

Cite as Det. No. 93-139E, 13 WTD 278 (1994).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For)	<u>D E T E R M I N A T I O N</u>
Correction of Tax Assessment of)	
)	No. 93-139E
)	
. . .)	Registration No. . . .
)	FY . . . /Audit No. . . .
)	
. . .)	Registration No. . . .
)	FY . . . /Audit No. . . .

[1] RCW 82.16.020: PUBLIC UTILITY TAX -- CAR HIRE RECEIPTS -- THE RAILROAD REVITALIZATION AND REGULATORY REFORM ACT -- CONSTITUTIONALITY. Whether the Public Utility Tax violates the Railroad Revitalization and Regulatory Reform Act and is, therefore, unconstitutional is an issue beyond the authority of an administrative agency to decide. It is solely for the courts.

[2] RULE 175; RCW 82.08.0262: RETAIL SALES TAX -- LEASED RAILROAD CARS -- REPAIR CHARGES. Railroad car repair charges were exempt from retail sales tax under RCW 82.08.0262, where the railroad leased the rail cars and used them to transport property for hire primarily in interstate commerce.

[3] RCW 82.12.0254: USE TAX -- EXEMPTION -- SWITCH ENGINES. Use tax is not due on switch engines or component parts of switch engines used primarily for conducting interstate and foreign commerce.

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:

A railroad and an engine switching company petition for a correction of use taxes assessed on switch engines.

. . .

FACTS:

Okimoto, A.L.J. -- . . . Railroad Co. (hereafter referred to as Railroad or the taxpayer) and . . . Switching, Co. (hereafter referred to as Switching) conduct railroad car switching activities in the state of Washington. Railroad's books and records were audited by a Department of Revenue auditor for the period January 1, 1986 through December 31, 1989. As a result of that audit, Document No. . . . was issued [in December 1991] for additional taxes and interest In addition, Switching's books and records were audited by a Department of Revenue auditor for the period January 1, 1986 through December 31, 1989. As a result of that audit, Document No. . . . was issued [in January 1991] for additional taxes and interest

TAXPAYER'S EXCEPTIONS:

RAILROAD

Schedules V & XXVIII - Public Utility Tax Due on Car Hire Receipts

In this schedule, the auditor reclassified car hire receipts from the .00471-Retailing B&O tax classification to the .03852 Railroad Car Business tax classification of the Public Utility tax.

The taxpayer explained this activity in its petition as follows:

[The taxpayer] interchanges freight cars with other railroads in accordance with the Car Service and Car Hire Agreement and Rules of the Association of American Railroads as required by federal law. It is both a user and lender of such cars. When freight cars are interchanged to other railroads, the cars are used on tracks other than those of [the taxpayer], and [the taxpayer] receives a daily per diem. The taxpayer reported the per diem receipts under the retailing B&O tax classification. The auditor reclassified the receipts under the railcar business classification of the public utility tax ...

The taxpayer argues that by reclassifying fees received for the use of rail cars to the higher Public Utility tax rate, the state

is violating 49 U.S.C. 11503, The Railroad Revitalization and Regulatory Reform Act (4-R Act) by taxing railroads in a discriminatory manner. The taxpayer argues that under the 4-R Act, railroads must be accorded equal tax treatment with the general class of "all other commercial and industrial taxpayers in the state, and may not be subjected to a state tax which differs in incidence or rate from those generally applicable to commercial and industrial taxpayers." The taxpayer states that the 4-R Act preempts any inconsistent state law.

Schedule II & IV: Gross Railroad Car Repair Revenue Reclassified From Retailing to Wholesaling-Other

The taxpayer explained at the hearing that it had been reporting income earned from repairing rail cars owned by other persons under the Retailing [B&O classification subject to retail sales tax]. The rail cars are owned by private companies, leasing companies, and other rail carriers. The taxpayer incorporates these cars into existing trains and transports them on its railroad tracks. If they become damaged during transit while in the taxpayer's possession, American Association of Railroad (AAR) regulations require the taxpayer to make the necessary repairs and to bill the owners. The regulations also preclude the taxpayer from adding any taxes (including sales tax) to the billing. The auditor considered all repair charges made to leasing companies to be for resale and therefore reclassified those amounts from the Retailing [classification subject to retail sales tax] to the Wholesaling B&O tax classification. The auditor reasoned that these repair charges were performed on rail cars which would be subleased to railroad companies. In a post assessment adjustment, the auditor left repair charges made to private rail car owners under the Retailing [classification subject to retail sales tax].

