Cite as Det. No. 15-0353, 36 WTD 183 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	DETERMINATION
	)	No. 15-0353
. . .	)	Registration No. . . .

1. WAC 458-20-211 – RETAIL SALES TAX – LEASE PAYMENTS – TRACTORS/TRAILERS – LEASE PAYMENTS IN EXCESS OF COST – EXEMPTION. Lease payments in excess of the cost of equipment did not constitute the simple movement of money – exempt from retail sales tax – to the lessor. Because the leases were structured and treated by all parties as true operating leases in which the affiliated companies retained ownership of the equipment, they must be taxed accordingly.

2. WAC 458-20-193D – B&O TAX – INTERSTATE COMMERCE DEDUCTION - INTRASTATE HAUL – IMPORTED GOODS PICKED UP AT PORT – NO THROUGH BILLS OF LADING – EXEMPTION. When a motor carrier moves goods within Washington under the authority of a through bill of lading that originates outside of Washington, the interstate commerce deduction will apply. Absent a through bill of lading, the exemption will not apply.

3. RCW 82.32A.020(2) – B&O TAX – WAIVER – EFFECT OF PRIOR AUDIT – SPECIFIC OFFICIAL WRITTEN ADVICE OR TAX REPORTING INSTRUCTIONS – EXEMPTION. A taxpayer has a right to waiver of tax where it relied to its detriment on specific… advice or tax reporting instructions.

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.

Bauer, A.L.J. – A trucking company objects to the assessment of retail sales tax on (1) lease payments it made to related companies that exceeded the equipments' purchase price, and (2) the denial of the interstate/foreign deduction from public utility tax [(PUT)] on hauls it made of imported goods between Washington ports and Washington destinations. It further asserts that the [Department of Revenue (Department)] is [precluded] from assessing these taxes because the Audit Division (Audit)] did not assert them in prior audits. The assessment is sustained.[1]

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

ISSUES

1. Whether, under WAC 458-20-211 (Rule 211), lease payments for tractors and trailers are exempt from retail sales tax when those payments exceed the original cost of the equipment?

2. In the absence of through bills of lading, are intrastate hauls of imported goods picked up at Washington ports considered to be the continuation of import transportation exempt from [business and occupation (B&O)] tax in accordance with WAC 458-20-193D?

3. Is the Department precluded from asserting tax on lease payments and intrastate hauls because Audit [did not] tax them in a prior audit?

FINDINGS OF FACT

[Audit] audited the books and records of [Taxpayer] for the period January 1, 2010, through December 31, 2013 (audit period). As a result, on October 20, 2014, Audit issued an assessment for the following amounts:

$ . . .	Retail Sales B&O Tax
. . .	Retail Sales Tax
. . .	Motor Transportation Tax
. . .	Urban Transportation
. . .	Motor Vehicle Tax
. . .	Total Debit
. . .	Interest through October 20, 2014 (interest has continued to accrue)
. . .	5% Assessment Penalty (Substantial Underpayment Penalty)
$ . . .	Total Assessed

Taxpayer appealed the assessment, . . . , on December 19, 2014.

Taxpayer's business activities in Washington State during the audit period included the transportation of goods as a common carrier. Taxpayer has locations in . . . , Washington, and [out-of-state], as well as trucks located in . . . , Washington.

Taxpayer is licensed to haul goods in interstate commerce. Taxpayer does not dispute that [a certain amount] of the tractors and trailers it used did not meet Washington's substantial use in interstate commerce test for exemption from use tax.

Lease Payments. Taxpayer leased motor vehicles, tractors, and trailers (equipment) from three other related companies. Certain pieces of equipment did not meet the substantial use threshold for exemption from use tax. Some of the leases for this equipment were 25-30 years old. According to Taxpayer, all of the related companies were set up for estate planning tax purposes and for funneling "compensation" to individual shareholders.[2,3]

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[2] The father of four children (two sons and two daughters), ostensibly for federal estate tax purposes, set up the following companies for his [children].

