

Cite as 3 WTD 1 (1987)

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<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> <u>N</u>
For Correction of Assessments of)	
)	No. 87-105
)	
)	Registration No. . . .
. . .)	Notice of Use Tax Due
)	Tax Warrant No. . . .
)	Yacht . . .
and)	
)	
)	Notice of Use Tax Due
. . .)	Renovation of Yacht . . .
)	
)	
and)	
)	
)	Notice of Use Tax Due
. . .)	Yacht . . .
)	

[1] **RULE 178, RCW 82.12.020:** USE TAX -- USE OF YACHT IN WASHINGTON -- PERSON IN THIS STATE. The use tax is imposed on the use in this state as a consumer of any article of tangible personal property. The tax applies to all persons in this state whether a resident or nonresident unless there is a statutory exemption granted. Where a nonresident foreign corporation owned a yacht that was based in Washington for three years and used as a residence by its two sole stockholders, a married couple, and used by one of them as president of the corporation to manage the corporate business affairs, the corporate owner of the yacht became subject to use tax liability.

[2] **RULE 178, RCW 82.12.0251:** USE TAX -- EXEMPTION -- NONRESIDENT TEMPORARILY IN THIS STATE -- REPAIRS. There is an exemption from use tax for a nonresident temporarily in this state as to use of personalty

brought into this state. There is no specific statutory exemption from use tax on the personalty used in this state merely because it was brought into the state for repairs. The exemption would arise if the nonresident is temporarily in this state. Where a yacht was brought into this state for repairs and remained in this state for more than three years during which time it was used for other purposes, it cannot be said that the yacht nor its users were in this state temporarily.

- [3] **RULE 178, RCW 82.12.020:** USE TAX -- EXEMPTION -- TRANSPORTATION FINALLY ENDED -- POPE AND TALBOT CASE. The use tax does not apply with respect to use of personalty purchased outside this state by a nonresident until the transportation of such article has finally ended. Transportation of an article "finally ends" when it is home-based in Washington and thereby acquires a tax situs. Pope and Talbot case cited. Where a yacht purchased abroad is berthed in Washington for over three years under renewed annual moorage agreements, the transportation of the yacht is held to have "finally ended" in Washington because it was home-based in Washington.

- [4] **RULE 178, RCW 82.12.0254:** USE TAX -- EXEMPTION -- WATERCRAFT USED PRIMARILY IN INTERSTATE COMMERCE -- INTENT -- FIRST USE IN WASHINGTON. The use tax does not apply with respect to the use of watercraft used primarily in conducting interstate or foreign commerce by transporting therein property and persons for hire. Where a yacht was used in Washington for other purposes for over three years while awaiting authority to engage in the charter trade, it did not qualify for the exemption. Intent by itself to use the yacht for charter trade does not give rise to the exemption. First use as a consumer in Washington is the incident which gives rise to use tax liability.

- [5] **RULE 178, RCW 82.12.035:** USE TAX -- CREDIT FOR TAX PAID TO ANOTHER STATE -- VALUE ADDED TAX (VAT) -- FOREIGN COUNTRY. A credit is allowed for the amount of retail sales or use tax paid by the user to any other state prior to the use of the property in this state. The tax credit mechanism of the . . . VAT is such that it does not become the equivalent of a

retail sales tax on goods sold for export. The facts in this case led to a conclusion that the taxpayer paid no tax at all on its purchase of a yacht in [foreign country] which it then removed from [the foreign country].

- [6] **RULE 178, RCW 82.12.035:** USE TAX -- CREDIT FOR TAX PAID TO A FOREIGN COUNTRY -- SIMPSON V. STATE CASE. Under the holding of the Court in Simpson v. State, 26 Wn.App. 687 (1980), the payment of retail sales or use tax to a foreign country qualifies for the credit allowed in RCW 82.12.035 on constitutional grounds. But, the Court held that the term "state" in RCW 82.12.035 does not otherwise include a foreign country.

- [7] **RULE 178, RCW 82.12.035, RCW 82.56.010:** USE TAX -- CREDIT FOR TAX PAID TO ANOTHER STATE -- DEFINITION OF SALES TAX -- VAT. The Multistate Tax Compact, chapter 82.56 RCW, provides a definition of "sales tax" in RCW 82.56.010 which clarifies the retail sales tax credit to be granted in RCW 82.12.035. Under RCW 82.56.010, "sales tax" is defined as a tax imposed on a sale which is required by state or local law to be separately stated from the sales price by the seller or which is customarily separately stated from the sales price. Because under the VAT system of taxation the seller is not required by law to separately state the tax nor is the tax customarily separately stated from the sales price where the buyer is the ultimate consumer, the VAT cannot be deemed a retail sales tax which would qualify for a credit under RCW 82.12.035.

- [8] **RULE 178, RCW 82.12.020, RCW 82.12.010(1):** USE TAX -- MEASURE OF TAX -- VALUE OF ARTICLE USED. Use tax is imposed in an amount equal to the "value of the article used" multiplied by the tax rate. The value of the article used is the purchase price if the article is sold under such conditions that the purchase price represents the true value. Where there is documentary evidence of the purchase price and there was an arm's length negotiation in arriving at the purchase price, it is incorrect to use fair market value or an appraisal to arrive at the "value of the article used" that is the measure of the tax.

