

Cite as Det. No. 14-0008R, 34 WTD 084 (2015)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for)	<u>D E T E R M I N A T I O N</u>
Reconsideration of Assessment of)	
)	No. 14-0008R
. . .)	
)	Registration No.
)	

[1] RCW 82.32.730: B&O TAX – RETAIL SALES TAX – LEASE PAYMENTS. Under the provisions of RCW 82.32.730 the first rental payment is sourced to the business location of the seller, with subsequent payments sourced to the primary location of the property.

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.

Lewis, A.L.J. – Taxpayer, a renter of road signs, requests reconsideration of Determination No. 14-0008, which sustained an assessment of retailing business and occupation (“B&O”) tax and retail sales tax on the first lease payment of equipment rented at a Washington location and subsequently transported to an Oregon job site. Taxpayer’s petition is denied.¹

ISSUE:

In accordance with RCW 82.32.730, for purposes of collecting or paying sales or use taxes on the first lease payment when the lessee took delivery of the equipment in Washington for subsequent transportation to a construction job located out-of-state, is the first lease payment sourced to Washington?

FINDINGS OF FACT:

Taxpayer operates retail locations in Oregon and Washington that sell and rent traffic control equipment. Such equipment includes: Truck-mounted attenuators, variable message boards, changeable message boards, sequential arrow boards, portable traffic lights, and portable traffic signs.

In some cases, Taxpayer rents equipment from a Washington retail location and the customer transports the equipment to a job site located out-of-state. Taxpayer’s sales invoices reflect the

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

location from which the equipment was rented and the location of the job where the equipment will be used.

The Department's Audit Division audited Taxpayer's business records for the period January 1, 2008 through September 30, 2011. On audit, the Audit Division discovered that Taxpayer business records were lacking or incomplete.

For 2008, Taxpayer did not provide records. In the absence of records, the Audit Division estimated income for the period. For the 2009 through 2010 period, the Audit Division reconciled the income coded on QuickBooks to Washington to that reported on the excise tax returns. The Audit Division discussed the preliminary audit adjustments with Taxpayer. Taxpayer provided some sales invoices that indicated that Taxpayer delivered the equipment to the customer in Oregon. Those sales were then treated as exempt interstate sales. Some invoices indicated that the customer picked the equipment up in Washington and took the equipment to the job site in Oregon. Some rentals were continuous monthly rentals and others were one-time rentals. In the case of continuous rentals, the Audit Division assessed retail sales tax on the first payment and treated the subsequent payments as exempt interstate sales. Most of the sales invoices were for one-time rentals. In those instances, the Audit Division assessed retail sales tax on rentals where the customer picked up the equipment in Washington for use in Oregon.

On December 31, 2012, the Department issued a \$. . . assessment.² Taxpayer disagreed with the assessment. On January 18, 2013, Taxpayer filed a petition requesting correction of the assessment of retailing B&O and retail sales tax on leases of equipment that was picked up in Washington by the customer for use on a job located in Oregon. Taxpayer maintained the adjustment and future reporting instructions were "contrary to statute and administrative rule" and that RCW 82.32.730 "cannot and does not trump the state or federal constitutions."

On January 15, 2014, the Department issued Determination No. 14-0008. Determination No. 14-0008, sustained the assessment concluding the assessment followed RCW 82.32.730(2), which requires sourcing the first periodic rental payment to the business location of the seller, with subsequent payments sourced to the primary property location. Determination No. 14-0008 explained that the Department as "[a]n administrative body does not have authority to determine the constitutionality of the law it administers; only the courts have that power." *Bare v. Gorton*, 84 Wn.2d 380 (1974). Thus, the Department does not have the requisite authority to consider or declare a tax unconstitutional.

Determination No. 14-0008 also concluded that:

[T]he Department is authorized to estimate a taxpayer's tax liability in the event the taxpayer fails to preserve and provide suitable records. Because Taxpayer did not provide the required documentation for some sales to show that a lease extended beyond the first payment, we conclude the Audit Division correctly taxed those lease transactions when the customer took possession of the equipment in Washington.

