Cite as 10 WTD 395 (1990).

BEFORE THE INTERPRETATION AND APPEALS DIVISION

DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	No. 91-044
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] RULE 178: USE TAX--WITHDRAWAL FROM INVENTORY--REGULAR COURSE OF BUSINESS--TRADE FOR OWN USE. Use tax is due when an item is withdrawn from inventory by a taxpayer to be traded to another business for an item to be used by the taxpayer rather than put into inventory. The tax is due on the removal of the item from inventory, because its removal is not for the purpose of "resale in the regular course of business." Accord: ETB 482. See also Det 86-251 1 WTD 167 (1986), 87-036 2 WTD 183 (1987), Det 87-067 2 WTD 331 (1987), Det 88-032 5 WTD 077 (1988).

[2] RULE 247: LIKE-KIND EXCHANGE--COMPUTER SYSTEMS--SOFTWARE FOR HARDWARE. In order to qualify for a like-kind exchange under Rule 247, the property traded must be of the same general category. Computer software and hardware are not of the same general class and do not qualify for that treatment. Accord: Det. 88-322, 6 WTD 305 (1988).

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.

NATURE OF ACTION:

Taxpayer protests the assessment of use tax on two asserted like-kind exchanges.

FACTS AND ISSUES:

Hesselholt, Chief A.L.J. -- Taxpayer develops and sells software systems to others. Its books and records were examined for the period January 1, 1985 through December 31, 1988. As a result, an assessment was issued, most of which was not disputed. The assessment has been paid.

Taxpayer protested the assessment of use tax on two items. The first item was the trade of software it held in inventory for other software owned by another company. Taxpayer used the software it received itself. Taxpayer considered the transaction to be a trade-in of like kind items under WAC 458-20-247, (Rule 247), and therefore not taxable. Since taxpayer took its software from inventory to trade, no sales or use tax was ever paid on that software. Taxpayer states that no intervening use of the traded software took place. Apparently the value of the traded software was equivalent. The Audit Section disallowed the exemption, stating that the

> . . . presumption in the trade-in rule is that the asset being traded-in had Sales Tax paid at the time of the original acquisition. Since neither tax had been paid, Use Tax is due on the software acquired from [Company] and capitalized by you.

The second issue also involves a trade of property. In this case, taxpayer traded some of its hardware for software. Taxpayer considered this to also be an exchange of like-kind property under Rule 247. Taxpayer argues as follows:

> Hardware and software fall under the general classification of "computer system" as per WAC 458-20-155: "The term `computer system' means a functional unit, consisting of one or more computers and associated software." The WAC goes on to give a specific definition of hardware and software that falls under the general classification. Because these items fall within a general classification, we excluded the transaction from sales or use tax . . .

The Audit Section disallowed this exemption, stating that "software and hardware do not provide the same function and use nor are they interchangeable."

DISCUSSION:

Use tax is imposed on the use of property within this state on which retail sales tax has not been paid. RCW 82.12.020. Use is defined as the "first act within this state by which the taxpayer assumes dominion and control over the property" and includes the "storage, withdrawal from storage, or any other act preparatory to subsequent actual use within this state." RCW 82.12.020(2). Rule 247 provides that

> Initiative Measure No. 464, approved November 6, 1984 amended RCW 82.08.010(1), the statutory definition of "selling price," by excluding from that term the value of "trade-in property of like kind." The effective date of this exclusion is December 6, 1984. As a result, the retail sales tax measure on trade-in sales is reduced by the value of the property traded in. Thus, on and after the effective date, the value of "trade-in property" may be excluded from the measure of retail sales tax to be collected and reported by the seller who accepts the trade-in property as payment for new or used property sold. . . .

This also applies to any use tax that may be due. See Det. 88-154, 5 WTD 173 (1988).

The Audit Section disallowed the deduction because no use tax had been paid on the property traded. The disallowance for that reason is incorrect. The Department has allowed the exemption for property traded on which no sales or use tax was ever due or paid. See Det. 88-154, supra.

[1] Generally, a trade of an item is considered a sale, as it is a transfer of property for consideration (the property received.) RCW 82.04.050 defines retail sales to mean:

> every sale of tangible personal property . . . to all persons irrespective of the nature of their business . . . other than a sale to a person who (a) purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person . . . (Emphasis supplied.)

