Cite as Det. No. 03-0269, 23 WTD 182 (2004)

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. 03-0269 Registration No. . . . . . . /Audit No. . . . Docket No. . . .

[1] RULE 171; RCW 82.12.020; ETA 004: RETAIL SALES TAX – USE TAX PUBLIC ROAD CONSTRUCTION – APPLICATION OF MATERIALS. A contractor that applies sand, gravel, rock, and similar materials in performance of a public road construction contract is the consumer of the materials, and is liable for retail sales tax on the purchase of the materials, or use tax if the materials were acquired under circumstances in which the retail sales tax was not paid. The fact that the public owner of the land later builds upon the surface created by the contractor's application of the materials does not make the public owner the consumer of the materials.

[2] RULE 171: USE TAX – PUBLIC ROAD CONSTRUCTION – USE OF MATERIALS TAKEN FROM A COUNTY STOCKPILE. A public road contractor is not exempt from use tax on its use of rock materials taken from a county stockpile. The provision in Rule 171 that partially excludes from the use tax the use of materials a county or city has taken from its own pit and stockpiled for placement on its own roadway is an exemption for cities and counties only.

[3] RULE 171; ETA 330: USE TAX – ROAD CONSTRUCTION – JOB SITE – DESIGNATED STOCKPILES. Where building materials or components are fabricated at a location off the job site, use tax is due on the use of the materials, measured by the value of the materials, including the labor of preparation. The exception that recognizes asphalt and concrete mixing plants that the contractor has temporarily located in the vicinity of the job as part of the job site, does not extend to off-site county stockpiles of materials designated by the county for use in the project.

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.

Prusia, A.L.J. – A contractor that applied crushed rock material taken from county stockpiles in performing its portion of two county road construction projects protests the assessment of use tax on the value of the rock materials. The contractor makes several arguments, in the alternative: it was not the user of the materials; the use of the materials was exempt because they were taken from a county stockpile; the county should have paid the use tax when it stockpiled the materials for use by a private contractor; any use tax due applies only to the value of the unprocessed rock because the pit from which the materials were loaded and hauled is part of the "job site"; and, the amount of any use tax must be reduced to reflect the true value of the material. We conclude that the taxpayer used the rock material in performing public road construction, and is liable for use tax on the value of the material it used. We remand to the Audit Division to allow the taxpayer an opportunity to establish that the value of the material was less than the value upon which the assessment is based.[1]

ISSUES

1. Was the taxpayer the user of the rock material for purposes of use tax liability?

2. Does WAC 458-20-171 (Rule 171) exempt from use tax the use of material that is taken from a county stockpile in a county pit or quarry, regardless of who places the material?

3. Should the county have paid the use tax when it stockpiled the rock material for use by a private contractor?

4. For purposes of determining the value of the rock materials the taxpayer applied, are the county pits from which the taxpayer took the materials considered part of the construction job site?

5. How should the value of the rock materials be determined?

FINDINGS OF FACT

The taxpayer, . . . , is a Washington corporation that engages in heavy construction in Washington, principally public road construction.

This appeal concerns two public road projects on which Taxpayer performed construction services for [county]. We hereafter refer to the former as "Project 1" and the latter as "Project 2."

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

On both projects, . . . County contracted with the taxpayer to perform only a portion of the road improvement work -- the widening, grading, and preparation of the base. The county itself completed the projects, doing final grading, applying oil and chips, and doing the final rolling.

The bid solicitation broke the work into specified tasks, grouped under the headings "preparation," "grading," "surfacing," and "other items." The surfacing task consisted of two subtasks: providing, placing, spreading, and compacting crushed surfacing base rock; and providing, placing, spreading, and compacting maintenance rock.

The focus of this appeal is the rock material the taxpayer spread and compacted in performing the two surfacing subtasks. On Project 2, the bid solicitation required bidding a price for the surfacing in terms of price per ton of rock material required. The bid solicitation stated that rock aggregates for use in the project were available at a specified county stockpile at a price of $ . . . per ton for the crushed surfacing base rock and $ . . . per ton for the maintenance rock. It gave the bidder the option of obtaining the materials from third parties. A standard form paragraph in the bid solicitation stated that the unit contract price per ton "shall be full payment for the purchase, loading, hauling, placing and compacting of materials." Another standard form paragraph stated that if the contractor chose to use materials in the county's existing stockpile, the county would deduct its charge for the materials from its payments to the contractor.

