

Cite as Det. No. 16-0154, 35 WTD 619 (2016)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Correction of	)	<u>D E T E R M I N A T I O N</u>
Assessment of	)	
	)	No. 16-0154
	)	
...	)	Registration No. . . .
	)	

[1] RULE 24003; RCW 82.63.020: HIGH TECHNOLOGY SALES AND USE TAX DEFERRAL – APPLICATION. The deferral application must be completed with specificity. The machinery and equipment must be used where specified on the deferral application.

[2] RULE 24003; RCW 82.63.020: HIGH TECHNOLOGY SALES AND USE TAX DEFERRAL – APPLICATION. The deferral application must be completed with specificity. Expenses for tenant improvements must be listed on the deferral application.

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.

Lewis, A.L.J. – A taxpayer protests the denial of a High Technology Sales and Use Tax Deferral (“Deferral”) because either the otherwise qualifying machinery and equipment was used at a location not specified in the deferral application or the expenses were for tenant improvements, which were also not specified in the original application. Taxpayer’s petition is denied.<sup>1</sup>

### ISSUES

1. Under chapter 82.63 RCW and WAC 458-20-24003 (“Rule 24003”), do expenses for the purchase of machinery and equipment qualify for the Deferral if the machinery and equipment is used at a location other than the one listed in the Deferral application?
2. Under chapter 82.63 RCW and Rule 24003, do expenses for tenant improvements qualify for the Deferral if those improvements are not listed in the Deferral application?

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

## FINDINGS OF FACT

Taxpayer develops and licenses voice recognition technology. Taxpayer's applications run on in-car systems, personal navigation devices, PC tablets, entertainment systems, smart phones, and mobile computing devices.

On November 12, 2013, Taxpayer applied for a Deferral for machinery and equipment used at its facility located in . . . , Washington. On November 14, 2013, the Department of Revenue's ("Department") Special Programs Division ("Special Programs") informed Taxpayer that the Deferral was approved based on the information provided in the application. The application stated that the location of the investment project was . . . , Washington. Thus, Taxpayer's application was for the costs of machinery and equipment used in research and development operations at its . . . , Washington location. Over the next fourteen months, Taxpayer made substantial purchases increasing the amount of deferral from the original application's \$ . . . amount to \$ . . . .

In early 2015, Taxpayer contacted Special Programs and requested a Deferral completion audit. On June 30, 2015, the Audit Division issued a \$ . . . assessment.<sup>2</sup> The audit narrative explained that it disallowed the deferral taken on: 1) the purchase of machinery and equipment located at . . . , Washington, and 2) structural expenses.

The audit narrative explained that certain purchases of machinery and equipment were disallowed because they were used at a different location than the one specified in the deferral application. Specifically, the deferral application granted a deferral for machinery and equipment located at: . . . , Washington. The audit disallowed the deferral taken on the purchases of machinery and equipment located at . . . , Washington.

The audit narrative also explained that the purchases of tenant improvements were disallowed because Taxpayer had only applied for the Deferral on the purchase of machinery and equipment.

Taxpayer disagreed with the assessment. On July 27, 2015, Taxpayer filed a petition requesting correction of the assessment. Taxpayer's petition disputed the denial of the Deferral on both the equipment purchased for an adjacent location and the tenant improvements. Taxpayer made the following arguments in regards to the denial of the deferral on the equipment purchased for an adjacent location:

- The application did not indicate that a separate application must be completed for qualifying equipment used at an adjacent location.
- Nothing in Chapter 82.63 indicates that an eligible investment project is limited to machinery and equipment used at a single mailing address.
- Much of the equipment that was denied the deferral was laptop computers, software, smartphones, and similar equipment that are inherently mobile.

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<sup>2</sup> The \$ . . . assessment consisted of \$ . . . tax, \$ . . . interest, and \$ . . . assessment penalty.

Taxpayer made the following arguments in regards to the denial of the deferral on tenant improvements:

- The failure to request a deferral on tenant improvements was an oversight based on a lack of familiarity with the Deferral application form.
- The Department does not provide a legal basis for denying the Deferral based on inadvertently failing to provide estimates for the specific types of costs on the application form.

### ANALYSIS

Generally, all sales of tangible personal property in Washington are subject to retail sales tax. RCW 82.08.020(1). In addition, the use of tangible personal property in Washington is generally subject to use tax when retail sales tax has not already been paid on that tangible personal property. RCW 82.12.020(2). Thus, a taxpayer is liable for either retail sales tax or use tax on the purchase of, or first use of, tangible personal property in Washington, unless some specific exception applies. Additionally, construction labor & materials are subject to retail sales tax.

One such exception is the Deferral. Chapter 82.63 RCW provides a sales and use tax deferral program for equipment and buildings used for research and development in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology. The benefits of the deferral program are only available to businesses that meet the requirements of the program. Under the provisions of chapter 82.63 RCW and Rule 24003, entitlement to the deferral not only requires performing qualifying research and development, but also complying with certain procedural requirements.

Here, the Department does not challenge that Taxpayer performed qualifying research and development. Rather, certain purchases were denied the Deferral because of deficiencies in the application.