Whether a particular transaction is in the regular course of business is a question of fact to be determined from all of the surrounding circumstances. ETB 482.12.178 states that in order to consider a sale for resale in the regular course of business,

> it must be determined that the purchaser is actually and regularly engaged in selling the type of property purchased, is registered with the Department of Revenue and reporting the appropriate taxes, and that at the time of the transaction the purchaser intended the sale to be for resale without intervening use by the purchaser.

Here, when the taxpayer removed the software from inventory for the purpose of trading it, that trade was NOT in the regular course of business. The trade was for the purpose of receiving something that it wished to use for itself. The removal of the software from inventory, then, was not for the purpose of resale in the regular course of business and was therefore a taxable transaction. The trade of software for software was a qualified trade-in of like-kind merchandise, but it is the initial removal of the software from inventory that triggers the tax liability. The use tax was due on the item removed from inventory, not on the item received. The file will be returned to the Audit Division to verify the correct amount of use tax due.

[2] Taxpayer argues that computer software and hardware fall within a general classification and should be considered like-kind property for purposes of Rule 247.

Rule 247 provides as follows:

> The term "property of like kind" means articles of tangible property of the same generic classification. It refers to the class and kind of property, not to its grade or quality. The term includes all property within a general classification rather than within a specific category in the classification. Thus, as examples, it means furniture for furniture, motor vehicles for motor vehicles, licensed recreational land vehicles for licensed recreational land vehicles, appliances for appliances, auto parts for auto parts, audio/video equipment for audio/video equipment, and the like. These general classifications are determined by the nature of the property and its function or use. It may be that some kinds of property fit within more than one general classification. For example, a motor home is both a motor vehicle and a licensed recreational land

> vehicle. Thus, for purposes of this rule, a motor home may be taken as a trade-in on a travel trailer, truck, camper, or a truck with camper attached, and vice versa. Similarly, a travel trailer may be taken as trade-in on a motor home even though a travel trailer is not a motor vehicle; both are licensed recreational land vehicles. Conversely, a utility trailer may not be taken as trade-in on a travel trailer, for purposes of this rule, because a utility trailer is neither a motor vehicle nor a licensed recreational land vehicle. Similarly, a car may not be taken as trade-in on a camper and vice versa.
>
> Under these definitions it is not required that a car be traded-in exclusively on another car in order to get the trade-in reduction of the tax measure. It could, as well, be traded-in as part payment for a truck, motorcycle, motor home, or any other qualifying motor vehicle. Similarly, a sofa for a recliner chair, a pistol for a rifle, a sailboat for a motorboat, or a gold chain for a wrist watch are the kinds of generic trade-in transfers which would qualify. However, the exclusion of the value of property traded-in does not include such things as a motorcycle for a boat, a diamond ring for a television set, a battery for lumber, or farm machinery (including tractors and self propelled combines) for a car.

The Audit Section argued that computer hardware and software do not provide the same function and use and are not interchangeable. In Det. 88-322, 6 WTD 305 (1988), we stated that

> In order to qualify as trade-in property of like kind, both items must be of the same general class--road vehicles for road vehicles, farm machinery for farm machinery, furniture for furniture, etc.

[2] Here, taxpayer argues that both items were part of a computer system, as defined in WAC 458-20-155, and therefore should qualify. We disagree.

WAC 458-20-155 (Rule 155) defines a computer system as a

> functional unit, consisting of one or more computers and associated software, that uses common storage for all or part of the data necessary for execution

> of the program; executes user-written or user-designated programs; performs user-designated data manipulation; including arithmetic operations and logic operations; and that can execute programs that modify themselves during their execution.

The mere fact that Rule 155 refers to software and hardware as a "functional unit" does not make software and hardware property of the same general class. Hardware is generally the mechanical and electronic parts of a computer; software (programs) is generally the instructions that command the hardware. Indeed, Rule 155 defines hardware and software separately. Software and hardware are like a car and gasoline; the hardware is like the car and the gas is like the software. A trade of gas for a car is not a like-kind exchange. Software and hardware do not serve the same purpose and are not of the same general class.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 14th day of February 1991.