Cite as Det. No. 00-122, 20 WTD 461 (2001)

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. 00-122
. . .	)	Registration No. . . .
	)	Use Tax Assessment

[1] WAC 458-61-335; RCW 82.45.032: REAL ESTATE EXCISE TAX (REET) -- EASEMENT. An easement interest is a real property interest for real estate excise tax (REET) purposes.

[2] WAC 458-61-335; RCW 82.45.032: REAL ESTATE EXCISE TAX (REET) -- FIXTURES. RCW 82.45.032(1) classifies as real property, for REET purposes, anything that would be a fixture at common law if affixed to land by the land owner.

[3] WAC 458-61-335; RCW 82.45.032: REAL ESTATE EXCISE TAX (REET) -- UTILITY EASEMENT -- FIXTURES. For REET purposes, fiber optic cable and other underground improvements in utility easements are considered to be real estate of the company owning them during the life of the easement.

[4] WAC 458-61-335; RCW 82.08.020; RCW 82.45.032, -.010, -.060: RETAIL SALES TAX -- REAL ESTATE EXCISE TAX (REET) -- UTILITY EASEMENT -- BURIED TRANSMISSION LINE. A buried telecommunications transmission line, located in easements, is not subject to retail sales tax when sold by one telecommunications service provider to another. Rather, the real estate excise tax (REET) applies to the sale by a telecommunications company of an easement and property annexed to the easement that the company owns during the life of the easement.

[5] WAC 458-12-010: EASEMENTS OF PUBLIC SERVICE CORPORATIONS -- PROPERTY TAX -- EXCISE TAX. The property tax treatment of easements of public service corporations does not control excise tax treatment of the sale of such easements.

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.

NATURE OF ACTION:

The owner of a buried fiber-optic cable network used to transmit telecommunications signals for hire requests cancellation of use tax assessment on the cable, contending the cable is not tangible personal property, but rather a fixture, and therefore not subject to retail sales tax or use tax.[1]

FACTS:

Prusia, A.L.J. -- The taxpayer is a [foreign] corporation engaging in business activities in Washington. In November 1998, the taxpayer purchased assets of [Seller]. At the time of sale, [seller] was the subject of proceedings pursuant to . . . the U.S. Bankruptcy Code. . . . The purchased assets consisted almost entirely of an existing fiber optic cable network running from [outside Washington], to [a city] Washington, including the easements and rights of way through which the network runs. The taxpayer uses the fiber optic network to transmit telecommunications signals for hire. The taxpayer did not pay retail sales tax on the purchase of the [Seller] assets. We inquired of the taxpayer whether [Seller] paid Washington real estate excise tax (REET) on the sale of the assets, but the taxpayer was unable to obtain that information. The Department is unable to find any record that REET was paid.[[2]]

On April 27, 1999, the Compliance Division of the Department of Revenue ("Department") assessed the taxpayer use taxes totaling $. . . on "Fiber Optic Cable" purchased from [Seller].[3] The assessment is based on a value of $. . . . The assessment additionally imposed a 20% delinquency penalty of $. . . . The assessment remains unpaid.

The taxpayer petitioned for cancellation of the assessment in its entirety. The petition states: "We believe the [Department] improperly classified the underground fiber optic cable, which was the subject of the assessment, as personal property. In accordance with Washington law, the buried cable is considered real property. As such, it is not within the scope of the use tax." The petition cites *Western Ag Land Partners et al. v. Dept. of Revenue*, 43 Wn. App. 167, 716 P.2d 310 (1986); Excise Tax Advisory 238.08.12.130 (ETA 238); *Corvin v. Cook*, BTA Docket No. 29506 (1986); and *Lincoln Ballinger*, BTA Docket No. 51253 (1998), in support of its position.

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

[[2] The fact that we find no evidence of the payment of REET does not necessarily mean that the transaction was not subject to REET. If the property were in fact a fixture subject to REET, and its sale was ordered as a result of a confirmed Chapter 11 plan in bankruptcy, the transaction would have been exempt from REET. It would not have been exempt if consummated prior to confirmation. WAC 458-61-230.]