Rules of statutory construction must be adhered to in reviewing Taxpayer's qualification for the deferral. Tax statutes conferring credits, exemptions, refunds, or deductions are strictly construed. *Lacey Nursing v. Dep't of Revenue*, 128 Wn. 2d 40, 905 P.2d 338 (1995). Tax credits are "a matter of legislative grace, and taxpayers bear the burden of clearly showing that they are entitled to them." *Schumacher v. US*, 931 F.2d 650, 652 (10th Cir. 1991); *accord Port of Seattle v. State*, 101 Wn App. 106, 1 P.3d 607 (2000). Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it. *Lacey Nursing v. Dep't of Revenue*, 128 Wn.2d 40, 905 P.2d 338 (1995); *Port of Seattle v. State*, 101 Wn. App. 106, 1 P.3d 607 (2000); Det. No. 13-0279, 33 WTD 75 (2014). Thus, in this case because Taxpayer seeks the benefit of a tax [deferral], it bears the burden of showing that it is entitled to the [deferral].

RCW 82.63.020 requires those seeking participation in the deferral program to file an application. RCW 82.63.020(1) provides:

Application for deferral of taxes under this chapter must be made before initiation of construction of, or acquisition of equipment or machinery for the investment project. In

the case of an investment project involving multiple qualified buildings, applications must be made for, and before the initiation of construction of, each qualified building. The application must be made to the department in a form and manner prescribed by the department. The application must contain information regarding the location of the investment project, the applicant's average employment in the state for the prior year, estimated or actual new employment related to the project, estimated or actual wages of employees related to the project, estimated or actual costs, time schedules for completion and operation, and other information required by the department. The department must rule on the application within sixty days.

(Emphasis added.)

Rule 24003(5) mirrors the requirements of RCW 82.63.020 regarding the requirements to file timely applications:

Applicants must apply for deferral to the department of revenue before the initiation of construction of, or acquisition of equipment or machinery for the investment project. When an application for sales and use tax deferral is timely submitted, costs incurred before the application date are allowable, if they otherwise qualify. In the case of an investment project consisting of "multiple qualified buildings," applications must be made for, and before the initiation of construction of, each qualified building.

Similarly, Rule 24003(5)(e) mirrors the requirements of RCW 82.63.020 in regards to the requirement to file information regarding location of the investment projects:

The application form should include information regarding the location of the investment project, the applicant's average employment in Washington for the prior year, estimated or actual new employment related to the project, estimated or actual wages of employees related to the project, estimated or actual costs, and time schedules for completion and operation. The application form may also include other information relevant to the project and the applicant's eligibility for deferral.

RCW 82.63.020 and Rule 24003 make clear that the application must be completed with specificity. The application is approved or [disapproved] based on the information the Taxpayer provides. While a Taxpayer has the right to rely on written instructions provided by the Department, the Department will not be bound by instructions it gives based on inaccurate or incomplete information. RCW 82.32A.020.

Taxpayer appealed the denial of purchases made for tenant improvements. Taxpayer's application made no mention of requesting the Deferral for structural expenses. The Deferral Certificate states it is only valid for machinery and equipment:

This authorization extends only to state and local retail sales tax and use tax due by the CERTIFICATE HOLDER for qualified machinery and equipment.

- Qualified Machinery and Equipment includes machinery and equipment that are an integral and necessary part of a pilot scale manufacturing or qualified research and development operation. The equipment must be used exclusively for or in support of qualified research and development or pilot scale manufacturing.

Had the [Taxpayer] read the certificate it would have been apparent that the Department had not authorized a Deferral for tenant improvements. The Deferral Certificate was used in error for purchases of these improvements.

When Taxpayer submitted its application, no request was made for Deferral of tenant improvements. The statute law and administrative rule are clear that a taxpayer must apply for the Deferral before initiation of the construction. That time has long since passed. In sum, Taxpayer failed to follow the requirements for the obtaining Deferral of tenant improvement expenses. Accordingly, Taxpayer's request for relief regarding this matter is denied.

Taxpayer also appealed the denial of Deferral on the purchase of machinery and equipment that is located at a location not specified in the application. RCW 82.63.090 imposes specific requirements for qualified research taking place at multiple locations. RCW 82.63.090(1) provides that had Taxpayer wanted to treat the two locations as a single investment project, the Taxpayer must make a preliminary election before a temporary certificate of occupancy is issued. Under RCW 82.63.020 and Rule 24003, if Taxpayer had wished to treat the two locations as separate then Taxpayer should have completed another application for the additional site.

The requirements imposed are not without good purpose. It is important for the Department to know where the machinery and equipment are being used. Each Deferral certificate also has reporting requirements for the number of employees dedicated to each tax deferral location. RCW 82.63.020. All machinery and equipment is moveable, granted some easier than others. The fact that Taxpayer's purchased equipment that is easily moved is not a basis for granting relief. We have no basis to grant the relief Taxpayer requests. Accordingly, Taxpayer's request for relief regarding this matter is denied.<sup>[3]</sup>

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 26th day of April, 2016.

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<sup>3</sup> [RCW 82.08.0265 exempts retail sales tax on sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation or research and development operation. RCW 82.12.02565 provides the corresponding use tax exemption. Both exemptions are referred to collectively as "the M&E exemption." When a taxpayer is found not to qualify for the deferral under chapter 82.63 RCW, the taxpayer is not required to pay retail sales tax or use tax on machinery and equipment which, at the time of purchase, would have qualified for exemption under RCW 82.08.02565, or which, at the time of first use, would have qualified for exemption under RCW 82.12.02565. However, Taxpayer does not manufacture articles for sale as tangible personal property, and therefore does not have a manufacturing operation as defined in RCW 82.08.02565(2)(f). The Department has determined that taxpayers engaged solely in performing research and development, that do not also operate a "manufacturing operation," do not qualify for the M&E exemption.]