

Cite as Det. No. 15-0143, 35 WTD 393 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund of) D E T E R M I N A T I O N
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 No. 15-0143
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 Registration No. . . .
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[1] RULE 115; RCW 82.04.050; RCW 82.04.040: B&O TAX – PALLETS – PALLET-POOLING. When pallets are required to be returned rather than being kept by the customer, they are not being “resold,” but are instead being consumed. Under a pallet-pooling arrangement, pallets are required to be returned to the pallet vendor instead of to the seller of the merchandise being shipped on the pallets. Under the pallet-pooling system, the seller is a pallet consumer that rents tangible personal property to its customers. Thus, the seller’s rental of the pooled pallets from the pallet vendor is a retail sale, subject to retail sales 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 fresh fruit packer petitions for refund of use tax paid on its rental of pooled pallets, on the grounds that the pooled pallets were purchased for resale and are exempt from use tax as packing materials. We deny the petition.¹

ISSUE

1. Whether a company’s rental of pooled pallets for use in shipping merchandise to its distributors is a “rental for purposes of sublease or subrent” under RCW 82.04.050(4)(b), when the company has provided no evidence of a sublease or subrental arrangement.
2. Whether a company’s rental of pooled pallets for use in shipping merchandise to its distributors is a wholesale “sale of packing materials” under WAC 458-20-115, when the pallet vendor specifically retains ownership and control of the pallets at all times, under the terms of the pallet vendor’s pallet-pooling program.

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

FINDINGS OF FACT

[Taxpayer] is a corporation headquartered in . . . , Washington. Taxpayer is a packer and shipper of fresh fruit. Taxpayer was audited by the Audit Division of the Department of Revenue (“Department”) for the period of January 1, 2009 through December 31, 2012.

During the audit period, Taxpayer used pallets from [Pallet Vendor], a pallet manufacturer and pallet provider. The Pallet Vendor’s pallet program is based on a pallet-pooling system. The pallets acquired by Taxpayer from the Pallet Vendor are used to deliver products to Taxpayers’ distributors. All of Taxpayer’s distributors also participate in the Pallet Vendor’s pallet-pooling program. The Pallet Vendor’s website describes a pallet pool as the shared use of standardized pallets by multiple customers who collectively benefit from the scale of the pool, instead of having to manage pallets individually.² The standardized pallets are designed to transport products through the supply chain.³ The Pallet Vendor owns and controls the pallets at all times.

Taxpayer acquires the pallets from the Pallet Vendor after paying a one-time non-refundable “issue fee” to the Pallet Vendor for each pallet acquired. Upon receipt of the Pallet Vendor’s pallets, Taxpayer packs and loads its products on the pallets to prepare the products for shipping. Taxpayer only uses the pallets to pack and ship its products; it does not use the pallets in its warehouse or for storage. After Taxpayer delivers its products to a distributor, the pallet is not returned by the distributor to Taxpayer. Instead, the Pallet Vendor’s “pooling manager” arranges with Taxpayer’s distributors for the return of any pallets to the Pallet Vendor. Once the pallets are transferred to the Pallet Vendor’s pooling manager, they are inspected, and, if suitable for reuse, they are placed into a pool of available pallets where they reside until they are eventually transferred back into the available pallet pool.

According to Taxpayer’s Supplemental Rental Agreement with the Pallet Vendor, Taxpayer is charged a specified per-pallet issue fee for each pallet issued to Taxpayer. Taxpayer and all of Taxpayer’s distributors participate in the Pallet Vendor’s pallet pooling program, which tracks incoming and outgoing pallets. Because Taxpayer’s distributors undertake their own contractual obligations with the Pallet Vendor, the Pallet Vendor waives its transfer fee when Taxpayer ships goods on the Pallet Vendor’s pallets to Taxpayer’s distributors. However, in the event Taxpayer was to ship goods to a distributor that did not have a contractual relationship with the Pallet Vendor, Taxpayer would be charged a “transfer fee” for each of the pallets shipped to that distributor by the Pallet Vendor.

