Cite as Det. No. 19-0300, 41 WTD 01 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 19-0300
. . .	)	Registration No. . . .

[1] WAC 458-20-102; RCW 82.08.130: DEFERRED SALES TAX. A taxpayer is liable for deferred sales tax on purchases of certain tangible personal property (TPP), when the taxpayer purchases the TPP with a reseller permit but uses the TPP itself and cannot show proof that sales tax has been paid.

[2] WAC 458-20-102; WAC 458-20-108; WAC 458-20-178; RCW 82.08.130; RCW 82.08.020; RCW 82.12.020: USE TAX – RESELLER PERMIT – PROMOTIONAL MATERIAL. Use tax applies to TPP purchased by a taxpayer with a reseller permit, but subsequently used in performing maintenance services for customers redeeming coupons. In these transactions, a taxpayer is not reselling the TPP to its customers, but is instead using it first in this state, as a "consumer," in its free services promoting the sale of its products.

[3] WAC 458-20-102; RCW 82.32.291: PENALTY – MISUSE OF RESELLER PERMIT. The penalty for the misuse of a reseller permit is applicable when the buyer previously provided its reseller permit to the sellers, the taxpayer knew that the sellers were operating under the assumption that all sales to the taxpayer were for resale, and the taxpayer did not inform the sellers when certain sales were not for resale and subject to retail 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.

LaMarche, T.R.O. – A taxpayer that operates an automotive repair and maintenance business disputes the assessment of deferred sales tax on certain purchases of capital assets and consumables used in its services. The taxpayer says it has additional documents to support adjustments to tax imposed on those purchases, and asserts that the Department erroneously counted a large invoice twice in the audit.

The taxpayer also contests the assessment of use tax on certain transactions where it alleges it provided substantially discounted services to customers who redeemed certain coupons, rather than providing those services for free. The taxpayer argues that the services were not promotions

subject to use tax, but were instead retail sales taxable only on the cash surrender value of the coupon and the customer's goodwill. Alternatively, the taxpayer argues that deferred sales tax, not use tax, is the proper tax, and tax should be based on its purchase price from its vendor. We deny the petition in part, grant it in part, and remand to the operating division to make adjustments accordingly.[1]

ISSUES

1. Under RCW 82.04.050(1); RCW [82.08.130]; and WAC 458-20-102 (Rule 102), does Taxpayer owe deferred sales tax on certain purchases it made with a reseller permit, then used in this state, or purchases for which it has not shown it paid sales tax?

2. Under RCW 82.08.020; RCW 82.12.020; WAC 458-20-108 (Rule 108); and WAC 458-20-178 (Rule 178), does use tax apply to the tangible personal property Taxpayer purchased with a reseller permit, but subsequently used in performing maintenance services for customers who redeemed coupons that offered the services for no charge?

3. Under RCW 82.32.291(1) and Rule 102(9), did the Department of Revenue properly assess misuse of reseller permit penalties, and if so, has Taxpayer shown a basis for waiving them?

FINDINGS OF FACT

. . . (Taxpayer) provides automotive repair and maintenance services to customers in Washington State. The Department of Revenue's (Department) Audit Division (Audit) audited Taxpayer's business activities for the period from December 1, 2015, through March 31, 2017. Taxpayer and Audit agreed to use sampling as a basis for the audit.

Taxpayer had many transactions where it provided discounted services, such as military or new customer discounts, or offered coupon discounts. Taxpayer provided examples of its coupons and other discounts during the audit, some of which offered free services. After filing its petition, Taxpayer offered an additional example, a partial copy of a certificate that does not bear Taxpayer's name, or show what the coupon is for. The document states that it has a cash surrender value of 1/20 of one cent. Also, Audit attached to its response to the petition, a copy of a flyer advertising Taxpayer's services. The flyer contains nine cutout coupons, some of which tout free services, such as wheel alignment checks or brake checks, and others that offer services at a lower rate, such as oil changes and alignments.

During the audit, Audit noted that in some instances, Taxpayer's discounts covered nearly the entire cost of the service, and Taxpayer posted the relatively small sale amounts on its books as retail sales, and reported and paid sales tax on those transactions. Audit accepted these transactions, and imposed no additional tax.

