Cite as Det. No. 14-0359R, 36 WTD 016 (2017)

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. 14-0359R
. . .	)	Registration No. . . .

Rule 178 & 17001; RCW 82.12.010; RCW 82.04.190: USE/DEFERRED SALES TAX – GOVERNMENT CONTRACTING. As the consumer of materials manufactured for installation, a government contractor owes use tax on the value of completed cabinets it manufactured and installed rather than only owing tax on the value of the component materials used to fabricate those cabinets.

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.

Kreger, A.L.J. – A company, engaged in the manufacture and installation of custom casework, seeks reconsideration of a decision that use tax was due on value of cabinets installed rather than on the cost of component materials. We affirm our decision that, because the company was the "consumer" of the materials it manufactured for installation under RCW 82.04.190(6), it owed use tax on the value of the cabinets under RCW 82.12.010(1)(a) and WAC 458-20-17001(7)-(9) rather than just on value of the component parts. We sustain the assessment as issued and deny the Taxpayer's petition.[1]

ISSUE

Whether the measure of use tax for cabinets installed in a government contracting project is the value of the component materials or the value of the completed cabinets under RCW 82.12.010(1)(a) and WAC 458-20-17001(7)-(9)?

FINDINGS OF FACT

[Taxpayer] is a Washington corporation engaged in the business of manufacturing and installing casework and custom millwork. The Audit Division of the Department of Revenue (Department) audited the Taxpayer's Washington business activities for the period of January 1, 2009, through December 31, 2012. At the conclusion of the audit, the Department issued an assessment, Document No. . . . in the amount of $ . . . for additional tax due, to the Taxpayer. The Department assessed $ . . . in Retail Sales Tax, $ . . . in Use Tax or Deferred Sales Tax, and

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

interest of $ . . . . The Taxpayer does not dispute the additional retail sales tax assessed on sales that were reclassified from wholesaling to retailing and for a number of deductions that were denied, and remitted a partial payment on November 18, 2013, in the amount of $ . . . . The sole contested issue is the additional use tax assessed on the cabinets fabricated and installed for government contracting work.

The Taxpayer reported use tax on the cost of the materials it purchased [and] used to manufacture custom cabinetry and millwork that the Taxpayer subsequently installed in the course of its government contracting work. The Audit Division assessed tax based on the value of the completed cabinets that the Taxpayer manufactured and installed. The Taxpayer reported use tax on a portion of the revenue from the cabinet [installations] at issue based on the assumption that the raw material costs on average comprised approximately 42% of the [contract price].

For the work at issue in this appeal, the Taxpayer builds the cabinetry at their facility in . . . and completes the installation of the cabinets at the customer's location.

On reconsideration, the Taxpayer does not dispute or assign error to the facts detailed above.

ANALYSIS

Because retail sales tax cannot be imposed directly on the federal government, Washington has developed a statutory framework whereby federal government contractors pay sales or use tax on materials used in completing the contract. [2] The sales or use tax becomes part of the cost of the project and may be passed on to the United States in the contract price, thus allowing the state to collect some state tax on federal government contracts without directly taxing the United States. This statutory framework was sustained by the United States Supreme Court in *Washington v. United States*, 460 U.S. 536 (1983).

RCW 82.04.050(11) excludes from the definition of a retail sale charges made for the following labor and services provided to the federal government:

> [T]he 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, any instrumentality thereof, or a county or city housing authority created pursuant to chapter 35.82 RCW, 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.

[2] The United States Supreme Court has interpreted the Supremacy Clause of United States Constitution, Art. VI, cl. 2, such that a state may not "lay a tax directly upon the United States or upon any agency or instrumentality so closely connected to the United States that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." *United States v. New Mexico*, 455 U.S. 720, 735 (1982).

In addition, RCW 82.04.190(6) states that a person providing these services is a consumer of the installed tangible personal property:

> Any person engaged in the business of constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property of or for the United States, any instrumentality thereof . . . 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 . . . Any such person is a consumer within the meaning of this subsection in respect to tangible personal property incorporated into, installed in, or attached to such building or other structure by such person . . .

Under this section, a government contractor becomes the consumer of the items installed. *Id.*

The use tax is imposed for the privilege of using within this state as a consumer any articles of tangible personal property manufactured by the user. RCW 82.12.020(1)(a), RCW 82.12.020(2). RCW 82.12.010(7)(b) explains that the value of articles used in government contracting is the retail selling price:

> In case any such articles of tangible personal property are used in respect to the construction, repairing, decorating, or improving of, and which become or are to become an ingredient or component of, new or existing buildings or other structures under, upon, or above real property of or for the United States, any instrumentality thereof, or a county or city housing authority created pursuant to chapter 35.82 RCW, including the installing or attaching of any such articles therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, then the value of the use of such articles so used shall be determined according to the retail selling price of such articles. . .

WAC 458-20-17001 (Rule 17001) is the administrative rule addressing government contracting. The use tax must be reported and paid by the government contractor who actually installs or applies the property to the contract. Rule 17001(9).