- [9] **RULE 178, RULE 175, RCW 82.12.0254:** USE TAX -- EXEMPTION -- WATERCRAFT COMPONENT PART -- INTERSTATE COMMERCE. There is a sales/use tax exemption on the use of personalty which becomes a component part of watercraft used in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire. The exemption was not available to the taxpayer because its yacht was not used in interstate commerce to transport for hire.
- [10] **RULE 173, RCW 82.08.0265:** SALES TAX -- EXEMPTION -- USE OUTSIDE THIS STATE -- REPAIR WORK -- COMPONENT PART. There is a sales tax exemption for sales of component parts sold to nonresidents for use outside this state, and on repair work done for nonresidents where the seller delivers the property to a purchaser outside this state. The exemption was not available to the taxpayer because the property sold was not for use outside this state and the repaired property was not delivered outside this state.
- [11] **RCW 82.08.0273:** SALES TAX -- EXEMPTION -- NONRESIDENT PERMIT -- USE OUTSIDE THIS STATE. A nonresident may make purchases tax exempt through use of nonresident permit if the property purchased is for use outside this state. The exemption is not available in this case because the user of the nonresident permit was not a nonresident of this state and the property was not purchased for use outside this state.
- [12] **RULE 106, RULE 178:** USE TAX -- EXEMPTION -- ADJUSTMENT OF BENEFICIAL INTEREST -- TAX NOT PREVIOUSLY PAID BY TRANSFEROR. Where there has been a transfer of the capital assets to or by a business, the use of such property is not deemed taxable to the extent the transfer was accomplished through an adjustment of the beneficial interest in the business, provided the transferor previously paid sales or use tax on the property transferred. In this case, the transferor had not previously paid sales or use tax. The transferor had used the property in Washington. The transferee used the property in Washington. The transferor is held primarily liable for the use tax. The transferee is held secondarily liable with its liability limited, upon the transferor's payment in full of its use tax liability, to the difference between the use tax

liability of the transferor and that of the transferee.

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 HEARING: February 20, 1987

NATURE OF ACTION:

Petition protesting assessment of use tax on a yacht and on the repairs and renovation of the yacht.

FACTS AND ISSUES:

Krebs, A.L.J.--A Notice of Use Tax Due was issued to [the taxpayer] on October 28, 1986. Use tax was assessed in the amount of \$237,000 because of the taxpayer's ownership and use in Washington of the yacht The Notice also included the assessment of a five percent penalty in the amount of \$11,850 for a total amount due of \$248,850 which remains unpaid.

On October 28, 1986, the Department of Revenue issued also against the taxpayer Tax Warrant No. . . . for liability of \$260,700 which included the use tax liability of \$237,000, delinquent penalty of \$11,850 and warrant penalty of \$11,850. The tax warrant was filed on . . . in . . . Superior Court, Judgment Docket No. . . . , and remains unsatisfied.

On December 10, 1986, the Department issued a Notice of Use Tax Due to [Mr. . . .], Use tax was assessed in the amount of \$19,182.78 because [he] had repairs and renovation done on the yacht in Washington without payment of sales tax through his use of a nonresident permit. The use tax remains unpaid. A tax warrant has not been issued in connection with this unpaid liability.

The taxpayer is an Alaska corporation whose sole stockholders are [a married couple]. [The husband] is the president of the taxpayer corporation whose principal place of business is in . . . , Alaska where it operates a . . . business and is engaged in real estate development and management.

Based on the documents and information supplied by the taxpayer and the Department's own investigation, the following chronology is set forth with respect to the taxpayer's acquisition and use of the yacht:

1981: The taxpayer commences to negotiate for the purchase of the yacht and negotiations are discontinued. The yacht is a 128-foot motor yacht built in [the United States] in 1930. The yacht is capable of transporting people but not cargo.

1982: The taxpayer resumes negotiations to purchase the yacht from The yacht is located in [a foreign country].

March 24, 1982: [The owner of the yacht] pays Value Added Tax (VAT) to [the foreign country]

October 4, 1982: [The] seller, executes a Bill of Sale for the yacht to the taxpayer as buyer. The consideration is stated to be "Ten (\$10.00) Dollars and certain other valuable considerations."

October 26, 1982: The taxpayer's customhouse broker transfers by wire \$283,500 to the yacht seller's (. . .) Swiss bank account.

October 28, 1982: The taxpayer-buyer took possession of the yacht in . . . and soon thereafter left . . . with the yacht for Barbados in the Caribbean area. In Barbados, the taxpayer tried to lease out the yacht by charter for television commercials. When the charter was not attained, the yacht proceeded via the Panama Canal to San Diego, California and then to . . . , Washington where it arrived in February 1983.

May 1, 1983: The yacht commences moorage at the . . . Marina (. . .), [in] . . . , Washington. [The taxpayer] had previously applied for berthing space at the Marina on October 29, 1980 and was placed on a waiting list.

May 9, 1983: [The taxpayer's stockholders (married couple)] request written permission from the Marina to live aboard the yacht while it was moored at the Marina. They received written authorization. In 1983, they were in . . . , Alaska for more time than living at the Marina in In 1984, [the husband] lived aboard the yacht at the Marina about 50 percent of the time while [the wife] lived there most of the time. In 1985 and 1986, [the married couple] lived mostly aboard the yacht at the Marina. The taxpayer corporation

claimed the yacht's operating expenses as a deduction on its federal income tax returns.

The taxpayer asserts that the yacht was not purchased for [the married couple] to use as a home. They owned a condominium residence in Alaska before the yacht was purchased and still have it.

