Cite as Det. No. 13-0279, 33 WTD 75 (2014)

BEFORE THE 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. 13-0279 Registration No. . . .

[1] RCW 82.32A.020; ETA 3065.2009: RETAILING B&O TAX – RETAIL SALES TAX – BAD DEBT DEDUCTION – ORAL INSTRUCTIONS. The Department lacks authority to waive the taxes based on oral instructions. RCW 82.32A.020 only provides authority to waive taxes based upon reliance on specific, official written advice or written reporting instructions from the Department.

[2] RULE 17401; RCW 82.12.0264; RCW 82.32.070: USE TAX – EXEMPTION FOR INTERSTATE CARRIERS – COMPONENT PARTS. Taxpayers are required to keep records that are necessary to determine their tax liability. Lack of adequate records will bar a taxpayer from claiming that certain purchases were component parts for vehicles used in the commission of interstate commerce, which are exempt from use tax liability.

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.

Yonker, A.L.J. – Taxpayer petitions the Department for refund of assessed taxes Taxpayer paid as a result of an audit. Specifically, Taxpayer protests the disallowance of bad debt deductions taken against the retailing business and occupation (B&O) tax and retail sales tax paid. Taxpayer also protests use tax assessed on certain business purchases. We deny Taxpayer's petition.[1]

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

ISSUES

1. Did Taxpayer reasonably rely on alleged oral advice that he was entitled to the bad debt deductions under RCW 82.04.4284, as claimed on his combined excises tax returns filed during the audit period?

2. Is Taxpayer entitled to an exemption for use tax/deferred retail sales tax under RCW 82.12.020 on certain business purchases in the absence of business records required under RCW 82.32.070?

FINDINGS OF FACT

Taxpayer, a sole proprietorship, operates a towing company in . . . Washington. Taxpayer holds a permit issued by the Interstate Commerce Commission (ICC) to transport property for hire across the boundaries of Washington. Taxpayer reports his income to the Department using the cash method.

As part of Taxpayer's regular business, he sometimes tows and stores vehicles, and collects payment from his customers when those customers reclaim their vehicles. In such cases, Taxpayer pays retailing B&O tax on those services, and collects and remits retail sales tax when the customers reclaim their vehicles and pay for Taxpayer's services. However, if vehicle owners never reclaim their vehicles, Taxpayer eventually sells the unclaimed vehicles at auction or for scrapping. In those cases, Taxpayer pays retailing B&O tax, and collects and remits retail sales tax, when he sells the unclaimed vehicle. In addition, when vehicles are unclaimed, Taxpayer takes a "bad debt" deduction for his costs in towing and storing such vehicles against the retailing B&O tax and retail sales tax that Taxpayer reports on the auction or scrapping sale.

In 2013, the Department's Audit Division conducted an audit of Taxpayer's books and records from January 1, 2009 through December 31, 2012. As a result of the audit, the Audit Division took the following actions:

(1) reclassified amounts Taxpayer reported under the retailing B&O tax classification that were attributable to "non-routine" towing jobs to the wholesaling B&O tax classification,
(2) gave Taxpayer a credit for over-reported retailing B&O tax and retail sales tax,
(3) disallowed bad debts Taxpayer deducted from the measure of the retailing B&O tax and retail sales tax reported,
(4) assessed use tax on certain purchases for which the Audit Division determined did not qualify for exemption from retail sales tax.[2]

On May 8, 2013, the Department issued a tax assessment in which it assessed $ . . . in taxes and $ . . . in interest, for a total of $ . . . . Taxpayer subsequently appealed the entire tax assessment.

However, Taxpayer presented arguments on appeal that related only to items (3) and (4) discussed above.[3] Taxpayer fully paid the tax assessment on June 7, 2013.

Regarding the bad debt deductions in item (3), Taxpayer argued on appeal that he claimed those deductions based on oral advice he received from a Department representative during a telephone conversation in 1998. Taxpayer was unable to provide any additional details regarding the alleged telephone conversation.