On Project 1, the bid solicitation had the above provisions with the following pertinent difference: the rock aggregates for use on the project were available from a specified county stockpile at "No charge," and the bid proposal form required the bidder to bid a price per ton on surfacing with materials "from Stockpile." The effect of these different provisions was that on Project 1, contractors were forced to use the county's stockpiled rock. A contractor could not make a competitive bid if it elected to purchase rock for the project from a third party.

The taxpayer's bids on both projects were based on taking rock material from the designated county stockpiles. Both bids assumed the taxpayer would not owe retail sales tax or use tax on the rock material. In performing the two projects, the taxpayer took the rock material it needed from those designated stockpiles. On Project 2, . . . County deducted the price for the material set out in the bid solicitation from its monthly progress payments and final payment. The county did not include retail sales tax in the amount deducted. The taxpayer did not pay retail sales tax or use tax on any rock it took from the county stockpiles.

The price at which commercial pits were selling crushed rock during the period of these two projects was $ . . . per ton. The taxpayer believes . . . County's actual cost of producing the crushed rock the taxpayer used was about $ . . . per ton. . . . County told the Department of Revenue (DOR) that the price it charged the taxpayer on Project 2 coincided with its cost to have the rock extracted and crushed.

DOR's Audit Division conducted a partial audit of the taxpayer's books and records for the period January 1, 1999 through December 31, 2002, limited to the above two projects. On February 7, 2003, the Audit Division issued tax assessment . . . against the taxpayer. The assessment assessed $ . . . in use tax on the crushed rock that the taxpayer applied to the roadbeds

on the two projects.[2] For Project 1, on which the rock material was provided by the county free of charge, the assessment multiplied the total tons of rock by $ . . . per ton to arrive at the value of rock applied. The taxpayer appeals the assessment of use tax.

ANALYSIS

For excise tax purposes, the classification of the activity of building roads and similar structures depends upon the identity of the contractor's customer. Construction for the state or for private parties is classified as retailing activity. The state or private owner of the road is a retail customer of the prime contractor, and the prime contractor must collect retail sales tax on the full contract price. WAC 458-20-170(4) (Rule 170(4)). The building, repairing, or improving of a street, road, or highway owned by a municipal corporation, a political subdivision of the State, or for the United States, is classified as "public road construction." Public road prime and subcontractors pay B&O tax on their total contract price under the public road construction classification. The contractors, rather than their customers, are the consumers of the material, equipment, and supplies used or consumed in performing the contracts, and the retail sales tax applies upon sales to them of those items. WAC 458-20-171 (Rule 171). The use tax applies to their use of materials, equipment, and supplies upon which the retail sales tax has not been paid, including articles they produce or manufacture for their own use. Rule 171.[3]

The measure of the use tax is the value of the article used. RCW 82.12.020(4). "Value of the article used" is defined in RCW 82.12.010(1). It is the consideration paid or given or contracted to be paid. If the article is acquired by lease or by gift, or is extracted or produced by the person using it, or is sold under conditions wherein the purchase price does not represent the true value, and in other situations not relevant here, then the value "shall be determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character." RCW 82.12.010(1)(a).

A DOR Excise Tax Advisory, ETA 004,[4] specifically explains the sales and use tax liability of public road construction contractors on the sand, gravel, rock, and similar materials they apply in the performance of a road construction project. It states:

> A person who applies sand, gravel, rock and similar materials in the performance of a contract to construct or repair streets, roads, highways, bridges, etc. which are owned by a municipal corporation or political subdivision of the state of Washington or by the United States is the consumer of such materials as a public road contractor. Sales of sand, gravel, rock and similar materials to such persons are subject to the retail sales tax.

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[2] . . . .

[3] The use tax applies to the use within this state, as a consumer, of tangible personal property "purchased at retail [without paying retail sales tax], or acquired by lease, gift, repossession, or bailment, or extracted or produced or manufactured by the person so using the same . . . ." RCW 82.12.020(1).

[4] The full name of the ETA is Excise Tax Advisory No. 004.08.12.171.

> Such persons are liable for payment of the use tax upon the value of applied materials where the materials are extracted from private pits or quarries as well as those owned by or leased to the public authority whose street, road, etc. is being constructed or repaired, or otherwise acquired under circumstances in which the retail sales tax is not paid.
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> In the case of extracted materials which have been crushed, washed, screened, mixed with other processed materials or otherwise subjected to any form of manufacturing or processing, the measure of value for computing the use tax is the total cost of extraction and processing, including the cost of transportation to the processing point, but not including labor and transportation from the processing point to the job site.
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> In the case of fill dirt, quarry rubble, pit ran sand, gravel, rock or riprap, and similar natural materials which are not processed after extraction, the measure of value for computing the use tax is the cost of extraction, but not including labor and transportation to the job site.