The taxpayer asserts that the yacht was purchased to engage in the charter trade on the West Coast of the United States. Before the yacht could be put to use in the charter trade, the yacht had to undergo repairs and renovation. This work was done in . . . at the Marina. Also, it required federal legislation to authorize the Coast Guard to issue a certificate authorizing the yacht to operate in coastwise charter trade. This was accomplished when the U.S. Congress enacted [legislation in November 1986].

It is the taxpayer's position that the yacht could be brought into Washington for the necessary repair and renovation work without incurring any sales/use tax liability. The taxpayer points to the following statutes as granting exemptions from sales/use tax liability applicable to the circumstances in this case:

RCW 82.08.0262 and RCW 82.12.0254: Exemption for repairs and components of watercraft for use in conducting interstate or foreign commerce by transporting therein or therewith property or persons for hire.

RCW 82.08.0265: Exemption for repairs and related sales of components to nonresidents.

RCW 82.08.0251: Exemption for personalty of nonresident temporarily within the state.

RCW 82.08.0273: Exemption for purchases by certain nonresidents for use outside Washington.

If use tax liability is sustained, the taxpayer seeks a credit against the liability in the amount of the VAT paid to [the foreign country] pursuant to the provisions of RCW 82.12.035. With reference to the . . . VAT, the taxpayer in its petition explains as follows:

It operates as a value-added tax on manufacturers and sellers who are in the chain of distribution of goods. However, when imposed on the ultimate

purchaser or consumer (such as the Taxpayer here), the tax operates exactly like a sales tax - except that it is at a higher rate. Like our sales tax, the seller is required to remit the tax to the government, and the seller collects it from the purchaser along with the purchase price (as was done in this case). We understand that I & A has recently considered a case involving a German tax that was imposed on a manufacturer. However, we believe that the tax and circumstances involved here present an issue of first impression. Unlike a manufacturer or any seller in the chain of distribution, the purchaser gets no credit or offset against its . . . tax liability. As to this Taxpayer, the tax is a consumer tax that was required in order to consummate its purchase. It has none of the attributes of a value-added tax when (as here) applied in the case of the ultimate purchaser. This Taxpayer did not receive any credit, offset, refund, or abatement of any kind against the [value added] tax. The actual economic effect on it of the [value added] tax was exactly the same as that of Washington's sales tax. Given this identity of the economic reality under these circumstances, we believe that the entitlement of this Taxpayer to the credit is clear.

If use tax liability is sustained, the taxpayer protests the measure of the tax. The Department's October 28, 1986 Notice of Use Tax Due valued by estimate the yacht at \$3,000,000 (measure of the tax). The valuation of \$3,000,000 was based on the English translation, . . . , of [the foreign] document, . . . , concerning a compromise settlement of a legal proceeding against . . . , former owner of the yacht, for taxes owed to [the foreign country].

The estimated valuation of \$3,000,000 in the Notice of Use Tax Due was also arrived at after consultation with the Watercraft Valuation Section of the Department's Property Tax Division.

The taxpayer asserts that it bought the yacht on October 25, 1982 from . . . and paid \$283,500 which amount included \$52,928 for value added tax (VAT). Thus, the taxpayer contends that the measure of the tax (valuation of the yacht) is properly \$230,572 (\$283,500 less \$52,928), not \$3,000,000.

In support of its contention, the taxpayer has submitted the following documents (. . .):

1. Bill of Sale dated October 4, 1982 The consideration is stated to be:

Ten (\$10.00) Dollars and certain other valuable considerations.

2. Undated Closing Statement of . . . customhouse broker, showing that it paid \$283,500 to . . . , seller of the yacht. Apparently, the customhouse broker held \$318,750 in funds received from the taxpayer who had borrowed that amount from Rainier Bank. The closing statement accounts for the disbursement of the funds of \$318,750.

3. Copy of check number 3027 dated October 26, 1982 drawn by the customhouse broker on its trust account. The check is in the amount of \$283,500 payable to Peoples National Bank to facilitate wire transfer of the funds to the yacht seller's account at a Swiss bank.

4. Copy of teletype message dated October 26, 1982 from the customhouse broker to . . . , officer and stockholder of the taxpayer corporation, . . . , advising him that \$283,500 was transferred to the yacht seller's Swiss bank account.

It is noted that except for the Bill of Sale (item number 1 above), none of the other above documents were furnished previously to the Department.

With respect to Department's Notice of Use Tax, . . . , issued December 10, 1986 against [the husband], individually, the taxpayer contends there was no use tax liability on the repair and renovation work done on the yacht because of the exemptions from sales/use tax liability granted by the following statutes:

RCW 82.08.0262 and RCW 82.12.0254: Exemption for repairs and components of watercraft for use in conducting interstate or foreign commerce by transporting therein or therewith property or persons for hire.

RCW 82.08.0265: Exemption for repairs and retail sales of components to nonresidents.

RCW 82.08.0273: Exemption for purchases by certain nonresidents for use outside Washington.

The measure of the tax (cost of goods and services for repairs and renovation of the yacht) was ascertained by the Department to be \$242,820. This figure was based on schedules provided by the taxpayer's accountant, . . . , who stated that sales tax or use tax had not been paid on the goods and services purchased for the repairs and renovation of the yacht. [The husband] had used a nonresident permit.

If use tax liability is sustained, the taxpayer seeks a reduction of the measure of the tax based on the assertion that [the husband] in some instances actually paid sales tax on some purchases included in the measure of the tax, that the accountant did not segregate the work done on a basis of what might be exempt, and that the accountant's figure of \$242,820 may be too high.

