

Cite as Det. No. 15-0183, 35 WTD 337 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of) D E T E R M I N A T I O N
Assessment of)
) No. 15-0183
)
...) Registration No. . . .
)

[1] RULE 106; RCW 82.12.020; ETA 3070.2009: USE TAX – CASUAL AND ISOLATED SALE – SUCCESSOR – BUSINESS REORGANIZATION. Cash purchases of the capital assets of a corporation are subject to retail sales tax or use tax.

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.

Weaver, A.L.J. – A contracting company petitions for the correction of assessment of retail sales tax on acquired capital assets from its predecessor company arguing that it received the capital assets in a business reorganization. Taxpayer's petition is denied.¹

ISSUES

Whether, under WAC 458-20-106 [and RCW 82.12.020(1)(a)], a taxpayer that was previously adjudicated as a “successor” company is liable for retail sales tax or use tax on the transfer of capital assets to it from the predecessor company.

FINDINGS OF FACT

Taxpayer, . . . (Taxpayer), is a limited liability company engaged in construction. Taxpayer was formed on June 3, 2011. Taxpayer's predecessor company, . . . (Predecessor), was formed as an S-Corporation on November 29, 2005. On November 15, 2011, Predecessor transferred certain capital assets to Taxpayer including tools, office equipment, inventory, and 19 vehicles.² On

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

² The 19 vehicles transferred are listed, as follows:

2008 Ford E350	\$. . .	1994 Ford Ranger Pickup	. . .
2008 Ford E350	. . .	2004 Ford F150 Pickup	. . .
2008 Ford E350	. . .	1995 Chevrolet K1500 Pickup	. . .
1995 Ford Econoline Van	. . .	2001 Ford Expedition	. . .
2006 Ford E250 Van	. . .	2002 GMC K1500 Pickup	. . .
2004 Ford F250 Pickup	. . .	2002 Ford F350 Pickup	. . .

August 1, 2012, Predecessor was inactivated by the Office of the Washington Secretary of State for failure to file an annual report.

Predecessor was 100% owned by . . . , jointly, as spouses. Taxpayer was likewise 100% owned by . . . , 50% by . . . (Member) and 50% by . . . (Managing Member).

On September 5, 2012, the Compliance Division of the Department of Revenue (Department) issued Predecessor a tax assessment (Document No. . . .) for business and occupation (B&O) tax under the retailing and wholesaling tax classifications in the amount of \$. . . and for collected but unremitted retail sales tax in the amount of \$. . . On October 8, 2012, Predecessor closed its business registration with the Department, effective November 30, 2011. The final excise tax return reporting business receipts for Predecessor was for September 2011.

On November 28, 2012, the Department informed Taxpayer that it would pursue a Successorship Assessment for Predecessor's outstanding tax debt, due, in part, to the fact that Taxpayer had acquired Predecessor's capital assets. On December 4, 2012, the Compliance Division mailed Taxpayer an Assessment of Successorship Liability in the amount of \$. . . , the amount of tax (less interest and penalties) owed on a warrant issued against Predecessor on November, 6, 2012. Taxpayer appealed the Assessment. In Det. No. 14-0043, [33 WTD 394 (2014),] the Department held that Taxpayer was liable as a successor for the debts of Predecessor.³

Det. No. 14-0043[, 33 WTD 394 (2014),] stated that the Department's Compliance Division audited Predecessor and discovered multiple documents, including an Asset Purchase Agreement between Taxpayer and Predecessor in which Taxpayer agreed to purchase all of Predecessor's business and assets for \$ The assets listed in the Asset Purchase Agreement included all of Predecessor's 19 vehicles, tools, office equipment, and inventory. Section 7 of the purchase agreement – “IRS Considerations” – provided that any sale would be conditional on Predecessor obtaining any necessary release or discharge of IRS liens. Det. No. 14-0043[, 33 WTD 394 (2014),] further states that Member claimed that he personally purchased a \$. . . cashier's check from his personal credit union account on November 15, 2011, and paid that amount to the IRS. This check was in addition to the separate cashier's check in the amount of \$. . . , which was the

1999 Ford Ranger Pickup	...	2004 Western Dump Trailer	...
2006 Ford F150 Pickup	...	2004 Eagle Trailer	...
1996 Ford Econoline Van	...	Meyer ST 7.5 Snow Plow	...
1997 Ford F150 Pickup	...		
2006 Ford F150 Pickup	...		
2004 Eagle Trailer	...	VEHICLE TOTAL	\$. . .

Other assets were:

Miscellaneous Office Equipment	\$. . .
Miscellaneous Tools	...
TOTAL MISCELLANEOUS	...
TOTAL VEHICLES AND MISC	\$. . .

³ Taxpayer petitioned for reconsideration of the successorship determination and that petition was also denied.

amount remaining in Predecessor's account. *See* Det. No. 14-0043, [33 WTD 394 (2014),] at 4 n.6.