² The \$. . . assessment consisted of \$. . . tax, \$. . . interest, and \$. . . assessment penalty. On July 6, 2012 Taxpayer made a payment of \$. . . towards satisfaction of the assessment.

The determination sustained the Audit Division's estimate of tax due for 2008 because of lack of records.

Taxpayer disagreed with the determination. On February 7, 2014, Taxpayer filed a petition for reconsideration. Taxpayer's reconsideration asserted:

[T]he Department improperly *applied* RCW 82.32.730 as a means to reach beyond this state's borders, and it is this *policy as applied*, which stands in direct violation of existing statutes and administrative rules. It is this *policy* which the Taxpayer contests.

Taxpayer also requested that the Audit Division examine sales records for 2008, which have recently been discovered.

ANALYSIS:

On reconsideration, Taxpayer maintained that the Determination failed to thoroughly discuss arguments raised in the original appeal petition.

Taxpayer's first concern was that RCW 82.32.730 is a "sourcing" statute and pertains only to "taxable" retail transactions. Accordingly, if the tax is not imposed it cannot be sourced.

RCW 82.32.730 provides:³

(1) Except as provided in subsections (5) through (8) of this section, for purposes of collecting or paying sales or use taxes to the appropriate jurisdictions, all sales at retail shall be sourced in accordance with this subsection and subsections (2) through (4) of this section.

(a) When tangible personal property, ... is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

...

(2) The lease or rental of tangible personal property, other than property identified in subsection (3)⁴ or (4)⁵ of this section, shall be sourced as provided in this subsection.

(a) For a lease or rental that requires recurring periodic payments, the first periodic payment is sourced the same as a retail sale in accordance with subsection (1) of this section. Periodic payments made subsequent to the first payment are sourced to the primary property location for each period covered by the payment. ...

³ RCW 82.32.730 became effective July 1, 2008.

⁴ This includes motor vehicles, trailers, semitrailers, or aircraft that do not qualify as transportation equipment. RCW 82.32.730(3).

⁵ This includes transportation equipment. RCW 82.32.730(4).

(b) For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with subsection (1) of this section.

(Emphasis added.)

Here, Taxpayer's customer takes delivery of the equipment at Taxpayer's business location within Washington. The equipment is leased. In the case of continuous rentals, the lease involves a contract for a series of transactions. *Gandy v. State*, 57 Wn.2d 690, 695, 359 P.2d 302 (1961). The retail sales tax applies to each successive retail sale (here, each lease payment). RCW 82.08.020. In the case of a one-time rental, there is a single retail transaction.

The provisions of RCW 82.32.730 are consistent with existing Washington state excise tax law that requires payment of B&O tax and collection of retail sales tax when the buyer takes delivery of equipment in Washington.

Taxpayer's second concern was that a "taxable event" must first occur before RCW 82.32.730 applies. Taxpayer maintained that no "taxable event" occurred because the constitutional constraints provided by RCW 82.08.0254⁶ and RCW 82.12.0255⁷ apply. We agree with Taxpayer that there would be no tax to source if the constitutional exemption applied. However, that is not the case here.

The original decision discussed at length Taxpayer's constitutional challenge to the tax imposed and concluded that there is no constitutional prohibition of taxing the first lease payment when the customer takes delivery of the equipment within Washington:

Taxpayer challenges that fair apportionment prong of the four-pronged test the Supreme Court articulated in *Complete Auto* as it is being applied in this case. The underlying principle of apportionment is that a state may only tax its fair share of an interstate transaction. *Goldberg v. Sweet*, 488 U.S. 252, 260-61, 109 S. Ct. 582 (1989); *see also Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184, 115 S. Ct. 1331 (1995).⁸

⁶ RCW 82.08.0254 provides:

The tax levied by RCW [82.08.020](#) shall not apply to sales which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States.

⁷ RCW 82.12.0255 provides:

The provisions of this chapter do not apply in respect to the use of any article of tangible personal property, extended warranty, digital good, digital code, digital automated service, or other service which the state is prohibited from taxing under the Constitution of the state or under the Constitution or laws of the United States.

