

Cite as Det. No. 04-0120, 24 WTD 247 (2005)

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. 04-0120
)	
...)	Registration No. . . .
)	Document . . .
)	Audit No. . . .
)	Docket No. . . .

- [1] RULE 178, RULE 211; RCW 82.12.010: USE TAX – SHAREHOLDER’S USE OF PLANE OWNED BY CORPORATION. Use tax was due when plane purchased for resale was put to intervening use.
- [2] RULE 178; RCW 82.12.020: USE TAX – VALUE OF ARTICLE USED – PURCHASE PRICE. The value of article used was found to be the purchase price plus the cost of improvements where an article was improved prior to the first intervening use.
- [3] RULE 230; RCW 82.32.050: STATUTE OF LIMITATIONS – FRAUD – EVASION. The statute of limitations was tolled by a fraudulent misstatement of fact. An owner of an airplane made a fraudulent misstatement of fact when it told the Department it had purchased the plane for resale only, when evidence demonstrated that the plane had been put to intervening use.

NATURE OF ACTION:

Chartoff, A.L.J. – Taxpayer protests the assessment of use tax on an airplane. At issue is whether Taxpayer used the plane as a consumer in Washington, and if so, whether the assessment is barred by the statute of limitations. We find that Taxpayer first used the plane as a consumer in 1997 and that the statute of limitations was tolled by Taxpayer’s misrepresentation of a material fact in 1998. Taxpayer’s request for cancellation of the assessment is denied, and the matter is remanded to Audit for correction of assessment in accordance with this decision.¹

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

ISSUE:

Whether Taxpayer owes use tax because he used the plane as a consumer in Washington, and if so, whether the assessment is barred by the statute of limitations.

FINDINGS OF FACT:

. . . (Taxpayer) is a Washington Corporation in the business of owning airplanes. In August 1996, Taxpayer purchased the airplane at issue, a [plane], for \$. . . from a Washington Company. Taxpayer gave the Washington seller a resale certificate at the time of purchase, and no retail sales tax was paid to any state on the sale. Taxpayer took delivery of the plane [outside Washington in] 1996.

After delivery, Taxpayer flew the plane [outside Washington] to attach new floats, following which it flew the plane to [Washington] in late 1996 for repairs to the floats and other repairs and improvements to the plane. When the [plane] was not in use, it was stored at [a Washington airport].

Taxpayer does not have a maintenance or flight log to document its use of the [plane]. Audit was able to obtain records regarding international flights from the National Crime Information Center (NCIC). These records indicate that Taxpayer made 17 international flights from May 20, 1997 through March 14, 1998, all beginning or ending at [a Washington airport].² Audit learned from US Customs that . . . , Taxpayer's sole shareholder, piloted the plane on those flights.

Taxpayer sold the plane on . . . , 1998, for \$ During the period that Taxpayer owned the plane, no rental income was reported in Taxpayer's financial records or to the Department.

Taxpayer's records were audited for a prior period: 1992 through 1995. In that audit, Audit determined that Taxpayer owned several planes, and that the planes were used in the business only 25% of the time. Audit assessed use tax on the planes because sales tax had not been paid and the planes were not used strictly for bare rentals. Audit stated in its Detail of Differences and Instructions to Taxpayer that "When the first personal use of the plane is made, the plane is subject to use tax. These planes were not used strictly for bare rentals, therefore use tax has been asserted on the purchase value." Audit issued these instructions to Taxpayer on March 24, 1997, approximately seven months after Taxpayer purchased the [plane], and two months prior to Taxpayer's first international flight, per the NCIC records.

On April 3, 1998, the Department's Compliance Division (Compliance) sent Taxpayer a letter asking if Taxpayer had paid use tax on four airplanes including the [plane]. Taxpayer received the letter on April 7, 1998. On April [x], 1998, one day after the plane was sold, Taxpayer

² International flights were recorded on the following dates: . . .

replied to the letter stating that it “purchased the aircraft for resale or leasing purposes only” and “have resale certificate.” Compliance took no action on the plane at issue and we do not have records to show if Compliance investigated further. Taxpayer testified that Compliance was satisfied that Taxpayer purchased and held the [plane] for resale, without intervening use.

In October 2001, Audit and Taxpayer entered into a managed audit agreement covering 1997 through 2001. Taxpayer executed Statute of Limitations waivers for 1997 through 2001.

In the course of its review, Audit found that Taxpayer had reported no airplane charter income for the period at issue. Audit then asked Taxpayer about the [plane]. Taxpayer explained that it purchased the [plane] for resale. However, Taxpayer found that the [plane] was too large to use and was always under repair, so it never left [a Washington airport]. On November 8, 2002, Audit obtained the NCIC flight records that document 17 international flights during Taxpayer’s ownership of the [plane]. Audit told Taxpayer that the plane was flown on numerous flights in 1997 and the first quarter of 1998. Taxpayer told Audit those were test flights by mechanics during repairs. Upon being told that the flights were international flights, Taxpayer stated that in addition to the test flights, prospective buyers also flew the plane.