The taxpayer now petitions for a refund of all retail sales taxes reported and paid on rail car repair charges. First, the taxpayer agrees with the auditor that repair charges made to leasing companies should be considered for resale. Furthermore, since the taxpayer absorbed the sales tax, and did not pass it on to the customer, then it contends that it should be entitled to a full refund of retail sales taxes paid in error. Second, even if the repair charges are made to consumers (such as private owners), the taxpayer argues that the charges are exempt from retail sales tax under RCW 82.08.0262; i.e., repair of property used in conducting interstate or foreign commerce.

Schedule XV - Use Tax on Unreported Parts Withdrawn From Inventory For Use on Switch Engines

In this schedule, the auditor assessed use tax on parts used as components to repair switch engines (locomotives). The auditor denied the exemption allowed by RCW 82.12.0254 because he believed that switch engines were not used "primarily in conducting interstate or foreign commerce by transporting ... therewith property for hire." Instead, the auditor characterized switch engine activity as shifting rail cars between different locations within a single railroad yard and concluded that it involved only intrastate commerce. The auditor also relied, in part, on the fact that switch engines did not cross state boundaries while performing their switching activity.

The taxpayer challenges this assessment. First, it disputes the assertion that switch engines remain in a single railroad yard and that they do not cross state boundaries. On the contrary, the taxpayer states that all of its locomotives are rotated on a regular basis, and that while one may be assigned to a switching activity for a specified period, it may later be reassigned for interstate hauls. Second, the taxpayer states that even railroad yard switch engines do not remain in the yard 100% of the time. The taxpayer regularly uses some switch engines to pick-up rail cars at the customer's plant which are then returned to the yard and incorporated into larger and usually interstate-bound trains. Similarly, switch engines are also used to deliver rail cars from the rail yard to its ultimate destination point. Finally, the taxpayer contends that even the switching activity that occurs wholly within a railroad yard constitutes interstate commerce within the meaning of the exemption allowed by RCW 82.12.0254. The taxpayer argues that these switch engines are doing the exact same activity as line-haul engines, but for only a much smaller duration; i.e., physically connecting with and pushing or pulling other rail cars containing freight over railroad tracks.

The taxpayer further argues that Rule 175 allows an exemption for all "property used in conducting interstate or foreign commerce by transporting ... property and persons for hire" to those persons engaged in the business of transporting that property in interstate commerce. Since the taxpayer is engaged in that business, all property used in conducting that business is exempt.

The taxpayer argues in its petition:

The locomotives involved here, like locomotives generally, transport property for hire by moving other rail cars. These particular locomotives move rail cars in a portion of their movement in interstate commerce. Often that portion of the interstate journey occurs in the general vicinity of

switching yards or terminal areas. Locomotives performing this function are often called "switch engines."

[Taxpayer's] shippers contract with it (or a connecting railroad) to pick up freight cars at the shipper's loading dock and deliver them to the destination designated by the customer. The contract is not completed until the entire movement -- from pick-up to final delivery -- is performed. Thus the interstate carriage begins when the rail car is picked up at the customer's loading dock; continues as the car is moved toward its destination by a succession of locomotives (including being switched from one train to another, and sometimes from one carrier to another); and ends only when the car is delivered at its ultimate destination (typically a loading dock, siding, or other location designated by the customer).

SWITCHING:

Schedule II: Use Tax on Bailment of Switch Engines

In this schedule, the auditor assessed use tax on switch engines bailed to Switching by the two railroad companies that own and operate Switching as a joint venture. These switch engines were loaned without charge to Switching so that it could conduct its rail car switching business operation in this state. [Switching] explained at the hearing that these switch engines perform essentially the same activities as those owned by Railroad and described above. The auditor relied on a prior determination of this same taxpayer, . . . , which held that similar switch engines were subject to use and/or deferred retail sales tax.

