Cite as 9 WTD 292-17

BEFORE THE INTERPRETATION AND 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. 90-220
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .
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[1] **RULE 24001:** SALES AND USE TAX DEFERRAL -- MACHINERY AND EQUIPMENT -- NEW LEASED BUILDING. Machinery and equipment purchased for an eligible investment project is still eligible for the sales and use tax deferral if it is placed in a new, leased facility, whether or not that facility is eligible for the deferral.

[2] **RULE 24001:** SALES AND USE TAX DEFERRAL -- NEW BUILDING -- SOLD AND LEASED BACK. A building that is newly built and then sold to the owner of the land, who then leases it back to the builder, is not eligible for the sales and use tax deferral provided by Chapter 82.60, when the underlying ownership of the leased building and the machinery and equipment are not owned by the same person. Once the building has been sold, the original builder no longer has an investment in the building, nor any need for the relief of delayed payment of the taxes, as it has recovered its investment through the sale of the building.

[3] **MISC:** ESTOPPEL -- ORAL INSTRUCTIONS. The Department cannot be estopped from asserting a tax liability because of claimed oral instructions and information given by a Departmental employee. The

taxpayer must show that the Department made a statement or act that was contrary to its later position by more evidence than the word of the taxpayer. Accord: Professional Promotion Services, Inc. v. Department of Rev., Docket No. 36912 (BTA 1990).

[4] RULE 24001, RULE 228, RCW 82.32.050: INTEREST -- ACCRUAL -- DUE DATE OF TAXES. Interest accrues on unpaid tax liabilities at the rate of 9% per annum from the date the tax was due. When taxes originally deferred are found to be due, the due date of the taxes is the due date given to the taxpayer when the liability is accelerated. Interest then accrues on that liability at 9% per annum, calculated from the last day of the year in which the taxes were due. The interest is not compounded, but is instead only simple interest, calculated on a daily basis.

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: . . .
. . .

DATE OF TELEPHONE CONFERENCE: . . .

NATURE OF ACTION:

Taxpayer protests the revocation of a tax deferral certificate.

FACTS AND ISSUES:

Hesselholt, A.L.J. -- Taxpayer is a start-up manufacturing company. Taxpayer decided to base its plant in . . . County in part because that county qualified for sales and use tax deferrals. Taxpayer states that it worked closely with the Department of Revenue to prepare its application and to understand the workings of the statutes and regulations.

On July 8, . . . , taxpayer submitted its initial application for the deferral. That application stated that the taxpayer was going to lease a new facility that would be built by and leased from the [Municipal Corporation]. That application estimated the cost of newly acquired machinery and equipment

at $3 million. On July 13, . . . , it made several changes to its application, none of them relevant here. On July 20, . . . , the Department granted taxpayer the use and deferral certificate for purchases made from July 10, . . . through November 6, ...

In September . . . , taxpayer submitted an amended application to the Department. It stated that the building would be built by taxpayer for $700,000, and the equipment purchases would be approximately $2.5 million. Taxpayer states that the reason for this is that the [M.C.] was unable to timely arrange for construction. Taxpayer also asked for an extension of time to complete its purchases. Also in September, taxpayer agreed to build the building, sell it to the [M.C.], and lease it back. Those agreements were signed September 11,. . . . Taxpayer has submitted a copy of notes taken by its accountant of a telephone conversation between the accountant and the Department's excise tax examiner handling the deferral program. Those notes indicate that the examiner was asked if the sale/leaseback agreement would "screw up" the deferral. The notes indicate that the answer was "no, won't screw up." These notes are dated September 3, ...

On September 16, . . . the Department granted the request for amendment of the sales and use tax deferral. Several more extensions were granted of the time in which to use the certificate. The project was finally completed, and in September, . . . the Department's excise tax examiner requested that an audit be done of the project to determine the use tax to be deferred on qualified purchases, the use tax due on nonqualifying purchases, and the tax to be forgiven on the direct labor charges. In October . . . a field audit was performed, resulting in the assessments cited above. The auditor visited the site and had full access to the taxpayer's books, including the monthly financial statements showing the monthly lease payment to the [M.C.] for the plant. The assessments were amended in August of . . . , and assessments were deferred under the statute and rule.

In January . . . the taxpayer began working with another unit of the Department of Revenue regarding leasehold excise tax on its lease with the [M.C]. Copies of the sale/leaseback agreement were provided to the Department. An appeal to this section was made regarding the leasehold excise tax, which was decided on May 24, ...

On June 26, . . . , the excise tax examiner sent a letter to the taxpayer, stating, in part, that

> This is written to advise you that the deferral assessments for the sales and use tax due on the investment project authorized under certificate . . . have been declared as due immediately.
>
> 82.60.020 RCW states in part:
>
> > (5) "Investment project" means an investment in qualified buildings and qualified machinery and equipment. . .
>
> Further
>
> 82.60.070 RCW states:
>
> > (2) If on the basis of a report under this section or other information, the department finds that an investment project is not eligible for tax deferral under this chapter for reasons other than failure to create the required number of qualified employment positions, the amount of deferred taxes outstanding for the project shall be immediately due. (Emphasis supplied.)
>
> The building that was built by [TP] as part of the "Investment Project" has been sold to the [M.C.] which in turn has leased the facility back to [TP].
>
> Since [TP] no longer has an investment in qualified buildings, the action, as set forth in 82.60.070(3) RCW, is hereby enforced.