Upon learning the plane was purchased and brought to Washington in 1996, Audit extended its review period to 1996, which was beyond the four-year statute of limitations period, and assessed use tax on the plane. Audit’s position was that Taxpayer made material misstatements of fact sufficient to toll the statute of limitations. Audit also assessed deferred sales tax on improvements and repairs made to the [plane] and to other planes owned by the Taxpayer.³

Taxpayer appealed the assessment arguing there was no taxable use of the plane. Taxpayer contends it purchased the plane to either rent bare to employees of a related company, or to provide interstate flights to a related company for hire, which the Taxpayer believes qualifies as interstate commerce. Taxpayer contends that it never “used” the plane for tax purposes. Specifically, Taxpayer’s petition to Appeals states:

As a repossessed plane, the [plane] was in repair for most of the time it was owned by . . . [Taxpayer]. The flights were either to test the plane[’]s repair or demonstrate it to potential customers after the decision was made that it was not economically feasible to rent or charter the plane to the affiliated company. . . It is [Taxpayer’s] position that these were various test flights by mechanics and prospective buyers during which the [plane] was held for resale.

(Emphasis ours). Taxpayer’s representatives further represented in the appeal hearing that [taxpayer’s sole shareholder] was afraid of the plane and would not fly it.

³ Audit and Compliance, in previous investigations, had assessed tax on the use of the other planes. However, Taxpayer continued to obtain repairs on these planes without paying sales tax.

After the hearing Audit contacted the US Customs Service who reported that [taxpayer's sole shareholder, flew the plane himself on all of the flights. Taxpayer then admitted [taxpayer's sole shareholder] did fly the plane but insisted that the flights were maintenance flights to keep the plane in good working order for sale. As evidence, Taxpayer submitted letters from two airplane dealers stating that a plane such as the type owned by Taxpayer must be flown for three to four hours a month to stay in good working order.

ANALYSIS:

[1] RCW 82.12.020(1) imposes the use tax and provides: "There is hereby levied and there shall be collected from every person in this state a tax or excise for the privilege of using within this state as a consumer: (a) Any article of tangible personal property purchased at retail"

RCW 82.12.010(3)(a) defines "use" for purposes of the tax as:

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;

RCW 82.04.190(1) defines "consumer" as:

Any person who purchases, acquires, owns, holds, or uses any article of tangible personal property irrespective of the nature of the person's business . . . other than for purpose (a) of resale as tangible personal property in the regular course of business

WAC 458-20-178 (Rule 178) implements the use tax and provides in part:

(3) When tax liability arises. Tax liability imposed under the use tax arises at the time the property purchased, received as a gift, acquired by bailment, or extracted or produced or manufactured by the person using the same is first put to use in this state.

Where an article of tangible personal property is purchased and held for renting or leasing such property, without operator, in the regular course of business, the item is not used as a consumer. WAC 458-20-211(6)(a). However, where a person holds property solely for renting or leasing, but thereafter uses the property as a consumer, liability for the tax is triggered upon the first use as a consumer. Rule 178(3); WAC 458-20-102(11)(a).

In this case, Taxpayer contends it purchased the [plane] in 1996 for rental without an operator. Taxpayer therefore did not purchase the [plane] for use as a consumer. However, in May of 1997, Taxpayer, through the actions of [taxpayer's sole shareholder], used the plane by taking it on the first of 17 international flights. There is no corresponding rental income, or any evidence to establish that Taxpayer did not use the plane as a consumer.

We find Taxpayer's testimony that [taxpayer's sole shareholder] flew the [plane] for maintenance purposes is not credible. We note the Taxpayer originally told Audit that the [plane] was too large to use, always under repair, and never left [Washington airport]. After Audit told Taxpayer it had evidence of many flights during 1997 and 1998, Taxpayer stated that mechanics flew the plane. When told the flights were international flights, Taxpayer stated that prospective buyers also flew the plane.

Taxpayer testified in the appeal hearing that [taxpayer's sole shareholder] was afraid to fly the plane. After being confronted with evidence that [taxpayer's sole shareholder] was the pilot on all of the flights, [taxpayer's sole shareholder] finally admitted to flying the [plane], but claimed it was for maintenance reasons only. Taxpayer states that the [plane] must be flown three to four hours a month to stay in good working order. Taxpayer's explanation is not consistent with the fact that 14 of the 17 international flights occurred within the five month period from May through October 1997.

Because Taxpayer has made multiple false or contradictory statements to the Department on this issue, we are unable to give any weight to Taxpayer's testimony. Accordingly, we agree with Audit that Taxpayer used the plane as a consumer in Washington. However, we find that Audit should have assessed the tax in 1997, the year Taxpayer first used the plane as a consumer.

[2] The use tax is assessed on the value of the article used, which generally means the purchase price of the property. RCW 82.12.010(1)(a). However, where the purchase price does not represent the true value of the property, "the value of the article used shall be determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character" *Id.*; Det. No. 99-042, 19 WTD 784 (1999). In this case, Taxpayer purchased the [plane] in August 1996 for \$ Taxpayer then made significant improvements to the plane prior to Taxpayer's use as a consumer. Under these circumstances, we find that the value of the [plane] at the time of first use is equal to the purchase price plus amounts paid for repairs and improvements to the plane. The fact that Taxpayer sold the plane in April 1998 for [more than the purchase price] substantiates our finding that the value of the plane in May 1997 was significantly higher than the original purchase price.

