Cited as 1 WTD 353 (1986)

BEFORE THE INTERPRETATION AND APPEALS SECTION
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. 86-292
. . .	)	Registration No. . . .

[1] **RULE 135 AND RULE 171:** USE TAX - ROAD CONSTRUCTION - EXTRACTED MATERIALS. The extraction and application upon the roadway of materials by a road builder is a use of those materials for use tax purposes.

[2] **RULE 135 AND RULE 171:** USE TAX - ROAD CONSTRUCTION - EXTRACTED MATERIALS - LOGGING ROADS - SALES TAX COLLECTED FROM CUSTOMER. Use tax will not be asserted on the use of extracted materials by persons building logging roads where those persons held a reasonable and good faith belief that they were performing a retail sale and they collected sales tax from their customers on the total charge.

[3] **RULE 135, RULE 171 AND RULE 178:** USE TAX - VALUE OF ARTICLE USED - ROAD CONSTRUCTION - MATERIALS EXTRACTED BUT NOT PROCESSED. Prior to December 28, 1982, under the terms of Excise Tax Bulletin (ETB) 4.8.12.171, use tax is not applied to materials extracted by road builders and used in building roads if the materials are not processed or manufactured. As of that date, under the terms of the ETB as revised, use tax is applicable. Under the ETB it is measured by the cost of

> extraction. Where cost figures are not available the tax is measured by the retail selling price, as nearly as possible, of similar products.

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.

TAXPAYER REPRESENTED BY: . . .
. . .
. . .

DATE OF HEARING: March 28, 1986

NATURE OF ACTION:

The taxpayer petitions for correction of an assessment of taxes. The assessment was issued as the result of an audit of the taxpayer's records.

FACTS:

Potegal, A.L.J.--The taxpayer is in the business of building logging roads. It performs this work primarily for the U.S. Forest Service but also for the State and the private sector. With respect to the work for the federal government the taxpayer used materials from Forest Service land near the road construction sites. Using its own equipment the taxpayer scooped material from the pits, loaded it onto its dump trucks, hauled it a short distance (typically one-half mile), and dumped it at the construction site.

A routine audit was conducted covering the period from January 1, 1981 through December 31, 1984. The audit disclosed a tax and interest deficiency of $. . . . Tax Assessment No. . . . in that amount was issued on November 5, 1985. A payment of $. . . , representing unprotested taxes, has been made.

ISSUES:

The taxpayer objects to the assessment of use tax on materials used in road construction. There are several grounds for this objection:

1. The taxpayer never acquired such dominion and control over the materials that use tax should apply. The material was acquired by bailment from the federal government and the

taxpayer had only momentary possession. Under similar circumstances the Board of Tax Appeals held that the use tax did not apply. Active Moving & Storage Company, Inc. v. Department of Revenue, BTA Docket No. 203 (1968).

2. A portion of the assessment is attributable to use tax on materials used in performing work for the State and for private persons. The taxpayer collected sales tax from its customers in those cases and remitted the tax to the state.

3. The value attributed to the materials by the auditor was vastly overstated. The auditor estimated the value to be 40 percent of the taxpayer's contract income. The auditor used an estimate because records were not available to him to otherwise determine the value of the materials. At the hearing the taxpayer presented evidence of the volume in cubic yards of material used in the federal jobs and of the value per cubic yard of the material. Furthermore, ETB 4.8.12.171, prior to its revision dated December 28, 1982, provides that materials extracted by road builders which were not processed by them were not subject to use tax at all. The revision of December 28, 1982 provided that such materials would be valued for use tax purposes at the cost of extracting them.

DISCUSSION:

The taxpayer's grounds for objection will be discussed in the same order presented in the ISSUES section.

1. The use tax is imposed

> . . . for the privilege of using within this state as a consumer any article of tangible personal property . . . acquired by . . . bailment, or extracted . . . by the person so using the same . . . (Emphasis ours.)

RCW 82.12.020.

[1] In order for use tax to apply the property must be acquired by bailment or extracted and be used as a consumer. The excise tax statutes do not define "bailment." They are more helpful in providing a definition of what "extracted" means. RCW 82.04.100 defines "extractor" in terms of what activities an extractor performs and thereby explains what it means to extract. That statute states:

> "Extractor" means every person who from his own land or from the land of another under a right or license granted by lease or contract, either directly or by contracting with others for the necessary labor or mechanical services, for sale or for commercial or industrial use . . . takes . . . stone, sand, gravel, . . . It does not include persons performing under contract the necessary labor or mechanical services for others. . .á.