At the conference, the Department was informed that the taxpayer's corporate Board of Directors had resolved on February 21, 1986 to liquidate and dissolve the taxpayer corporation. Such action was approved by the taxpayer's sole shareholders, . . . , on February 21, 1986. . . . On April 2, 1986, the taxpayer transferred ownership of the yacht to [the married couple]. . . .

The taxpayer contends that under WAC 458-20-106 (Rule 106), . . . , use tax liability does not attach to [the married couple] because there was "an adjustment of the beneficial interest" in that there was a transfer of "capital assets by a corporation to its stockholders in exchange for surrender of capital stock," and that the taxpayer "transferor previously paid sales tax or use tax on the property transferred." The contention that sales tax was previously paid is based on the situation already in issue that the taxpayer paid VAT and that the VAT is a sales tax.

DISCUSSION:

[1] The use tax is imposed by RCW 82.12.020 which in pertinent part 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 any article of tangible personal property purchased at retail, or acquired by . . . The tax shall be levied and collected in an amount equal to the value of the article used by the taxpayer

multiplied by the rate in effect . . . (Emphasis supplied.)

The term "value of the article used" is defined in RCW 82.12.010(1) to mean:

. . . the consideration . . . , expressed in terms of money, paid or given or contracted to be paid or given by the purchaser to the seller for the article of tangible personal property, the use of which is taxable under this chapter. The term includes, in addition to the consideration paid or given . . . the amount of any tariff or duty paid with respect to the importation of the article used. In case the article used . . . is sold under conditions wherein the purchase price does not represent the true value thereof, 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 . . . (Emphasis supplied.)

The use tax does not depend upon residence or domicile but rather upon the privilege of using tangible personal property, such as a yacht, in Washington. However, exemptions from use tax are granted based upon residency.

RCW 82.12.010(2) provides the following definition:

"Use," "used," "using," or "put to use" shall have their ordinary meaning, and shall mean 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, or any other act preparatory to subsequent actual use or consumption within this state; . . .

The term "consumer" is defined in pertinent part in RCW 82.04.190 to mean:

(1) Any person who purchases, acquires, owns, holds or uses any article of tangible personal property irrespective of the nature of the person's business
. . .

. . .

(5) Any person who is an owner, lessee, or has the right of possession to personal property which is being constructed, repaired, improved, . . . or otherwise altered by a person engaged in business.

In this case, the salient facts are:

1. The taxpayer corporation, acting through its president, . . ., purchased at retail a yacht in . . . in October 1982.
2. The yacht entered Washington in February 1983 and remained in Washington until the end of 1986. [The married couple] lived on board the yacht most of that time with [the husband] managing the taxpayer's corporate business affairs.
3. The taxpayer corporation, acting through its president, [the husband], used the yacht as a consumer in this state. See statutory definitions, supra, of "used," "using," and "consumer." The taxpayer corporation claimed the yacht's operating expenses as a deduction on its federal income tax returns.

Accordingly, we conclude that the statutory conditions for the imposition of the use tax have been met. RCW 82.12.020.

[2] As to the taxpayer's position that the yacht could be brought into Washington for the necessary repair and renovation work without incurring use tax liability on the yacht's "use" in this state, there is no such specific statutory exemption. However, RCW 82.12.0251 in pertinent part provides:

The provisions of this [use tax] chapter shall not apply in respect to the use of any article of tangible personal property brought into the state by a nonresident thereof for his use or enjoyment while temporarily within the state unless such property is used in conducting a nontransitory business activity within the state; . . . (Bracketed words and emphasis supplied.)

Furthermore, the statute imposing the use tax, RCW 82.12.020, in pertinent part provides:

. . . This tax will not apply with respect to the use of any article of tangible personal property purchased . . . outside this state until the

transportation of such article has finally ended . . .

In the taxpayer's situation, the yacht was not "temporarily within the state." The yacht arrived in Washington in February 1983 and remained until the end of 1986. Moreover, the annual renewing of its berthing space at the Marina in . . . during those years illustrates that the yacht was not "temporarily within this state" nor intended to be so.

[3] With reference to the "transportation finally ended" principle, the Washington Supreme Court in Pope and Talbot v. The Department of Revenue, 90 Wn.2d 191 (1978) held that where a foreign corporation used an airplane, purchased in Oregon, in Washington on eight occasions, and remained at Washington airports overnight on two occasions, the transportation of the airplane had not "finally ended." The Court stated:

Under RCW 82.12.020, the transportation of an airplane might be found to "finally end" in Washington when it is home-based here, and thereby acquires a tax situs. In that event, the plane would be subject to the use tax . . .

The yacht, having been home-based continuously at the Marina for more than three years, must be deemed to have had its "transportation finally ended" in Washington.

All this is not to say that if a nonresident yacht owner brought a yacht into Washington temporarily for repairs, lived aboard the yacht while the repair work was done and then left the state that use tax would apply on the use of the yacht in Washington. In such situation, the yacht was in this state temporarily and its transportation had not "finally ended" in Washington. Use tax would not apply. But the facts in this case do not correspond to such scenario.

[4] The taxpayer has claimed exemption from use tax on the use of the yacht granted by RCW 82.12.0254 which in pertinent part provides:

The provisions of this chapter shall not apply in respect to the use of any . . . watercraft used primarily in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire . . . (Emphasis supplied.)