[3] The assessed taxes consisted of state use tax of $. . ., local use tax of $. . ., and regional transit authority tax in the amount $. . . .

The Department contends the fiber optic cable is tangible personal property and subject to retail sales tax and use tax. The Department argues as follows. Under Washington property tax statutes, specifically RCW 84.12.280 and RCW 84.20.010, any property contained in an easement owned by a public service company is specifically classified as personal property. The property tax statutes may be relied upon to define property for excise tax purposes. Under common law, fiber optic cable does not meet the definition of a fixture.

The cable system consists of a . . .-strand fiber optic cable, with hub facilities [outside Washington] and [in Washington], points of presence at [several Washington cities], and manholes along the route. The cable runs through conduit, which is buried for most of the route. The cable system is almost entirely located in easements and rights of way granted . . . and by . . . U.S. cities and counties. Because the cable is in conduit, the taxpayer can remove the cable to repair it, accessing the cable through the manholes. The taxpayer anticipates leaving the fiber optic cable in place for its entire useful life, and intends to abandon it at the end of its useful life.

The nature of the use of the surface under which the cable is buried is railroad tracks, for approximately 80% of the route in the U.S., and public highways and streets for most of the remaining 20%.

The taxpayer has provided us with summaries of three of the right-of-way agreements entered into by its predecessor, [Seller] -- agreements with [grantor A], the [grantor B], and [grantor C]. The [grantor A] agreement is for 20 years with two 10-year renewal periods at the grantee's option. The agreement provides for annual fee payments. Entry by the grantee requires 10 days' notice except for routine maintenance and emergencies. The agreement provides that [grantor A] can require the grantee to change the location of the cable whenever [grantor A] determines it needs to relocate or place . . . improvements. The [grantor B] agreement is for a term of five years plus unlimited 5-year automatic renewal periods. It provides a one-time fee of $. . . . The third agreement, with [grantor C], is for as long as the easement is used for telecom purposes. The summary mentions no fee. None of the three summaries indicates whether the grantee may or must remove the cable system when the easement expires. The Department has provided a copy of the actual easement agreement between [grantor C] and [Seller]. It provides, in part:

> Grantor, for and in consideration of the payment of [$. . .], . . . hereby grants to Grantee an easement on a right of way ten (10) feet in width and approximately four hundred and twenty (420) feet long to construct, operate, maintain, replace and remove a buried fiber optic communications cable hereinafter referred to as the "Line," under and across the east 10 feet of the following . . . .

The [grantor C] agreement also provides that the grantor "acknowledges that Grantee has pledged its fiber optic cable system as security for project financing." The taxpayer's predecessor, [Seller], used the fiber optic cable as collateral in financing the construction of the cable system, in several Uniform Commercial Code financing statements (UCC-1 financing statements). The financing statements apply to specific fibers or "strands" within and comprising part of the fiber-optic cable system.

At hearing, the taxpayer raised additional issues, concerning the value upon which the assessment is based. It stated 32.2% of the purchased assets were located [outside Washington], and 67.7% in Washington. It stated the $. . . purchase price included $. . . to $. . . in assets other than fiber optic cable. It contended the assessment should be adjusted to reflect these facts.

The purchase agreement between the taxpayer and [Seller] is unclear as to the total purchase price paid. In a letter dated April 21, 1999, the taxpayer stated it had purchased assets from [Seller] "totaling $. . . . This basically consisted of a Fiber Optic cable running between [outside Washington] and [Washington]." However, the taxpayer's petition states: "Most of the purchase price was allocated to the fixed assets. Of this amount, $. . . represented the value of fixtures upon real property in the form of buried fiber optic cable."

The purchase agreement includes a schedule allocating the purchase price 32.2% to [foreign] assets and 67.7% to U.S. assets. The same schedule allocates $1 . . . of the purchase price to rights of way in the U.S. Another schedule lists the fixed assets included in the purchase. The assets include the . . .-strand fiber optics cable and all manholes along the route, numerous assets located in the hubs and points of presence along the route (such as air conditioning systems, fire suppression systems, power plants, panels, microwave systems, computers, and switches), test equipment, office equipment, and conduits in [outside Washington].

