in its original combined excise tax returns.

Beginning October 1, 2005, upon every person engaging within this state in the business of manufacturing commercial airplanes, or components of such airplanes, or making sales, at retail or wholesale, of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is, in the case of manufacturers, equal to the value of the product manufactured and the gross proceeds of sales of the product manufactured, or in the case of processors for hire, equal to the gross income of the business, multiplied by the rate of:

- (i) 0.4235 percent from October 1, 2005, through June 30, 2007; and
- (ii) 0.2904 percent beginning July 1, 2007.

Alternatively, RCW 82.04.290(3) provides a separate preferential tax rate for non-manufacturing aerospace product development, which provides a preferential B&O tax rate of 0.9 percent for “every person engaging within this state in the business of performing aerospace product development for others.”

In order to qualify for either of these preferential tax rates in any given year, both RCW 82.04.260(11)(d) and RCW 82.04.290(3)(a) require a taxpayer to file a completed annual report.

1. RCW 82.32.545, the Law Applicable to Tax Periods Prior to 2010

We have recently held that for tax periods prior to 2010, RCW 82.32.545 was the statute controlling the process for filing annual reports. Det. No. 13-0331, 33 WTD 368 (2014). Under RCW 82.32.545, annual reports are “due by March 31st following any year in which a preferential tax rate . . . is used.” RCW 82.32.545(2)(a), *repealed by* Laws of 2010, ch. 114, § 152. Thus, under RCW 82.32.545(2)(a), there must first be some “use” of the preferential tax rate to trigger the requirement to file an annual report.

In Determination No. 13-0331, the taxpayer requested a refund in 2012 for the difference between the B&O tax rate under which the taxpayer originally reported for 2008 and 2009, and the aerospace manufacturing preferential tax rate. *Id.* Taxpayer was not aware of the preferential tax rate at the time it originally reported its tax liability for those years. *Id.* We held in that case that the taxpayer’s subsequent request for refund in 2012 did not constitute the preferential tax rate being “used” as required by RCW 82.32.545(2)(a). *Id.* In addition, we held that the due date of the annual reports for calendar years 2008 and 2009 were March 31, 2009, and March 31, 2010, respectively. *Id.*

Here, the circumstances are similar to the circumstances in Determination No. 13-0331. Taxpayer was not aware of the aerospace preferential tax rates at the time it originally reported its tax liability for 2007, 2008, and 2009. Taxpayer only learned of the preferential tax rate when it was already engaged in an audit process with the Audit Division in 2011. Then, on April 30, 2011 Taxpayer requested the Audit Division adjust Taxpayer’s tax liability for 2007, 2008, and 2009 to give Taxpayer credit for the preferential tax rate. We conclude that Taxpayer, like the taxpayer in Determination No. 13-0331, did not “use” the preferential tax rate when it requested the adjustment during the audit on April 30, 2011. In addition, consistent with our previous decision in Determination No. 13-0331, we conclude that the due date for the annual reports for calendar years 2007, 2008, and 2009, were March 31, 2008, March 31, 2009, and March 31,

2010, respectively. Because Taxpayer filed its annual reports for those years beyond those due dates, we conclude the Department properly disallowed Taxpayer's request for an adjustment of its B&O taxes reported for 2007, 2008, and 2009.

2. RCW 82.32.534, the Law Applicable to Annual Reports Due in 2011 or Later

In 2010, RCW 82.32.545, discussed above, was repealed by the legislature, and was replaced with RCW 82.32.534(1)(a), which states the following:

Every person claiming a tax preference that requires a report under this section must file a complete annual report with the department. The report is due by April 30th of the year **following any calendar year in which a person becomes eligible to claim the tax preference** that requires a report under this section.

(Emphasis added). The legislature ordered the repeal of RCW 82.32.545 (Laws of 2010, ch. 114, § 152), and the associated change in annual report due date and other language now contained in RCW 82.32.534 (Laws of 2010, ch. 114, § 103), to go into effect “beginning with annual surveys and annual **reports due in 2011.**” Laws of 2010, ch. 114 § 203 (emphasis added); *see also* WAC 458-20-267(7)(e)(i) (stating that the language of RCW 82.32.534(1)(a) was applicable “[f]or reports due 2011 or later”). Thus, beginning January 1, 2011⁵, pursuant to RCW 82.32.534, only those reports submitted by April 30th which related to a claimed tax preference in the immediately preceding year would be timely. To illustrate, under RCW 82.32.534(1)(a), if a taxpayer was “eligible” for a tax preference in 2010, then the annual report was due for that calendar year on April 30, 2011 because 2011 is “the year following” 2010. To further illustrate, under RCW 82.32.534(1)(a), if a taxpayer was “eligible” for the preferential tax rate in 2009 but did not file its annual report related to that year until 2011, under the plain language of RCW 82.32.534(1)(a), that taxpayer's claim for the preferential tax rate for 2009 would be barred since 2011 is not “the year following” 2009, as required under RCW 82.32.534(1)(a).

