Cite as Det. No. 87-171, 3 WTD 153 (1987)

BEFORE THE INTERPRETATION AND APPEALS SECTION
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. 87-171[1] |
| . . . | ) | Registration No. . . . |

[1] **RULE 193B and RULE 211**: B&O TAX -- LEASE PAYMENTS -- OUT-OF-STATE LESSOR -- ETBs 384 and 447. Persons who lease tangible personal property for use in this state are subject to the state's B&O tax upon the gross proceeds from such rentals, even if the lease agreement was consummated outside this state, and the lessor maintains no place of business, employees, or other business establishment in the state.

[2] **RULE 193B and RULE 211**: B&O TAX -- LEASE PAYMENTS -- OUT OF STATE LESSOR -- DUE PROCESS NEXUS. The presence of leased property in this state, used by the lessees in their business, constitutes sufficient nexus to support imposition of this state's B&O tax on the lessor. The connection between the taxing state and the out-of-state taxpayer necessary to establish nexus is an economic rather than a physical relationship.

[3] **RULE 193B**: B&O TAX -- LEASED PROPERTY USED IN INTERSTATE COMMERCE --COLUMBIA RIVER -- APPORTIONMENT -- BURDEN OF PROOF. A tax on the lessor's income from lease payment for barges used by the lessee in interstate commerce is valid where the assessment was apportioned so as to tax only the portion of the use in Washington's territorial waters. The burden is on the taxpayer to show the apportionment is unreasonable.

[4] **RULE 193B and 211**: RETAIL SALES TAX/USE TAX -- OUT-OF-STATE LESSOR. Out-of-state lessors are required to collect and remit Washington's retail sales tax or use tax if they regularly engage in the leasing of property located within this state.

[1] The reconsideration determination, Det. No. 87-171A, is published at 5 WTD 281 (1988).

[5} **RULE 103 and RCW 82.12.020**: -- RETAIL SALE -- LEASE -- TIME AND PLACE OF SALE. When property is leased, the taxable sale does not occur where the lease agreement is consummated or where the property is transferred, but where the property is used.

[6] **RULE 178 and RCW 82.12.020**: USE TAX -- LEASED MOBILE PROPERTY -- PURCHASED PROPERTY DISTINGUISHED. The statutory exemption provided by RCW 82.12.020 does not apply to property that is acquired by lease. Pope & Talbot distinguished.

[7] **RULE 178 and RCW 82.12.0254**: USE TAX -- BARGES -- USE IN INTERSTATE COMMERCE. RCW 82.12.0254 does not provide an exemption for barges used by a lessee in interstate commerce to transport its own materials between its own facilities; such transportation is not transporting for hire.

[8] **RULE 228**, **RCW 82.32.100 and 82.32.105**: UNREGISTERED TAXPAYER -- PENALTIES AND INTEREST -- WAIVER. The Revenue Act requires the Department to add interest and late payment penalties where a taxpayer fails to register and pay taxes as required and none of the situations described in Rule 228 apply.

[9] **RULE 228 and RCW 82.32.100**: FAILURE TO FILE RETURNS -- PENALTIES -- UNREGISTERED TAXPAYER -- DEPARTMENT POLICY. RCW 82.32.100 provides no statute of limitations for the assessment of taxes against a taxpayer who has not registered as required by the Revenue Act. The Department policy, however, is to limit assessments against unregistered taxpayers to seven years.

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: September 23, 1986

NATURE OF ACTION:

The taxpayer petitions for a correction of assessment of retailing B&O and retail sales tax on 50 percent of the lease payment received by the taxpayer/lessor for the lease of three barges used by the lessee on the Columbia River.

FACTS AND ISSUES:

Frankel, A.L.J.-- . . . (hereinafter referred to as the taxpayer) is an Oregon corporation that leases marine equipment. The taxpayer's records were audited for the period Januaryá1, 1981 through Juneá30, 1985. As a result, Tax Assessment No. . . . was issued on Decemberá26, 1985 for taxes, interest and penalties owing in the amount of $ . . . . Prior to the audit at issue, the taxpayer was not registered in this state because it believed it did not have sufficient "nexus" with this state for the imposition of Washington's B&O taxes on its income.