(1) Taxpayer, which is 100% owned by the two brothers,

All of the equipment that Taxpayer leased had been acquired by the other entities prior to 2005. According to Taxpayer, the shareholders' father had, before his death, set up the following lease terms between the companies:

- 14.4% of the cost yearly for the first 5 years
- 12.0% of the cost for the next ; and
- 6% of the cost <u>thereafter</u>.

(Emphasis added.) After Taxpayer's lease payments equaled the cost of the equipment, Taxpayer did not take title to the equipment, but continued to make lease payments, as the lease term "6% of the cost thereafter" dictated. Taxpayer characterizes those later lease payments (and all lease payments during the audit period) as a means of moving money to the other entities. Taxpayer characterized such payments as "compensation" upon which no retail sales taxes were due.

<u>Interstate Commerce Deduction.</u> Taxpayer explains that it operated two divisions in Washington – a heavy haul division and a bulk haul division. A substantial portion of Taxpayer's Washington business in both divisions involved trucking between the ports of . . . and . . . and designated Washington destinations. Taxpayer treated these hauls as deductible interstate hauls on its Washington Excise Tax Returns.

As to its "heavy haul" division, Taxpayer explains that it participated in the shipment of individual pieces of heavy construction and logging equipment from [out-of-country] to two storage yards in Washington – one in . . . and one in . . . – from which the pieces of equipment would be further distributed to dealers. Dock workers individually off-loaded the pieces of equipment . . . by driving them off their respective ships. None of the equipment manufacturers had their own storage areas at either port. Customs checked each piece of equipment individually, and thereafter, according to Taxpayer, [the equipment] could only remain on port property for a short period of time. Taxpayer was hired to pick them up for delivery to the appropriate yard.

Taxpayer explains that it provided uninterrupted movements of this equipment from the Port of . . . "to the actual point of entrance in Washington." Taxpayer states that it treated these hauls as part of interstate commerce under federal regulations (49 CFR 390.5) that Taxpayer believed was industry practice. Taxpayer thus treated these hauls as deductible interstate hauls.
Taxpayer has provided a copy of two Pick-Up/Delivery Orders that it contends were integral parts of their respective bills of lading, and thereby constituted sufficient documentation under the provisions of WAC 458-20-193D (Rule 193D) to support the deduction.

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(2) a corporation that is owned by the same two brothers and their two sisters,
(3) a LLC wholly owned by one of the brothers, and
(4) a LLC wholly owned by the other brother.

The father's intention was that the LLCs and the corporation would purchase the equipment and Taxpayer "would pay for it." Taxpayer entered into lease agreements with the other three entities that owned the equipment. All equipment subject to the audit was acquired prior to 2005 by the other entities, where title remained throughout the audit period, and the leases subject to the audit were all entered into before 2005.

[3] Taxpayer uses the term "compensation" to mean a form of sharing money between family members.

The first example of documents provided by Taxpayer is a Pick Up/Delivery Order whereby Taxpayer was to pick up a . . . Excavator being delivered from [out-of-country], at the [container yard] in . . . after clearing customs, and to deliver it to the [warehouse yard] in . . . . The Order instructs that Taxpayer was to make an appointment with the Port before picking up the excavator. A separate sea waybill was attached under which authority the excavator had to be shipped by sea from [out-of-country] to the Port of . . . .

The second example is a Pick Up/Delivery Order whereby Taxpayer was to pick up four new wheel loaders at the Port of . . . and haul them to an address in . . . , Washington. A separate sea waybill ordered that the loaders be shipped from [out-of-country] to the Port of . . . .

As to its bulk order division, Taxpayer made hauls from the [terminal] at the Port of . . . . Bulk cement arrived by ship from [out-of-country] or by rail from [out-of-country], and was then put into silos at the Port of . . . . Taxpayer picked up the bulk cement from the silos, and then hauled it to whatever . . . plant was designated by the . . . , which owned the plants.

Taxpayer treated all heavy equipment and bulk hauls that originated or terminated at port locations as deductible interstate hauls. Audit chose a sample of these hauls to determine what percentage qualified for the interstate deduction.[4] Of this sample, Audit did not find any of Taxpayer's documentation to be sufficient to support the deduction, and thus projected a 100% error rate for the entire sample.

