

Cite as Det. No. 14-0412, 34 WTD 386 (2015)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 14-0412
)	
...)	Registration No. . . .
)	

[1] RULE 251, RCW 82.04.4291, RCW 82.04.432: B&O TAX – SEWER – CITY. A Washington city that receives compensation from another Washington city for providing sewage treatment may also deduct that income from its own measure of service and other activities B&O tax.

[2] RCW 82.04.050: RETAIL SALES TAX – SELLER’S RESPONSIBILITY. A city that failed to collect retail sales tax or obtain a copy of a reseller’s permit from the buyer was liable for the uncollected 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.

M. Pree, A.L.J. – A Washington city appeals business and occupation (B&O) tax assessed under the services and other activities classification on payments from another Washington city under a joint operating agreement for the costs of operating and expanding a sewer treatment plant. The city also disagrees with the assessment of retail sales tax on the sale of its street sweeper through the Department of Enterprise Services’ surplus program. Because payments derived by a political subdivision of the state of Washington from another political subdivision of the state for the services at issue are deductible, we grant the petition in part. The assessment of retail sales tax is sustained.¹

ISSUES

1. Under RCW 82.04.4291, RCW 82.04.432, and WAC 458-20-251 (Rule 251), may a city deduct payments received from another city under a joint operating agreement for the costs of operating and expanding a sewer treatment plant?
2. Under RCW 82.08.050, was the city liable for retail sales tax on the sale of a street sweeping vehicle through the Department of Enterprise Services’ surplus program?

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

FINDINGS OF FACT

[Taxpayer] is located in Washington, where it operates and maintains a sewage treatment facility under a joint cooperative arrangement with the [City]. The City pays the taxpayer a percentage for the City's share of the costs for operating and expanding the facility under an [interlocal agreement]. The taxpayer did not report or pay taxes on amounts that the City paid the taxpayer for the City's share of the costs. Nor did the taxpayer collect or remit retail sales tax on a street sweeping vehicle sold through the Department of Enterprise Services' surplus program.

The Department's Audit Division reviewed the taxpayer's records for the period from January 1, 2009 through March 31, 2013. On January 8, 2014, the Audit Division issued Document No. . . . and assessed the taxpayer a total of \$. . . in taxes and interest. The taxpayer appealed \$. . . in B&O tax assessed under the service and other activities classification and \$. . . in retail sales tax, plus the interest on the disputed taxes. The taxpayer does not dispute \$. . . in public utility tax assessed on a standby fee for water distribution in case of fire.

With respect to the disputed B&O taxes, the taxpayer provided a copy of an interlocal agreement with the City for the services at issue. According to its terms, the interlocal agreement is "for the primary purpose of providing for the continued treatment and disposal of sanitary sewage generated in the regional area . . . and to provide for the enhancement and expansion of the [facility] to accomplish that purpose."² The taxpayer and the City agreed to share expansion costs proportionate to their capacity right in the facility³ and operation and maintenance costs proportionate to sewage treated. The taxpayer employed the workers and paid the bills to both expand and run the sewage treatment facility, then invoiced the City its proportionate share of the costs. The City did not pay the taxpayer to collect sewage through its lateral system. Our issue pertains to the taxability of money the City paid to the taxpayer for its proportionate share of the costs of both expanding and running the sewage treatment plant under the agreement.

Next, the taxpayer disputes retail sales tax imposed on the sale of a street sweeping vehicle. The taxpayer assigned the vehicle to the Washington State Department of Enterprise Services to sell as surplus. The Department of Enterprise Services sold the sweeper through its on-line auction site and wired \$. . . to the taxpayer. The Department of Enterprise Services did not provide further detail regarding who bought the vehicle, where it was delivered, or whether retail sales tax was charged. The Audit Division assessed retail sales tax against the taxpayer for failure to collect and remit the tax on the sale.

The Audit Division requested information from the taxpayer to show that either retail sales tax was collected and remitted to the Department, or that the buyer paid use tax when the vehicle was licensed. The Audit Division also asked the taxpayer for records showing that the sale was exempt from Washington's retail sales tax (e.g., the vehicle was delivered to a nonresident buyer outside of Washington). The taxpayer was unable to identify the buyer or provide any documents of the sale.