On October 24, 2014, the Department's Compliance Division issued an assessment against Taxpayer for unpaid retail sales tax on the vehicles, equipment, and tools acquired from Predecessor. *See* Assessment No. . . . That assessment totaled \$. . . , including \$. . . in retail sales tax, \$. . . in motor vehicle tax, a delinquency penalty of \$. . . , interest of \$. . . , a 5% assessment penalty of \$. . . , and \$. . . in additional interest from November 25, 2014 to January 16, 2015.

Taxpayer appeals this assessment, claiming that the vehicles were transferred pursuant to a business reorganization, and that the Department after determining that Taxpayer was a successor company to Predecessor, in Det. No. 14-0043, [33 WTD 394 (2014),] cannot now assess tax on the assets acquired by Taxpayer.

On appeal, Taxpayer maintains that the Asset Purchase Agreement was never actually executed and that it was drafted as a potential method by which to satisfy the IRS. Taxpayer's Member and Managing Member both signed declarations that state that the Asset Purchase Agreement was never executed and its terms were never carried out.

Instead, Taxpayer claims that its Member paid \$. . . of his personal funds to the IRS in return for its release of interest in Predecessor's assets. Taxpayer states that the assets were then transferred from Predecessor to Taxpayer as "capital contributions" as Predecessor discontinued operations. Det. No. 14-0043[, 33 WTD 394 (2014),] found that:

Taxpayer took possession and used all of Predecessor's vehicles, tools, office equipment, and inventory, none of which was obtained by Taxpayer's owner or by Taxpayer from the IRS

See Det. No. 14-0043, [33 WTD 394 (2014),] at 7. We follow Det. No. 14-0043[, 33 WTD 394 (2014),] and find that Taxpayer received the capital assets at issue directly from Predecessor. We find that the Taxpayer received the capital assets in exchange for \$. . . and that no sales tax was paid on the transaction.

ANALYSIS

The capital assets at issue are tangible personal property. All sales of tangible personal property to consumers in the state of Washington are subject to retail sales tax unless the sales are exempt from taxation. RCW 82.08.020; RCW 82.04.050. RCW 82.12.020 provides, in relevant part:

There is levied and collected from every person in this state a tax or excise for the privilege of using within this state as a consumer any:

- (a) Article of tangible personal property acquired by the user in any manner, including tangible personal property acquired at a casual or isolated sale, . . .

RCW 82.12.020(1) (emphasis added). “Use tax complements the retail sales tax, and in most cases mirrors the retail sales tax. Articles of tangible personal property used or certain services purchased in Washington are subject to use tax when the state’s retail sales tax has not been paid, or where an exemption is not available.” WAC 458-20-178.

Taxpayer, in this case, received the assets at issue from Predecessor, in exchange for \$ After the transfer, Predecessor ceased doing business and Taxpayer kept “effectively the same business going as a successor.” *See Det. No. 14-0033, [33 WTD 394 (2014),] at 9.* Taxpayer received the assets at issue from Predecessor for \$

WAC 458-20-106 (Rule 106) is the Department’s administrative rule concerning the taxation on transfers of capital assets. It reads, in pertinent part, as follows:

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.

....
(2) Transfers of capital assets by an individual or by a partnership to a corporation, or by a corporation to another corporation in exchange for capital stock therein.

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

....
The burden is upon the taxpayer to establish the facts concerning the adjustment of the beneficial interest in the business when exemption is claimed.

Use Tax

The use tax applies upon the use of any property purchased at a casual retail sale without payment of the retail sales tax, unless exempt by law. Uses which are exempt from the use tax are set out in RCW 82.12.030.

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.

Rule 106. Thus, to succeed on a Rule 106 claim, the taxpayer will need to establish: (1) a transfer of capital assets; (2) for a change in beneficial interest; and (3) the transferor previously paid sales or use tax on the capital assets. *See Rule 106.*

In this case, there was certainly a transfer of capital assets. However, Taxpayer has not proved that the capital assets in question were transferred in exchange for a change in beneficial interest. *See Rule 106 (2), (3).* Taxpayer has produced no documentation evidencing a transfer of the

capital assets in question were exchanged for capital stock, or for the surrender of capital stock. *Id.* Indeed, the evidence provided in this case, which is consistent with the fact findings in Det. No. 14-0043, [33 WTD 394 (2014),] tends to show that the capital assets in question were transferred for \$. . . in cash. That cash was then used to pay the IRS for debts owed by Predecessor. Taxpayer has failed to show that the capital assets in question were transferred in exchange for a change in beneficial interest and, for that reason, Taxpayer cannot avail itself of any of the Rule 106 exemptions.⁴