From the time of purchase in October 1982 until November 10, 1986, the yacht was without authority to operate in coastwise charter trade. The yacht during that time was not used at all in "conducting interstate or foreign commerce." The exemption granted by RCW 82.12.0254 is not available to the taxpayer. While the taxpayer may have intended to use the yacht for the purpose stated in the statute, such intent by itself does not give rise to the exemption. Under the law, the first use as a consumer in Washington is the incident which gives rise to use tax liability measured by the value of the article used. RCW 82.12.010 and RCW 82.12.020. The yacht was used as a residence for [the married couple] on which [the husband] conducted the corporate business affairs of the taxpayer. The taxpayer exercised dominion or control over the yacht. Thus, the taxpayer used the yacht in Washington. RCW 82.12.010(2).

For the reasons expressed and the law set forth, we conclude that the taxpayer is properly subject to use tax liability on its use of the yacht in Washington.

[5] We now turn to the matter of the credit claimed by the taxpayer against the use tax liability in the amount of the VAT paid to [the foreign country].

RCW 82.12.035 in its entirety provides:

A credit shall be allowed against the taxes imposed by this chapter upon the use of tangible personal property in this state in the amount that the present user thereof or his bailor or donor has paid a retail sales or use tax with respect to such property to any other state, political subdivision thereof, or the District of Columbia, prior to the use of such property in this state.

Thus, for the taxpayer to be entitled to the credit, the following conditions must be met:

1. The taxpayer (present user) must have had to pay a retail sales or use tax with respect to the yacht.
2. The payment of the tax must have been to another "state, political subdivision thereof, or the District of Columbia."

The facts, as we understand them, relevant to the alleged payment of the VAT to [the foreign country] are as follows:

1. [The] seller of the yacht, was a party in legal proceedings brought against him by the . . . Office of Customs and Indirect Taxes based on various import violations. On May 3, 1982, a compromise settlement was reached. . . .

2. The Compromise Settlement indicates that VAT was paid in . . . on March 24, 1982 [to the foreign country].

. . .

. . .

4. The taxpayer negotiated to purchase the yacht in 1981 but negotiations were discontinued. The taxpayer resumed negotiations in 1982 and purchased the yacht in October 1982. At the time of the 1982 negotiations, the seller owed VAT The taxpayer and seller reached a tentative agreement that the taxpayer would reimburse the seller for the VAT to be paid to This agreement was reached because allegedly the [foreign] government would not let the seller sell the yacht until the VAT was paid. The taxpayer told the seller to pay the VAT so that the sale could be made.

5. The taxpayer arranged for payment of \$283,500 to the seller on October 26, 1982 which allegedly included \$52,928 as reimbursement for the VAT paid by the seller on March 24, 1982.

It is clear from the above facts that the seller's liability for VAT to [the foreign country] existed independently of any sale to the taxpayer. The seller paid VAT on March 24, 1982. The taxpayer purchased the yacht in October 1982. If the seller never sold the yacht, it was still liable for VAT. Why is that?

Our understanding of the . . . VAT is based on the . . . Business Law Guide, 1986 CCH Edition. The . . . VAT is based on a tax credit mechanism that allows each taxable person (excluding ultimate consumers) to calculate tax based on the price of goods that the person sells, or services rendered, after deducting the tax borne by the elements that made up this price. As a result, the total amount paid . . . by successive sellers of a product is equal to the tax based on the final sales price to the customer. . . . Any item imported . . . is subject to . . . VAT as it enters customs. Items exported . . . are untaxed, that is, the exporter receives a refund of the input VAT paid on the elements that make up the cost price of the export. Thus, if the property

sold is destined for a foreign country, the . . . VAT is not due since the export exemption comes into play.

The yacht was built in [the United States] in 1930. Its entry into [the foreign country] must be deemed as an "imported item."

Returning to the question of why was the seller liable for VAT if it never sold the yacht, we find the answer is that the seller had "imported" the yacht into [the foreign country] some time before March 1982 and thereby incurred the tax liability for VAT. Accordingly, regardless of the negotiated selling price between the taxpayer and the seller as including an understanding between them that the selling price included payment or reimbursement of the VAT previously paid by the seller for import of the yacht, the basic fact is that the taxpayer did not actually pay VAT on its purchase of the yacht.

Furthermore, there is no evidence that the seller paid the VAT on its sale of the yacht to the taxpayer. Indeed, since the property sold was destined for a foreign country, there was no VAT due . . . by the seller on the sale because the export exemption is available to the seller.

We conclude that the credit allowed by RCW 82.12.035 is not available to the taxpayer because it paid no tax at all, let alone retail sales or use tax, with respect to the yacht. This conclusion makes it unnecessary to determine whether the VAT can be deemed to be a retail sales tax and whether [the foreign country] is included within the statute's "other state, political subdivision thereof, or the District of Columbia" as the recipient of the tax paid.

[6] and [7] However, because we have done extensive research on the question as to whether a VAT is to be deemed a retail sales tax within the purview of RCW 82.12.035, we would be remiss if we did not tackle the question.

Chapter 82.56 RCW, Multistate Tax Compact, provides at RCW 82.56.010 that:

The following multistate tax compact, and each and every part thereof, is hereby approved, ratified, adopted, entered into and enacted into law by the state of Washington.

This statute includes and sets forth the Multistate Tax Compact. Article II, Definitions, paragraph 7 provides:

"Sales tax" means a tax imposed with respect to the transfer for a consideration of ownership, possession or custody of tangible personal property or the rendering of services measured by the price of the tangible personal property transferred or services rendered and which is required by state or local law to be separately stated from the sales price by the seller, or which is customarily separately stated from the sales price, but does not include a tax imposed exclusively on the sale of a specifically identified commodity or article or class of commodities or articles. (Emphasis supplied.)