Audit then looked at the origin and destination of these hauls to establish what percentages of these hauls should have been taxed under Motor Transportation [PUT] and Urban Transportation PUT. The percentage of each of these was then applied to the sample and assessed under Schedules 4A (Motor Transportation) and 4B (Urban Transportation).

Although Taxpayer agreed with the sample selection, it disagreed with Audit's conclusion that it did not qualify for the interstate deduction on these hauls. Taxpayer, however, was unable to provide Audit with bills of lading for its own hauls with origination points other than Washington ports. Taxpayer asserts that, in making a decision based merely on documentation, Audit ignored [substance] over [form].

ANALYSIS

Lease Payments. RCW 82.04.040(3)(a) defines a lease or rental as "any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration." WAC 458-20-211(2)(f) (Rule 211(2)(f)) discusses "true leases":

> The term "true lease" (often referred to as an "operating lease") refers to the act of leasing property to another for consideration with the property under the dominion and control of the lessee for the term of the lease with the intent that the property will revert back to the lessor at the conclusion of the lease.

[4] A sampling method was used as follows: Data for the audit period was provided in electronic format. Customers with total unreported hauls under $2,000, hauls under $100, negative amounts, and zero amounts were excluded from the population. Hauls of $3,000 or larger were removed from the population and examined on an actual basis.

Another type of lease is a "financing lease." Although financing leases are structured as leases, they function more like installment sales and are taxed as such. Rule 211(2)(g) provides the following as to financing leases:

> (g) The term "financing lease" (often referred to as a "capital lease") typically involves the lease of property for a stated period of time with ownership transferring to the "lessee" at the conclusion of the lease for a nominal or minimal payment. The transaction is structured as a lease, but retains some elements of an installment sale. Financing leases will generally be taxed as if they are installment sales. The presence of some or all of the following factors indicates a financing lease with the transaction treated as an installment sale:
>
> (i) The lessee is given an option to purchase the equipment, and, if so, the option price is nominal (sometimes referred to as a "bargain purchase option");
> (ii) The lessee acquires equity in the equipment;
> (iii) The lessee is required to bear the entire risk of loss;
> (iv) The lessee pays all the charges and taxes imposed on ownership;
> (v) There is a provision for acceleration of rent payments; and
> (vi) The property was purchased specifically for lease to this lessee.

(Emphasis added.) Under Rule 211(6)(b), financing leases are treated for state tax purposes as installment sales, and retail sales tax applies to the full selling price. *See also* WAC 458-20-198. If, as Taxpayer contends, the leases had been financing or capital leases as described in WAC 458-20-211(2)(g), ownership of the equipment would have transferred to Taxpayer when the purchase price was satisfied. Taxpayer has produced no documentation to indicate that Taxpayer, as lessee, intended to, or did, acquire any equity or interest in the various pieces of equipment. Instead, the lease payments continued, and ownership of the equipment remained with the related companies.

Although Taxpayer has not provided the terms of the leases under which the equipment was rented, it appears that all lease payments made to the related companies continued just as if they were operating leases (or true leases), as defined in WAC 458-20-211(2)(f). In an operating lease, the equipment, in which the Taxpayer as lessee had no interest or responsibility, simply reverts back to the lessors, the related companies in this case, at the conclusion of the lease. Taxpayer owed retail sales tax on all operating lease payments, no matter how long the payments continued.

Taxpayer, however, essentially argues that the original leases were financing leases, and that the payments during the audit period were actually payments over and above the cost of the equipment. Taxpayer asserts that because it had already paid off the cost of the equipment with lease payments made prior to the audit period, their continued payment should be regarded as a mere nontaxable "compensation" arrangement between the related entities.