The taxpayer petitioned for a correction of the assessment. The taxpayer contended the assessment contained mathematical and factual errors. Also, the taxpayer provided resale and exemption certificates that had not been available at the time of the audit. The original audit was adjusted, reducing the assessment to $ . . . . The taxpayer has paid $ . . . toward the assessment.

The remaining issue concerns the assessment of retailing B&O and retail sales tax on one-half the receipts from the taxpayer's lease of three barges to . . . (hereinafter referred to as the lessee).[2] The lease was completed in Oregon and the barges were constructed and maintained and based in Oregon. The barges are leased without operator and used by the lessee to transport its products from its Oregon place of business to its plant in Washington.

The taxpayer has no employees, agents, or independent contractors operating within this state. It has no warehouse, inventory, stock of goods or other property in Washington. The auditor assessed the tax on the lease payments, relying in part on RCW 82.04.040 and WAC 458-20-211. He concluded that because the barges were operated by the lessee on the Columbia River, one-half of the use of the barges was in Oregon and one-half in Washington. He assessed the tax on 50 percent of the lease payments at issue.

ISSUES

1. The primary issue is whether imposition of Washington's B&O and retail sales tax on one-half of the gross receipts from the lease is an unconstitutional burden on interstate commerce or a denial of due process. In other words, whether the use of an out-of-state lessor's mobile personal property within this state by the taxpayer's lessee provides a sufficient nexus with this state for the imposition of Washington's B&O and retail sales tax on the lease payments.

2. The second issue is whether the imposition of retail sales tax or use tax on payments for the lease of a barge used by the lessee to transport its products between its Oregon and Washington facilities is prohibited by Washington law, specifically RCW 82.12.020 or RCW 82.12.0254.

---

[2] Section 11 of the lease agreement provided that the lessor/owner shall bear all property and income taxes arising out of the contract and that the lessee shall pay all other taxes. Because of the lessee's potential tax liability, it submitted a written memorandum and participated in the hearing.
This Determination, however, refers to the lessor as the "taxpayer," as its tax assessment is at issue.

DISCUSSION:

[1] B&O tax--RCW 82.04.220 imposes a business and occupation tax "for the act or privilege of engaging in business activities." Retailing B&O is assessed on persons "engaging within this state in the business of making sales at retail." RCW 82.04.250. The leasing of tangible personal property constitutes a retail sale. RCW 82.04.040 and RCW 82.04.050. See also WAC 458-20-211.[3]

A lease is not a single "sale," but a contract for a series of transactions or sales. Gandy v. State, 57 Wn.2d 690, 695 (1961). For excise tax purposes, the sales take place in this state when the property is used in this state by the lessee. WAC 458-20-103. It is not material, therefore, that the lessor maintains no place of business, employees or other business establishment in the state. ETB 384.08.211. The situation is analogous to that of an out-of-state vendor who maintains a warehouse or stock of goods in this state from which he makes sales for delivery to customers in Washington. In such a case, the fact that all incidents of the sale except delivery to the customer take place outside this state is immaterial. The transaction is local, and taxable, because the goods are located in the state at the time of sale to the purchaser.

The ownership of income-producing lease property in this state itself constitutes a commercial or business situs sufficient to support imposition of this state's B&O and retail sales tax. This position is clearly stated in WAC 458-20-193B (Rule 193B) and ETBs 384.08.211 and 447.04.211. Rule 193B is the administrative rule which defines the constitutional limits upon this state's ability to impose its excise tax upon sales of goods originating in other states to persons in Washington. The rule provides that the B&O tax is assessed on persons outside this state who rent or lease tangible personal property for use in this state upon the gross proceeds from such rentals, "irrespective of the fact that possession to the property leased may have passed to the lessee outside the state or that the lease agreement may have been consummated outside the state."

