STATE OF ARIZONA

Department of Revenue
Office of the Director
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Governor

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Director

The Director's Review of the Decision of the Administrative Law Judge Regarding:	)	**O R D E R**
[redacted]	)	**Case No. 200800088-S**
License No. [redacted]	)	

On August 18, 2008 the Administrative Law Judge issued a decision regarding the protest of [redacted] ("Taxpayer"). The Taxpayer appealed this decision on September 17, 2008. The appeal being timely, the Director of the Department of Revenue ("Director") issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the Administrative Law Judge's decision and now issues this order.

STATEMENT OF CASE

The Transaction Privilege and Use Tax Section of the Audit Division ("Division") of the Department issued a Notice of Proposed Assessment for State and [redacted] ("City") use tax to Taxpayer for the use of a watercraft starting in late February 2005. Taxpayer argues that he purchased the watercraft from a private party, not a retailer, so use tax is not owed. Further, Taxpayer maintains that the first actual use of the watercraft was in [redacted] and, as a nonresident who is not using the watercraft in a business, he is not liable for use tax.

FINDINGS OF FACT

The Director adopts from the findings of fact in the decision of the Administrative Law Judge and makes additional findings of fact based on the record below and the evidence submitted on appeal:

1. In February 2005 Taxpayer was a resident of [redacted].

2. On February 1, 2005 Taxpayer entered into a rental agreement for a space in [redacted], Arizona for the storage of watercraft, serial [redacted].

3. On February 11, 2005 Taxpayer agreed to purchase a [redacted] watercraft, serial [redacted] (hereafter "the Watercraft"), at [redacted] (Vendor) in [redacted].

4. The invoice/bill of sale for the Watercraft has Vendor's letterhead, is signed by one of its employees, reflects an amount as down payment and an additional amount to be paid or financed, reflects that no tax is being charged, and has notes saying: (1) "Unpaid deposit amount due on or before pick-up/delivery…", (2) "private sale transferred and delivered for [redacted]" and (3) "Delivered out of State. Sold out of state to [redacted] [sic], Arizona."

5. Vendor carried a large inventory of new and used watercraft with some of the inventory of used watercraft being held on consignment.

6. Taxpayer used the Watercraft in [redacted] on February 10, 11 and 12, 2005, part of which Taxpayer concedes was for purposes of testing.

7. Taxpayer failed to establish that the entire purchase price was paid on February 11, 2005 or that the Vendor transferred title to the Watercraft on that date.

8. On August 21, 2005, after having received a billing for California use tax on the Watercraft, Taxpayer informed the California State Board of Equalization that the "watercraft's sole use and purpose is for recreational use, in fresh-water, at [redacted], Arizona; This watercraft will be used no where other than, Arizona. …the watercraft is insured in Arizona, stored in Arizona, and for 'use' only in Arizona."

9. Taxpayer registered the Watercraft with the United States Coast Guard with a California hailing port.

CONCLUSIONS OF LAW

The Director adopts from the conclusions of law in the decision of the Administrative Law Judge and makes additional conclusions of law as follows:

1. Arizona imposes a tax on the storage, use or consumption in this state of tangible personal property purchased from a retailer. A.R.S. § 42-5155(A).

2. Tangible personal property is presumed to be subject to use tax when the property was purchased outside Arizona and is then brought into Arizona for use, storage or consumption. The purchaser bears the burden of proving that a purchase is *not* subject to the Arizona use tax. *See* A.A.C. R15-5-2304(B).
3. The term "purchase" means a "purchase *for* storage, use or consumption in Arizona." *See* A.A.C. R15-5-2301(2).
4. Departmental determinations are presumed correct and the burden is on the taxpayer to overcome this presumption. *See* Arizona *State Tax Commission v. Kieckhefer,* 67 Ariz. 102, 191 P.2d 729 (1948); A.A.C. R15-10-118.
5. A.R.S. § 42-5151(17) defines "retailer" for use tax purposes to include every person engaged in the business of making sales of tangible personal property for storage, use or other consumption, which includes consignment sales.
6. Vendor was a retailer and Taxpayer's purchase of the Watercraft was a purchase from a retailer whether Vendor was a broker or sold the Watercraft on consignment.
7. A purchaser is not subject to use tax if (1) the property is not used in conducting a business in Arizona; and (2) either (a) that the property was purchased for bona fide use outside Arizona, with bona fide use presumed to be under a purchase/use standard of three months, or (b) that the property was purchased by a nonresident and the first actual use occurred outside Arizona. *See* A.A.C. R15-2-2304(A) and R15-5-2352(C).
8. The Model City Tax Code, as adopted by the City, levies an excise tax on the storage or use in the City of tangible personal property. See City code §3.06.610.A. The City tax rate is two percent (2%) of the cost of the property acquired from a retailer upon storing or using the property in City.
9. Similar to State law, the Model City Tax Code, as adopted by the City, states at §3.06.620 in pertinent part:

> The following persons shall be deemed liable for the tax imposed by this Article, and such liability shall not be extinguished until the tax has been paid to this City, except that a receipt from a retailer separately charging the tax ... is sufficient to relieve the person ... from further liability for the tax to which the receipt refers:
> (a) Any person who acquires tangible personal property from a retailer, whether or not such retailer is located in this City, *when such person stores or uses said property within the City.*

Emphasis added here.