The assessment of use tax against the taxpayer was based on application of the above provisions and ETA.

[1] The taxpayer argues that it is not liable for the use tax assessed, because it was not the user of the rock for purposes of use tax liability. The taxpayer argues the county was the owner of the rock at all times. The taxpayer merely handled the county's rock for a brief period, only hauling and placing it for the county's use. The county then resumed possession, and it was the county that used the rock to create the paved road surface.

That position is not consistent with the contractual relationship the county and the taxpayer entered into. The taxpayer did not contract just to haul and deliver the county's material for the county's use. The taxpayer contracted to provide, place, spread, and compact the rock. Both bid solicitations stated that the contract price for the surfacing work "shall be full payment for the purchase, loading, hauling, placing and compacting of materials." The use of the rock materials was by the taxpayer, as a consumer. RCW 82.04.190(3). The county subsequently used the structure the taxpayer had built, not the component materials as such.

Taxpayer argues that if the use tax applies to it, the value on which the tax is assessed must be adjusted downward, by the costs of the labor that went into mining, crushing, and stockpiling the rock, under another provision in WAC 458-20-171, which states:

> The use tax does not apply in respect to the use of any sand, gravel, or rock to the extent of the cost of or charges made for labor and services performed in respect to the mining, sorting, crushing, screening, washing, hauling, and stockpiling such sand, gravel, or rock, when such sand, gravel, or rock is taken from a pit or quarry which is owned by or leased to a county or a city, and such sand, gravel, or rock is either (1) stockpiled in said pit or quarry for placement or is placed on the street, road, place, or highway of the county or city by the county or city itself (i.e., by its own employees), or (2) sold by the county or city to a county or a city at actual cost for placement on a street, road, place, or highway

> owned by the county or city. This exemption shall not apply to the use of such material to the extent of the cost of or charge made for such labor and services, if the material is used for other than public road purposes or is sold otherwise than as here indicated.[5]

[2] The taxpayer argues this provision recognizes a use tax exemption for the value of rock materials taken from a county stockpile, and argues the exemption applies regardless of who takes the material from the stockpile to place on the road. Thus, the exemption applies to the taxpayer. The taxpayer argues that the limiting language in the provision -- "by the county or city itself (i.e., by its own employees)" -- applies only to materials that are not stockpiled, but rather are taken directly from the pit and placed on the road. When the rock is stockpiled between removal and placement, it is exempt from use tax even if a private contractor places it.

Two rules of statutory construction require that we reject the taxpayer's interpretation of the limiting language in the exemption, and construe the exemption as one for counties and cities only. The first rule is that a statutory subsection may not be construed in a vacuum, but must be considered in reference to the statute as a whole and in reference to the entire legislative scheme of which it is a part. 2A N. SINGER, STATUTES AND STATUTORY CONSTRUCTION, § 46.05 (1992); *Donovick v. Seattle-First Nat. Bank*, 111 Wn.2d 413, 757 P.2d 1378 (1988). The sources of the Rule 171 provision are three exemption statutes, RCW 82.04.415, RCW 82.08.0275 and RCW 82.12.0269. Those statutes relate to cities and counties. In the absence of those exemptions, cities and counties are liable for excise taxes on their extracting, crushing, selling, and use of road materials just like any other taxpayer. WAC 458-20-189. The three statutes provide tax exemptions for cities and counties that extract and crush rock for their own use, or for sale to other cities and counties that also intend to place the materials themselves. Nothing in the statutes suggests they have any purpose beyond exempting cities and counties from tax. Our interpretation is consistent with the wording of the B&O tax provisions of Rule 171, which explicitly apply the limiting language both to materials that are stockpiled and materials that are directly taken from the pit and applied to the road.[6] The other rule of statutory construction that requires the same conclusion is the requirement of a reasonable interpretation. "It has been called a golden rule of statutory interpretation that unreasonableness of the result produced by one among alternative possible interpretations of a statute is reason for rejecting that interpretation in favor or another which would produce a reasonable result." 2A N. SINGER, STATUTES AND STATUTORY CONSTRUCTION, § 45.12, at 61 (1992). The taxpayer has not

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[5] There is an identical provision in WAC 458-20-178, which explains use tax generally.