All of the assessments were accelerated, including the tax due on the machinery and equipment.

Taxpayer protests that all the facts were made known to the department; that the department knew exactly what the transactions were; that the department never warned taxpayer that its actions would cause the deferral to be rescinded; and that the taxpayer does in fact have an investment in a qualified building by way of its ten year, $10,000/month lease.

DISCUSSION:

Chapter 82.60 RCW provides a program granting deferrals for sales and use taxes for "eligible investment projects" in

certain distressed areas of the state. The deferrals are implemented by the Department of Revenue in WAC 458-20-24001 (Rule 24001). The rule largely repeats the definitions and qualifications set out by the legislature and adds the administrative provisions. That rule provides that the deferral generally applies to sales and use taxes on materials, labor, and services used in the construction of such a project. The deferral is available for actual construction of a building as well as the acquisition of equipment for "eligible investment projects." Investment projects are those which are "directly utilized" to create one full-time permanent employee for each three hundred thousand dollars of investment and either initiates a new operation or expands or diversifies an existing operation. An "eligible investment project" is

> (3)(i). . . an investment in qualified buildings and qualified machinery and equipment, including labor and services rendered in the planning, installation, and construction of the project. A person who does not build or remodel its own building, but leases from a third party, is eligible for sales and use tax deferral provided that an investment in qualified machinery and equipment is made by such person and a new structure used to house the manufacturing activities is constructed. The lessor/owner of the structure is not eligible for deferral unless the underlying ownership of the buildings, machinery, and equipment vests in the same persons.

Qualified buildings are

> (3)(k) new structures used to house manufacturing activities as defined above and includes plant offices, warehouses, or other facilities for the storage of raw material and finished goods if such facilities are essential or an integral part of a manufacturing operation. The term also includes parking lots, landscaping, sewage disposal systems, cafeterias, and the like, which are attendant to the initial construction of an eligible investment project. The term "new structures" means either a newly constructed building or a building newly purchased by the certificate holder. A preowned or existing building is eligible for deferral provided that the certificate holder expands, modernizes,

> renovates, or remodels the preowned or existing building by physical alteration thereof.

The obligation to repay the tax due on the labor portion is expressly excused if the application is made after a certain date and the eligibility for the deferral is perfected. Rule 24001(24). Taxpayers must apply for the deferral before initiation of the construction. The Department verifies the information and either grants or denies the deferral request. The deferral can be revoked if the Department finds that the applicant has not made the required investment in buildings, machinery or equipment. (Rule 24001(22). If revoked for that reason, the taxes are immediately due.

[1] In this case, even with the sale of the building and leaseback from the [M.C.], the acquisition of machinery is still eligible for the deferral. The rule provides that the acquisition of machinery or equipment can qualify for the deferral if it is to be placed, as in this case, in a new leased facility. The initial plan was to lease the building and the taxpayer's application stated that clearly. The original deferral was granted on that plan. Taxpayer retains its original investment in that machinery and equipment. Taxpayer's petition is granted on this issue.

[2] The second issue is whether the sale of the building to the [M.C.] is a cause to revoke the deferral. We believe that it is. In RCW 82.60.020(4)(iii), an eligible investment project includes one in which the equipment and machinery are to be housed in a new, leased structure, but the "lessor/owner of the structure is not eligible for a deferral unless the underlying ownership of the buildings, machinery, and equipment vests exclusively in the same person." This same language is repeated in Rule 24001(3)(i). Here, the lessor of the structure would not be entitled to a deferral had it built the structure itself, because the underlying ownership of the building, equipment and machinery vest in two separate entities: taxpayer and the [M.C.]. In taxpayer's original proposal, it intended to house its equipment and machinery in a structure to be built by the [M.C.] and leased to taxpayer. When that changed, taxpayer decided to build the structure and sell it to the [M.C.]. It would then lease the structure, thus putting it in exactly the same position as it would have been had its initial plan been followed. The taxpayer is not being injured here, because it has received compensation from the [M.C.] for the cost of the building. The deferral program was created by the legislature to stimulate economic growth in certain distressed areas. The legislature determined that it

would be beneficial to apply this program "under circumstances where the deferred tax payments are for investments or costs that result in the creation of a specified number of jobs." RCW 82.60.010. Taxpayer incurred certain costs in building the facility. Those costs were recovered when the facility was sold. Taxpayer no longer has an "investment" in the building. Taxpayer argues that its $10,000 per month rental payment is an investment in the building, but that is clearly not an "investment" contemplated by the legislature in creating the program. The legislature was very clear in specifying what would and would not be eligible for deferral. It meant to ease the start-up costs of certain kinds of businesses in distressed areas of the state. This goal is not advanced by allowing taxpayers to obtain a deferral, build a structure, and then sell it, while still retaining the right to defer payment to the state for taxes when the cost of the building (and the taxes) has been recovered from a buyer. Taxpayer's petition is denied as to this issue.