Regarding the use tax assessed on certain purchases in item (4), Taxpayer argued on appeal that those purchases were exempt from retail sales tax or use tax because Taxpayer held an ICC permit, which allows Taxpayer to purchase "component parts" for his vehicles without having to pay retail sales tax. On appeal, Taxpayer did not provide any additional documentation to support the argument that any of the purchases at issue were specifically for "component parts."[4]

ANALYSIS

1. Disallowance of Bad Debt Deduction

RCW 82.04.4284(1) allows for a bad debts deduction from the measure of the B&O tax, stating, "[i]n computing tax there may be deducted from the measure of tax bad debts, as that term is used in 26 U.S.C. Sec. 166 . . . **on which tax was previously paid**." (Emphasis added). RCW 82.04.4284(2) explains that bad debts do not include expenses "incurred in attempting to collect debt" or "[r]epossessed property." RCW 82.08.037 allows for bad debt deductions from the measure of retail sales tax in the same manner, subject to the same limitations.

WAC 458-20-196 (Rule 196), is the Department's rule implementing both RCW 82.04.4284 (relating to B&O tax) and RCW 82.08.037 (relating to retail sales tax). Rule 196(1)(a) states that "[b]ad debt credits, refunds, and deductions occur when income reported by a taxpayer is not received. Taxpayers who report using the cash method do not report income until it is received. For this reason, bad debts are most relevant to taxpayers reporting income on an accrual basis." Here, Taxpayer reports his income to the Department using the cash method.

Under Rule 196(2), "sellers are entitled to a credit or refund for sales and use taxes **previously paid** on 'bad debts' under section 166 of the Internal Revenue Code." (Emphasis added).

Further, under Rule 196(3), "taxpayers may deduct from the measure of B&O tax 'bad debts' under section 166 of the Internal Revenue Code . . . on which tax was **previously paid**." (Emphasis added). As such, a taxpayer is entitled to deduct from the measure of both retail sales tax and B&O tax any bad debts so long as tax was previously paid on such bad debts, and those bad debts meet the definition of section 166 of the Internal Revenue Code.

[3] Because Taxpayer's petition did not state any objections to, or present any arguments with respect to (1) and (2), we do not address them in this determination.

[4] On appeal, Taxpayer offered his own estimated percentages of purchases from each vendor that Taxpayer believed were for "component parts" for his vehicles, and therefore exempt from retail sales tax.

Here, Taxpayer did not previously pay B&O tax or retail sales tax to the Department when he towed and stored vehicles not claimed by their owners because Taxpayer, a cash basis reporter, did not receive income when he towed and stored the vehicles at issue. Instead, Taxpayer only received income and reported such income when he sold the vehicles at auction or for scrapping. This is not a case in which Taxpayer reported income from certain transactions and then never actually received the reported income, as described in Rule 196(1)(a). As such, Taxpayer is not entitled to claim a bad debt deduction for his business expenses for towing and storing the vehicles. We conclude, therefore, that the Audit Division correctly disallowed the bad debt deductions Taxpayer claimed.

Taxpayer argues further, however, that he claimed the bad debt deductions in this manner because a Department representative allegedly instructed Taxpayer to do so, and argues, therefore, that the bad debt deductions he claimed should be allowed. Taxpayer stated this alleged instruction was oral advice he received in a telephone conversation with a Department representative in 1998. Taxpayer does not recall the date of the telephone call nor does he recall the name of the individual with whom he spoke.

Pursuant to RCW 82.32A.020, a taxpayer has the right to "rely on **specific, official written advice and written tax reporting instructions** from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment." (Emphasis added). Taxpayers have no corresponding right to rely on oral advice. Here, Taxpayer did not receive specific, official written advice from the Department. Instead, Taxpayer alleges he received only oral advice. The Department has addressed the issue of reliance on alleged oral instructions numerous times and has consistently stated that the Department lacks legal authority to waive interest, penalties, or tax deficiency assessments based on oral instructions that are not corroborated. Det. No. 00-001, 19 WTD 681 (2000); *see also* Det. No. 96-114, 16 WTD 188 (1996); Det. No. 92-004, 11 WTD 551 (1992); Det. No. 87-130, 3 WTD 59 (1987).

The Department has also issued an advisory statement that explains its position regarding oral instructions. Excise Tax Advisory (ETA) 3065.2009 explains that "RCW 82.32A.020 does not authorize, nor does any other law permit, the Department to waive tax, interest, or penalties on the basis of a taxpayer's recollection of oral instructions by an agent of the department."

Accordingly, we are unable to find that the alleged oral advice Taxpayer received in 1998 entitles Taxpayer to an abatement of his tax liability for the audit period. We conclude Taxpayer has not met his burden of proving that he is entitled to the bad debt deductions taken during the audit period.