ISSUES:

1. Is a buried telecommunications transmission line, located in easements, subject to retail sales tax (or use tax if retail sales tax is not paid) when sold by one telecommunications service provider to another?

2. Does the assessment overstate the value of the articles upon which the assessment is based?

DISCUSSION:

This appeal involves a telecommunications transmission line that an easement grantee constructed in the easement for the purpose of conducting its business, and whether the easement grantee's sale of the system constituted the transfer of tangible personal property, rather than real property, for use tax purposes.

We first note that the assessment is on "Fiber Optic Cable," but is based upon a value that represents the purchase price of the entire transmission system, $. . . . That price includes easement rights, manholes, conduit, strands of fiber optic cable, various structures, and equipment for operating the line. For purposes of this appeal, we will treat the assessment as applying to the entire purchase. That treatment is consistent with the taxpayer's description of the basic nature of its purchase in its April 21, 1997 letter.

Neither the use tax statutes nor Department rules define "tangible personal property" for use tax purposes. The Department relied upon definitions and tax treatment provided in ad valorem property tax statutes and rules, Chapter 84.04 RCW and Chapter 458-12 WAC. We believe the statutes and rules relating to the real estate excise tax (REET) provide a more appropriate basis for classifying the assets purchased. The issue is what tax was appropriate to the sale, not what tax is appropriate for property tax assessment purposes.

Pursuant to Chapter 82.45 RCW, the real estate excise tax (REET) applies to the sale of real estate. The seller of the real property is responsible for filing the required REET affidavit and for paying REET. When the seller has not paid the tax by the due date and has not recorded evidence of the sale in the official records of the county in which the property is conveyed, and neither the buyer nor the seller has notified the Department of the sale within thirty days of the sale, the buyer is also liable for the tax. RCW 82.45.100(3). If a portion of the selling price is attributable to tangible personal property, the personal property transferred is subject to use tax under Chapter 82.12 RCW. The purchaser is responsible for paying the use tax. If the sale of property is the sale of real property and subject to REET, the purchaser does not owe use tax upon its use. *See* Det. No. 89-055, 7 WTD 151 (1989).

The term "real property" is defined for REET purposes, as follows, in RCW 82.45.032(1):

> "Real estate" or "real property" means any interest, estate, or beneficial interest in land or anything affixed to land, including the ownership interest or beneficial interest in any entity which itself owns land or anything affixed to land. The term includes used mobile homes, used floating homes, and improvements constructed upon leased land.

See also, WAC 458-61-030 (definitions) and WAC 458-61-430.[4]

[1] An easement is an incorporeal right or interest in another's property. *Perrin v. Derbyshire Scenic Acres Water Corp.*, 63 Wn.2d 716, 388 P.2d 949 (1964). It is an interest in land, although not an estate in land. *Bakke v. Columbia Valley Lumber Co.*, 49 Wn.2d 165, 298 P.2d 849 (1956); *Orniston v. Boast*, 68 Wn.2d 538, 413 P.2d 969 (1966); *Veach v. Culp*, 92 Wn.2d 570, 599 P.2d 526 (1979).[5] Thus, an easement interest is a real property interest for REET purposes.

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[4] The latter provides, *inter alia*, that the sale of an improvement constructed on real property is subject to REET if the contract of sale does not require that improvements be removed at the time of sale.

[5] A public utility easement is a classic easement "in gross." It directly benefits an individual or entity and is not tied to a specific beneficial tract of land. *See Winsten v. Prichard*, 23 Wn. App. 428, 597 P.2d 415 (1979). At common law, easements in gross were not alienable, except easements that required practically exclusive possession of the land and, for that reason, were akin to possessory estates, such as easements for railroad rights of way, pipe line purposes, and burial rights. Wm. E. Burby, HANDBOOK Of THE LAW OF REAL PROPERTY, Third Edition (1965), at 67-68. Easements in gross of a commercial character also generally are alienable. Powell & Rohan, POWELL ON REAL PROPERTY § 418 (1984); Annot., 10 A.L.R.3d 960 (1966).