The significance of the definition of "sales tax" in the Multistate Tax Compact is that it directly relates to the subject matter of RCW 82.12.035, that is, retail sales taxes paid to other states.

Under the VAT system, where the buyer is the ultimate consumer, the seller is not required by law to separately state the tax nor is the tax customarily separately stated from the sales price. In American parlance, it would be a "hidden tax." There is no need to separately state the VAT because the ultimate consumer is no player in the tax credit mechanism. The seller and his suppliers and vendors need to know the amount of VAT paid because they can claim a credit for the amounts paid by others. The VAT is separately stated to them but never to the ultimate consumer except where the goods sold are exported, in which case, the VAT is either deducted from the charge or refunded to the customer, and the customer has no credit to claim under RCW 82.12.035.

Because the VAT on a sale to the ultimate consumer is not separately stated nor customarily separately stated from the sales price, we find that it does not meet the definition of "sales tax" in RCW 52.56.010 and the VAT is not qualified as a credit allowed under RCW 82.12.035.

With respect to the question as to whether [the foreign country] would be deemed to be included in RCW 82.12.035's "other state, political subdivision thereofá.á.á.," the answer is provided by the decision in Simpson v. State, 26 Wn.App. 687 (1980) where the Court held at page 690 that the term "state" in RCW 82.12.035 does not include foreign countries.

However, the Court opined further that to administer a use tax exemption statute in such a way as to limit the exemption based upon whether property had been purchased in another state as opposed to another country would discriminate within a class of similarly situated purchasers. Such discrimination, the Court ruled, is not rationally related to the legislative purpose of equalizing the use tax burden among all residents and is invalid under the equal protection clause of the State and U.S. Constitutions. Equal protection guarantees, the Court said, apply to resident aliens as well as to citizens. The Court reasoned, supported by U.S. Supreme Court precedent in Wengler v. Druggists Mut. Ins. Co., 446 U.S. 142, 64 L.Ed.2d 107 (1980), that rather than to rule the exemption statute as invalid on its face, the defect could be cured by simply granting the exemption to all persons within the class without regard to their nationality or where they purchased the property used here. In this manner the integrity of the law was maintained consonant with the legislative intent manifested in the entire use tax act. The result is that payments of retail sales or use tax to foreign countries qualify for the credit allowed in RCW 82.12.035 and this position on the matter has been adhered to by the Department following the decision in Simpson v. State, supra.

[8] We now turn to the matter of the measure of the tax. The Department's October 28, 1986 Notice of Use Tax Due valued the yacht by estimate at \$3,000,000 (measure of tax). At the February 20, 1987 conference, the taxpayer requested that the measure of the tax be promptly determined for the purpose of adjusting the outstanding warrant against the taxpayer. This was done and on March 3, 1987, an amended Notice of Use Tax Due (. . .) was issued reducing the measure of tax to \$670,940. Warrant No. . . . was amended to reflect this value. . . .

With respect to the measure of the use tax, RCW 82.12.020 in pertinent part provides:

The tax shall be levied and collected in an amount equal to the value of the article used by the taxpayer multiplied by the rate . . . (Emphasis supplied.)

The term "value of the article used" is defined in RCW 82.12.010(1) to mean:

. . . the consideration . . ., expressed in terms of money, paid or given or contracted to be paid or

given by the purchaser to the seller for the article of tangible personal property, the use of which is taxable under this chapter. The term includes, in addition to the consideration paid or given . . . the amount of any tariff or duty paid with respect to the importation of the article used. In case the article used . . . is sold under conditions wherein the purchase price does not represent the true value thereof, 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 . . .

The yacht in question is a motor yacht built in [the United States] in 1930. After purchase in [the foreign country] by the taxpayer in October 1982, the yacht arrived in Washington in February 1983 where it was repaired and renovated at a cost of \$242,820. The yacht is now insured at an "agreed valuation" of \$750,000.

The measure of the tax (estimated at \$3,000,000) as stated in the Notice of Use Tax Due represented the current fair market value of the yacht in Washington. The Department had no documentary evidence at that time as to the purchase price. Now, the Department has the documentary evidence which shows that the taxpayer paid \$283,500 to the seller and \$1,370.23 to the broker, . . . , in the purchase transaction.

There was no tariff or duty paid with respect to importation of the yacht into the United States because the yacht was deemed to be returning to the United States.

The yacht was not sold under conditions wherein the purchase price did not represent the true value. It was an arm's length transaction with negotiations beginning in 1981, discontinued for a time, and then resumed in 1982.

Accordingly, the "value of the article used" is the consideration in the amount of \$283,500 paid by the taxpayer-purchaser to the seller, RCW 82.12.010(1); not the \$3,000,000 estimated valuation.

However, there is additional documentation indicating that the purchase price was greater than the amount of \$283,500. [In] a letter dated August 12, 1983 by the taxpayer to Rainier Bank which had previously loaned \$318,750 to the taxpayer. . . . the purchase price [is reported] to be \$332,398 [with] other

expenditures which would fall within the measure of the use tax such as \$67,273 for equipment and \$11,279 for electronics.

It is noted that the above letter of August 12, 1983 is within a year of the date of purchase of the yacht in October 1982. Thus, it must be deemed a more accurate representation of the taxpayer's expenditures in acquiring the yacht and equipment.