[Switching] protests the assessment on two grounds. First, it seeks an exemption from use and/or deferred retail sales tax under RCW 82.12.0254 as property "used primarily in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire." Second, it contends that a true bailment of the switch engines has not been established.

ISSUES:

1. Where RCW 82.16.020 imposes a higher tax rate on the renting of railroad cars than upon other rentals of tangible property, does this violate the 4-R Act?
2. Are rail car repair charges exempt from retail sales tax under RCW 82.08.0262, if the rail cars are leased by a

railroad and subsequently used by the railroad to transport property for hire?

3. Is use tax due on switch engines or component parts of switch engines that are used to conduct switching activity that occurs wholly within the state of Washington?

DISCUSSION:

RAILROAD:

Schedules V & XXVIII - Public Utility Tax Due on Car Hire Receipts

Whether RCW 82.16.020 is inconsistent with the 4-R Act and therefore unconstitutional is an issue that is not within the power of an administrative agency to decide. Such a determination is solely for the courts. Bare v. Gorton, 84 Wn.2d 380, 526 P.2d 379 (1974). Accordingly, we must deny the taxpayer's petition on this issue.

Schedule II & IV: Gross Railroad Car Repair Revenue Reclassified From Retailing to Wholesaling-Other

[2] In this schedule, Railroad petitions for a refund of retail sales taxes paid in error on charges made for repairing rail cars owned by leasing companies, other railroads, and private companies.

RCW 82.08.0262 provides a sales tax exemption for:

The tax levied by RCW 82.08.020 shall not apply to sales of ...locomotives, railroad cars, ... for use in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire ...; also sales of tangible personal property which becomes a component part of such ..., locomotives, railroad cars, ..., in the course of constructing, repairing, cleaning, altering, or improving the same; also sales of or charges made for labor and services rendered in respect to such constructing, repairing, cleaning, altering, or improving.

(Emphasis ours.)

Railroad further points out that it is required to pay the owners of the rail cars a daily per diem or rental for each day the cars are used to transport commodities over its railroad tracks. We believe that this daily per diem constitutes a de facto rental of

the same rail cars which Railroad subsequently repairs. Since Railroad is renting these cars for use in conducting interstate or foreign commerce by transporting therein or therewith property for hire, then these rail car rental charges would be entitled to a retail sales tax exemption under RCW 82.08.0262. Consequently, we believe that repair charges incurred during the time that they are being rented by Railroad are also entitled to the sales tax exemption.

Railroad has testified that it was precluded by AAR regulations from collecting retail sales tax on these repair charges and that it has absorbed the retail sales tax liability out of its own profits. Sample invoices submitted by Railroad support its assertion that retail sales tax was neither billed nor collected on repair charges. Accordingly, the Railroad's petition for a refund of retail sales taxes paid in error is granted subject to verification by the Audit Division that Railroad has actually remitted the tax.

Schedule XV - Use Tax on Unreported Parts Withdrawn From Inventory For Use on Switch Engines

[3] RCW 82.12.0254 provides a use tax exemption for:

The provisions of this chapter shall not apply in respect to the use of any ... locomotive, railroad car, or watercraft used primarily in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire... and in respect to use of tangible personal property which becomes a component part of any such ... locomotive, railroad car, ...

The above use tax exemption has the following requirements. First, the rail car or locomotive must be used "primarily in conducting interstate commerce or foreign commerce." The Department has interpreted "primarily" to mean more than 50% of the time. Second, the locomotives and cars must be conducting interstate or foreign commerce "by transporting therein or therewith property or persons." Finally, the operator of the car or locomotive must be transporting the property or persons in interstate commerce "for hire."

We first note that crossing state boundaries is not a requirement for the use tax exemption allowed under RCW 82.12.0254. Indeed, this question was recently discussed in Final Det. No. 91-323ER, 13 WTD__, (1992) regarding the above use tax exemption as it applied to watercraft. In finding that the Legislature had not intended a boundary-crossing requirement, the Department

recognized the following position of the Washington State Supreme Court in United Parcel Service v. Department of Rev., 102 Wn.2d 355, 687 P.2d 186, (1984).

