Cite as 10 WTD 385 (1990).

BEFORE THE INTERPRETATION AND APPEALS DIVISION

DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 91-019
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] RULE 115: USE AND/OR DEFERRED SALES TAX -- PALLETS --SECURITY DEPOSIT VS. SALE -- IDENTIFIED OWNER. A separately itemized charge for shipping pallets imprinted with the originating brewery's name was found to be a refundable security deposit and not part of the selling price of the product sold. Washington distributors receiving and using those pallets for storage and delivery were found to be bailees and subject to use tax on the reasonable rental value of that use.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

A taxpayer protests additional taxes and interest assessed in an audit report.

DATE OF HEARING: August 10, 1990

TAXPAYER REPRESENTED BY: . . .
. . .
. . .

FACTS:

Okimoto, A.L.J. -- [The taxpayer] operates a beer and wine distributorship in . . . , Washington. A Department of Revenue (Department) auditor examined the taxpayer's books and records for the period January 1, 1985 through March 31, 1989. As a result of this audit examination, Document No. . . . was issued [in October of 1989] for additional taxes, interest and penalties in the amount of $ . . . . The taxpayer has protested the entire assessment and it remains due.

TAXPAYER'S EXCEPTIONS:

Schedule VIII: Use Tax on Pallets

In the audit report, the auditor assessed use and/or deferred sales tax on shipping pallets because he considered it to be "a purchase and unrestricted intervening use of pallets which may never be returned to any brewery or winery...."

The taxpayer protests this assessment and explains the facts in its petition as follows:

> Breweries and wineries use pallets to transport beer and wine products to the wholesale distributors of the product. In this case [the taxpayer] of . . . Washington is the wholesale distributor of the product. [Taxpayer] distributes [liquor products]. During the periods in question, [taxpayer] was also a distributor of wines.
>
> Wooden pallets are an essential means of transporting beer and wine products. The pallets are designed to be used with forklift trucks in transporting and moving the product. The product (i.e. cartons of beers and wines, kegs) are placed on pallets and loaded by the manufacturer on rail cars as well as trucks for transportation to the wholesale distributor. At the warehouse of the wholesale distributor, the product loaded on pallets is stored and moved around by use of forklift trucks.
>
> A stated amount is billed to [the taxpayer] by the manufacturer for each pallet. It is agreed between the manufacturer and [the taxpayer] that the same amount for each pallet will be credited by the manufacturer for the account of [the taxpayer] upon return of the pallet. It is also agreed and assumed

> that all pallets will be returned. The pallets have the name of the particular liquor product manufacturing company imprinted on the pallet.
>
> Besides the pallets themselves, some bottles enclosed in special cartons and kegs are returned to the manufacturer. In such case the goods returned are placed on the pallets for return. However, a high percentage of the pallets are returned to the shipping manufacturer without containing returned bottles or kegs.

The taxpayer makes the following arguments as to why the pallets are not subject to use tax.

First, the taxpayer argues that it has an oral agreement to return all pallets to the originating brewery or winery. In this respect, the originating brewery or winery retains title to the pallets at all times, and that the charges made to the taxpayer are merely "deposits" which are refunded upon return of the pallets. The taxpayer argues that therefore under WAC 458-20-115, (Rule 115) such charges are exempt from tax. In support of this, the taxpayer points out that each pallet is specifically imprinted with name of the originating brewery, and that each brewery will only refund deposits upon receipt of its own pallets. The taxpayer also contends that each originating brewery or winery pays retail sales tax upon the pallets when it acquires them.

Second, the taxpayer argues that even assuming that title to the pallets pass to the taxpayer, these purchases are exempt from retail sales tax or use tax as "returnable containers for beverages and foods, including but not limited to soft drinks, milk, beer and mixers" under RCW 82.12.0276 and RCW 82.08.0282. The taxpayer cites the Pennsylvania case, of Commonwealth v. Yorktowne Paper Mills, Inc., 426 Pa. 18, 234 A.2d 287 (1967), in support of its position that pallets are containers.