² . . .
³ . . .

We checked the Department of Enterprise Services' web site, which provides the terms and conditions regarding the state's responsibility on sales of surplus property. The payment sections provide:

Sales tax on vehicles is paid when the title is transferred at your local licensing agency. Sales tax of 8.7% will be charged to Washington state residents on non-title items. A copy of your resellers permit must be supplied for all Washington State businesses who wish to qualify for a tax exemption.

State of Washington DES Surplus Operations Terms and Conditions available at <http://www.publicsurplus.com/sms/docviewer/aucterms?auc=1110570> (last visited June 17, 2014).

The Audit Division checked the registration for the sweeper, which showed that the sweeper was still registered in the taxpayer's name. The taxpayer had not provided further information to substantiate that title was transferred to any buyer and that sales tax was collected.

ANALYSIS

The B&O tax is imposed on every person "for the act or privilege of engaging in business activities" and applies to the "gross income of the business." RCW 82.04.220. The "legislature intended to impose the business and occupation tax upon virtually all business activities carried on within the state." *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000). As a result, unless an exemption or deduction applies, a taxpayer owes B&O tax on all income received for the rendition of services, including services related to construction and operation of sewage treatment facilities. *See City of Kennewick v. Washington*, 67 Wn.2d 589, 409 P.2d 138 (1966) (the court held that a city rendering a sewer service was subject to B&O tax on its fees that were used to pay interest on bonds and to redeem bonds issued to finance capital construction of sewer facilities). Under RCW 82.04.080, "gross income of the business" means:

[T]he value proceeding or accruing *by reason of the transaction of the business engaged in* and includes gross proceeds of sales, *compensation for the rendition of services*, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

(Emphasis added.)

RCW 82.04.432 provides a deduction from the B&O tax measure for amounts paid by municipal sewerage utilities and other public corporations to any other municipal corporation or governmental agency for sewage interception, treatment, or disposal. *See* Rule 251(5). Thus, in such cases the service and other activities B&O tax on sewer services does not have a pyramiding effect, [with two cities paying B&O tax on what is effectively the same income for providing sewage treatment services..] *Id.*

In addition, RCW 82.04.4291 provides a deduction for compensation for services between political subdivisions of Washington: “In computing tax there may be deducted from the measure of tax amounts derived by a political subdivision of the state of Washington from another political subdivision of the state of Washington as compensation for services which are within the purview of RCW 82.04.290.”

In our case, the Audit Division assessed the B&O tax at issue under the service and other activities classification within the purview of RCW 82.04.290, which imposes B&O tax in subsection (2):

(a) Upon every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under another section in this chapter or subsection (1) or (3) of this section; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of 1.5 percent.

Thus, the local government entity that receives compensation from another local government entity for providing sewage interception, treatment, or disposal for that other government entity may also deduct the income from its own measure of service and other activities B&O tax, provided this amount has been included in the gross amount reported on the combined excise tax return. Rule 251(5). In such a case, neither entity pays tax on the amounts represented by the payments made for sewage interception, treatment, or disposal. *Id.*

Both the taxpayer and the City are cities in Washington. While RCW 82.04.4291 does not define “political subdivision,” in an executive level determination, we held that that the amounts a city received from a county health department were deductible under RCW 82.04.4291. Det. No. 98-033E, 17 WTD 402, 413 (1998). We analyzed an Attorney General’s Office opinion, AGLO 1975 No. 97, and concluded that for the purpose of RCW 82.04.4291, cities were political subdivisions.⁴

In Det. No. 00-025, 19 WTD 937, 940 (2000), we did not allow a city a deduction under RCW 82.04.4291 for the operating and maintenance costs of a sewage treatment plant paid by an Idaho city because that city was not in Washington. In this case, both the taxpayer and the City are Washington cities, and political subdivisions of the state of Washington.⁵

⁴ The AGLO addressed RCW 82.04.430(10), an earlier codification of the present RCW 82.04.4291.

