Cite as Det No. 10-0017, 29 WTD 65 (2010)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund	)	D E T E R M I N A T I O N
	)	
	)	No. 10-0017
. . .	)	
	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .
	)	

RULE 13601; RCW 82.08.02565: EXEMPTIONS -- SALES OF MACHINERY AND EQUIPMENT -- DEMOLITION AND EXCAVATION COSTS. A demolition and excavation contract for the removal of a facility foundation, after obsolete equipment is removed and before new equipment is installed, is not a contract for services "rendered in respect to installing" "qualifying machinery and equipment" for purposes of the M&E exemption provided for in RCW 82.08.02565.

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.

Weaver, A.L.J. – Taxpayer appeals the assessment of [deferred sales] tax on a contract for demolition and excavation work performed at a manufacturing facility. The demolition and excavation work was for the removal of foundations in the facility after obsolete milling equipment was removed and before new milling equipment was installed. The Department holds that the demolition and excavation contract is to be evaluated independently from the contracts for other activities related to the removal and installation project. The Department further holds that the demolition and excavation work performed does not constitute "installation" of qualifying machinery and equipment and is therefore not subject to a retail sales tax exemption. Taxpayer's appeal is denied.[1]

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

ISSUE

Whether demolition [and] excavation . . . qualifies for the machinery and equipment (M&E) exemption under RCW 82.08.02565, RCW 82.12.02565 and WAC 458-20-13601.

FINDINGS OF FACT

Taxpayer . . . was audited for the period January 1, 2002, through December 31, 2003. On December 26, 2008, the Audit Division of the Department of Revenue issued an assessment against Taxpayer . . . . Taxpayer has paid the assessment in full and petitions for a refund for the payment of deferred retail sales tax assessed on the labor and services provided on a contract for certain demolition and excavation services performed at Taxpayer's facilities. . . .

In 2006, Taxpayer decided to surplus [some] milling machines . . . . The . . . milling machines had been in service for [a number of] years and represented old and outdated . . . technology . . . . The . . . mills were replaced by [improved] mills …. The new mills, installed in a single area, would replace the older mills located at various locations throughout [Taxpayer's] building.

The new mills, because of their larger size and weight and [increased processing] ability . . . require a more robust foundation than the old machines to support their greater weight and to dampen vibrations. The process of [replacing] the old mills required four steps: 1) Remove the old …mills, 2) demolish and excavate the site, 3) set the forms, run utilities, pour and finish the concrete, and 4) install the new mills. This appeal concerns step 2. . . .

Because time was of the essence, as soon as the design and engineering work was completed on the demolition/excavation phase of the project, a contract for the demolition and excavation work was put out to bid. Likewise, when the design and engineering work on the form and concrete work was finished, a contract for that work was separately put out to bid. One vendor won the demolition/excavation contract. A second vendor, unaffiliated with the vendor performing the demolition and excavation work, won the contract for the form/concrete work.

... The demolition and excavation portion of the project was given contract # . . . and the form and concrete portion was given contract # . . . . The Audit Division's worksheet delineates these jobs as Control # A-09 and Control # A-10.

At audit, the Audit Division assessed tax on the demolition/excavation contract (Control # A-09). . . . The vendor received $. . . for the work performed under the Control # A-09 contract, $. . . of which was paid by Taxpayer during the audit period in this appeal. Taxpayer appeals the assessment of tax on these payments under the Control # A-09 contract.

ANALYSIS

The purchase and use by a manufacturer of machinery and equipment used directly in a qualifying manufacturing operation is exempt from sales and use tax. RCW 82.08.02565. During the audit period, that statute read as follows:

> The tax levied by RCW 82.08.020 shall not apply to sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation . . . or to sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving the machinery and equipment . . . .

RCW 82.08.02565 (1999). There is a corresponding statutory exemption from use tax. *See* RCW 82.12.02565. The M&E exemption, like all tax exemptions in Washington, is strictly construed in favor of application of the tax and against the person claiming the exemption. *See, e.g.*, Det. No. 01-007, 20 WTD 214 (2001). The burden of proof is upon the one claiming the exemption. *See, e.g., Budget Rent-A-Car, Inc. v. Dep't. of Revenue*, 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972); *All-State Constr. Co. v. Gordon*, 70 Wn.2d 657, 425 P.2d 16 (1967); *Yakima Fruit Growers Ass'n v. Henneford*, 187 Wash. 252, 258, 60 P.2d 62 (1936). In this case, Taxpayer argues that the demolition and excavation performed under the Control # A-09 contract constitutes the "installation" of qualified machinery and equipment, and is therefore subject to the M&E exemption.

. . . [T]he Audit Division assessed deferred retail sales tax on the charges made under the demolition and excavation contract (Control # A-09), finding that the demolition and excavation work did not constitute "installation" of M&E. Taxpayer disagrees with this distinction.