ETB 447, issued in 1972, discusses the application of the B&O and retail sales tax on the proceeds from leases or rentals of tangible personal property put to use by the lessee both inside and outside of this state. That bulletin provides:

> . . . The controlling factor which determines whether Washington State possesses taxing jurisdiction over such lease or rental income is the physical location of the property in this state during the term of the lease. The taxable incident takes place in this state when the property is "used" in this state by the lessee. Conversely, when leased tangible personal property is used by the lessee outside Washington State, this state does not impose its jurisdiction with respect to that use. (See Longview Tugboat Company v. State (1964) 64 Wn.2d 323, and Stone v. Stapling Machines Co., Miss. 1954, 71 S. 2d 205.)

---

[3] The lessee relied in part on Trimount Coin Machine v. Johnson, 124 Atlantic 2d 753, for its assertion that no retail sales or use tax should be assessed in this case. That case is distinguished, as the Maine statute at issue only imposed sales or use tax on a lease that was an installment sale. Washington's statute makes no such distinction. See note 4 infra.

> Thus, persons who lease or rent tangible personal property for use both within and without Washington are taxable upon that portion of gross income derived from its use by the lessee in Washington, providing accurate records are maintained to substantiate the amount of "use" claimed outside this state.

[2] The taxpayer contends that the tax is invalid because Washington does not have adequate jurisdictional "nexus" with the lease payments at issue to impose a tax on the interstate activities. Accordingly, the taxpayer contends the tax violates both the Commerce Clause and the Due Process Clause of the Fourteenth Amendment. The Due Process Clause requires a "minimal connection" between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 436-37 (1980).

In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), the Court overruled prior decisions which held that a tax on the privilege of engaging in an activity in the state may not be applied to an activity that is part of interstate commerce. The court noted that such a rule has no relationship to economic realities. "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business." 430 U.S. at 279 quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938).

To be valid, the state tax on interstate commerce must meet four requirements: (1) there must be a sufficient nexus between the interstate activities and the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. Complete Auto Transit at 279. Accordingly, if a tax meets those requirements, it is not invalid even if on an activity which is part of interstate commerce.

In addition to arguing that it does not have sufficient contact with this state to impose the tax, the taxpayer contends the tax should not be assessed because the lease at issue was for mobile personal property and the taxpayer has no control over the use of the barges by the lessee. A similar argument was raised by a taxpayer in American Refrigerator Transit Co. v. State Tax Commission, 238 Ore. 340, 395 P.2d 127 (1964). The taxpayer in that case (ART) owned refrigerator cars which it leased to railroads. ART had no rental agreement with any railroad operating in Oregon, but some of ART's cars were used by railroads operating in Oregon. As in the present case, all major repairs were done outside the taxing state and ART had no control over the routing or use of the leased railroad cars by the lessees.

Oregon assessed its income tax on the rental income received by ART for the use of its cars in Oregon. As here, the taxpayer protested the tax because of a lack of sufficient nexus between it and Oregon. The Oregon tax court agreed. The Oregon Supreme Court, however, rejected the lower court's view of the nexus requirement, finding:

> . . . We do not regard it as essential to the existence of a nexus that the taxpayer, through its agents, directly engage in some form of physical activity within the

> state in furtherance of a business purpose. The connection between the taxing state and the out-of-state taxpayer necessary to establish nexus is essentially an economic rather than a physical relationship. The theory is that a state is free to exact a reasonable tribute from those using its economic resources.
>
> . . .
>
> The nexus exists whenever the corporation takes advantage of the economic milieu within the state to realize a profit. The state is entitled to tax if the benefits it provides are a substantial economic factor in the production of the taxpayer's income. These benefits are found in the maintenance of conditions essential to the production or marketing of goods. They may be realized simply in the protection of the taxpayer's property used in the production of income.