Third, the taxpayer argues that even assuming that title to the pallets pass to the taxpayer, these purchases are for resale back to the manufacturer during the regular course of business and therefore exempt from retail sales tax.

ISSUES:

1. Where a brewery separately itemizes a charge for a pallet imprinted with the brewery's name and agrees to refund that

charge if and when the pallet is returned, is that charge a refundable security deposit, or an outright sale of the pallet?

DISCUSSION:

[1] WAC 458-20-115 (Rule 115)[1] states in part:

> Sales of packing materials to persons who sell tangible personal property contained therein or protected thereby are sales for resale and are not subject to the retail sales tax if title thereto passes with the goods contained therein. (Emphasis ours)

It further defines "packing materials" as including:

> ...all boxes, crates, bottles, cans, bags, drums, cartons, wrapping papers, cellophane, twines, gummed tapes, wire, bands, excelsior, waste paper, and all other materials in which tangible personal property may be contained or protected within a container, for transportation or delivery to a purchaser.

The Department has consistently interpreted pallets as falling within the above definition of packing materials and taxable in a similar manner as containers.

Rule 115 further states:

> Sales of containers to persons who sell tangible personal property therein, but who retain title to such containers which are to be returned, are sales for consumption. The retail sales tax or the use tax must be paid upon the sale or use thereof. This class includes wooden or metal bottle cases, barrels, gas tanks, carboys, drums, bags and other items, when title thereto remains in the seller of the tangible personal property contained therein, and even though a deposit is not made for the containers, and when such articles are customarily returned to him. If a charge is made against a

[1]WAC 458-20-115 was revised midway through the audit period in 1988 in order to make the rule easier to read and understand. Although no substantive changes occurred, we have nevertheless referred to Rule 115 as it was originally written.

> customer for the container, with the understanding that such charge will be cancelled or rebated when the container is returned, the amount charged is deemed to be made as security for the return of the container and is not part of the selling price for tax purposes. (Emphasis ours)

We believe that in order to determine whether separately itemized pallet charges are part of the selling price of the product, or merely refundable security deposits, Rule 115 requires a determination of whether title to the pallets passed to the customer upon delivery. If title passed to the customer upon delivery, then all pallet charges are part of the selling price of the product and all purchases of pallets by the seller are for resale. On the other hand, if title to the pallets is retained by the seller after delivery, then all purchases of pallets by the seller are for consumption and any amounts charged to the customer are deemed to be a security deposit and excludable from the selling price of the product sold. However, the mere fact that a separately itemized pallet charge is made is not determinative of the issue of title passing. Such a determination must be based upon all the circumstances and intentions of the parties involved in the transactions.

Applying the above analysis to the taxpayer's case, we find that title to the pallets did not pass to the distributor upon delivery but remained with the brewery. Accordingly, we find that all separately itemized pallet charges constituted a refundable security deposit and are excludable from the selling price of the product sold.

In making this determination, we find the following factors persuasive:

1. It is agreed between the taxpayer/distributor and the originating breweries that all pallets will be returned. It is also agreed that upon return, the same amount that was originally charged will be refunded and credited to the distributor's account.

2. In addition, all pallets bear the imprinted name of the originating brewery and that pallet charges are refunded only upon the return of the originating brewery's pallets. No credit is granted by breweries for the pallets that do not belong to them.

Because the breweries retain title to the pallets after delivery, their purchases of pallets are for consumption and fully subject to retail sales tax or use tax. In addition, because the taxpayer/distributor uses the brewery-owned pallets for shipping and storage that is unrelated to the sale of those pallets, it is subject to use tax as a bailee on the reasonable rental value of that use. Of course if the originating brewery (bailor) has already paid the appropriate use and/or deferred sales tax on the pallets, then the taxpayer's use is exempt from tax. See WAC 458-20-178. This issue shall be remanded to the audit division to allow the taxpayer additional time to present documentation that the originating breweries have in fact, paid use tax on the pallets. On those brewery-owned pallets which the taxpayer is unable to provide the appropriate documentation, the audit division shall recompute the use tax due based on its reasonable rental value.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part.

DATED this 23rd day of January, 1991.