The taxpayer in this case is an extractor. Its contracts with the Forest Service allow it to remove material from pits on Forest Service land. It thus takes material "from the land of another under a right or license granted by lease or contract." Contrary to the taxpayer's argument it does this for itself and does not perform "the necessary labor or mechanical services for others." The taking of materials is not something that is done for the federal government but is something that the Forest Service permits the taxpayer to do so that it may build roads. The building of roads is what the taxpayer has contracted to do. Finally, it takes the materials "for commercial or industrial use." That term is defined by RCW 82.04.130 as follows:

> "Commercial or industrial use" means the following uses of products, including byproducts, by the extractor or manufacturer thereof:
>
> 1) Any use as a consumer . . .

"Consumer" is defined by RCW 82.04.190(3) to be:

> Any person engaged in the business of contracting for the building, repairing or improving of any . . . road, . . . which is owned by the United States and which is used or to be used primarily for foot or vehicular traffic . . . in respect to tangible personal property when such person incorporates such property as an ingredient or component of such publicly owned . . . road, . . . by installing, placing or spreading the property in or upon the right of way of such . . . road . . .

The taxpayer places the materials on the roads it constructs and is therefore a consumer of the materials. The taxpayer has satisfied all elements of the statutory definition of "extractor."

For an extractor to be liable for use tax it must use the extracted tangible personal property as a consumer. RCW 82.12.020. The discussion of "extractor" demonstrated that the taxpayer was a consumer of the materials. If the taxpayer has used the materials it is liable for use tax. RCW 82.12.010(2) states:

> "Use," "used," "using," or "put to use" shall have their ordinary meaning, and shall mean the first act within this state by which the taxpayer takes or assumes dominion or control over the article of tangible personal property (as a consumer), and include installation, storage, withdrawal from storage, or any other act preparatory to subsequent actual use or consumption within this state; . . .

The taking, hauling, and placing upon the roadway of the materials constitutes use within its ordinary meaning. Furthermore, the definition of consumer quoted earlier clearly leads to the conclusion that materials placed upon the roadway are used. Under that definition the person who places the materials is the consumer of those materials. If one consumes property, one must have used that property.

The taxpayer is subject to use tax on its use of materials in its road building activities. It has extracted those materials and used them as a consumer.

Active Moving is distinguishable from this case. Active Moving involved a taxpayer who contracted with the federal government for the construction and packing of crates. The government owned the materials out of which the crates were built. The Department of Revenue argued, and the Board of Tax Appeals agreed, that the materials were acquired by bailment. The Board stated:

> . . . the statutes, taken together, indicate an intent upon the part of the Legislature to impose Use Tax on bailed property over which the bailee has an extended period of recurring use sufficient to be measured on a rental basis. This Board is also of the opinion, in regards to the measure of value to be used, that because the use of the property is so limited that its rental value cannot be determined, these statutes should not be separated to the extent that the property should be taxed at its full value under other statutory provisions as a consequence.

. . .

> It is the opinion of this Board [that] the Legislature did not intend its definition of bailment be extended for tax purposes to a contractor who does no more with the property concerned than to convert lumber and nails into crates. . . . In the instant appeal the property concerned was merely converted from one form to another, from lumber and nails to crates in a one-time process. There wasn't the recurring use of the property . . .

The instant appeal is distinguishable on at least two grounds. First, the taxpayer acquired the materials by extraction, a method of acquisition which by statute leads to use tax liability. Second, the legislature specified that road builders were consumers of the materials they used in building roads. The legislative intent to apply use tax to the use of materials extracted and used by road builders is clear. The discussion in Active Moving is not applicable to this case.

2. In general, the building of roads for the State of Washington and for private persons is a retail sale. RCW 82.04.050 and WAC 458-20-171. Accordingly, when the taxpayer built roads for the State and for private persons it collected sales tax from these customers and remitted that tax to the Department of Revenue. It did not pay sales or use tax on materials.

In some instances, however, the construction of logging roads is treated the same as logging and is taxed as extracting or extracting for hire. In those cases the road builder would be liable for sales or use tax on materials because it would be the consumer of those materials. It would not collect sales tax from its customers.

This position had its genesis in Lyle Wood Products, Inc. v. Department of Revenue, 91 Wn.2d 193, 588 P.2d 215 (1978). In that case a road builder constructing roads in accordance with specifications of a state timber contract was held to be engaged in a logging activity rather than road building. It took several years for the Department of Revenue to determine some of the ramifications of this case and to announce them in public rules. In 1983 the Department adopted an amendment to WAC 458-20-135 which stated that the construction of logging roads in connection with state or federal timber contracts was an extracting activity. In 1986 the rule was amended again to

indicate that logging road construction performed for anyone was an extracting activity if performed pursuant to a timber harvest operation.

The 1986 version of the rule was provided to the taxpayer during the audit. The taxpayer has now been informed that logging road construction performed in connection with a timber harvest operation is extracting whether performed for the federal government, the State, or private persons.