Paragraph 5, of Taxpayer’s “Supplemental Rental Agreement”⁴ with the Pallet Vendor reads, as follows:

5. TRANSFER TO AND FROM OTHER [PALLET VENDOR] CUSTOMERS: As contemplated in paragraph 3 of the Agreement, the Lessee [Taxpayer] may transfer pallets to other [Pallet Vendor] customers and receive pallets

² See . . . , last visited June 2, 2015.

³ *Id.*

⁴ The original agreement being supplemented was not provided by the Taxpayer. The Supplemental Rental Agreement is silent as to Taxpayer’s right to sell, rent, resell, rerent, sublease or subrent the Pallet Vendor’s pallets.

from other [Pallet Vendor] customers. A [Pallet Vendor] customer is defined as a manufacturer who has signed a rental agreement stipulating his responsibility regarding payment of issue, repositioning and transfer fees, rent and other associated costs related to pallet rental. Should Lessee elect to ship pallets to another [Pallet Vendor] customer, the transfer fee will be waived for those pallets. In addition, if the Lessee elects to receive pallets from another [Pallet Vendor] customer, the issue and repositioning fee is waived for those pallets. A [Pallet Vendor] customer is not, in this instance, a distributor. At no time will Lessee receive pallets returned from distributors without first being routed through a [Pallet Vendor] depot.

Agreement, ¶ 5. As the Supplemental Agreement indicates, the Pallet Vendor retains ownership and control over the pallets throughout the entire shipping process, whether the pallets are in Taxpayer's possession or in the possession of Taxpayer's distributors.

Taxpayer did not pay sales tax or report use tax on the issue fees it paid to the Pallet Vendor during the audit period, because it historically treated its pallet acquisitions as wholesale transactions exempt from tax. On November 14, 2013, the Audit Division issued an assessment totaling \$. . . , which included \$. . . in retail sales tax, \$. . . in retailing business and occupation (B&O) tax, \$. . . in use tax, and \$. . . in interest. On December 15, 2013, the Audit Division issued a Post-Assessment Adjustment (PAA) totaling \$. . . , where the retail sales tax and retailing B&O tax was eliminated, but with \$. . . in use tax, \$. . . in interest, and \$. . . in additional interest remaining. On January 16, 2014, the Audit Division issued PAA #2 totaling \$. . . , after reducing the use tax to \$. . . , the interest to \$. . . , and assessing additional interest of \$. . . from December 17, 2013 to February 18, 2014.

Taxpayer paid the assessment in full and filed a timely appeal of the use tax assessed on the pallets acquired from the Pallet Vendor.

ANALYSIS

Washington imposes retail sales tax on each retail sale in this state. RCW 82.08.020. The use tax is a "compensating" tax imposed "for the privilege of using within this state as a consumer . . . any article of tangible personal property purchased at retail" unless "the sale to, or use by, the present user" was already subjected to the retail sales tax. RCW 82.12.020 (2010); *see also Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937); *N. Pac. Ry. Co. v. Henneford*, 9 Wn.2d 18, 113 P.2d 545 (1941). The use tax supplements the retail sales tax by imposing a tax of like amount upon the use by a consumer of any article of tangible personal property where the user or other specified persons have not paid retail sales tax on the purchase.

A "retail sale" means every sale of tangible personal property. RCW 82.04.050(1)(a). However, a "retail sale" does not include purchases of tangible personal property for the purpose of resale. RCW 82.04.050(1)(a)(i). RCW 82.04.040 defines a "sale" as a transfer of ownership, title, or possession of property for a valuable consideration. RCW 82.04.040(1). RCW 82.04.040 also defines the "lease or rental" of possession or control of tangible personal property for a valuable consideration as a "sale." The lease or rental of tangible personal property is considered a "retail sale" when the lease or rental of the tangible personal property is to "consumers." RCW

82.04.050(4)(a). However, when the lease or rental of tangible personal property is not to a consumer, but is, instead, for “sublease or subrent,” then the lease or rental is not a “retail sale” and is not subject to the retail sales tax. *See RCW 82.04.050(4)(b).*