However, in other instances, customers used coupons that offered oil changes and other services for no charge. The customers did not have the obligation to purchase anything else. For these

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

transactions, Taxpayer posted the cost of parts and labor it would have otherwise charged for the service, and under a column entitled "Discounts" entered a discount amount that offset the entire amount of parts and labor. For these "zero" transactions, Taxpayer entered no sales revenue on its books.

Audit asked Taxpayer about the zero entries, and Taxpayer explained that the business offered discounts to earn "customer loyalty and subsequent business." (*See* Audit Response, at 1.) Audit concluded that the zero entries were not for sales, but for promotions, and assessed use tax on the tangible personal property used to perform the services. Audit did not impose tax on the labor portion of the services. The use tax was based on the amount Taxpayer listed as the marked-up charge to customers for similar property used in regular sales, rather than Taxpayer's purchase price when buying those items from its vendor.

Audit also found that Taxpayer made some purchases with its reseller permit of items it subsequently used itself, rather than reselling to its customers. Taxpayer did not report or remit deferred sales tax on those items. The misuse of reseller permit penalty was imposed on those purchases

The Department issued an assessment on October 26, 2018, . . . , totaling $. . . , which consisted of . . . use tax and/or deferred sales tax; . . . misuse of reseller permit penalties; and . . . interest. Taxpayer did not pay the assessment, but timely filed a petition for review.

After filing the petition, Taxpayer provided additional invoices as examples that showed it had paid sales tax on some of the disputed purchases of capital assets and consumables, and showed that some purchases qualified as valid purchases for resale. Taxpayer also showed that Audit had erroneously counted a certain invoice twice. Audit reviewed the documents and found that they support some adjustments, and agreed to a remand to make the adjustments.

ANALYSIS

Washington State imposes sales tax on all sales of tangible personal property within the RCW 82.04.050 definition of "retail sale," unless an exemption or exclusion applies. RCW 82.04.050. RCW 82.04.050(2)(b) also defines a retail sale to include "the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to . . . the installing, repairing, . . . or improving of tangible personal property of or for consumers." [RCW 82.04.050(1)(a)(ii) excludes from "retail sale" purchases of tangible personal property that is incorporated into personal property of consumers, without intervening use. *See* 82.04.190(1)(b) (A person incorporating tangible personal property into personal property of consumers during repair is not a "consumer.").]

Retail sales tax is levied and collected on the sales price for each retail sale in this state. RCW 82.08.020. "Sales price" means the "total amount of consideration . . . for which tangible personal property . . . or other services . . . defined as a retail sale under RCW 82.04.050 are sold [or] valued in money, whether received in money or otherwise." RCW 82.08.010(1)(a)(i) (emphasis added).

RCW 82.08.010(1)(b) states: "'Selling price' or 'sales price' does not include: Discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale." (Emphasis added.)

Purchases of tangible personal property for purposes of resale in the ordinary course of business are not subject to retail sales tax. RCW 82.04.050(1)(a)(i).[2] With regard to situations where a buyer normally consumes and resells tangible personal property in its business, such as Taxpayer does here, and does not know at the time of purchase whether it will consume the property itself or resell it, RCW 82.08.130(1) says:

> [The] buyer may use a reseller permit or other documentation authorized under RCW 82.04.470 for the entire purchase if the buyer principally resells the property according to the general nature of the buyer's business. The buyer must account for the value of any articles purchased with a reseller permit or other documentation authorized under RCW 82.04.470 that is used by the buyer and remit the deferred sales tax on the property to the department.

(Emphasis added.) The purchases described in RCW 82.08.130(1) are referred to as purchases for dual purposes.

1. Capital asset and consumable supply purchases

Here, Taxpayer made purchases of certain tangible personal property, some of which it purchased with a reseller permit and did not resell, but used itself, such as cleaning fluids and tools. Taxpayer made other purchases for which it did not show that it paid sales tax, or did not show that the purchase was a valid purchase for resale. In those instances, Taxpayer is liable for deferred sale tax as indicated in RCW 82.08.130(1). As discussed above, . . . Taxpayer provided additional documents to support some adjustments and showed that a certain invoice was erroneously counted twice. Audit has agreed to a remand to make adjustments accordingly. We grant the petition in part regarding this issue, to the extent Taxpayer can provide supporting documents.