⁸ The Supreme Court in *Complete Auto* held that the Commerce Clause requires that the tax: 1) be applied to an activity with substantial nexus with the taxing state; 2) be fairly apportioned; 3) not discriminate against interstate commerce; and, 4) be fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

The inquiry at issue is whether the tax is both internally and externally consistent. Internal consistency is preserved if the tax is such that, if every state imposed an identical tax, no multiple taxation would result. Here, there is no internal consistency problem. If every state were to impose a tax identical to RCW 82.32.730(2) only one state would tax each lease payment because only one state can claim to be the business location of the seller, and only one state can claim to be the equipment's "primary location."

External consistency looks to the degree of relationship between the taxing state and the entity that it seeks to tax. *Jefferson Lines*, 514 U.S. at 185. This test asks whether a state has taxed only the portion of the revenue from the interstate activity that reasonably reflects the in-state component of the activity being taxed. *Goldberg*, 488 U.S. at 262. We thus examine the in-state business activity that triggers the taxable event and the practical or economic effect of the tax on that interstate activity. *Goldberg*, 488 U.S. at 262. Courts have routinely upheld the constitutionality of unapportioned retail sales tax because the incident of "sale" is presumed to occur in one, and only one, state. See generally WALTER HELLERSTEIN, STATE TAXATION 19A.06 n. 400 (3d ed. 1998) ("Indeed the difficulties of apportioning a retail sales tax underlie the well entrenched (and constitutionally sanctioned) tradition of generally assigning the retail sales tax base to a single jurisdiction. . . ."). We further observe that "[n]o internally consistent tax has failed the external consistency test for lack of further apportionment." *Jefferson Lines*, 514 U.S. at 192. Here, there is no evidence that the state taxed revenue that did not reasonably reflect the in-state component of the activity being taxed.

Det. No. 14-0008. Taxpayer has not presented anything to challenge the conclusion in the original decision.

Taxpayer's third concern was that the original decision did not explain why WAC 458-20-145 ("Rule 145") did not apply. Rule 145 is the administrative rule that discusses the sourcing of local sales and use tax. Rule 145(1) provides:

(1) **Introduction.** Effective July 1, 2008, Washington implements new rules governing how local retail sales taxes are sourced within Washington. See RCW 82.32.730 and 82.14.490. These rules govern where the local retail sales tax attributable to the sale of tangible personal property, retail services, extended warranties, and the lease of tangible personal property is sourced.

"Source," "sourced," or "sourcing" refer to the location (as in a local taxing district, jurisdiction, or authority) where a sale or lease is deemed to occur and is subject to retail sales tax. (Emphasis added.)

We do not find Taxpayer's reliance on Rule 145 particularly helpful to its argument for relief of tax. Rule 145(2)(a), explains:

If the seller ships or delivers tangible personal property to a customer who receives that property outside Washington, the sale is deemed to have taken place outside Washington and is not subject to Washington state or local retail sales tax.

...

If a purchaser receives tangible personal property, a retail service, or an extended warranty at the seller's business location, the sale is sourced to that business location.

Consistently with RCW 82.32.730, WAC 458-20-193, and WAC 458-20-145, the Audit Division did not assess B&O or retail sales tax in those cases where the Taxpayer delivered the equipment to its customer outside Washington. Conversely, the Audit Division assessed B&O and retail sales tax on the one-time rental payments where the customer took delivery at Taxpayer's place of business, and on the first payment on continuous leases where the customer took delivery at Taxpayer's place of business for use in Oregon. The assessment of Tax was consistent with the guidance provided by Rule 145.

Taxpayer's fourth concern was that the original decision did not explain why WAC 458-20-103 ("Rule 103") did not apply. Rule 103 is the administrative rule that discusses the time and place of sale. Rule 103 provides in pertinent part:

With respect to the charge made for renting or leasing tangible personal property, a sale takes place in this state when the property is used in this state by the lessee.

