Cite as Det. No. 14-0177, 34 WTD 102 (2015)

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. 14-0177 Registration No. . . .

[1] RCW 82.04.050: B&O TAX – RETAIL SALES TAX – GOVERNMENT CONTRACTING. Taxpayer who was obligated to perform cleanup measure imposed by the Environmental Protection Agency (EPA) was not engaged in government contracting. The work was not done on land owned by the U.S. government, and the EPA was not the purchaser of the work. Instead, the work occurred on Taxpayer's land and Taxpayer was the entity making the purchases and on whom the retail sales tax was assessed.

[2] Rule 171; RCW 82.04.050: B&O TAX – RETAIL SALES TAX – PUBLIC ROAD CONSTRUCTION. Rule 171 makes clear that only those items that are actually "part of" the road system, its lighting system, or its drainage system are exempt from retail sales tax. While Taxpayer maintains that the "capping" of the land, as required by the EPA, was necessary prior to constructing public roads and walkways on the land, such activities are not "directly related to" the construction of such roads and walkways because Taxpayer was required by the EPA to "cap" the land regardless of the nature of improvements Taxpayer eventually constructed atop the land.

[3] RCW 82.04.051: B&O TAX – RETAIL SALES TAX – SERVICES IN RESPECT TO CONSTRUCTION. If a contract involves both an activity that would be subject to service and other activities B&O tax and construction services, then we must also determine if the "predominant activity" involved "service rendered in respect to constructing." Mosaic tile design work was completed "in respect to" the construction of the mosaic tile images on the walkway, all of which work was apparently combined under one agreement, subjecting the tile design component to retail sales tax along with the tile setting work.

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.

Chartoff, A.L.J. – A limited liability company engaged in speculative building protests an Audit assessment of deferred sales and/or use tax on certain retail purchases. Taxpayer contends that certain purchases were exempt from retail sales tax because they were purchases either for the U.S. government or for public road construction. Taxpayer also contends that certain amounts it paid for mosaic tile work were for design services, and therefore exempt from retail sales tax. We deny the petition.[1]

ISSUES

1. Is Taxpayer's activity of "capping" its land with various layers of soil in compliance with the orders of the Environmental Protection Agency (EPA) exempt from retail sales tax under RCW 82.04.050(12)?

2. Is Taxpayer's activity of "capping" its land with various layers of soil in compliance with the orders of the EPA exempt from retail sales tax under RCW 82.04.050(10) and WAC 458-20-171?

3. Where Taxpayer contracted with an artist to design and install mosaic tiles on a walkway, can Taxpayer exclude the separately invoiced design charges from the measure of use tax and/or deferred sales tax under RCW 82.04.051?

FINDINGS OF FACT

Taxpayer is a Washington limited liability company that, during the relevant time period, was engaged in the speculative construction of apartments and other local improvements on 97 acres of real property (land) Taxpayer owned in . . . , Washington.

The land upon which Taxpayer constructed the various improvements was previously an industrial smelter site. The previous owner of the land was ordered in a consent decree from U.S. District Court to engage in a number of cleanup measures imposed by the Environmental Protection Agency (EPA). In 2005, the previous owner of the land filed for bankruptcy. Also in 2005, the previous owner of the land entered into a purchase agreement for a third party to purchase the land. In 2006, the bankruptcy court approved the purchase agreement on the condition that (1) the purchaser and the EPA agree on what cleanup measures the purchaser would complete on the land and (2) such purchase agreement is approved in U.S. District Court. Subsequently, the third party purchaser assigned its interest in the purchase agreement to Taxpayer.

Taxpayer subsequently entered into negotiations with the EPA regarding the cleanup measures Taxpayer had to complete prior to making improvements on the land. Those negotiations resulted in an amended consent decree from U.S. District Court in which Taxpayer became the obligated party to complete the various cleanup measures imposed by the EPA in its Statement of Work.

Included in the measures imposed by the EPA in its Statement of Work is a requirement that Taxpayer "cap" the majority of the land with five layers of soil to protect improvements from

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

residual pollution from the previous industrial activity. According to the Statement of Work, the "cap" had to consist of the following layers starting from the bottom:

- A layer of "dense (highly compacted) soil."
- A "physical marker layer designed to provide a visual indicator and some perforation protection."
- A 12-inch layer "constructed of fine-grained, highly compacted cohesive soil.
- An 18-inch layer of "dense, clean cover soil."
- A six inch layer of "clean topsoil and vegetation."

This cap was specifically not required in "areas of the [land] where building foundations, roadways, parking lots, promenades and concrete walkways may be approved as the functional equivalent of the site cap." Taxpayer completed the capping on the land as required by the EPA.