3. Estoppel.

Taxpayer argues that the Department knew exactly what it (taxpayer) was doing at all stages and never indicated that any of its actions would jeopardize its deferral. Thus, it argues, the Department is estopped from denying the deferral now.

"The doctrine of estoppel will not be lightly invoked against the state to deprive it of the power to collect taxes." Kitsap-Mason Dairymen's Ass'n v. State Tax Commission, 77 Wn.2d 812, 818, 467 P.2d 312 (1970).

> Three elements must be present to create an estoppel: (1) an admission, statement, or act inconsistent with the claim afterwards asserted, (2) action by the other party of the faith of such admission, statement, or act, and (3) injury to such other party resulting from allowing the first party to contradict or repudiate such admission, statement, or act.

Harbor Air v. Board. of Tax Appeals, 88 Wn.2d 359, 367, 560 P.2d 1145 (1977). In Harbor Air, the Department was estopped to assert taxes against a successor prior to . . . , when it had taken some affirmative actions on which the taxpayer could have reasonably relied.

[3] In this case, the taxpayer was granted the deferral on July 20, ... In September, taxpayer amended its application to show that it would build the facility itself. Nowhere on the amended application or letter or transmittal does it state that the facility will be sold to the [M.C.] and leased by the taxpayer. The notes of the telephone conference between the CPAs and the Department's excise tax examiner are somewhat ambiguous. According to taxpayer, it specifically asked if the sale and leaseback of the facility would "screw up" the deferral, and was told that it would not. Such a statement is literally true--the deferral for the machinery and equipment should not have been affected. However, it is not clear that the excise tax examiner understood that the taxpayer was asking for a deferral on a building that it intended to sell and then lease back.

Excise Tax Bulletin 419.32.99 (ETB 419) has been adopted by the Department to explain its position regarding oral instructions regarding tax liability. It states that the Department "cannot give consideration to claimed misinformation resulting from telephone conversations or personal consultations with a Department employee." The reason for this is that there is no record of the facts given to the employee; there is no record of the instructions given by the employee; and there is no evidence that the taxpayer completely understood what the employee told him. This ETB has been affirmed by the Board of Tax Appeals in Professional Promotion Services, Inc. v. Department of Rev., Docket No. 36912 (BTA 1990). In that case, the Department argued that to prove estoppel, a taxpayer must show a statement "inconsistent with a claim later asserted" by "evidence greater than testimony of the allegedly wronged taxpayer as to his or her recollection of a conversation with a Department employee." PPS, at 7. The Department employee in this case denies any knowledge of the sale/leaseback transaction. There is no written documentation to show that the Department should have known about it at the time.

Taxpayer argues also that the Department's auditor had complete access to its books and should have seen the rental payments to the [M.C.] and realized that they were for the lease of the facility. This may be so, but we believe that it is just as reasonable for the auditor to have believed that the lease payments were for the lease of the land, rather than the building. All the applications showed that the land would be leased from the [M.C.]. None of them show that the building would be sold and leased back from the [M.C.]. In Martin Air Conditioning, supra, the court held that the state

could not be estopped from asserting a tax liability because its auditors had failed to find the error. In Kitsap-Mason, supra, the Department had also failed to discover taxpayer's reporting error
over several audits, but the court found no estoppel against the Department.

Here, there is no written evidence to support taxpayer's assertion that the Department was notified that it intended to sell the building to the [M.C.] and lease it back. The Department cannot be estopped from asserting the taxes legally due.

4. Interest.

[4] Taxpayer has argued that no interest should accrue on the deferred tax prior to the date that the taxes were found to be due. In the letter sent to taxpayer, no interest was asserted. However, when the taxpayer petitioned to the Interpretation and Appeals Division, it was sent standard form letters regarding the accrual of interest on the tax liability. Taxpayer has argued extensively that it should not be liable for any interest on the taxes based on RCW 82.60.070(2).

In RCW 82.32.050, the Department is instructed by the legislature to impose interest at the rate of 9% per annum on any taxes found to be due, calculated from the last day of the year in which the taxes were due. Taxpayer argues that the Department has alleged that interest is due from October 28, 1988, which was the date that the deferred assessments were issued. We are unable to determine where taxpayer has been charged any interest. The original assessments were amended in August 1989, and new assessments sent to taxpayer showing a due date of September 29, 1989. We believe that its tax liability accrued as of September 29, 1989. Interest should therefore be charged at the rate of 9% per annum starting January 1, 1990, through the new due date of the assessments on the amount of tax found to be due. (This is referred to as extension interest in the Decision section below.) The interest is not compounded, but is accrued daily, so that the interest liability can be calculated for any due date.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part and denied in part. The sales and use tax deferral is revoked as it applies to the costs for the building that was sold to the [M.C.]. The

deferral is still valid as to the machinery and equipment purchased for the project.

DATED this 25th day of May 1990.