⁵ “Political subdivision” is a concept that is defined differently in at least a half dozen Washington statutes, but consistently includes cities as political subdivisions of the state: RCW 39.34.020(1); RCW 38.52.010; RCW 42.30.020(1)(b); RCW 43.160.020, RCW 43.250.020; RCW 80.50.300. RCW 43.250.020 defines political subdivision to mean any county, city, town, municipal corporation, political subdivision, or special purpose taxing district. Under RCW 38.52.010, “Political subdivision” means any county, city or town. RCW 43.160.020 defines “political subdivision” to mean any port district, county, city, town, special purpose district, and any other municipal corporations or quasi-municipal corporations in the state providing for public facilities under that chapter. Under RCW 80.50.300(4), “political subdivision or subdivisions of the state” means a city, town, county, public utility district, port district, or joint operating agency.

Washington courts also consider cities to be political subdivisions of the state. *See City of Seattle v. Williams*, 128 Wn.2d 341, 358, 908 P.2d 359, 367 (1995); *King County Water Dist. No. 54 v. King County Boundary Review Bd.* 87 Wn.2d 536, 540, 554 P.2d 1060, 1063 (1976); *City of Mountlake Terrace v. Wilson*, 15 Wn. App. 392, 394, 549

Subsection (5) of Rule 251 provides an on-point example:

For example, Washington Municipality A operates a sewerage collection business. Rather than invest in its own treatment facilities, it contracts with Washington Municipality B to provide sewage transfer, treatment, and disposal services to Municipality A. . . . Municipality A pays public utility tax on its gross receipts from the sewerage collection business. Municipality A also pays service and other activities B&O tax on income derived from that portion of sewage transfer that it undertakes to move the waste to Municipality B for further transfer, treatment, and disposal by Municipality B. However, Municipality A may deduct from its gross income subject to service and other activities B&O tax the amount of any payments made to Municipality B for sewage transfer, treatment, or disposal services provided by Municipality B. In addition, pursuant to RCW 82.04.4291, *Municipality B may deduct from its gross income subject to service and other activities B&O tax the amount of the payments received from Municipality A.*

(Emphasis added.)

The example in Rule 251(5) matches our issue, and addresses it. The payments from the city to the taxpayer were assessed B&O tax under the service and other activities classification within the purview of RCW 82.04.290. We conclude that under RCW 82.04.4291, the payments at issue from the city to the taxpayer were deductible under RCW 82.04.4291.

Next, the taxpayer disputes the assessment of sales tax on its sale of a street sweeper vehicle. RCW 82.08.020 imposes a tax on each retail sale. RCW 82.04.250 imposes a retailing B&O tax on retail sales. RCW 82.04.050(1)(a) includes the sale of tangible personal property, such as street sweepers, in the definition of retail sale.

RCW 82.08.050(1) requires sellers to collect retail sales tax from buyers.⁶ RCW 82.08.050(3) provides that sellers who fail to collect the tax, or having collected the tax, fail to pay it to the Department, are personally liable to the Department for the amount of the tax. The sale of a street sweeper is the sale of tangible personal property and is subject to retail sales tax. If the seller fails to collect retail sales tax from the buyer, the seller is nevertheless responsible for remitting the retail sales tax to the Department.

The Department has determined that holding sellers liable for retail sales tax is the expressed legislative intent of RCW 82.08.050 because, “the best interests of the state require that sellers be held personally liable for the amount of the tax.” Det. No. 05-0059, 24 WTD 430 (2005). We consistently recognize the seller’s responsibility for the tax. *Id.* at 431 (citing prior determinations).

P.2d 497, 498-99 (1976). To be consistent with this authority, we conclude that for the purpose of RCW 82.04.4291, cities are political subdivisions of the state.

⁶ . . .

In this case, the taxpayer failed to collect the tax or obtain a copy of a reseller's permit from the buyers. We conclude that Audit was within its authority to proceed against the taxpayer for uncollected retail sales tax in this circumstance.

DECISION AND DISPOSITION

We grant the taxpayer's petition in part and deny it in part. B&O tax assessed under the service and other activities classification on Schedule 2 of the assessment for income the taxpayer received from City to expand and run its sewage treatment facility will be cancelled. We uphold the other taxes assessed.

Dated this 24th day of December 2014.