[6] Rule 171 states with respect to the B&O tax:

> The business and occupation tax does not apply to the cost of or charge made for labor and services performed in respect to the mining, sorting, crushing, screening, washing, hauling, and stockpiling of sand, gravel, and rock, when such sand, gravel, or rock is taken from a pit or quarry which is owned by or leased to a county or city and such sand, gravel or rock is
> (a) Stockpiled in said pit or quarry for placement on the street, road, or highway by the county or city itself using its own employees, or
> (b) Placed on the street, road, or highway by the county or city itself using its own employees, or
> (c) Sold by the county or city at actual cost to another county or city for road use.

advanced any reason why stockpiling before application would have the tax consequence that results under the taxpayer's interpretation, nor can we imagine any reason why it would. A literal and reasonable reading of the exemption is that it exempts from use tax materials that a county or city itself, using its own employees, places on its roads, and that is how we read it. The exemption does not apply when a private contractor applies county or city materials to a roadway.

The taxpayer alternatively argues that . . . County should have paid the use tax when it took the rock from its pit and stockpiled it for use by persons other than the county itself. It argues . . . County used the rock in that it took control of it "preparatory to actual use." Rule 178(3)(4). It argues . . . County was not entitled to the Rule 171 use tax exemption because its stockpiling was not for subsequent placement by the county itself.

That argument overlooks the fact that retail sales tax liability and use tax liability fall upon the consumer of the property. A person who purchases or holds property for the purpose of resale as tangible personal property in the regular course of business is not a consumer. RCW 82.04.190(1). If . . . County stockpiled the material for subsequent placement by itself, the use tax did not apply to its use under the provisions of RCW 82.12.0269 and Rules 171 and 178. If . . . County stockpiled the material for sale to road contractors, it was holding the material for resale, and the use tax did not apply.

[3] The taxpayer alternatively argues that it does not owe use tax on the labor and services component of the value of the materials, because the pit from which the materials were loaded and hauled was part of the "job site." It argues that DOR has uniformly ruled that where building materials or components are fabricated at a plant located at the job site, the fabricating is inseparable from other work performed in connection with the construction, and therefore use tax is applicable only to the value of the materials delivered to the job site. It argues that in this case, . . . County designated particular pits for use on these projects, and under DOR practice those pits are considered part of the job site. The taxpayer cites ETA 330.12.170 (ETA 330) in support of its argument. The taxpayer further argues that in this case the rock had no value beyond the labor and services that went into crushing and otherwise processing it, and therefore the measure of the use tax is zero.

ETA 330 states a DOR policy of accepting the value of materials as the measure of the use tax "in limited cases where **asphalt or concrete** mixes are prepared **by the contractor** at temporary sites even though not on the site of construction," and a policy of interpreting the term "job site" as including "**asphalt and concrete** mixing plants temporarily located for the primary purpose of servicing one or more particular road construction contracts **previously awarded to the contractor.**" (Emphasis added.) The taxpayer's facts do not bring it within the limited situation described in ETA 330, because someone other than the taxpayer mined and crushed the materials, the stockpiles were designated before the road construction contracts were awarded, and the materials in question were not asphalt or concrete mixes. We conclude that the policy described in ETA 330 does not apply to the taxpayer's projects. Instead, the general rule applies -- where building materials or components are fabricated at a plant located off the job site, use tax must be measured by the value of the fabricated materials, including the labor of preparation.

The taxpayer alternatively argues that the assessment must be adjusted downward, because the price . . . County set for the rock materials used in Project 2, and the value the assessment assigned to the materials used in Project 1, were arbitrary values that overstate the county's cost.

Even if the taxpayer could establish that . . . County's cost was less than the values used in the assessment, it would not be entitled to an adjustment of the assessment. RCW 82.12.010(1)(a) states that if an article is acquired by gift or is sold under conditions wherein the purchase price does not represent the true value, then the value "shall be determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character." Thus, value is based not on . . . County's cost, but rather on the retail selling price of similar products. The taxpayer stated at hearing that the price at which commercial pits were selling crushed rock during the period of these two projects was $ . . . per ton. The values used in the assessment were at or below that price.

Finally, the taxpayer argues that if it has to bid prices for public road construction that incorporate sales or use tax, it will not be awarded any bids. The implication of the argument is that other contractors will not pay use tax on rock materials taken from county stockpiles and will submit bids that do not reflect any use tax liability. That competitors may not be paying the taxes they owe, and obtain a competitive advantage thereby, does not relieve the taxpayer of liability for taxes due.

DECISION AND DISPOSITION

The taxpayer's petition is denied

Dated this 20th day of August 2003.