Also included in the cleanup measures imposed by the EPA was a requirement for Taxpayer to allow on-site disposal of contaminated residential soils from the surrounding neighborhoods. According to the Statement of Work, residential soils were to be placed as sub-grade at the smelter site as long as development allows. Such soils were eventually capped, as described above.

Taxpayer's subsequent improvements on the land included a pedestrian walkway. Taxpayer contracted with an artist to design and install a series of mosaic tile images along the walkway. According to Taxpayer's records, Taxpayer paid $. . . for the tile design and $. . . for setting the tiles. Taxpayer paid these amounts in six invoices the artist issued throughout the process. All but one of the invoices included partial amounts for both tile design and tile setting.

In 2013, the Department's Audit Division conducted a review of Taxpayer's books and records for the period of January 1, 2009 through December 31, 2012 (audit period). The Audit Division found that Taxpayer had presented a reseller permit to its suppliers and subcontractors relieving suppliers and [subcontractors] of the duty to collect retail sales tax from Taxpayer on those transactions. However, the Audit Division found that in some transactions, Taxpayer did not purchase the items at issue for resale, and therefore remained liable for deferred sales tax and/or use tax.

As a result of that review, on June 4, 2013, the Department issued a tax assessment for $. . . , including $. . . in deferred sales tax and/or use tax, and also including $. . . in interest. Taxpayer timely appealed the tax assessment.

ANALYSIS

1. Government Contract Work

Taxpayer argues on appeal that its expenses incurred for "capping" the land, as ordered by the EPA, [were] not subject to retail sales tax. Washington imposes a tax on "retail sales," which include the following:

> the sales of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to . . . (b) the constructing, repairing, decorating, or

> improving of new or existing buildings or other structures under, upon, or above real property of or for consumers . . . .

RCW 82.04.050(2). For such "retail sales," the responsible party for paying the tax is the owner of the property upon which the construction, repair work, or decorating work occurs. RCW 82.04.190(4). The retail sales tax is measured by the full contract price for the construction, including the cost of materials consumed in the construction, labor costs, and markups. WAC 458-20-170(4)(a). Here, Taxpayer does not dispute that its activity on the land constituted "constructing," which is subject to retail sales tax unless some exclusion applies. Taxpayer contends that the expenses in question were for the U.S. Government, and therefore exempt from retail sales tax.

When construction is performed for the United States or its instrumentalities, the activity is statutorily excluded from the definition of "retail sale." RCW 82.04.050(12) states the following:

> The term ["retail sale"] does not include the sale of or charge made for labor and services rendered in respect to the constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for the United States, [or] any instrumentality thereof . . . . Nor does the term include the sale of services or charges made for the clearing of land and the moving of earth of or for the United States, [or] any instrumentality thereof . . . .

. . .

Here, Taxpayer argues that the "capping" involved the moving of earth of or for the U.S. Government because the work was required by the EPA, which is a U.S. government agency. Yet, the "capping" was not done on land owned by the U.S. government, and the EPA was not the purchaser [of the work]. Instead, the work occurred on Taxpayer's land and Taxpayer was the entity making the purchases and on whom the retail sales tax was assessed. Taxpayer has provided no evidence suggesting that it is "so closely connected" to the government that we cannot view Taxpayer as separate from the government. Indeed, all available evidence indicates that Taxpayer is a privately-owned entity without any direct tie to a government entity.

It is clear that the government exclusion from retail sales tax liability is reserved [primarily] for those situations in which the government itself would otherwise be taxed by a state. This is simply not the case here, where the retail sales tax falls on Taxpayer, a privately-owned entity. Thus, the circumstances of this case do not implicate the exclusion from retail sales tax under RCW 82.04.050(12).

2. Public Road Construction

Taxpayer next argues that because it constructed public roads and walkways on portions of the land, the "capping" Taxpayer completed on the land under those public roads and walkways should be exempt from retail sales tax under RCW 82.04.050(10), which states that a "retail sale" does not include the following:

> the sale of or charge made for labor and services rendered in respect to the building, repairing, or improving of any street, place, road, highway, easement, right-of-way, mass public transportation terminal or parking facility, bridge, tunnel, trestle which is owned by a municipal corporation or political subdivision of the state or by the United States and which is used or to be used primarily for foot or vehicular traffic including mass transportation vehicles of any kind.

WAC 458-20-171 (Rule 171) defines further "building, repairing or improving of a publicly owned street, place, road, etc." to specifically not include the following:

> the constructing of water mains, telephone, telegraph, electrical power, or other conduits or lines in or above streets or roads, **unless such power lines become a part of a street or road lighting system** as aforesaid; nor does it include the construction of sewage disposal facilities, nor the installing of sewer pipes for sanitation, **unless the installation thereof is within, and a part of, a street or road drainage system**.