238 Ore. at 346-347.

Although the court recognized nexus did not exist in every case where a state's economy could be said to have contributed to the production of income, it found nexus exists where "the taxpayer's property itself is employed in the taxing state to produce income." The fact that the property was mobile personal property used in interstate commerce and that the property was used by lessees rather than the taxpayer's own agents was not significant:

> Whether the income derived from property located in a state comes to the owner indirectly in the form of rent under a lease or directly in the form of income from its own use of its property, the source of the income is the same, and it is the taxing state that has provided the source by providing and maintaining the economic setting out of which the owner reaps its profit.

[3] The auditor attempted to tax only the revenue from the use of the barges in Washington's territorial waters of the Columbia by assessing tax on 50 percent of the lease payments. In Smith v. State, 64 Wn.2d 323 (1964), the Court found such an assessment not a duplicitous tax nor an impermissible burden on interstate commerce.[4] If Oregon can assert liability on the revenue received for the lessee's use of the barges in Washington, the taxpayer has the burden to show the actuality or substantial likelihood of such multiple taxation. See, e.g., Washington-Oregon Shippers Cooperative Association, Inc. v. Schumacher, 59 Wn.2d 159 (1961). If the lessee's books and records show the 50 percent apportionment unreasonable, that evidence may be presented to the auditor. We would agree the taxpayer could delete from the measure of the tax the portion of the rental income for the days the barges were in Oregon and not used by the lessee for transporting its materials on the Columbia. A daily rental rate could be established by dividing the annual rental payment for each vessel by 365. The product of the daily rate times

[4] In Smith v. State, the court upheld an apportionment of 50 percent of the taxpayer's income from towing between two Washington points on the Columbia River where the taxpayer's books and records made a precise mathematical formula impossible. No attempt was made to tax property actually in transit in interstate commerce, and the Court stated such property would likely be exempt from state taxation. 64 Wn.2d at 337-39. That case was decided prior to Complete Auto Transit v. Brady, however.

the number of days the barges were not used in Washington could be excluded from the measure of the tax.

[4] Retail Sales Tax -- Rule 193B provides that an out-of-state vendor is required to collect and remit the retail sales tax or use tax if it: "[r]egularly engages in any activity in connection with the leasing or servicing of property located within this state." Consumers who lease tangible personal property from others without paying retail sales tax are liable for the use tax on the amount of the rental payment at the time the payment is due. WAC 458-20-211 and WAC 478-20-178. As Rule 178 states, the retail sales tax and use tax complement each other to provide a uniform tax upon the sale or use of all tangible personal property in this state, regardless of where or how the property was acquired.

[5] The lessee argues that RCW 82.08.020 only provides for a tax on retail sales "in this state" ( . . . ). The lessee contends there was no retail sale between it and the taxpayer lessor because the lease was executed outside this state. As discussed above, though, the taxable sale did not occur where the lease agreement was consummated or where the property was transferred, but where the property is used. WAC 458-20-103.

[6] The use tax is imposed on every person in this state for the privilege of using within this state as a consumer "any article of tangible personal property purchased at retail or acquired by lease, gift repossession, or bailment, or extracted or produced or manufactured by the person so using the same . . ." RCW 82.12.020 (Emphasis added). The lessee contends its use of the barge does not constitute taxable "use" as defined by the statute. The lessee emphasized the following language in that statutory provision in support of its argument:

> This tax will not apply with respect to the use of any article of tangible personal property purchased, extracted, produced or manufactured outside this state until the transportation of such article has finally ended or until such article has become commingled with the general mass of property in this state.

The lessee contends the "obvious import" of this language is to preclude imposition of the use tax on the transitory use of an article of tangible personal property which is manufactured outside the state of Washington ( . . . ). We disagree.

The use tax is imposed on the lessee for its use of property in Washington which was "acquired by lease." The use tax is not being imposed because the lessee is using property which it extracted, produced or manufactured. To find that the exemption was applicable in this case, we would have to find that the lessee "purchased" the property outside this state.