Our initial determination concurred with the Taxpayer's assertion that it was not making use of the cabinetry in its manufacturing process and that, therefore, the provisions of WAC 458-20-134 (Rule 134), which address taxation of items used in the manufacturing process were not applicable to this appeal. We affirm this conclusion but on reconsideration note that use in the manufacturing operation is only one of the enumerated examples of commercial or industrial use. The rule also defines "any use as a consumer" as a commercial or industrial use. Rule 134(1)(a). Therefore, as a statutory consumer of the materials at issue, the completed cabinets, the Taxpayer is making a commercial use of these items.

On reconsideration, the Taxpayer disputes that the provisions of Rule 17001 support tax being due on the [retail value] of the cabinets rather than on their component materials, relying on the provisions of the rule addressing use tax:

> The use tax applies upon the value of all materials, equipment, and other tangible personal property purchased at retail, acquired as a bailee or donee, or manufactured or produced by the contractor for commercial or industrial use in performing government contracting and upon which no retail sales tax has been paid by the contractor, its bailor or donor.

Rule 17001(7). The Taxpayer emphasizes the property purchased at retail clause, but does not address the manufactured or produced by the contractor clause. Thus, in addition to providing that use tax will be due on the value of materials purchased at retail, the rule also includes the alternative that use tax is due on the value of materials that are manufactured or produced by the contractor. If these values were the same, there would be no need for inclusion of the phrase "manufactured or produced by the contractor."[3] As noted above, the Taxpayer is manufacturing the cabinets and is a consumer of those items, and is correspondingly making a commercial or industrial use of these manufactured items and subject to use tax on their value under Rule 17001.

. . .

In *Morrison-Knudsen Co. v. State*, 64 Wn.2d 86 , 390 P.2d 712 (1964) , the court affirmed an assessment based on the conclusion that a contractor who had constructed bridge pontoons and anchor shells in Seattle, many miles from the Hood Canal bridge, where they were, eventually, installed was engaged in manufacturing. The court reasoned that the contractor had produced tangible personal property for commercial or industrial use and that, therefore, Manufacturing B&O tax and use tax were due on the fabrication of these construction components. *See Also* Excise Tax Advisory 3152.2009 (February 2, 2009)(For items fabricated off-site, use tax measure by the value of raw materials and the labor to create them.) Similarly, here the taxpayer is producing tangible personal property, the cabinets it manufactures, for use in its subsequent government contracting work.

Finally, the Taxpayer asserts that a Board of Tax Appeals decision, *Metalfab, Inc. v. Dep't of Revenue*, BTA No. 93-33 (1995) (*Metalfab*), supports its assertion that tax should only be levied on the cost the component materials. We disagree. We note initially that the BTA has only the powers and authority conferred by statute. BTA decisions are not binding on the Department except with regard to the specific parties before the Board. See generally RCW 82.03, et seq.; Det. No. 13-0358, 33 WTD 171 (2014). However, even if this decision were precedential, it is not persuasive in this case because the *Metalfab* decision does not support the Taxpayer's position. That decision affirmed a subcontractor's liability for use tax on materials and supplies. The Board did not address or reach the argument that the Taxpayer was [manufacturing] a different product . . . . The dispute in that case was whether the taxpayer had correctly classified its activity as a sale for resale and the Board affirmed the Department's position that it had not. That decision does not detail any dispute regarding the measure of the tax such as is at issue here and, accordingly, we do not find it applicable to this case.

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[3] Rules of statutory construction apply to the interpretation of administrative rules and regulations. *Multicare Medical Ctr. v. Dep't of Social and Health Services*, 114 Wn.2d 572, 591, 790 P.2d 124 (1990). Statutes are to be construed, wherever possible, so that no clause, sentence or word shall be superfluous, void, or insignificant. *Lakemont Ridge Homeowners Ass'n v. Lakemont Ridge Ltd. P'ship*, 156 Wn. 2d 696, 699 (2006).

As previously noted the Audit Division applied the provisions of the general use tax rule WAC 458-20-178 (Rule 178) in determining the value of the cabinets at issue:[4]

> (13) Value of the article used. The tax is levied and collected on an amount equal to the value of the article used by the taxpayer. The term "value of the article used" is defined by the law as being the total of the consideration paid or given by the purchaser to the seller for the article . . . . In case the article used was extracted or produced or manufactured by the person using the same or was acquired by gift or was sold under conditions where the purchase price did not represent the true value thereof, the value of the article used must be determined as nearly as possible according to the retail selling price, at the place of use, of similar products of like quality, quantity and character. In case the articles used are acquired by bailment, the value of the use of the articles so used shall be in an amount representing a reasonable rental for the use of the articles so bailed, determined as nearly as possible according to the value of such use at the places of use of similar products of like quality and character. In case the articles used are acquired by lease or rental, use tax liability is measured by the amount of rental payments to a lessor who has not collected the retail sales tax.

The item to be valued is the cabinetry manufactured by the Taxpayer rather than the component parts the Taxpayer purchased. As there was an actual sale price for the cabinetry, the Audit Division used that value.

We affirm our conclusion that the Taxpayer was a consumer of the items it manufactured, the finished cabinets, for installation and subject to use tax on the value of those cabinets. We sustain the assessment as issued and deny the Taxpayer's petition for reconsideration.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 17th day of June, 2015.

[4] Rule 178 was revised effective May 11, 2014. The provision cited in this determination is the language of the prior rule, which was in force during the audit period at issue.