10. Similar to state law, the Model City Tax Code §3.06.660, as adopted by the City, states, in pertinent part:

> The storage or use in this City of the following tangible personal property is exempt from the Use Tax imposed by this Article:
>
> (a) tangible personal property brought into the City by an individual who was not a resident of the City at the time the property was acquired for his own use, if the first actual use of such property was outside the City, unless such property is used in conducting a business in this City.

10. Taxpayer failed to establish that the sale was completed on April 11, 2005.
11. Whether or not the sale was complete on April 11, 2005, Taxpayer's conduct with regard to the Watercraft in [redacted] constituted activity related to the sale and not the first actual use of the Watercraft.
12. The use of the Watercraft in [redacted], Arizona, is subject to State and City use tax.
13. A.R.S. § 42-1125 imposes penalties on unpaid taxes. A.R.S. § 42-1125(A) provides that if a taxpayer files a tax return late, a penalty is added to the tax unless the failure is due to reasonable cause and not willful neglect.
14. "Reasonable cause" is generally defined to mean the exercise of "ordinary business care and prudence." *Daley v. United States,* 480 F. Supp. 808 (D.N.D. 1979).
15. A.R.S. § 42-1125(S) provides as follows:

> For the purposes of this section, and only as applied to the taxes imposed by chapter 5, articles 1 through 6 and chapter 6, articles 1, 2, and 3 of this title, "reasonable cause" means a reasonable basis for the taxpayer to believe that the tax did not apply to the business

> activity or the storage, use or consumption of the taxpayer's tangible personal property in this state.

16. Taxpayer has presented no evidence of "reasonable cause" under either of the preceding definitions.
17. A.R.S. § 42-1123 imposes interest on unpaid taxes from the date the taxes were due; such interest continues to accrue on unpaid tax until the time the tax is paid.
18. Late file penalty and interest are due in addition to the tax imposed.

DISCUSSION

At issue in this case is whether use tax should be imposed on the purchase price of a watercraft purchased in [redacted] and shipped into Arizona for personal use in Arizona by a non-resident. A.R.S. § 42-5155(E) provides that purchasers are liable for the Arizona use tax on the storage, use or consumption in Arizona of the property purchased from a retailer outside Arizona. Taxpayer argues that he purchased the Watercraft from a private party, not a retailer, with Vendor acting as a broker, so use tax is not owed. Further, Taxpayer maintains that the Watercraft was first used in [redacted] and, as a nonresident of Arizona who is not using the Watercraft in a business, he does not owe use tax.

Purchase from a retailer

The Division maintains that Taxpayer purchased the Watercraft from Vendor who was a retailer. On appeal the Division stated that Vendor had an inventory of new and used watercraft and provided copies from Vendor website, showing that "[redacted] carries a large inventory of pre-owned boats, including consignment boats." The copies were from the current website, but the inference is that it represented what Vendor's business was at the time of the purchase at issue. The Division argues that Vendor was a retailer of new and used watercraft, some of which are available on consignment, but there is no indication that Vendor acted as a broker.

Subsequent to the memorandum in which the Division made these statements, Taxpayer had the opportunity to respond to those statements, but did not submit anything. The uncontroverted evidence is that Vendor had an inventory of watercraft of new and used watercraft, including some on consignment.

An Arizona business is considered a retailer subject to tax under the retail classification if it sells on consignment. A.A.C. R15-5-111 states:

> A. The following definitions apply for purposes of this rule:
> 1. "Consignee" means the party that is in the business of selling tangible personal property belonging to a consignor.
> 2. "Consignor" means the party with the legal right to contract the services of the consignee to sell tangible personal property on behalf of the consignor.
> B. Gross receipts from consignment sales are subject to tax under the retail classification.
> C. A consignee shall obtain a transaction privilege tax license before making consignment sales.