Taxpayer's first argument is that the demolition and excavation contract (Control # A-09) was one stage of a broader project to remove old milling machines and install new ones. As such, Taxpayer asserts that the Department should consider the project as a "single activity" before applying the M&E exemption.

The Department has repeatedly addressed the issue of when it is appropriate to segregate or bifurcate activities contained in a single contract for tax purposes. *See, e.g.*, Det. No. 98-012, 17 WTD 247 (1998); Det No. 89-433A, 11 WTD 313 (1992); *see also* Rule 170(1)(e). But we could not find, and Taxpayer did not cite, any direct authority relating to the issue of whether separately bid contracts to unrelated vendors should be "consolidated" under one project heading for purposes of applying the M&E exemption. While the Department has not addressed this particular issue directly, the Washington Supreme Court decision in *Chicago Bridge and Iron*, is instructive. *Chicago Bridge and Iron, Co. v. Dep't of Revenue*, 98 Wn.2d 814, 659 P.2d 463, *appeal dismissed*, 464 U.S. 1013 (1983).

In *Chicago Bridge and Iron*, the Court held that if services subject to separate contracts are functionally integrated, then the entire contract price is subject to tax at a single rate for purposes of subjecting the entire contract price to Washington B&O tax. *Id*. at 822-23, 659 P.2d at 468-

69. However, the contracts in question in *Chicago Bridge and Iron* were between the taxpayer and one specific vendor. *Id*. at 822, 659 P.2d at 468. In its decision affirming the assessment of tax, the Court, in *Chicago Bridge*, further held that "a company's internal accounting techniques are not binding on a state for tax purposes." *Id*. at 823, 659 P.2d at 469 (citing *Exxon Co. v. Dep't of Revenue*, 447 U.S. 207 (1980)).

In this case, the form/concrete contract (Control # A-10) and the demolition and excavation contract (Control # A-09) were separately bid, were separately executed, and the work was performed under those contracts by two unrelated vendors. Taxpayer takes the position that the entire project is an integrated job and cites its internal project code. Under the authority in *Chicago Bridge and Iron*, the Department finds that Taxpayer's internal project code is not determinative. The work performed under the demolition and excavation contract (Control # A-09) was separately billed, separately executed, and performed by the vendor who won the bid for that particular contract. Therefore, the demolition and excavation performed under the Control # A-09 contract should be considered independently for purposes of applying the M&E exemption.

Taxpayer argues that, even if the work done under the demolition and excavation contract (Control # A-09) is considered separately, it is still subject to the M&E exemption. Taxpayer takes the position that the demolition and excavation work constitutes "services rendered . . . with respect to installing . . . machinery and equipment." RCW 82.08.02565. With respect to the "machinery and equipment" in question, Taxpayer makes alternative arguments. Taxpayer first argues that qualifying machinery and equipment is the new . . . machines. Taxpayer also takes the position that the foundation laid beneath the . . . machines can be considered either an "industrial fixture" or "support facility" which are defined as qualifying "machinery and equipment." *See* Rule 13601(6).

WAC 458-20-13601 (Rule 13601) provides the following guidance:

> (4) **Sales and use tax exemption**. The M&E exemption provides a retail sales and use tax exemption for machinery and equipment used directly in a manufacturing operation or research and development operation. Sales of or charges made for labor and services rendered in respect to installing, repairing, cleaning, altering, or improving qualifying machinery and equipment are also exempt from sales tax.

Rule 13601(4) (2000). The term "installing" is not defined in either RCW 82.08.02565 or in Rule 13601. When statutory terms are not defined, the Department turns to their "ordinary dictionary meaning." *Western Telepage, Inc. v. City of Tacoma*, 140 Wn.2d 599, 609, 998 P.2d 884 (2000). Webster's Third New International Dictionary defines the word "install" as "**3 :** to set up for use or service." WEBSTER'S THIRD NEW INTERATIONAL DICTIONARY 1170 (1993). The determinative question on this appeal is whether the demolition and excavation work performed under Control # A-09 can be considered "installation" of qualifying M&E.

According to the Audit Division, the demolition and excavation work performed under contract Control # A-09 was for the "removal of foundations" and that other contractors were engaged to pour the new foundations for the milling machines, supply the milling machines, and install the

milling machines. Given the nature of the work performed, the Department finds that the demolition and excavation work performed under the Control # A-09 was not undertaken to "set up" the milling machines "for use or service."[2] Audit's assessment of deferred retail sales tax on the work performed under the Control # A-09 contract is hereby affirmed.

DECISION AND DISPOSITION

Taxpayer's appeal is denied.

Dated this 16th day of February, 2010.

[2] Because the Department holds that the demolition and excavation work does not constitute "installation" as a matter of law, the Department hereby declines to address whether the actual M&E in question was the milling machines or the foundation laid beneath the milling machines.