We conclude that the measure of the tax be based on the following:

\$332,398 Purchase price as reported to Rainier Bank by the taxpayer in letter of August 12, 1983 which includes the \$285,500 consideration paid by the taxpayer to the seller.

67,273 For equipment as reported in letter of August 12, 1983

11,279 For electronics as reported in letter of August 12, 1983

1,370 Paid by the taxpayer to the broker,

242,820 Cost of repairs (see below) subject to use tax liability

10,000 For 1985 17-foot Seaswirl boat added to yacht as reported in [the] insurance endorsement

4,500 For 1984 13-foot Boston Whaler as reported in [the] insurance endorsement

1,300 For 1984 Periwinkle dinghy as reported in [the] insurance endorsement

\$670,940 Measure of tax

With respect to the \$242,820 item above pertaining to cost of repairs, it is noted that the Department issued a Notice of Use Tax Due (. . .) on December 10, 1986 holding [the husband] individually liable for use tax on the repairs because he used a nonresident permit to secure exemption from the sales tax. A tax warrant has not been issued in connection with this unpaid liability. It appears to us that the taxpayer corporation is also liable for the use tax as the ultimate consumer of the repairs. Therefore, we have added

the cost of the repairs to the measure of the tax in the above.

The December 10, 1986 Notice of Use Tax Due is also being protested by [the husband] on the basis of the exemptions granted by RCW 82.08.0262, RCW 82.12.0254, RCW 82.08.0265 and RCW 82.08.0273.

RCW 82.08.0262 provides for an exemption from sales tax on sales of tangible personal property which becomes a component part of watercraft used in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire.

[9] RCW 82.12.0254 provides for an exemption from use tax on the use of tangible personal property which becomes a component part of watercraft used in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire.

From the time of purchase in October 1982 until November 10, 1986, the yacht was without authority to operate in coastwise charter trade. The yacht during that time was not used at all in "conducting interstate or foreign commerce." From February 1983 until the end of 1986, the yacht was in Washington with [the married couple] living on board the yacht most of that time. They used the yacht as their residence with [the husband] managing the taxpayer's corporate business affairs. The exemptions granted by RCW 82.08.0262 and RCW 82.12.0254 are not available to [the husband] or the taxpayer.

[10] RCW 82.08.0265 provides for a sales tax exemption. The statute in its entirety states:

The tax levied by RCW 82.08.020 shall not apply to sales to nonresidents of this state for use outside of this state of tangible personal property which becomes a component part of any machinery or other article of personal property belonging to such nonresident, in the course of installing, repairing, cleaning, altering, or improving the same and also sales of or charges made for labor and services rendered in respect to any installing, repairing, cleaning, altering, or improving, of personal property of or for a nonresident, but this section shall apply only when the seller agrees to, and does, deliver the property to the purchaser at a point outside this state, or delivers the property to a common or bona fide private carrier consigned

to the purchaser at a point outside this state.
(Emphasis supplied.)

Because the sale of the personalty was not "for use outside of this state" and the repair work was done on the yacht in Washington without the seller of the repair services delivering the yacht "at a point outside this state," the exemption is not available to [the husband] nor to the taxpayer.

[11] RCW 82.08.0273 provides for a sales tax exemption to nonresidents who obtain a Nonresident Permit. [The husband] obtained and used Nonresident Permit Numbers . . . to make purchases exempt of sales tax. The items purchased were for use on the yacht in this state. The statute in pertinent part provides:

The tax levied by RCW 82.08.020 shall not apply to sales to nonresidents of this state of tangible personal property for use outside this state when the purchaser has applied for and received from the department of revenue a [nonresident] permit . . .
(Bracketed word and emphasis supplied.)

[The husband] was a resident of this state by residing aboard the yacht most of the time from February 1983 until the end of 1986. The items purchased sales tax exempt were for use in this state. The sales tax exemption under RCW 82.08.0273 is not available to [the husband]. Because sales taxes were not paid on the purchases and the items purchased were used in this state, [the husband] is liable for use tax. RCW 82.12.020.

The measure of the tax (cost of goods and services for repairs and renovation of the yacht) subject to use tax in the Department's Notice of Use Tax Due issued December 10, 1986 to [husband] is \$242,820. This figure was based on schedules provided to the Department by the taxpayer's accountant, . . . , who stated that sales tax or use tax had not been paid. Copies of these schedules were provided to the taxpayer's attorney;

It should be noted that the \$242,820 measure of tax has also been included in the measure of tax (\$670,940) in the amended Notice of Use Tax Due issued March 3, 1987 to the taxpayer. This does not mean that the Department is seeking to collect the tax twice. The taxpayer is liable because it was the ultimate consumer of the repairs and renovation of the yacht.

[The husband] is liable because he made the purchases without payment of sales tax. The liability of [the husband] will terminate upon the taxpayer's payment in full of its use tax liability.

The taxpayer and [the husband] question the measure of tax on the basis that the accountant's figure of \$242,820 includes purchases where [the husband] actually paid sales tax. This is a factual question where the burden is on them to establish such instances, especially in view of the fact that their own accountant has supplied the figure to the Department. If the taxpayer establishes such instances, the measure of tax will be reduced, and if the tax has already been paid a refund will be made depending on the reduction of the measure of tax.

[12] On March 3, 1987, the Department issued a Notice of Use Tax Due, . . . , to [the married couple] on their acquisition and use of the yacht. The measure of tax is \$750,000 based on the "agreed valuation" as stated in the insurance policy, . . . , issued September 26, 1986. The taxpayer asserts that it transferred the yacht to Mr. and Mrs. . . . pursuant to surrender of their shares of stock on the liquidation and dissolution of the taxpayer corporation.