2. Discounted sales and promotions

Taxpayer's transactions where it performs fully discounted services for customers redeeming certain coupons are not sales. [*See* RCW 82.04.040(1) (definition of "sale"); *Activate, Inc. v. Dep't of Revenue*, 150 Wn. App. 807, 817-18, 209 P.3d 524 (2009) (seller who gave away cellular phones to promote the sale of wireless services did not "sell" the phones because there was no valuable consideration).] And as we mention above, "sales price" is defined as the total amount of "consideration" for which tangible personal property or retail services are sold, and excludes discounts, such as "coupons." RCW 82.08.010(1)(a)(i); RCW 82.08.010(1)(b). Therefore, by definition, the coupon cannot be part of the sales price, or consideration, for the sale.[3]

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[2] RCW 82.04.050 was amended during the audit period in 2015 with regard to amusement and recreation services, bee pollination services, and certain agricultural subjects. Laws of 2015, ch. 169, § 1; Laws of 2015, 3rd spec. sess., ch. 6, § 1105. None of the amendments affect this case.

[3] Taxpayer also asserts that "goodwill" formed part of the consideration. However, goodwill is an asset of the business, not of the customer. *See, e.g., Newark Morning Ledger Co. v. U.S.*, 507 U.S. 546, 555, 113 S.Ct. 1670 (1993).

Washington imposes use tax under RCW 82.12.020 "for the privilege of using within this state as a consumer any . . . article of tangible personal property acquired by the user in any manner," if the sale to or use by the present user has not already been subject to retail sales tax. RCW 82.12.020(1) (emphasis added); *See* WAC 458-20-178(1) (Rule 178). Rule 178(2) states: "Use tax complements the sales tax, and in most cases mirrors the retail sales tax."

[In addition to its primary definition in RCW 82.04.190], a "consumer" is defined under RCW 82.12.010(1) to include "any person who distributes . . . any article of tangible personal property, . . . the primary purpose of which is to promote the sale of products." *See Activate,*, 150 Wn. App. at 815-16 (seller who distributed "free" cellular phones to promote the sale of cellular phone service contracts was a "consumer" of those phones).[4] *See also Sprint Spectrum, LP v. Dep't of Revenue*, 174 Wn. App. 645, 662, 302 P.3d 1280, 1288 (2013) [("Sprint was a consumer under the plain language of RCW 82.12.010(6) when it gave away fully-discounted phones primarily for the purpose of promoting its wireless services and, accordingly, is liable for use tax on these transactions."),] *rev. denied*, 178 Wn.2d 1024, 312 P.3d 651 (2013).

Liability for the use tax arises at the time the property is first put to use in this state. RCW 82.12.020; Rule 178(3). The tax is levied and collected on an amount equal to the value of the article used by the taxpayer. Rule 178(13); RCW 82.12.020(4); *see* Det. No. 13-0237R, 33 WTD 349 (2014). RCW 82.12.010(7)(a) defines "value of the article used" in relevant part as the "purchase price for the article of tangible personal property, the use of which is taxable under this chapter."

WAC 458-20-17803 (Rule 17803), the Department's administrative rule that addresses use tax on "promotional material," defines that term, in relevant part, to mean:

> [A]ny article of tangible personal property, . . . displayed or distributed in the state of Washington for the primary purpose of promoting the sale of products or services. Examples of promotional material include, but are not limited to . . . flyers, . . . coupons, [or] free gifts . . . .

Rule 17803(4) (emphasis provided). In this case, use tax was not imposed on coupons, but was imposed instead on what amounted to Taxpayer's "free gift" of maintenance services to its customers. [Taxpayer consumed certain articles of tangible personal property in providing these services.] In these transactions, Taxpayer did not resell the tangible personal property to its customers, but instead used it first in this state, as a "consumer," in its free services promoting the sale of its products. RCW 82.12.010(1). Therefore, use tax was due on the tangible personal property at the time of use, based on the "purchase price for the article of tangible personal property." RCW 82.12.010(7)(a). However, we agree with Taxpayer that use tax was assessed on the wrong values.