Because the legislature made RCW 82.32.534(1)(a) applicable to annual reports “due in 2011” or later, to the extent that Taxpayer argued on appeal that the annual reports at issue here were due in 2011 or later, it is clear that RCW 82.32.534(1)(a) would control for those reports. It follows that RCW 82.32.534(1)(a), as illustrated above, precludes a taxpayer from filing annual reports later than the April 30th of “the year following” the year in which the taxpayer was “eligible” for the tax preference. Thus, Taxpayer's filing of annual reports for 2007, 2008, and 2009 on April 30, 2011 was not timely under RCW 82.32.534(1)(a).

We ultimately conclude that regardless of whether RCW 82.32.545 or RCW 82.32.534 applies, Taxpayer's annual reports for 2007, 2008, and 2009 were untimely. As such, Taxpayer cannot

⁵ Contrary to Taxpayer's argument that RCW 82.32.534(1)(a) did not apply until April 30, 2011, we conclude that it applied beginning on January 1, 2011. RCW 82.32.534(1)(a) states that the report is due “by” April 30th as opposed to “on” April 30th. Thus, a taxpayer that wished to submit its annual report that was due in 2011 was not precluded from submitting its annual report before April 30, 2011, and could have filed its annual report due in 2011 as early as January 1, 2011, when all data for the preceding year, 2010, would have been theoretically complete. Clearly someone filing earlier in 2011 before April 30th would not have been subject to the old statutory language under RCW 82.32.545, otherwise such taxpayer would have felt compelled to submit its annual report by March 31, 2011, as required under the old statutory language. This would be contrary to clear language of the new law, which stated that the new due date was effective with those annual reports due in 2011. Laws of 2010, ch. 114, § 203.

qualify for either of the aerospace-related preferential tax rates for those years.⁶ We, therefore, affirm the Audit Division's disallowance of Taxpayer's request for a reclassification of its income in those years from the service and other activities B&O tax classification to one of the two aerospace preferential B&O tax rates.

3. Tax Exemption for Computers

In its appeal petition, Taxpayer asserted that certain purchases of computers were exempt from retail sales tax and use tax. Washington imposes both a retail sales tax and a use tax. All sales of tangible personal property to consumers in the state of Washington are subject to retail sales tax, unless there is a specific exclusion or exemption. *See* RCW 82.08.020. The use tax supplements the retail sales tax, and use of tangible personal property in the state of Washington is subject to use tax if retail sales tax was not previously paid, unless there is a specific exclusion or exemption. *See* RCW 82.12.0252. RCW 82.08.975(1) provides for one such exclusion to retail sales tax, and provides as follows:

The tax levied by RCW 82.08.020 does not apply to sales of computer hardware, computer peripherals, or software, not otherwise eligible for exemption under RCW 82.08.02565, **used primarily in the development, design, and engineering of aerospace products or in providing aerospace services**, or to sales of or charges made for labor and services rendered in respect to installing the computer hardware, computer peripherals, or software.

(Emphasis added). RCW 82.12.975 provides for an equivalent exemption from use tax. Taxpayer argued on appeal that its purchase of certain computers during the audit period qualified for this exemption from retail sales tax and use tax.

We note that we are required to narrowly construe the taxpayer's eligibility for any of the argued exemptions. As stated in *Budget Rent-A-Car, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972), "[e]xemptions to the tax law must be narrowly construed. Taxation is the rule and exemption is the exception. Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it." *See Group Health Coop. of Puget Sound, Inc. v. Dep't of Revenue*, 106 Wn.2d 391, 401-02, 722 P.2d 787 (1986); Det. No. 00-099, 20 WTD 53 (2000).

During the Audit Division's review, Taxpayer did not provide documentation of which computer purchases [it claims] were exempt or the nature of the activity for which Taxpayer used the computers at issue, despite the Audit Division's request to provide such documentation. On appeal, Taxpayer provided no additional information regarding the basis for its argument on this issue.⁷ At the hearing, Taxpayer was unable to provide additional information related to its argument on this issue. We requested additional documentation of the basis for Taxpayer's argument related to the exempt status of Taxpayer's computer purchases following the hearing.

⁶ Because we conclude that Taxpayer did not timely file its annual reports for 2007, 2008, and 2009, as required in order to qualify for the preferential tax rates under RCW 82.04.260(11)(a) or RCW 82.04.290(3), we need not address the remaining requirements of those two statutes to determine if Taxpayer qualifies for those preferential tax rates.

⁷ Indeed, we note that Taxpayer's "appeal package," which includes an eight-page legal brief, does not contain any discussion of this issue.

Taxpayer, however, did not provide any additional documentation on appeal in response to our request.

Given Taxpayer's failure to provide additional information regarding this issue, we conclude that Taxpayer has failed to meet its burden of proving that any of the computer purchases at issue were exempt from retail sales tax and use tax. We, therefore, affirm the Audit Division's assessment of use tax and/or deferred sales tax on the capital purchases made during the audit period, which the Audit Division reviewed.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 23rd day of September, 2014.