Although a lease is defined as a retail sale, a true lease is not a "purchase" of the property.[5] Several rules of statutory construction support such a distinction and our conclusion that the exemption provided by RCW 82.12.020 is not applicable to property that was acquired by lease.

---

[5] In some cases, the Department has found a "lease" was a financing arrangement for the purchase of the property rather than a true lease. The Department has been guided by Courtright Cattle Co. v. Dolsen Co., 94 Wn.2d 645 (1980). For example, the Department has considered a transaction an installment/sale purchase if the lease

First, exemptions to taxes are narrowly construed. Budget Rent-A-Car, Inc. v. Department of Revenue, 81 Wn.2d 171, 174 (1972). Second, exemptions shall not be enlarged by construction, since the legislature has presumably granted in express terms all that it intended to grant. Norwegian Lutheran Church v. Wooster, 176 Wash. 581 (1934). And third, words in a statute are given their common, ordinary meaning absent a contrary statutory definition. John H. Sellen Construction Co. v. Department of Revenue, 87 Wn.2d 878, 882 (1976).

The statute imposes the use tax on property "purchased at retail or acquired by lease." The words "or acquired by lease" would be superfluous if purchased at retail included property acquired by lease. Statutes are to be construed, wherever possible, so that "no clause, sentence, or word shall be superfluous, void, or insignificant." United Parcel Service Inc. v. Department of Revenue, 102 Wn.2d 355, 361-62 (1984) (citations omitted).

Another elementary rule is that "where the legislature uses certain statutory language in one instance, and different language in another, there is a difference in legislative intent." Id. In this case, the legislature included the words "acquired by lease" in imposing the tax, but not in granting the exemption at issue. Accordingly, we do not find the exemption applies to property acquired by lease.

As additional support, the lessee cites Pope & Talbot v. Department of Rev., 90 Wn.2d 191 (1978). That case, however, did not concern leased property. Pope & Talbot had purchased an airplane in Oregon which it used to transport its executives and customers between its facilities, including Washington. The Department had levied a use tax based upon Pope & Talbot's use of the airplane in Washington. The court found the assessment invalid under RCW 82.12.020. In that case, because the property had been purchased, use tax would have been assessed on the total value of the airplane.

As noted above, however, use tax liability with respect to leased tangible personal property is limited to the amount of the rental payments paid or due the lessor. WAC 458-20-178. Because the tax is levied only on the portion of the lease or rental payment for use within Washington, we believe it is not controlling that the leased property is mobile. This result is in accord with the Oregon case, American Refrigerator Transit Co., discussed above and with Rules 103, 211 and 193B. These rules were duly adopted by the Department; therefore they have the same force and effect as the Revenue Act itself. RCW 82.32.300.

[7] As an alternative claim to a statutory exemption, the lessee relies on RCW 82.12.0254.[6] That statute provides a use tax exemption

---

contained a nominal purchase option. In such a case, the sales tax would be due on the total purchase price initially and not on the subsequent payments. In this case, the taxpayer has not contended that the lease was an installment purchase rather than a true lease.

[6] A corresponding retail sales tax exemption is provided by RCW 82.08.0262.

> . . . in respect to the use of any airplane, locomotive, railroad car, or watercraft used primarily in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire. . . .

The lessee contends the only conceivable basis for the auditor's failure to recognize its entitlement to exemption under this statute, would be a belief that barges were not watercraft. We disagree. The statutory provision is not applicable because the barges were used by the lessee for transporting its own materials between its facilities--not "by transporting therein or therewith property and persons for hire." (Emphasis added.) We believe "for hire" means for payment. The lessee has ignored this language in its interpretation of the statute.

In conclusion, we find the taxes assessed, measured by the in-state use of the leased property, do not violate the Due Process Clause of the Fourteenth Amendment or the Commerce Clause and are not statutorily exempt under Washington law.