Audit assessed use tax based on the amount Taxpayer listed as the marked-up charge to customers for similar property used in its regular sales, rather than Taxpayer's cost in acquiring those items

[4] Taxpayer notes that the parties in *Activate* and similar published cases did not give away items they had purchased with reseller permits, as Taxpayer has done here. As we will discuss, however, use of the reseller permit does not change the "promotion" analysis in the case here.

from its vendor. However, the purchase price in RCW 82.12.010(7)(a) as it relates to this case refers to Taxpayer's purchase of the tangible personal property from its vendor, and tax should not be based on the value of the tangible personal property if resold to a customer in a regular sale.

It appears the approach used in the audit was based on the portion of RCW 82.12.010(7)(a) that states:

> In case the article used is acquired by lease or by gift or is extracted, produced, or manufactured by the person using the same or is sold under conditions wherein the purchase price does not represent the true value thereof, the value of the article used is determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character under such rules as the department may prescribe.

We used this approach, for example, in Det. No. 15-0223, 35 WTD 217 (2016), where a winery used wine it manufactured as free samples to its customers. Because the winery did not pay sales tax on its "acquisition" of the wine, there was no "purchase price" on which to base use tax, so the Department applied the latter half of RCW 82.12.010(7)(a), and based the tax on sales of like kind products. *See also* Rule 178(4). That is not the case here, where it is clear from Taxpayer's invoices how much it paid its vendor for the items it used. As we note above, the use tax complements the sales tax, and generally mirrors the amount of retail sales tax that would have been paid on the original purchase. Rule 178(2). Therefore, we grant the petition in part with regard to the valuation basis for the use tax, and remand the assessment to Audit to make adjustments based on Taxpayer's original purchase from its vendors, pursuant to RCW 82.12.020(7)(a) and Rule 178(2) and (4).

We note Taxpayer's argument that use tax and sales tax are "mutually exclusive," and that use tax cannot be imposed on an item that is subject to "deferred sales tax." Taxpayer cites *Sprint Spectrum, LP v. Dep't of Revenue*, 174 Wn. App. at 659, which states that "[an] item of tangible personal property may not be subject to both use tax and sales tax." The court is quoting from *Discount Tire Co. of Wash., Inc. v. Dep't of Revenue*, 121 Wn. App 513, 521, which states, "An item cannot be subject to both use tax and sales tax. WAC 458-20-178(2). Once an item has been subjected to the sales tax, it may not later be subjected to use tax." Rule WAC 458-20-178(2), cited by the court, simply describes what use tax is, and states that "[u]se tax complements the sales tax." What the court means is that the same item cannot be taxed twice, not that the taxes are mutually exclusive.

Here, no tax at all was paid on the items Taxpayer used. [Taxpayer purchased the items for dual purposes, not knowing at the time which items would be resold as part of its sales of repair services and which items Taxpayer would consume when performing free promotional services.] Since Taxpayer purchased them with a reseller permit, it became subject to "deferred sales tax" on the items it used, under RCW 82.08.130. Also, because no tax had been paid on the items when Taxpayer used them, they also became subject to use tax at that time under RCW 82.12.020. RCW 82.12.020(1) broadly imposes the use tax "for the privilege of using within this state as a consumer any . . . article of tangible personal property acquired by the user in any manner," for which no sales tax has been paid. (Emphasis added.)

Chapter 82.12 RCW does not say that use tax liability does *not* arise when the tangible personal property has sales tax owed on it—it indicates the opposite. Use tax liability *always* arises when the required sales tax has not been paid on an item put to first use by a consumer in this state.[5] However, that is not to say that both sales tax and use tax can be collected on the item: generally, if the deferred sale tax liability is satisfied, the use tax liability goes away, and vice versa. [*See* Det. No. 00-150, 20 WTD 432, 440 (2001).]