[3] The next issue is whether Audit may increase the assessment for 1997 to include use tax on the [plane]. RCW 82.32.050(3) limits the time that the Department may issue an assessment of tax and provides:

No assessment or correction of an assessment for additional taxes, penalties, or interest due may be made by the department more than four years after the close of the tax year, except (a) against a taxpayer who has not registered as required by this chapter, (b) upon a showing of fraud or of misrepresentation of a material fact by the taxpayer, or (c) where a taxpayer has executed a written waiver of such limitation.

(Emphasis ours).

WAC 458-20-230 (Rule 230) provides, with regard to revised assessments:

(7) **Revised assessments.** The department may issue an assessment to correct errors found in examining tax returns or it may issue an assessment to correct errors based on a review of the taxpayer's records. Assessments which are based on a review of the tax returns are subject to further review and revision by future audit. Once issued, the department may revise an audit assessment subject to the following restrictions.

(a) The assessment generally may not be increased from the amount originally assessed for those years for which the statute of limitations would have expired if this were an original assessment. For these years an assessment can be reduced, but not increased.

(b) An assessment may be increased upon discovery of fraud/evasion or misrepresentation of a material fact.

(Emphasis ours).

When Audit issued the 1996 assessment, 1997 was not barred by the statute of limitations because Taxpayer had executed a written waiver of the limitations period for 1997. Had Audit assessed the tax for 1997 at that time, there would be no statute of limitations issue. Now 1997 is generally barred to new or increased assessments unless the Department can show fraud/evasion or a misrepresentation of a material fact.

Rule 230 interprets “fraud or material misrepresentation of fact,” and provides in part:

(4) **Evasion or misrepresentation.** There is no limitation for the period in which an assessment or correction of an assessment can be made upon a showing of evasion or of misrepresentation of a material fact. Evasion involves a situation where the taxpayer knows a tax liability is due and the taxpayer attempts to escape detection through deceit, fraud, or other intentional wrongdoing. The evasion must be shown by clear, cogent, and convincing evidence which is objective and creditable. However, in the case of evasion or misrepresentation, any assessment for taxes which extends beyond four years and the current year will be limited to taxes which were underpaid as a result of the evasion or misrepresentation. (See RCW 82.32.050 and 82.32.090.)^[4]

[Footnote added.] In order to assess Taxpayer for 1997, the Department must demonstrate by clear, cogent, and convincing evidence, which is objective and creditable, that there is a tax liability that the taxpayer knew to be due,⁵ and that the taxpayer attempted to escape detection through fraud, or in this case, a fraudulent misrepresentation of fact. *See* Det. No. 98-039, 19 WTD 101 (2000).

^[4]Although penalties are not at issue in this case (*see* RCW 82.32.090(6)), the evasion provisions are relevant regarding the statute of limitations.]

⁵ In certain circumstances, the Department does not have to establish knowledge and intent to evade. WAC 458-20-228(5)(e)(ii); Det No. 98-039, 19 WTD 101(2000).

We found, above, that Taxpayer used the [plane] in Washington as a consumer, and we find that there is clear, cogent, and convincing evidence of such use. The next issue is whether Taxpayer made a knowing misrepresentation of fact to conceal that tax liability. We find that Taxpayer committed fraud or misrepresentation when it told Compliance in 1998 that it purchased the [plane] for resale. We note that Audit issued written instructions to Taxpayer in 1997 explaining that use tax is due on the first use of a plane. Taxpayer then used the [plane] at least 17 times following receipt of those instructions. In 1998, Compliance asked Taxpayer in writing if sales or use tax had been paid on the [plane]. Taxpayer replied in writing that the plane was purchased for resale only.

Because Taxpayer had received written instructions from Audit on this very issue, Taxpayer was aware of the law and knew use tax was due on the [plane] at the time it made the statement to Compliance. We can also infer from the Taxpayer's continued false statements during the current Audit and Appeals proceedings that Taxpayer knew the use tax was due and was fraudulently trying to avoid the use tax. Det. No. 97-105R, 18 WTD 168 (1999) (fraud may be inferred when a taxpayer makes false and inconsistent statements to revenue agents).

We find by clear and convincing evidence that Taxpayer knew use tax was due on the [plane], and that Taxpayer made a material misstatement of fact to Compliance to conceal its liability for the tax. We find that Compliance relied on Taxpayer's statement in 1998 in not assessing the [plane]. Therefore, the statute of limitations on assessments was tolled on April [x], 1998. Accordingly, Audit is not barred from assessing use tax on the [plane] for the 1997 tax period.

DECISION AND DISPOSITION:

Taxpayer's petition for cancellation of the assessment is denied. However, we find that Taxpayer first used the [plane] in Washington in May 1997 rather than May 1996, and that the assessments will be adjusted to reflect this finding.

Dated this 27th day of May 2004.