[8] Interest and Penalties -- As the taxpayer failed to register and pay taxes as required, the Department was required to add interest and late payment penalties. RCW 82.32.090 and .100. RCW 82.32.100 provides that as soon as the Department procures the facts and information upon which to base the assessment, "it shall proceed to determine and assess against such person the tax and penalties due, . . . To the assessment the department shall add, the penalties provided in RCW 82.32.090." (Emphasis added.)

RCW 82.32.090 provides that if any tax due is not received by the Department of Revenue by the due date, there shall be assessed a penalty. The penalty for returns which are not received within 60 days after the due date is 20 percent of the amount of the tax. RCW 82.32.050 provides that if a tax or penalty has been paid less than properly due, the Department shall assess the additional amount due and shall add interest at the rate of nine percent per annum from the last day of the year in which the deficiency is incurred until the date of payment.

The only authority to cancel penalties or interest is found in RCW 82.32.105 which allows the Department to waive or cancel interest or penalties if the failure of a taxpayer to pay any tax on the due date was the result of circumstances beyond the control of the taxpayer. That statutory provision also requires the Department to prescribe rules for the waiver or cancellation of interest and penalties.

The administrative rule which implements the above law is found in the Washington Administrative Code 458-20-228 (Rule 228). Rule 228 lists the situations which are the only circumstances under which the Department will cancel penalties and/or interest. The situations described in Rule 228 are the same ones used by the IRS in determining whether the failure to file a federal tax return was based on "reasonable cause." See Federal Regulations + 301.6651-1bc. None of the situations described in Rule 228 apply in the present case. Lack of knowledge or a good faith belief that one is not conducting a taxable business in Washington is not identified by statute or rule as a basis for abating taxes, interest, or penalties. As an administrative agency, the Department does not have discretion to change the law and grant relief.

The state does try to provide accessible taxpayer information. There are 17 regional offices around the state to assist taxpayers and answer questions without charge. The state also maintains an office of taxpayer information. The ultimate responsibility for registering with the Department and properly reporting taxes, however, rests on persons in business. The Department is not required to make sure that every business knows its tax obligations before it can assess taxes, interest or penalties.

Penalty provisions for the late payment of taxes are common. See, e.g., I.R.C. + 6651. Penalty provisions encourage timely payment of taxes as well as punish those who do not pay taxes when due. North Slope Borough v. Sohio Petroleum Corp., 585 P.2d 534 (Alaska 1978). Primarily, imposition of the late penalty is viewed as a means to partially compensate the state for the additional expense in collecting taxes that are late or not paid. The state does recognize the difference between nonpayment due to lack of knowledge of a tax obligation and tax evasion. In the case of intentional tax evasion, the Department is required to impose a penalty of 50 percent of the additional tax found due. RCW 82.32.050.

No evasion penalty is assessed unless the intent to evade is specifically found. No such intent was found in the present case. Interest is imposed on late payments because the state has not had the use of the money that was owed.

[9] Because the Department does recognize, however, that many persons have failed to register and pay B&O taxes because of a good faith belief they were not conducting a taxable business, the policy is not to assess back taxes for more than seven years. RCW 82.32.100 only imposes a four-year statute of limitations for taxpayers who have registered. The Department policy, therefore, affords some relief for persons, as the taxpayer, who failed to register because they did not believe they were conducting a taxable business in this state.

## DECISION AND DISPOSITION

The taxpayer's petition for correction of Assessment No. . . . is denied except as provided herein. Tax Assessment No. . . . for the amount owing of $ . . . , plus extension interest through November 23, 1986,[7] of $ . . . , for a a total of $ . . . is due by June 22, 1987. If the lessee's books and records show a 50 percent apportionment unreasonable, the taxpayer may present such evidence to the auditor prior to the due date to receive a corrected assessment.

DATED this 22nd day of May 1987.

[7] Extension interest is waived after that date because the delay in issuing this Determination was for the convenience of the Department and not due to any action by the taxpayer. (The date is 6 months after the taxpayer's petition for correction of the revised assessment was received.)