

Cite as 5 WTD 245 (1988)

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	
For Correction of Assessment of)	<u>F</u> <u>I</u> <u>N</u> <u>A</u> <u>L</u>
<u>N</u>	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u>
)	
)	No. 87-184A
)	
. . .)	
)	Registration No. . . .

[1] **RULES 178, 159, AND 102:** RCW 82.12.020 -- USE TAX -
- RESALE CERTIFICATES -- SUBSTANCE OVER FORM. In
determining tax liabilities under the law the
Department of Revenue elevates substance over form
but does not ignore the formal agreements,
documents, and transactions which reveal the
substantive benefits derived. One of the primary
substantive effects of lease of tangible property to
a registered business for its business use (bare-
boat chartering) is the legal capacity of the
business to purchase materials for resale through
resale certificates, sans sales tax.

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.

TAXPAYER REPRESENTED BY: . . .
. . .

HEARING CONDUCTED BY DIRECTOR'S DESIGNEES:
Garry G. Fujita, Assistant Director
Edward L. Faker, Sr. Administrative Law
Judge

DATE AND PLACE OF HEARING: November 10, 1987; Olympia,
Washington

NATURE OF ACTION:

This is an appeal to the Director from the findings and conclusions of Determination No. 87-184, 3 WTD 205 (1987) which was issued on June 2, 1987 after an original appeal conference conducted on April 16, 1986. The Determination sustained the assessment of use tax upon the value of consumable materials and supplies purchased for the vessel, "Tahoe." Retail sales tax was not paid to suppliers of the consumables because resale certificates were tendered.

FACTS AND ISSUES:

The facts, audit detail, and tax assessment information are fully and properly set for the in Determination 87-184. By the taxpayer's admission the facts of the case are not in dispute. For perspective on the issue, the operative facts are that the former president of the taxpayer company executed a written lease agreement whereby the taxpayer leased the vessel "Tahoe" from the taxpayer's former president for purposes of bare-boat chartering of the vessel. This was only one of several vessels operated in this manner by the taxpayer company. The former president, who is now disassociated from the business and is bankrupt, commingled several of his business enterprises with the taxpayer company's business. (See Determination 87-184 p.2 para. 4). He purportedly advised the taxpayer company's accountant to maintain separate accounting records covering purchases for the "Tahoe." When such purchases were made, resale certificates were tendered to sellers and tax was thus avoided on such purchases, claimed to be for resale in connection with bare-boat charters of the "Tahoe."

The Department's auditor found, upon examination of the business records, that the purchased items were consumables rather than component parts of a vessel for resale. Determination 87-184 sustained use tax (deferred sales tax) upon the consumables, based upon the finding that the lease of the "Tahoe" to the taxpayer company was effectual and was taken advantage of for other purposes, e.g., the vessel was partially capitalized on the taxpayer's federal tax returns.

The single issue for our resolution is whether use tax is properly assessed against an ongoing business entity upon the value of consumables purchased by a former president of the business entity without payment of retail sales tax by improperly providing resale certificates to vendors.

TAXPAYER'S EXCEPTIONS:

The taxpayer asserts that the lease was a sham which was never effective and never used for anyone's benefit. It argues that Determination 87-184 is defective in concluding that the taxpayer cannot penetrate the form of the lease transaction to get to the substance of what happened. The taxpayer's petition to the Director includes the following:

The gravamen of the determination is that "[the] Department is not required to consider the taxpayer's arguments that in substance it did not lease the "Tahoe" and the vessel was never part of its business." As authority for this proposition, and for authority that a taxing authority may penetrate the form of a transaction to determine its substance, but a taxpayer may not, the determination cites a Supreme Court case, Higgins v. Smith, 308 U.S. 473 (1940).

. . .

The taxpayer argued and the Department of Revenue concedes that the evidence shows the existence of two separate businesses. The "Tahoe" vessel was the separate business and property of Mr. . . . ¹ and he alone should be liable for any taxes owing on purchases for that vessel. As stated in the Supreme Court case Higgins v. Smith, "it is command of income and its benefits which marks the real owner of property." Id. at page 478.

The Supreme Court again reiterated this established principle of law in Frank Lyon Company v. The United States, quoting Corliss v. Bowers, 281 U.S. 376:

This Court, almost 50 years ago, observed that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed - the actual benefit for which the tax is paid." 98 S.Ct. 1291, 1298 (1978).

In this case, actual command, control and benefit of the property was solely in the hands of Mr. . . .