We do not find Taxpayer's reliance on Rule 103 particularly helpful to its argument for relief of tax. RCW 82.12.010(6)(a) defines use as:

With respect to tangible personal property, ..., the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer), and include installation, storage, withdrawal from storage, distribution, or any other act preparatory to subsequent actual use or consumption within this state;

Under RCW 82.12.010's very broad definition of "use," the customer's use of the equipment occurs when it assumes dominion and control of the equipment at pick-up at Taxpayer's Washington business location. The assessment of is consistent with the provisions of Rule 103.

Taxpayer's fifth concern was that the original decision did not explain why WAC 458-20-193(5) ("Rule 193") did not apply. Rule 193 is the administrative rule that discusses the inbound and outbound interstate sale of tangible personal property. Rule 193(5)(d) provides in pertinent part:

Renting or leasing of tangible personal property. Lessors who rent or lease tangible personal property for use in this state are subject to B&O tax upon their gross proceeds from such rentals for periods of use in this state. Proration of tax liability based on the degree of use in Washington of leased property is required.

It is immaterial that possession of the property leased may have passed to the lessee outside the state or that the lease agreement may have been consummated outside the state. Lessors will not be subject to B&O tax if all of the following conditions are present:

- (i) The equipment is not located in Washington at the time the lessee first takes possession of the leased property; and

- (ii) The lessor has no reason to know that the equipment will be used by the lessee in Washington; and
- (iii) The lease agreement does not require the lessee to notify the lessor of subsequent movement of the property into Washington and the lessor has no reason to know that the equipment may have been moved to Washington.

We do not find Taxpayer's reliance on Rule 193 particularly helpful to its argument for relief of tax. WAC 458-20-193(5)(d)(i) explains the requirements for the tax exempt lease of property. One of the requirements is "[t]he equipment is not located in Washington at the time the lessee first takes possession of the leased property." Here, Taxpayer's customers take delivery of the equipment at Taxpayer's Washington business location. The assessment reflects the proper tax treatment on the use of the equipment within Washington.

Taxpayer also discussed the Department's decision in Det. No. 02-0163, 22 WTD 262 (2003). Most specifically, Taxpayer looked to the published determination for:

The Department's admission of: (1) "an interstate sales deduction," as cause for why out-of-state lease receipts are not taxable; (2) the fact "taxable" lease receipts are confined to "...use of the...[property]... in Washington;" and (3) the "*controlling factor*" in terms of jurisdiction and taxable lease receipts being triggered by "*when the property is 'used' in this state by the lessee.*"

We do not find Taxpayer's reliance on 22 WTD 262 (2003) particularly helpful to its argument for relief of tax. 22 WTD 262 dealt with the taxation of a motor carrier's rolling stock. There are specific requirements for tax exemption applicable to a motor carrier's rolling stock. However, whether rolling stock or signage equipment, use tax or deferred sales tax is triggered by when the property is first used in Washington. RCW 82.12.010(5); RCW 82.04.050. In Taxpayer's case, deferred retail sales tax was assessed on the equipment when it was used in Washington. We note that RCW 82.32.730 was effective on July 1, 2008, well after that decision was issued.

Finally, Taxpayer requested that the Audit Division examine Taxpayer's sales records for 2008. The Audit Division estimated the tax due for 2008 because Taxpayer was unable to provide records. Taxpayer's reconsideration petition advised that Taxpayer has since discovered . . . sales invoices [from 2008] in hard copy form. The Department's February 12, 2014, letter acknowledging Taxpayer's reconsideration petition advised Taxpayer that it may supplement its petition for reconsideration by providing additional information within 30 days from the date of the letter. The Audit Division's March 13, 2014, response to Taxpayer's reconsideration petition stated:

Records were not provided for 2008 and therefore an estimate was used. If the hard copy sales invoices and sales invoices and source documents supporting the completeness of the records are provided, these records can be used to calculate taxes owed in 2008.

Both the letter acknowledging Taxpayer's reconsideration petition and the Audit Division's response to Taxpayer's petition invited Taxpayer to provide additional documentation. The

additional documentation has not been provided. Taxpayer has provided no basis for adjustment of the original audit. The original assessment is sustained. After payment of the tax, Taxpayer may file for refund, following the guidelines contained in WAC 458-20-229.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 25th day of July 2014.