2. Assessment of Use Tax

Washington has both a retail sales tax and a use tax. Retail sales tax is an excise tax imposed on consumers when they purchase tangible personal property. RCW 82.04.050; 82.04.190; 82.08.020; 82.08.050. The use tax is a "compensating" tax; it is imposed when the sales tax has

not been paid. *See Henneford v. Silas Mason Co.*, 300 U.S. 577, 57 S.Ct. 524 (1937); *Northern Pacific Railway Co. v. Henneford*, 9 Wn.2d 18, 113 P.2d 545 (1941). The use tax is imposed "for the privilege of using within this state as a consumer any article of tangible personal property purchased at retail" on which Washington's retail sales tax has not been paid, unless an exemption applies. RCW 82.12.020; *see also* WAC 458-20-178.

The legislature has chosen to exempt private carriers from use tax if the carrier's business is conducting interstate commerce by transporting property for hire. Det. No. 04-0075, 25 WTD 95 (2006) (citing RCW 82.12.0254); RCW 82.12.0254(3) states in pertinent part:

> The provisions of this chapter do not apply in respect to the use by the holder of a carrier permit issued by the interstate commerce commission . . . of any vehicle . . . used in substantial part in the normal and ordinary course of the user's business for transporting therein persons or property for hire across the boundaries of this state . . . ; and in respect to the use of tangible personal property which becomes a component part of any vehicle used by the holder of a carrier permit issued by the interstate commerce commission . . . in the course of repairing, cleaning, altering, or improving the same; also the use of labor and services rendered in respect to such repairing, cleaning, altering, or improving.

WAC 458-20-17401 (Rule 17401) implements the statutory exemption from use tax for motor vehicles, trailers, and parts used in interstate or foreign commerce. Rule 17401(7)(a) states that "component parts" means

> Any tangible personal property which is attached to and becomes an integral part of the [vehicle]. It includes such items as motors, motor and body parts, batteries, paint, permanently affixed deals, and tires. . . . "Component parts" can include tangible personal property which is attached to the vehicle and used as an integral part of the motor carrier's operation of the vehicle, even if the item is not required mechanically for the operation of the vehicle. It includes cellular telephones, communication equipment, fire extinguishers, and other such items. . . . It does not include antifreeze, oil, grease, and other lubricants which are considered as consumed at the time they are placed into the vehicle, even though required for operation of the vehicle. It does include items such as spark plugs, oil filters, air filters, hoses and belts.

Rule 17401(7)(b) goes on to state that equipment, tools, parts and accessories that do not become a component part of a motor vehicle are not component parts.

Finally, we note that we are required to narrowly construe a taxpayer's eligibility for any of the claimed exemptions. As stated in *Budget Rent-A-Car, Inc. v. Department of Rev.*, 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972), "[e]xemptions to the tax law must be narrowly construed. Taxation is the rule and exemption is the exception. Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it." *See Group Health Coop. of Puget Sound, Inc. v. Dep't of Revenue.*, 106 Wn.2d 391, 401-02, 722 P.2d 787 (1986); Det. No. 00-099, 20 WTD 53 (2000). Further, RCW 82.32.070 requires taxpayers to maintain records

adequate for the Department to determine the tax liability of such taxpayer. *See* Det. No. 08-0116, 27 WTD 228 (2008).

Here, Taxpayer is the holder of an ICC permit to transport property for hire across the boundaries of Washington. Taxpayer did not provide source documents for various purchases he made during the audit period The Audit Division, however, did assess use tax on purchases for which Taxpayer provided no source documents related to the purchases.

RCW 82.32.070 provides that taxpayers must keep and preserve suitable business records:

> (1) Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue.

See also WAC 458-20-254; Det. No. 99-341, 20 WTD 343 (2001); Det. No. 12-0136, 32 WTD 65 (2012). During the appeal process, Taxpayer was given an opportunity to provide source documents for those purchases that Taxpayer believed were exempt from tax because he was the holder of an ICC permit. Taxpayer did not provide any such documentation, but instead, merely provided estimates of the percentage of purchases from each non-automotive business that he believed would be exempt from tax. We conclude that such estimates are inadequate documentation to support an exemption from tax on those purchases. Based on the lack of documentation, we conclude that Taxpayer has not met his burden of proving that any of the purchases upon which the Audit Division assessed use tax were exempt from taxation.

DECISION AND DISPOSITION

Taxpayer's petition for refund is denied.

Dated this 5th day of September, 2013.