Under the RCW 82.45.032(1) definition, "anything affixed to land" also is real property for REET purposes. The telecommunications line the taxpayer purchased is "anything," and if it is "affixed to land," it falls within the statute's definition of "real property." Chapter 82.45 does not define the term "affixed," nor is the term defined in the REET administrative rules, Chapter 458-61 WAC.

[2] The term "affixed" connotes the common law concept of "fixture," and we believe RCW 82.45.032(1) intends by its use, to classify as real property for REET purposes, anything that would be a fixture at common law if affixed to land by the land owner. Generally, "[g]oods are fixtures when they become so related to the particular real estate that an interest in them arises under real estate law." *Black's Law Dictionary* 638 (6th ed. 1990). "Fixture" necessarily implies something having possible existence apart from realty, but which may by annexation be assimilated into realty. *Gaspee Cab v. McGovern*, 51 R.I. 247, 153 A. 870 (1931). Because fixtures are a species of property which are the dividing line between real and personal property, "to decide on which side of the line certain property belongs is often a vexatious question." *Ottumwa Woolen Mill Co. v. Hawley*, 44 Iowa 57 (1876). Fixtures belong in the "twilight zone between things real and things personal." *Frost v. Schinkel*, 121 Neb. 784, 238 N.W. 659 (1931).

The courts in Washington have adopted a three-part common law test for determining whether an item is a fixture or personal property. The test is set out and described as follows in *Western Ag supra at 171-172*:

> According to the common law, whether an item is a fixture or personal property turns upon the application of three general tests, all of which must be satisfied:
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> > (1) Actual annexation to the realty, or something appurtenant thereto; (2) application to the use or purpose to which that part of the realty with which it is connected is appropriated; and (3) the intention of the party making the annexation to make a permanent accession to the freehold.
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> [*Department of Rev. v. Boeing Co.*, 85 Wn.2d 663, 667, 538 P.2d 505 (1975)]; (other citations omitted).
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> . . .
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> The first prong, annexation, is often considered in light of the actual relationship of the object to the realty--whether the article is "in use as an essential part" of the overall use of the property. *See Courtright Cattle Co. v. Dolsen Co.*, 94 Wn.2d 645, 675, 619 P.2d 344 (1980); 5 R. Powell & P. Rohan, *Real Property* § 660, at 96.4 (1984 & Supp. 1985). Furthermore, a fixture may be constructively annexed to the real property. Even though the article may not be physically attached to the realty, it may be constructively annexed because it is specifically fabricated for installation or because it is a necessary functioning part of or accessory to an object which is a fixture. (Citations omitted).

. . .

Intention is the most important of the three factors and is determined

> From the circumstances surrounding the annexation, including the nature of the article affixed, the annexor's situation in relation to the freehold, the manner of annexation, and the purpose for which it is made. The test is objective rather than subjective intent.

If the telecommunications transmission line that is the subject of this proceeding had been laid by the owner of the freehold, would it be classified as a fixture under the common law? Regarding the first common law prong, the conduit, manholes, and other structures that make up the line are firmly affixed to the soil. The strands of cable, on the other hand, are attached to the conduit, and are removable. This raises the question whether the strands of cable satisfy the first prong, or should be treated separately from the conduit and other items that clearly are annexed to the soil. We believe the better argument is that the cable also is sufficiently annexed to the real property to satisfy the first prong. The cable is specifically fabricated for burial in underground conduit, and is a necessary functioning part of the underground transmission system. We find persuasive the reasoning of the California Court of Appeals in *Chula Vista Electric Co. v. State Board of Equalization*, 125 Cal. Rptr. 827, 830 (Cal. Ct. App. 1975), where the court stated:

> The electrical transmission line as a whole is a structure which is part of the real property. [Citations omitted.] If the cable installed by taxpayer is necessary to the transmission line and so firmly attached to the structure as to become part of it, the cable is then a fixture within the meaning of title 18, section 1615 of the Administrative Code.
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> Unquestionably, the cable is necessary to the transmission line as a whole. The line will not operate without it. There remains only the question whether the cable is so attached to the conduit structure as to be a fixture. In the context of the law of fixtures, attachment to the realty is a concept broader than physical annexation. Adaptation to use with the real property and the intention with which the property is installed [citations omitted] must be considered as well as physical annexation.