According to Audit, the leases entered into by Taxpayer were set up and managed as "true" (or "operating") leases. Contrary to the position taken by Taxpayer, Rule 211 explains that lease payments under "operating leases" are subject to retail sales tax, unlike payments on "financing

leases," on which the sales tax applies only to the full selling price. Rule 211(6)(b). The Department may not change its manner of taxation to accommodate the taxpayer's chosen form, and the Department is not at liberty to disregard the structure of the taxpayer's transaction at the expense of the state. *See Washington Sav-Mor Oil Co. v. State Tax Comm'n*, 58 Wn.2d 518, 522-523, 364 P.2d 440 (1961). The leases in this case were structured and treated by all parties as true operating leases in which the affiliated companies retained ownership of the equipment. The Department must tax these leases accordingly.

Taxpayer's petition as to this issue is denied.

Interstate Commerce. Revenues from hauling property are generally subject to [PUT] under either the motor transportation (RCW 82.16.020(1)(f)) or urban transportation (RCW 82.16.010(1)(d)) classifications, depending on the length and locations of the hauls.[5]

RCW82.16.050(6), however, [allows a deduction for "[a]mounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States; . . . . "]

WAC 458-20-193D (Rule 193D) similarly provides, as to the [PUT]:

> In computing public utility tax, there may be deducted from gross income so much thereof as is derived from actually transporting persons or property . . . from this state to another state or territory or to a foreign country and vice versa.
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> * * *
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> Insofar as the transportation of goods is concerned, the interstate movement of cargo or freight ceases when the goods have arrived at the destination to which it was billed by the out-of-state shipper, and no deduction is permitted of the gross income derived from transporting the same from such point of destination in this state to another point within this state. Thus, freight is billed from San Francisco, or a foreign point, to Seattle. After arrival in Seattle it is transported to Spokane. No deduction is permitted of the gross income received for the transportation from Seattle to Spokane. Again, freight is billed from San Francisco, or a foreign point, to a line carrier's terminal, or a public warehouse in Seattle. After arrival in Seattle it is transported from the line carrier's terminal or public warehouse to the buyer's place of business in Seattle. No deduction is permitted of the gross income received as transportation charges from the line carrier's terminal or public warehouse to the buyer's place of business in Seattle.

(Rule 193D, emphasis added.) Thus, when a motor carrier moves goods within Washington under the authority of a through bill of lading that originates outside of Washington, the interstate commerce deduction will apply. But, if such movement is not under the authority of such a through bill of lading, the interstate commerce deduction will not apply. Det. No. 89-503, 8 WTD 341 (1989); *see also* Det. No. 93-240, 13 WTD 369 (1994).

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[5] See also WAC 458-20-180.

Taxpayer considers its hauls of heavy equipment to have been part of an uninterrupted interstate movements of goods because it was always intended that the heavy equipment would move smoothly from the ship, through the port, and then to the designated yards. As to its bulk hauls, Taxpayer argues that because there was never any intent that the cement remain at the port in silos, and because the cement was always destined for . . . individual plants, its hauls of cement from silo to the ultimate destinations were merely a continuation of import. Taxpayer points out that it would not have been possible to haul the cement straight off the ship to its ultimate destinations, as there were many truckloads on each ship.

In this case, the shipping documentation provided by Taxpayer indicates that the original shippers billed the transportation only as far as the Washington ports of entry, and Taxpayer had separate shipping documents. Transportation that is not on an original through bill of lading does not qualify Taxpayer for the interstate commerce deduction, even though such transportation might have been reasonably foreseeable and necessary to get the goods to their ultimate destinations.

Taxpayer's petition as to this issue is denied.

[Effect of Prior Audit.] Taxpayer contends that the Department's prior audit did not challenge its tax handling of either the leases or its hauling contracts. Taxpayer complains that it was therefore not afforded the opportunity to restructure its activities and documentation.

Under RCW 82.32A.020(2), a taxpayer has a right to waiver of tax where it relied to its detriment on specific, official written advice or tax reporting instructions. Taxpayer has not identified any prior audit reports or written statements by the Department to Taxpayer where the Department provided written instructions, or even addressed, the leases and hauling contracts similar to those here at issue. Therefore, Taxpayer is not entitled to waiver of taxes under RCW 82.32A.020(2).

. . .

Taxpayer's petition as to this issue is denied.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 23rd day of December, 2015.