3. Misuse of reseller permit penalty

The Department is required to impose a penalty on a buyer that improperly uses its reseller permit. RCW 82.32.291(1) provides in part:

> Except as otherwise provided in this section, if any buyer improperly uses a reseller permit number, reseller permit, or other documentation authorized under RCW 82.04.470 to purchase items or services at retail without payment of sales tax that was legally due on the purchase, the department must assess against that buyer a penalty of fifty percent of the tax due, in addition to all other taxes, penalties, and interest due, on the improperly purchased item or service.
> . . .

Rule 102(9) mirrors the language in RCW 82.32.291(1) in respect to improper use of a reseller permit, and states that the penalty can be imposed even when the taxpayer was not intending to evade paying retail sales tax. *See* Det. No. 14-0404, 34 WTD 337 (2015).

Here, Taxpayer made certain purchases at wholesale for items it consumed itself and did not resell to a customer. It did not pay use tax on the items or deferred sales tax on the transactions. Therefore, the Department was required by RCW 82.32.291(1) to impose a 50% penalty on the amount of unpaid tax for the misuse of the reseller permit.

RCW 82.32.291(2) addresses circumstances where the Department can waive the penalty:

> The department must waive the penalty imposed under subsection (1) of this section if it finds that the use of the . . . reseller permit . . . was due to circumstances beyond the taxpayer's control or if the . . . reseller permit was properly used for purchases for dual purposes.

Rule 102(13) addresses penalty waivers and RCW 82.32.291(2). As indicated by Rule 102, the taxpayer has the burden to show a basis for the waiver.

Here, Taxpayer does not provide an explanation why the reseller permit was misused, thus it has not shown a circumstance beyond its control.

[5 *See* ETA 3097.2009 Deferred Sales Tax (comparing a dual-purpose purchase where deferred sales tax is due on items later consumed, and purchase from a seller with no duty to collect sales tax where use tax is due when the item is later consumed).]

RCW 82.08.130 anticipates that some buyers normally engaged in both consuming and reselling certain types of tangible personal proper will make purchases for dual purposes (i.e., for items they will resell and items they will use). RCW 82.32.291(2) contemplates this [as well].

However, RCW 82.08.130 requires that the buyers report and remit the deferred sales tax on the items they use, rather than resell. Rule 102(12)(a)(i) states that such buyers must make a good faith effort to remit this tax liability or they will be subject to the penalty.

Buyers are considered to have shown good faith if they discover and report a minimum of 80% of their deferred sales tax liability within 120 days of the purchase, and remit the full amount of tax on their next excise tax return. Rule 102(12)(a)(i). If the buyer does not meet the 80% threshold, it may be able to avoid the penalty if it can show facts and circumstances[6] that it made a good faith effort to report and pay its taxes.

Here, Taxpayer made purchases for dual purposes using its reseller permit, but did not report deferred sales tax on any of the items it used itself rather than reselling. Therefore, Taxpayer has not shown that it made a good faith effort to pay the tax. Because Taxpayer has not shown a basis for waiving the misuse of reseller permit penalty, we must deny the petition as to this issue.

Taxpayer may avoid misuse penalties in the future by carefully documenting its purchases with its reseller permit, and timely reporting and paying the deferred sales tax on the items it consumes. *See* Rule 102(12)(a). Taxpayer also has the option of paying sales tax on all of its purchases, and claiming a tax paid at source deduction for the items it resells. *See* Rule 102(12)(b). The Department has many resources for taxpayers, including its website at www.dor.wa.gov, and tax assistance via telephone at 360-705-6705.

DECISION AND DISPOSITION

Taxpayer's petition is denied in part and granted in part. We deny the petition with respect to Taxpayer's claim that it owes no use tax on the tangible personal property it used in promotional services to customers, and to the misuse of reseller permit penalty waiver. However, we grant the petition with regard to the valuation of the tangible personal property used in its promotional services. We further grant the petition to correct the duplication error discussed above, and to the extent that Taxpayer can provide additional documents to support that it paid sales tax on some capital asset purchases and consumable.

Dated this 15th day of November 2019.

[6] Likewise, if the Department can show by other facts and circumstances that the buyer did not make a good faith effort in remitting its tax liability the penalty will be assessed, even if the eighty percent threshold is satisfied. Rule 102(12)(a)(i).