The second prong, application to the use or purpose to which that part of the realty with which it is connected is appropriated, clearly is met. The conduit, manholes, and cable lie in parts of the realty dedicated to use for telecommunications transmission lines. All have particular application to that use.

The third prong, intention to make a permanent accession to the land, is to be based upon objective factors surrounding the annexation, including the nature of the article affixed, the annexor's situation in relation to the freehold, the manner of annexation, and the purpose for which it is made. In this case, the transmission line as a whole is rather permanent in nature. The taxpayer's statement that it intends to leave the entire line in place when it is no longer useful to the taxpayer

likely reflects the intent of the original annexor. The line is not essential to the principal use of the land surfaces, but to the extent it is laid along railroad and highway routes (which it is for the most part), the line is an essential part of the customary use of such lands beyond vehicle travel. Railroad routes and highways are customarily used for utility transmission easements because they usually provide the straightest or easiest route between distant locations, and allow utility companies to minimize the number of easements they must obtain. We note that "accession" means "[t]he addition to or increase in value of property by means of improvements or natural growth." *Webster's II New College Dictionary*, page 6 (1995). The transmission line improvements increase the value of the easement and, to the extent they are permanent, the value of the freehold. The taxpayer did not pay millions of dollars for bare rights of way. Upon termination of the easement for any reason, the conduit and other components improve the revenue potential of the land for the owner of the fee. We find the annexor intended to enrich both its real property interest and the freehold when it installed the line.

The difficulty in this case lies in the fact that the line was not installed by the owner of the freehold, but by the owner of an easement. The annexor's situation in relation to the freehold is an important objective factor to be considered in determining the annexor's intent, and on the basis of this factor the Department concluded there was no intent to make a permanent accession to the land. The Department reasoned that the annexor had an interest in the property that was similar to a tenant's leasehold interest, and, on the basis of the common law of "trade fixtures," concluded the annexor had no intention of permanently enriching the freehold. The Department relied upon Det. No. 91-317, 12 WTD 51 (1993), in which the Department, interpreting Washington case law, held that when the relationship between an annexor and the freehold owner at the time of annexation is one of landlord-tenant, equipment installed by the annexor is presumed to remain the annexor's tangible personal property, and is subject to retail sales tax upon sale by the tenant to a purchaser.

The doctrine of trade fixtures is not applicable to the facts of this case. Trade fixtures is a concept "which is peculiar to the landlord-tenant relationship," and "refers to the machinery or equipment of any commercial or industrial business which operates on leased land or in rented quarters." WAC 458-12-005(9). The relationship between the freehold owners and the annexor in the present case is not that of landlord-tenant. Moreover, the doctrine of trade fixtures also is generally limited to machinery and equipment. To the extent annexations are improvements on leased property or otherwise not machinery or equipment, they are not subject to the doctrine. Indeed, under the REET statutes, REET applies to the transfer of leasehold improvements when the lessee owns the improvements. *See Washington Mutual Savings Bank v. Dept. of Revenue*, 77 Wn. App. 669, 893 P.2d 654 (1995).