Taxpayer’s primary argument in this appeal is that it leases pallets from the Pallet Vendor for purposes of sublease or subrent. However, Taxpayer has failed to produce any evidence that it has a contractual agreement with any of its distributors to sublease or subrent the pallets it acquired from the Pallet Vendor. Taxpayer has provided no contracts with its distributors evidencing a sublease or subrental agreement for pallets. Taxpayer has also provided no invoices showing that it is charging its distributors a rental or lease fee for the use of the pallets. Indeed, although it might be implied from the language in the Supplemental Rental Agreement that Taxpayer does not have the contractual right to sublease or subrent the pallets, it nonetheless did not provide the original pallet rental agreement with Pallet Vendor, which could explicitly address the issue. Therefore, based on the evidence provided by Taxpayer, we conclude Taxpayer has not entered into any subrental or sublease agreements with its distributors with respect to the pallets. Because Taxpayer has failed to prove that it is subleasing or subrenting the pallets to its distributors, we hold that Taxpayer has not met its evidentiary burden under RCW 82.04.050(4)(b) of proving that its pallet leases are not subject to retail sales tax.

Our holding is consistent with the holding made by the Indiana Supreme Court in *Brambles, Indus., Inc. v. Ind. Dep’t of State Rev.*, 892 N.E.2d 1287 (Ind. 2008) in a pallet-pooling case. The Indiana Supreme Court, in analyzing a similar exemption from the retail sales tax, held that the customer did not meet its burden of proving that it had a resale agreement with its distributors for the pallets and, thus, could not claim that it acquired the pallets for resale. *Brambles Indus., Inc.*, 892 N.E.2d at 1290. Likewise, here, Taxpayer cannot show that it had an independent agreement with its distributors to resell the pooled pallets at issue in this case.

In order to satisfy its evidentiary burden of proving a resale arrangement, Taxpayer relies on WAC 458-20-115 (Rule 115), the administrative rule that interprets the taxation of packing materials and containers. Rule 115 provides, in pertinent part:

(3) Business and occupation tax.

(a) Sales of packing materials to persons who sell tangible personal property contained in or protected by packing materials are sales for resale and subject to tax under the wholesaling classification. Sellers must obtain resale certificates for sales made before January 1, 2010, or reseller permits for sales made on or after January 1, 2010, from purchasers to document the wholesale nature of any sale as provided in WAC 458-20-102A (Resale certificates) and WAC 458-20-102 (Reseller permits)

Rule 115(3)(a). “Packing materials” is defined as “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.” Rule 115(2). The Department has consistently held that pallets are “packing materials and [are] taxable in the same manner.” Det. No. 90-302, 10 WTD 101, 104 (1990); Det. No. 88-440, 7 WTD 43(1988).

Thus, under Rule 115(3)(a), the Department administratively deems the sales of packing materials, such as pallets, to persons who sell tangible personal property contained therein, as sales for resale. Under Rule 115, those sales are subject to wholesaling B&O tax. The statutory authority for this rule provision is RCW 82.04.050(1)(a)(i), which provides wholesale treatment for “purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person.” Taxpayer argues that its rental of pallets meets the Rule 115 requirements for wholesale treatment.

As an initial matter, we note that Rule 115 does not address pallet-pooling arrangements. Furthermore, Rule 115(3)(b) indicates that when pallets are required to be returned to the “seller,” they are not “resold” and are therefore taxed at retail, rather than at wholesale. *See Rule 115(3)(b).* When determining whether pallets are “to be returned,” Rule 115 references whether the seller “retains title.” Specifically, Rule 115(3)(b) reads, as follows:

(b) Sales of containers to persons who sell tangible personal property contained within the containers, but who retain title to such containers which are to be returned, are sales for consumption and subject to tax under the retailing classification. This class includes wooden or metal bottle cases, barrels, bas tanks, carboys, drums, bags and other items, when title to the container remains with the seller of the tangible personal property contained within the container, and even though a deposit is not made for the containers, and when such articles are customarily returned to the seller

Rule 115(3)(b) (emphasis added). In this case, even though Taxpayer does not retain title to the pallets, it is clear that the Pallet Vendor retains title all of its pallets. It is also clear that the pallets must eventually be returned to the Pallet Vendor.

The clear import of Rule 115(3)(b) is that, when pallets are required to be returned rather than being kept by the customer, they are not being “resold,” but are instead being consumed. Rule 115 looks to whether the seller “retains title” to the pallets to determine whether the pallets are consumed or resold. *See Rule 115(3)(b).* If we were to accept Taxpayer’s interpretation of Rule 115, we would be in the position of denying wholesale treatment to taxpayers that buy pallets and retain title to the pallets, but would be granting wholesale treatment to taxpayers that rent pooled pallets and never have title to the pallets in the first place.