... UPS also cites the exemption in RCW 82.12.0254 for "the use of any airplane, locomotive, railroad car, or watercraft used primarily in conducting interstate or foreign commerce..." Again, this exemption contains no requirement that the airplanes, trains, or boats actually cross state boundaries. UPS argues that RCW 82.12.0254 can be construed consistently as a whole only if no line-crossing requirement is imposed for exemption of motor vehicles as well.

The State, refers to the elementary rule that where the Legislature uses certain language in one instance, and different language in another, there is a difference in legislative intent... . The presence of boundary-crossing language in the motor vehicle carrier exemption, taken together with the absence of such language in the exemption for other types of carriers, would thus support the State's interpretation of RCW 82.12.0254.

(Emphasis ours.)

Next, we must determine whether the taxpayer is using the locomotives "primarily for conducting interstate or foreign commerce." The taxpayer states that nearly 90 to 95 percent of the property being transported by Railroad originated from or will be delivered to a point outside the state of Washington. These transportation charges are also normally billed on a single through freight rate that includes all switching charges. Railroad, therefore argues that 90 to 95 percent of its switching activity involves the conducting of interstate commerce within the meaning of RCW 82.12.0254. To the extent that Railroad can show that its transportation services are being performed on goods that originated from, or are delivered to a point outside the state of Washington, we agree that it is conducting interstate or foreign commerce. See Department of Rev. v. Association of Washington Stevedoring Companies, 435 U.S. 734, (1977). Also Puget Sound Stevedoring Co. v. State, 302 U.S. 90, (1937).

Next, we must determine whether the locomotives are engaged in interstate or foreign commerce "by transporting therein or therewith property or persons." This issue was also raised in the above cited Det. No. 91-323ER. That determination distinguished between tugboats that actually physically connected with and towed interstate or foreign cargo-laden ships and those

tugs which merely escorted ships into port. The exemption was disallowed for escort tugs. The exemption was allowed for those tugs that physically connected to and towed other exempt cargo-laden ships. In that case the Department stated:

We find that by physically towing or hauling other exempt cargo-laden watercraft, the tugboats are continuing the movement of property in interstate or foreign commerce and that under these circumstances taxpayer's ship-assist tugboats are conducting interstate commerce notwithstanding that they never cross Washington's water boundaries. We find that these tugboats, moving exclusively within the territorial waters of Washington State, are actually transporting therewith exempt property and are thus an inseparable part of the movement of interstate commerce. Det. No. 91-323ER.

We similarly find that because the locomotives (switch engines) physically attach to other exempt property-laden locomotives and rail cars which are engaged in a continuing and inseparable movement of interstate or foreign commerce, they are also being used in conducting interstate or foreign commerce "by transporting... therewith property and persons".

Finally, we must determine whether performing switching activities with engines constitutes transporting therewith property or persons "for hire." Railroad testified that it does not separately bill for switching activity when it is switching its own railroad cars. The charges billed to its customers for transporting property from the point of origin to its ultimate destination includes all costs for switching activities. Under these circumstances, we find that Railroad is transporting property "for hire" when it performs its switching activity.

This analysis does not change where Railroad charges other railroads for conducting switching activity when those other railroads, in turn, recoup the cost of those switching services through transportation rates billed to their customers. In this case, Railroad is merely acting as a subcontractor of transportation switching services. Therefore, as with the tugboats in Det. No. 91-323ER, we find that switch engines, even though moving exclusively within the state of Washington, may still qualify as being "used in conducting interstate or foreign commerce by transporting therein or therewith property and persons for hire." The taxpayer's petition is granted subject to verification by the Audit Division of the facts stated in this determination .

SWITCHING:

Schedule II: Use Tax on Bailment of Switch Engines

In accordance with the above discussion, Switching's petition is granted subject to verification by the Audit Division of the facts stated in this determination.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. The taxpayer's file shall be referred to the Audit Division for the proper adjustments consistent with this determination.

DATED this 19th day of May 1993.