Similarly, an out of state business which makes sales of tangible personal property is a retailer for use tax purposes. A.R.S. § 42-5151(17) defines “retailer” for use tax purposes to include:

> (a) Every person engaged in the business of making sales of tangible personal property for storage, use or other consumption or in the business of making sales at auction of tangible personal property owned by that person or others for storage, use or other consumption.

While the definition doesn’t specifically mention consignment, it is not excluded. The copies from website demonstrate that Vendor makes sales of tangible personal property, some of which were on consignment and some of which were not. Even if the consignment sales don’t by themselves make Vendor a retailer, Vendor clearly is a retailer because of the sales of inventory it owns.

Taxpayer maintains its purchase was from [redacted] with Vendor acting as a broker. Taxpayer provided a letter from an employee of Vendor, [redacted], F&I Manager, dated August 26, 2008, three and a half years after the sale took place. In the letter, Ms. [redacted] states that the seller was [redacted] and Vendor acted as the broker on the sale of the Watercraft. While Taxpayer claims and the letter states that Vendor acted as a

broker, it is not clear what Taxpayer and the Vendor mean by "broker" and how that differs from selling on consignment. Nothing was provided with the letter to corroborate that statement or explain what it was to act as the broker.

The bill of sale indicates that there was a "private sale." The bill of sale states "private sale tranfered [sic] and delivered for [redacted]." However, the bill of sale, is signed by the customer and [redacted], an employee of Vendor. There is no question Vendor was a part of the sales transaction and the sale could have been a consignment sale.

Whether Vendor was the consignee or a broker in the sale of the Watercraft, the sale was by a retailer. As such, the storage and use of the Watercraft in Arizona is subject to use tax unless Taxpayer proves he is entitled to an exemption from use tax. The purchaser of the tangible personal property bears the burden to prove that a purchase is *not* subject to the Arizona use tax. *See* A.A.C. R15-5-2304(B). *See*, also Arizona *State Tax Commission v. Kieckhefer,* 67 Ariz. 102, 191 P.2d 729 (1948), A.A.C. R15-10-118.

First actual use by a non-resident

The hearing record demonstrates that Taxpayer purchased this Watercraft with the intent to bring it into Arizona and use it and store it in Arizona. A purchaser may demonstrate that use tax does not apply when he proves that (1) the property is not used in conducting a business in Arizona and (2) either (a) that the property was purchased for bona fide use outside Arizona, with bona fide use presumed to be under a purchase/use standard of three months, or (b) that the property was purchased by a nonresident and the first actual use occurred outside Arizona. *See* A.A.C. R15-2-2304(A) and R15-5-2352(C).

The uncontested evidence is that Taxpayer was not using the Watercraft for a business purpose and that Taxpayer was a nonresident of Arizona. In this case, the availability of the nonresident exemption revolves around "first actual use" of the Watercraft. The term "first actual use" is not defined in the statutes or in the administrative rules; therefore, the commonly understood meaning of the language must be determined.

Taxpayer argued that the "first actual use" of this Watercraft occurred after the sale while it was in [redacted]. The hearing record contains inconsistent information about the

"use" of the Watercraft in [redacted], including when the sale was complete. This information must be sorted and weighed.

Statements about [redacted] "use"

When arguing that he was not subject to California taxes on the purchase of the Watercraft, Taxpayer's 2005 letter to the California taxing authority states that "… *this watercraft's sole use and purpose is for recreational use, in fresh-water, in [redacted], Arizona; This watercraft will be used no where other than Arizona. … this watercraft is insured in Arizona, stored in Arizona, and for 'use' only in Arizona."* In this letter nearly contemporaneous with the sale, there was no mention of a use in [redacted].

Taxpayer claims that the first actual use was on February 11th after the sale was complete and then on February 12th. Taxpayer's memo to the auditor dated November 22, 2006 stated that Watercraft's first use was on February 10th, 11th and 12th. At hearing on July 30, 2008, Taxpayer stated that the Watercraft was used in [redacted] on February 10th, 11th and 12th, specifying that it was used "after[wards]…(the sale) and the next day." Later, at the hearing, Taxpayer admitted that he had "tested" the Watercraft (referring to the high price of the Watercraft, thereby inferring that a reasonable person would have tested the Watercraft out before agreeing to pay such a high price). In an August 26, 2008 letter from [redacted], an employee of Vendor, it was stated that the first actual use of the Watercraft as owner occurred on February 11th and 12th.

There are some inconsistencies in Taxpayer's statements about the exact dates of "first actual use" as opposed to testing. In addition, the August 26, 2008 from the Vendor makes conclusory statements about the ultimate conclusion (first actual use) rather than a statement of facts. Conclusions are to be drawn by the Administrative Law Judge and the Director after applying the law to the facts that have been established. The question remains whether what the Taxpayer did with the Watercraft in [redacted] was a "first actual use."