¹ The actual name of the taxpayer's former president has been deleted throughout this Final Determination.

The Department of Revenue, by law, must consider these facts.

. . . .

In addition, the Administrative Law Judge places great importance on the lease between Mr. . . . (d/b/a . . . Charters) and the taxpayer. However, the taxpayer stated at the hearing, and the Department of Revenue acknowledges, that Mr. . . . did not actually put the "Tahoe" vessel into the business. The taxpayer's business and Mr. . . .'s business were separate: they had separate books, separate worksheets, separate cash receipts, separate records, separate bank accounts, and two separate sets of books were audited. The existence of the lease does not change the substance of what actually took place. The Department of Revenue is constrained to consider these facts. The Supreme Court in Frank Lyon Company v. United States, citing Commissioner of Internal Revenue v. Tower, 327 U.S. 280, states that:

The Court has never regarded the simple expedient of drawing up papers as controlling for tax purposes when the objective economic realities are to the contrary. Id. at 1298.

The Frank Lyon Court went on to note, citing Pelvering v. Lazarus & Company, 308 U.S. 255, that:

In the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding. Id. at 1298.

It is erroneous for the Department of Revenue to single out the lease agreement in an effort to assess the tax liability against the taxpayer. The Department of Revenue should instead evaluate the substance of the transaction, taking care to examine the transaction as a whole, not as the sum of its component parts. c.f., Boyter v. C.I.R. Service, 668 F.2d 1382 (1981) (in evaluating the substance of a transaction the courts [should] take care to examine the transaction as a whole, not as the sum

of its component parts). The Boyter Court, citing Central Tablet Manufacturing Company v. The United States, 417 U.S. 673, states that "tax consequences follow what has taken place, not what might have taken place". This specifically is what taxpayer contends, and what the Department of Revenue must consider, as dictated by the Supreme Court of the United States.

At the November 10, 1987 hearing the taxpayer reiterated the arguments contained in its petition and those originally placed before the Administrative Law Judge. It testified that the lease of the vessel was signed by the taxpayer's former president on behalf of both the lessor, . . . Charters, and the taxpayer company. Beyond that, the taxpayer's arguments sound in equity, that the taxpayer company should not be held accountable for the tax liabilities incurred by the pro-forma transactions engaged in by its former chief executive officer.

DISCUSSION:

The resolution of the issue before us does not turn upon questions of law. There is no doubt, nor does the taxpayer deny that tax was legally due and owing upon purchases of consumables for the "Tahoe" and that resale certificates were improperly provided to sellers. Rather, the taxpayer asserts, "look to the substance and realities of what actually occurred." We have. We have fully considered the taxpayer's argument that, "in substance it did not lease the "Tahoe" and the vessel was never part of its business." (Taxpayer's petition, p.1, para. 5). This argument is without merit and is in conflict with the admitted facts.

[1] The crux of this case is that one of the very benefits derived from the lease was the ability of the taxpayer company, through its then president or any authorized purchasing agent, to provide the taxpayer company's tax registration number and resale certificates to materialmen and to thereby purchase materials and supplies sans sales tax. These were not ultra vires acts. It requires no case law or statutory support to conclude that the taxpayer company could do its business in any legal manner it chose. If the "Tahoe" had not been leased to the taxpayer company the use of the registration number and giving of resale certificates in the taxpayer's name would not have been legally possible. See WAC 458-20-102. The taxpayer company did business in this manner through the very business auspices, albeit machinations, of

its company president. It cannot now be heard to complain about the outcome.

The fact that the taxpayer's then president sold his stock and operating interests in the business enterprise and is now bankrupt cannot work to relieve the business itself from its legal tax liabilities. This consequence is not the result of elevating form over substance. Rather, the lease of the "Tahoe" and the subsequent recognition of the validity of that business undertaking by purchasing materials and giving resale certificates in the taxpayer's name were the very substance of the transactions. Elevating substance over form does not require us to totally ignore the pro-forma documents which reveal the substance of the transactions. This is not a case involving the piercing of the corporate veil. Ownership of the "Tahoe" is not in issue here. Clearly, there is no question that the taxpayer company benefited from the actions of its then president. Moreover, further discussion of the case law supports relied upon by the taxpayer is not helpful or necessary. Even under the propositions for which those cases stand, were they apposite here, we are constrained to sustain the findings and conclusions of Determination 87-184. The taxpayer has presented us with no persuasive testimony or arguments to controvert those findings and conclusions.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 23rd day of March 1988.