During the audit period, however, this was not apparent to a person in the taxpayer's position. An examination of the statutes and rules at the beginning of the audit period would lead to the conclusion that logging road construction for the State and for private persons was a retail sale. In the middle of the audit period the rule on extracting, but not the rules on road construction (WAC 458-20-170 and -171), was amended to indicate that logging road construction for the State might be an extracting activity. After the audit period was over the extracting rule was amended again to indicate that logging road construction for private persons might be an extracting activity.

[2] In view of the fact that the taxpayer collected and remitted sales tax in the reasonable and good faith belief, based upon the existing rules promulgated by the Department of Revenue, that logging road construction for the State and for private persons was a retail sale, that portion of the assessment attributable to use tax on materials used in logging road construction for the State and for private persons will be deleted. The sales tax remitted by the taxpayer far exceeds the amount of use tax assessed because it was measured by the total charge and not just the cost of materials. The taxpayer's petition will be granted on this item.

3. The use tax is measured by "the value of the article used." RCW 82.12.020. That term is defined in part by RCW 82.12.010(1) as follows:

> In case the article used is . . . extracted . . . by the person using the same . . . the value of the article used 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 under such rules and regulations as the department of revenue may prescribe.

The Department has not formally adopted any rules which discuss the value of extracted articles other than to repeat the statutory language quoted above. It has, however, published two versions of ETB 4.8.12.171 which deal specifically with the value to be attributed to materials extracted and applied by road contractors.

The version which was issued August 19, 1959 states in part:

> The Compensating (Use) Tax will not apply to the use by such contractors of fill dirt, quarry rubble, pit run sand and gravel and similar natural materials which are not processed after extraction.

The version which was issued December 28, 1982 states in part:

> In the case of fill dirt, quarry rubble, pit run 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 law mandates that, for use tax purposes, the value of extracted materials be determined by the retail selling price of such materials. The two versions of the ETB do not speak in terms of the retail selling price of materials extracted by road contractors and placed upon roads without processing. The first version states that the use tax will not apply to the use of such materials. We interpret this to mean that the Department's position was that such materials had a retail selling price of zero. The Department would have no other basis to say that use tax did not apply. The second version departs from that position and provides that for use tax purposes such materials have a value equal to the cost of extraction. To be consistent with the law this means that the cost of extraction equals the retail selling price.

In view of the Department's publicly stated position, use tax attributable to materials extracted but not processed will be deleted from the assessment for the period prior to December 28, 1982, the date of the revised ETB. On and after that date use tax is due on such materials.

The ETB indicates that the value is determined by the cost of extraction, not including transportation to the job site. The taxpayer testified that it did not have cost figures for extraction but believed the cost to be minor. The major cost

it incurred in connection with the materials was transportation from the pit to the job site.

Since the ETB in this instance is of no help in establishing a value, the language of the statute stands alone as the source for determining the measure of the use tax. To again quote RCW 82.12.010(1):

> The value of the article used 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.

The taxpayer argued that because the materials were in a remote, mountainous area and were of low quality they were worthless. Nevertheless, it submitted evidence that such materials did have a value. This was a letter from the Forest Service to the taxpayer's attorneys stating that the royalty price per cubic yard for materials such as those used by the taxpayer averaged 50 cents. This was for the same geographical area in which the taxpayer performed its contracts. The letter states that the 50 cent per cubic yard figure applied from 1981 until an unstated date when a market comparison appraisal method was adopted. The letter states that enclosures were supplied giving examples of the prices determined by the appraisal method. These enclosures were not provided to the Department.

[3] The Forest Service letter establishes "as nearly as possible" a retail selling price for the materials used by the taxpayer. Accordingly, the Forest Service values will be applied to the materials for the period on and after December 28, 1982. The taxpayer is directed to provide the Department's Audit Section with the enclosures to the Forest Service letter. If the Forest Service adopted the market comparison appraisal method during the audit period, values obtained by that method will be used from the date of adoption. Otherwise the 50 cent per cubic yard figure will be used.

Subject to verification of the taxpayer's figures for the volume of materials used and to receipt of the information on the market comparison appraisal method of valuation, the taxpayer's petition will be granted on this item.

DECISION AND DISPOSITION:

1. The taxpayer's petition is denied.

2. The taxpayer's petition is granted. Use tax attributable to jobs on which the taxpayer collected sales tax will be deleted from the assessment.

3. The taxpayer's petition is granted. Use tax assessed on the use of materials extracted, not processed, and applied on roads prior to December 28, 1982 will be deleted from the assessment. Subject to verification by the Audit Section, the value attributable to materials so used on and after December 28, 1982 will be adjusted in accordance with the DISCUSSION section of this Determination.

An amended assessment will be issued which will be due by a date indicated therein. Because the due date will have been extended for the sole convenience of the Department, interest on the amount remaining due will be waived for the period from June 28, 1986 through the new due date.

DATED this 13th day of November 1986.