Taxpayer made a clear statement of intent to purchase solely for the purpose of using the Watercraft in Arizona. In addition, Taxpayer stated that he was testing the Watercraft, although he also claims the test concluded on February 11th with the completion of the sale and he "used" the Watercraft twice thereafter. Whether the sale was completed on February 11th will be discussed below. However, even if the sale was complete on

February 11th, Taxpayer's conduct with the Watercraft later that day and the next does not rise to the level of "first actual use". The inclusion of the word "actual" in the phrase indicates there must be something more than a continuation of pre-sales activity.

Completion of sale

Taxpayer maintains the sale was completed when the wire transfer was completed on February 11th. At the hearing Taxpayer stated that "money" was wired on the 11th, but the record from the hearing does not document whether the wiring of money was payment in full. The bill of sale was dated February 11th, but it also indicates that the Watercraft must be delivered to Arizona and that it was an out of state sale. The Administrative Law Judge concluded that it was not clear that the sale was complete on February 11th and that transactions completed in interstate commerce call for shipments and deliveries to be made of the purchased property out of the (locale of sale) state. Therefore, the Administrative Law Judge concluded that Taxpayer had not established, by a preponderance of evidence, that first actual use of the Watercraft was in [redacted] after the sale/purchase.

On appeal, Taxpayer submitted the above-mentioned August 26, 2008 letter from Vendor's employee. In that letter it is stated that Taxpayer purchased the Watercraft from [redacted] and Vendor was a broker. Just as the statement that the first actual use as owner was February 11th and 12th, these statements are not statements of facts, they are conclusions. It should be noted the Administrative Law Judge had the Bill of Sale but not the wire transfer print out at the hearing. The Bill of Sale attached to the letter and the wire transfer print out do provide facts.

The wire transfer print out shows that Vendor received a transfer from "financial underwriters" on February 11, 2005 in the amount the Bill of Sale shows as the amount to Pay/Finance. The Bill of Sale contains the statement, "Unpaid deposit amount due on or before pick-up/delivery $6,000.00." This is also the amount reflected on the Bill of Sale as the cash down payment, which when added to the wire transfer amount equals the cash price. There is no document showing when the cash down payment was paid. The August 26, 2008 letter refers to a check dated February 11th but that check was not provided. It is not clear that the purchase price had been paid in full on February 11th.

Even if the total purchase price had been paid on February 11th, the facts are not clear that the Watercraft had been delivered to Taxpayer on that date. In fact, as stated above, the Bill of Sale contains a note "Delivered out of State, Sold out of state to [redacted] [sic], AZ." While Taxpayer may have completed his part of the contract to purchase, it appears Vendor had not completed its part. Whether this means the sale was not complete is the same question the Administrative Law Judge had. If the sale was not complete, then Taxpayer could not have been using the Watercraft as owner.

Even if the sale was complete on February 11th, Taxpayer's conduct with relation to the Watercraft the afternoon of February 11th and on February 12th seemed to be a continuation of conduct involved testing. The activity was associated with the sale and did not rise to the level of "first actual use" in [redacted].

Generally, Arizona case law provides that departmental determinations are presumed correct and the burden is on the taxpayer to overcome this presumption. *See* Arizona *State Tax Commission v. Kieckhefer,* 67 Ariz. 102, 191 P.2d 729 (1948). A.R.S. § 42-1255 was enacted to provide that the Department may have the burden of proof regarding factual issues that are relevant to ascertaining the tax liability of a taxpayer. However, A.R.S. § 42-1255 specifically does not abrogate a taxpayer's requirement to be able to substantiate an item of income or expense or, as interpreted herein, an entitlement to an exception from a tax. Therefore, A.R.S. § 42-1255 does not apply and Taxpayer continues to bear the burden of proof that the Department is mistaken about the facts or has failed to take into account the tax laws. *See also* A.A.C. R15-10-118.

Taxpayer failed to meet its burden of proof that its first actual use occurred in [redacted] prior to the Watercraft being used in Arizona. Therefore, the Administrative Law Judge correctly determined that Taxpayer is subject to use tax on the purchase price of the Watercraft.

O R D E R

The Administrative Law Judge's decision is affirmed.

This decision is the final order of the Department of Revenue. The Taxpayer may contest the final order of the Department in one of two manners. The Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15th Avenue, Suite 140, Phoenix, AZ 85007 or may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003) within sixty (60) days of the receipt of this order. For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-3763.

Dated this 24th day of April, 2009.

ARIZONA DEPARTMENT OF REVENUE

Gale Garriott
Director

Certified original of the foregoing
mailed to:

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