Det. No. 14-0043[, 33 WTD 394 (2014),] held that Taxpayer was a “successor” to Predecessor. Det. No. 14-0043, [33 WTD 394 (2014),] at 9; *see also* RCW 82.04.180; WAC 458-20-216. That determination did not hold that Taxpayer’s formation was a reorganization of Predecessor’s business. *See* Det. No. 14-0043[, 33 WTD 394 (2014)]. Indeed, as a “successor,” Taxpayer’s successorship liability is limited to the Predecessor’s tax liability. *See* RCW 82.32.140(2). A successor is not liable for penalties or interest accrued by the Predecessor. *See id.* In the event Taxpayer was actually formed in the context of a business reorganization of Predecessor, Taxpayer’s liability for Predecessor’s debts would have no such limitation. Therefore, the holding in Det. No. 14-0043[, 33 WTD 394 (2014),] that Taxpayer was a “successor” of Predecessor cannot be read as a holding that Taxpayer was formed in the context of a business reorganization. Successorships and business reorganizations are not synonymous. We find nothing in Det. No. 14-0043[, 33 WTD 394 (2014),] to support a holding that Taxpayer was formed as a part of a business reorganization of Predecessor and we, therefore, do not find that Taxpayer’s acquisition of the capital assets in question were acquired in the context of a business reorganization. Having previously found that Taxpayer acquired the capital assets in question in exchange for \$. . . in cash, we hold that transfer was retail-taxable.

Taxpayer’s briefing alludes to an alternative factual scenario, where the capital assets in question were not transferred directly from Predecessor to Taxpayer, but were instead transferred from Predecessor to its owners and then to Taxpayer. Indeed, Taxpayer’s brief contains the following factual allegation:

Pursuant to an agreement with the IRS [Predecessor’s Owner] paid \$. . . of personal funds to the IRS in return for its release of interest in some of Predecessor’s assets. [Predecessor’s Owner] then transferred those assets to Taxpayer as capital contributions and Predecessor discontinued operations.

Taxpayer’s Brief, at 1. Taxpayer seems to be alleging that Predecessor divested itself of the capital assets in question by selling them to its owners for the \$. . . in cash, and then the owners transferred the capital assets to Taxpayer in exchange for their membership interests.⁵

The Department has issued an Excise Tax Advisory (ETA) that is instructive in addressing this alternative factual scenario. ETA 3070.2009 reads, as follows:

⁴ Having found the assets were not transferred in exchange for a change in beneficial interest, we are not required to determine whether the transferor previously paid sales or use tax on the capital assets.

⁵ We do not find that this alternative factual scenario actually occurred. Our holding is consistent with the holding of Det. No. 14-0043[, 33 WTD 394 (2014),] that the capital assets in question were transferred directly from Predecessor to Taxpayer.

Taxable Transfers of Capital Assets

Are cash purchases of capital assets subject to retail sales tax and/or use tax where the purchase and sale agreement provides for the future issuance of common stock in the purchasing organization to members of the purchased organization?

Assume Cooperative Organization purchases all the capital assets of Co-Op for cash. Under the terms of the agreement, the members of Co-Op will receive voting stock in Cooperative Organization after a brief trial period of operation by Cooperative Organization. The former members of Co-Op were completely divested of ownership and control of assets.

Therefore Cooperative Organization is purchasing the capital assets outright for cash and the former members of Co-Op will not have unbroken and continuing control of and beneficial interest in the assets for any period of time for any reason, the provisions of WAC 458-20-106(2) will not apply.

Cash purchases of capital assets of a corporation are subject to retail sales tax or use tax. The purchase is for cash and taxable as a “sale at retail.”

ETA 3070.2009.

Here, Taxpayer alleges the capital assets at issue were transferred from Predecessor to Predecessor's Owner for cash that came from Predecessor's Owner in his individual capacity. Predecessor's Owner was thereby divested of his ownership interest in Predecessor and it discontinued operation. Then, Predecessor's Owner transferred the capital assets to Taxpayer in exchange for a membership interest in Taxpayer. Taxpayer received the assets at issue from Predecessor for cash; and, in exchange, Predecessor's stockholders received membership interests in Taxpayer. We find the facts of ETA 3070.2009 to be similar to the alleged facts and we likewise find its reasoning to be persuasive; the ETA holds that “cash purchases of capital assets of a corporation are subject to retail sales tax or use tax.” In this case, it is undeniable that the capital assets in question were transferred from Predecessor for \$. . . in cash.⁶ Because the capital assets were transferred for cash, rather than for a beneficial interest, under the authority of ETA 3070.2009, the transfer is subject to retail sales tax or use tax.

Therefore, for the reasoning espoused in ETA 3070.2009, we hold that the provisions of [Rule] 106(2) do not apply and that the transfer of the assets in question from Predecessor to Taxpayer is subject to retail sales tax or use tax. *See* ETA 3070.2009; *see also* Det. No. 93-303, 14 WTD 054 (1994) (holding that when the assets of Taxpayer 1 are transferred to Taxpayer 2 in exchange for cash, and Taxpayer 1 does not receive ownership interests in Taxpayer 2, the transaction is not a reorganization and Rule 106(2) does not apply.).

⁶ Because of the lack of documentary evidence showing who actually received the capital assets from Predecessor, we felt obligated to address alternative factual scenarios where (1) the assets were transferred directly to Taxpayer from Predecessor, and (2) the assets were transferred to Predecessor's Owner who then, in turn, transferred them to Taxpayer. For the reasons set forth in the determination, we find the transfer taxable under either factual scenario.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 15th day of July, 2015.