[3] There is another concept that is applicable to, and peculiar to, the treatment of underground improvements in easements. Historically, conduit, pipes, and other components of a utility system running through an easement have been considered both part of the fee and, for purposes of taxation, part of the real estate of the company owning them during the life of the easement. This concept is discussed at length in *Inhabitants of Paris v. Norway Water Company*, 127 A. 143, 144-145 (1893), as follows:

> The proper classification, under the rules of the common law, of this species of property, is not a new question. It has been many times considered in England during the last century. And water-mains and underground conduits have there been considered as fixed to, included in, and a part of the soil. They have been considered real estate, and have uniformly been held locally taxable as such to the "occupiers of lands," under the statute of 43 Eliz., or as our statute puts it, "to the person in possession thereof." *King v. Bath,* 14 East 609; *King v. Rochdale Water Works,* 1 M. & S. 634; *King v. Gas Light & Coke Co.* 5 B. & C. 466.
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> . . .
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> The city of Providence laid a tax on the pipes of the Gas Company in the streets, as real estate, under a statute authorizing such a tax against those "who hold or occupy the same," and it was held a valid tax like those laid under the statute of Elizabeth. *Providence Gas. Co. v. Thurber*, 2 R.I. 15.
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> So a pipe line, laid through the soil of New Jersey, under grants from the owners of the fee, is not only real estate when considered as part of the fee, but is held, for the purposes of taxation, to be real estate of the company owning it, under a statute defining real estate as including all lands and all buildings or erections thereon or affixed thereto. *Pipe Line v. Berry*, 52 N.J.L. 308.

[4] The REET statute reflects this historical treatment of pipes, conduits, and other installations in utility easements. It expressly includes in the definition of "real property" any interest in land and anything affixed to any interest in land. Thus, the REET applies to the sale by a telecommunications company of an easement as well as property annexed to the easement that the company owns during the life of the easement. It follows that the sale of the transmission line by [Seller] to the taxpayer was subject to REET, and the taxpayer's use of the line was not subject to Washington use tax**.**

[5] We find the Department's reliance upon property tax statutes, specifically RCW 84.12.280(2) and RCW 84.20.020, inappropriate for determining whether the transmission line, or the cable that is part of the line, is real property or tangible personal property for purposes of this assessment. The legislature has not directed application of the ad valorem tax definitions and treatment to use taxation. The various taxing statutes do not necessarily parallel each other, nor is it necessary that they do so. State tax law frequently employs relatively artificial, relatively self-contained, concepts. The Department does, properly, look to Washington's property tax statutes for guidance in determining the meaning of terms in an excise tax context, when the property tax statutes incorporate common law definitions. *See Western Ag*, *supra*. In the case of RCW 84.12.280 and RCW 84.20.010, however, the statute creates distinctions for certain companies that are contrary to the common law definitions and vary from the ad valorem tax treatment of other property owners. *See* WAC 458-12-010(4).[6] We conclude that those ad

[6] WAC 458-12-101(4) states that, for ad valorem tax purposes, "real property" includes: "Privately-owned easements and easement-like privileges, irrespective of whether the servient estate is public or privately-owned. However, easements of public service corporations other than railroads are personal property by reason of RCW 84.20.010."

valorem property tax statues provided no basis for classifying the transmission line or the cable that is part of the line for purposes of this assessment.

In sum, the telecommunications line, including the strands of fiber optic cable, that is the principal subject of the assessment, is in the nature of a fixture, and was real property for REET purposes when acquired by the taxpayer. Therefore, the assessment includes property that is not subject to use tax, and must be adjusted to exclude the value of property that was subject to REET.

Finally, it appears, from the list of assets the taxpayer has provided, that the purchase price included computers, power plants, and possibly other items, that may be related only to the taxpayer's particular use of the easement, and therefore are not in the nature of fixtures. Use tax would apply to the use of such property in Washington. According to the purchase agreement by which the taxpayer acquired the assets, the purchase price included property located [outside Washington]. The value of tangible personal property located [outside Washington] is not subject to Washington use tax. We will remand the file to the Compliance Division to adjust the assessment to exclude items that would be treated as real property under the REET statutes, and to exclude tangible personal property located [outside Washington].

DECISION AND DISPOSITION:

The taxpayer's petition is granted, in part. The file is remanded to the Compliance Division for further investigation and adjustment of the assessment consistent with this determination.

Dated this 27th day of June, 2000.