This would be an absurd result. Administrative rules and regulations are interpreted under the principles of statutory construction and are to be interpreted as a whole, giving effect to all the language and harmonizing all provisions. *See State v. Cannon*, 147 Wn.2d 41, 56-57, 50 P.3d 627 (2002). Courts are to avoid constructions that yield unlikely, absurd, or strained consequences. *Killian v. Atkinson*, 147 Wn.2d 16, 21, 50 P.3d 638 (2002). Departure from the literal construction is justified when such a construction would produce an absurd and unjust result and would clearly be inconsistent with the purposes and policies of the rule in question. *See State v. McDougal*, 120 Wn.2d 334, 350-51, 841 P.2d 1232 (1992) (quoting 2A N. Singer, *Statutory Construction* § 45.12 (4th ed. 1984)). In the absence of specific guidance in Rule 115 with respect to pallet-pooling arrangements, we interpret Rule 115 in a manner consistent with its clear import: namely, that when pallets are required to be returned, they are not for resale, and are instead being consumed.

There is no question, in this case, that the pallets that Taxpayer's distributors received from Taxpayer must be returned. They just have to be returned to the Pallet Vendor, instead of to Taxpayer. Once again, the Indiana Supreme Court addressed a similar argument. *See Brambles Indus., Inc.*, 892 N.E.2d at 1290-91. The Indiana Supreme Court held:

Neither the statute, the regulation, nor the dictionary definition of the word "return" require that the [pallet] go back to the person from whom it was immediately acquired to be considered "returned," as the manufacturers contend. It is enough that the pallets are pass[ed] back to an earlier possessor . . . Consequently, the Court concludes the pallets are returnable . . . and therefore the . . . lease payments do not qualify for the nonreturnable container exemption.

Id. at 1291. While the Indiana Supreme Court's holding is not precedential in this case, we are persuaded by the Court's reasoning. The pallet pooling system requires Pallet Vendor's customers to return the pallets to the Pallet Vendor and, therefore, the Pallet Vendor's customers are consumers of the pallets, not wholesalers of them.

Moreover, an example in Rule 115(6) also supports a finding that Taxpayer is not a wholesaler, but is the consumer of the pallets. Rule 115(6)(c) reads as follows:

(c) XY uses three types of pallets in its manufacturing operation. One type of pallet is used strictly for storing paper which is in the manufacturing process. A second type of pallet is returnable and the customer is charged a deposit which is refunded at the time the pallet is returned. The third type of pallet is nonreturnable and is sold with the product. XY is required to pay retail sales tax or use tax on the first two types of pallets. The third type of pallets may be purchased by XY without the payment of retail sales or use tax since these pallets are sold with the paper products.

Rule 115(6)(c). In this case, the pallets are likewise returnable.⁵ Furthermore, in the event the Taxpayer ships to a distributor that does not have a contractual relationship with the Pallet Vendor, the Taxpayer is charged a "transfer fee." . . . In the absence of a specific example regarding pallet-pooling arrangements, we find that the pooled pallets in this case are similar in nature to the second type of pallets referenced in Rule 115(6)(c). For the reasons discussed above, we hold that Taxpayer is the consumer of the pooled pallets and does not "resell" them. Therefore, Taxpayer's rental of the pallets from the Pallet Vendor is not a wholesale transaction under RCW 82.04.050(1)(a)(i).

Taxpayer is a consumer that rents tangible personal property in the form of pooled pallets. Thus, Taxpayer's rental of the pooled pallets from the Pallet Vendor is a retail sale subject to retail sales tax. RCW 82.08.020. Because Taxpayer has not previously paid retail sales tax on its pallet rentals, we sustain the use tax assessment. RCW 82.12.020; Rule 115(5)(a).

⁵ The only distinction being that they are returnable to the Pallet Vendor, rather than to the Taxpayer.

DECISION AND DISPOSITION

Taxpayer's petition for refund is denied.

Dated this 3rd day of June, 2015.