On February 21, 1986, the taxpayer's corporate Board of Directors resolved to liquidate and dissolve the taxpayer corporation. Such action was approved by the sole shareholders, Mr. and Mrs. . . . , on February 21, 1986. . . .

On April 2, 1986, the taxpayer transferred ownership of the yacht to Mr. and Mrs.

Mr. and Mrs. . . . continued to live aboard the yacht in Seattle after April 2, 1986. Thus, they became liable for use tax. WAC 458-20-106 (Rule 106), . . . , in pertinent part provides:

RETAIL SALES TAX

. . . .

A transfer of capital assets to or by a business is deemed not taxable to the extent the transfer is accomplished through an adjustment of the beneficial interest in the business. The following examples are instances when the tax will not apply.

. . .

3. Transfers of capital assets by a corporation to its stockholders in exchange for surrender of capital stock.

. . .

USE TAX

. . .

Where there has been a transfer of the capital assets to or by a business, the use of such property is not deemed taxable to the extent the transfer was accomplished through an adjustment of the beneficial interest in the business, provided, the transferor previously paid sales or use tax on the property transferred. (Emphasis supplied.)

In this case, the taxpayer-transferor has not previously paid sales or use tax on the property (yacht) transferred to Mr. and Mrs. Thus, Mr. and Mrs.á . . . are liable for use tax measured by the "value of the article used." RCW 82.12.010(1).

Although the taxpayer corporation is being held liable for use tax on its ownership and use of the yacht in Washington and Mr. and Mrs. . . . are being held liable for use tax on their ownership and use of the yacht in Washington, we find that the purpose and intention of the exemption in Rule 106 is not to tax a transfer of capital assets which is accomplished through an adjustment of the beneficial interest. Thus, while a literal reading of the exemption provided by Rule 106, in that the taxpayer transferor has not previously paid sales or use tax on the yacht transferred, would actually result in the Department collecting use tax from both the taxpayer and Mr. and Mrs.á . . . , we believe that the purpose and intent of Rule 106 does not support such result. We conclude that the taxpayer is primarily liable and that Mr. and Mrs.á . . . are secondarily liable to the extent of their use tax obligation. Their liability will be limited, upon the taxpayer's payment in full of its use tax liability, to the unpaid difference.

SUMMARY AND CONCLUSIONS:

1. The taxpayer corporation purchased a yacht in [a foreign country] in October 1982 without payment of sales or use tax or any tax at all.
2. The . . . Value Tax (VAT) is not a retail sales nor use tax available as a credit to the taxpayer or Mr. and Mrs. . . . under RCW 82.12.035 or under Rule 106.
3. The taxpayer brought the yacht to Washington in February 1983 where it remained until the end of 1986, where it was used as a residence for Mr. and Mrs. . . . , and where it was used by [the husband] in conducting the business affairs of the taxpayer.
4. There is no use tax exemption available to the taxpayer or [the husband].
5. Mr. and Mrs. . . . are liable for use tax on their ownership and use of the yacht in Washington which was transferred to them by the taxpayer on April 2, 1986. The use tax exemption under Rule 106 is not available to them.
6. The taxpayer is primarily liable for payment of use tax. The use tax liability of Mr. and Mrs. . . . will be limited, upon the taxpayer's payment in full of its use tax liability, to the difference between the use tax liability of the taxpayer transferor and that of the transferee (Mr. and Mrs. . . .).

DECISION AND DISPOSITION:

With respect to the taxpayer:

The taxpayer's petition is denied in part and granted in part as follows:

1. Use tax liability is sustained.
2. The measure of tax in the amount of \$3,000,000 as set forth in the Notice of Use Tax Due dated October 28, 1986 is not sustained.
3. The measure of tax in the amount of \$670,940 as set forth in the amended Notice of Use Tax Due issued March 3, 1987 is sustained. If the taxpayer establishes that sales tax has been paid in connection with [the husband's] purchases of goods and repair services, the tax will be reduced accordingly or a refund made if the tax has been paid to the Department.

Tax Warrant No. . . . issued October 28, 1986 and amended on March 3, 1987 for use tax liability of \$53,004.26, for filing fee of \$5, for delinquent penalty of \$2,650.21, for warrant penalty of \$2,650.21 plus accrued interest to Aprilá28, 1987 of \$3,498.28 for a total sum of \$61,807.95 is due for payment by Aprilá28, 1987. Payment after Aprilá28, 1987 results in additional interest due at the rate of \$583.04 for each 30 days or portion thereof. RCW 82.32.010.

With respect to [the husband]:

The petition of [the husband] is denied. Use tax liability is sustained. Use tax in the amount of \$19,182.78 is due for payment by May 4, 1987. If [the husband] establishes that sales tax has been paid in connection with his purchases of goods and repair services, the tax will be reduced accordingly or a refund made if the tax has been paid to the Department. The use tax liability of [the husband] will terminate upon the taxpayer's payment in full of its use tax liability.

With respect to Mr. and Mrs. . . .:

The petition of Mr. and Mrs. . . . is denied. Use tax liability is sustained. Use tax in the amount of \$59,250 is due for payment by May 4, 1987. Their liability for use tax will be limited, upon the taxpayer's payment in full of its use tax liability, to the difference between the use tax liability of the taxpayer transferor and that of the transferee (Mr. and Mrs. . . .).

DATED this 13th day of April 1987.