(Emphasis added). Rule 171 makes clear that only those items that are actually "part of" the road system, its lighting system, or its drainage system are exempt from retail sales tax. We have previously held that, pursuant to Rule 171, only those activities "directly related to" public road construction [are] exempt from retail sales tax; those activities that are "unrelated to . . . vehicular or pedestrian travel are not exempt." Det. No. 03-0236, 23 WTD 276 (2004). While Taxpayer maintains that the "capping" of the land, as required by the EPA, was necessary prior to constructing public roads and walkways on the land, such activities are not "directly related to" the construction of such roads and walkways because Taxpayer was required by the EPA to "cap" the land regardless of the nature of improvements Taxpayer eventually constructed atop the land.

Further, Taxpayer did not provide any evidence that it actually "capped" the land below the public roads and walkways. Indeed, the Statement of Work describing the cleanup measures required by the EPA indicates that "capping" was not necessarily required in those areas of the land where roadways, parking lots, promenades, and concrete walkways were approved as "functional equivalents" to actual capping. For all of these reasons, we conclude that Taxpayer's "capping" of the land was not exempt from retail sales tax under RCW 82.32.050(10) or Rule 171.

3. Mosaic Tile Work

Taxpayer argues that some of the mosaic tile work for which it contracted with an artist was not a retail sale, and, therefore, not subject to retail sales tax. According to Taxpayer, the mosaic tile work had two distinct components – tile design and tile setting – that require different treatments for retail sales tax purposes.

RCW 82.04.050(2) defines a "retail sale" to include:

> [T]he sale of or charge made for tangible personal property consumed and/or for labor and **services rendered in respect to** the following: . . . (b) the **constructing**, repairing, **decorating**, or improving of new or existing **buildings or other structures under, upon, or above real property of or for consumers**, including the installing or attaching

> of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, ...

(Emphasis added). WAC 458-20-170 (Rule 170) provides the following additional definitions:

> (d) The term "building or other structures" means everything artificially built up or composed of parts joined together in some definite manner and attached to real property. It includes not only buildings in the general and ordinary sense, but also . . . **pavements for foot or vehicular traffic**, etc.

(Emphasis added). Taxpayer concedes that the tile setting component of the work was either "constructing" or "decorating," and, therefore, a retail sale. However, Taxpayer maintains that the tile design component should be treated as a separate service activity not subject to retail sales tax. We agree that the mosaic tile work is "constructing" or "decorating" upon Taxpayer's land. Such activity is squarely within the definition of a retail sale under RCW 82.04.050(2). However we disagree with Taxpayer that the tile design service in this case is not also a retail sale.

RCW 82.04.050(2) clearly states that "services rendered in respect to" constructing or decorating is subject to retail sales tax. RCW 82.04.051 states the following:

> As used in RCW 82.04.050, the term "services rendered in respect to" means those services that are directly related to the constructing, building, repairing, improving, and decorating of buildings or other structures and that are performed by a person who is responsible for the performance of the constructing, building, repairing, improving, or decorating activity. The term does not include services such as engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services provided to the consumer of, or person responsible for performing, the constructing, building, repairing, improving, or decorating services.

If a contract involves both an activity that would be subject to service and other activities B&O tax and construction services, then we must also determine if the "predominant activity" involved "service rendered in respect to constructing." As RCW 82.04.051(2) states:

> A contract or agreement under which a person is responsible for both services that would otherwise be subject to tax as a service under RCW 82.04.290(2) and also constructing, building, repairing, improving, or decorating activities that would otherwise be subject to tax under another section of this chapter is subject to the tax that applies to the predominant activity under the contract or agreement.

The term "predominant activity" is not defined in the statute. However, we have previously held that "predominant" is not defined solely in quantitative terms, but also as having "greatest ascendancy, importance, influence, authority, or force." Det. No. 99-011R, 19 WTD 423 (2000).

Here, Taxpayer contracted with the artist to obtain a number of mosaic tile images on walkways on Taxpayer's land. There is no evidence that Taxpayer had separate contracts with the artist for the tile design and the tile setting. Indeed, the artist's invoices have both tile design and tile setting included on the same invoices. We conclude that setting the tiles and completing the

walkways to Taxpayer's satisfaction was the activity with the greatest importance to Taxpayer. While Taxpayer presumably contracted with the artist because of her talent and creativity, it was the end product – the mosaic images installed on the walkways – which Taxpayer ultimately sought.

We conclude that the mosaic tile design work was completed "in respect to" the construction of the mosaic tile images on the walkway, all of which work was apparently combined under one agreement, subjecting the tile design component to retail sales tax along with the tile setting work.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 4th day of June 2014.