

Cite as Det. No. 92-218, 14 WTD 145 (1995).

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

In the Matter of the Petition	)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment of	)	
	)	No. 92-218
	)	
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

- [1] RULE 211; RCW 82.12.020: USE TAX -- GOVERNMENT PROPERTY -- BAILMENT. Bailment arises where taxpayer's employees have possession and exercise dominion and control over government-owned items in performing contract tasks. Use tax applies even if the government retains control over the taxpayer's conduct with regard to the use of such items after delivery and the taxpayer does not have exclusive possession.
- [2] RULE 211: USE TAX -- BAILMENT -- ITEMS ANNEXED TO REAL ESTATE -- FIXTURES. Use tax is levied only on the use or bailment of tangible personal property, not real property. The Department follows the common law rules for determining whether an item is realty or personalty. When an owner attaches an article to land, it is rebuttably presumed to have annexed it with the intent to enrich the freehold. Without evidence to the contrary, the presumption stands.
- [3] RULE 211: USE TAX -- BAILMENT -- MEASURE OF TAX. The measure of use tax for bailed articles is their reasonable rental. The reasonable rental is determined as nearly as possible by the rental price at the place of use of similar products of like quality and character. The tax is not measured by the full replacement cost of the items. During the contract period when the taxpayer has possession of the items only for one-third of the time, the measure of the tax is reduced or prorated by two-thirds. The total tax assessed shall not exceed the full original value (likely to be original purchase prices) of the articles.

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:

Warehouse service provider protests an assessment of use tax on U.S. Government furnished equipment.<sup>1</sup>

FACTS:

De Luca, A.L.J. -- The taxpayer contracts with the federal government to provide warehousing services at a military base in the state of Washington. The warehouse facilities are government-owned and are on federal land. The taxpayer provides personnel to work at the facilities for one eight hour shift per day. At times the taxpayer's employees work alongside military personnel. However, the military personnel are the only people who work at the facilities the remaining two shifts each day.

The taxpayer's employees perform manual labor, inventory control and data entry at the warehouses. At the military's directions the taxpayer's employees store items and retrieve them as well as move supplies into and out of the warehouses. The employees use many government-owned items in order to perform their tasks. For example, they use fork lifts, tractors, dollies, carts, computers, desks, lamps, telephones, chairs, file cabinets, garbage cans, bar code readers, storage lockers, portable radios, tables and similar items.

Two other government-owned items the taxpayer uses are retrievers and carousels. A retriever resembles a Ferris wheel. It is a large cabinet divided into 20 bins or shelves. An operator rotates the bins to retrieve items. All retrievers ("lektrievers") are directly wired to separate circuit breakers installed for them. Each retriever is bolted to concrete embedded plates in the floor and is installed to withstand seismic activity. The retrievers weigh from 3,000 to 30,000 pounds and are 10' x 8' x 6' and 30' x 30' x 20'. The taxpayer states that to remove them would require tearing down a wall. The taxpayer also states that the government considers the equipment to be part of the facility and they are included in the facility layout plan.

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<sup>1</sup>Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Carousels are upright racks mounted on an oval track. The racks rotate around the track to allow an operator to retrieve items. The oval measures 12' x 20' x 6' while the racks are 12' high and 2' wide. Each carousel has its own circuit breaker. The track is bolted to concrete mounts embedded in the floor. Like the retrievers, the government considers the carousels part of the facility and they are included in the facility layout plan. The military has first priority over the use of its equipment. When not in use by military personnel, the taxpayer's employees may use the equipment. For example, a forklift may be used for one task by a military person and an employee of the taxpayer may use it for the next task when it becomes available. At other times, both military personnel and the taxpayer's employees may use some equipment together.

Other items, such as specific computers, desks, and telephones, are used by the taxpayer's employees during their one shift, but military personnel use the same equipment during the following shifts each day. The taxpayer may use the government's equipment only for government work, and the taxpayer's employees may not remove any government equipment from the facilities.

Section 11 of the parties' contract provides that the taxpayer and the government will conduct a joint inventory before commencing work under the contract to determine the exact number and serviceability of government furnished furniture, equipment, and material handling and transportation equipment. The contract section also states the taxpayer will ensure that all equipment provided is to be maintained operationally ready to achieve full life expectancy and minimize down time. All equipment must be operated in a safe manner with reasonable care. Finally, when the contract is completed or terminated, the taxpayer must return all government-owned equipment in the same condition as received, except for normal wear and tear. The taxpayer is responsible for the costs of any repairs caused by negligence or abuse by it or its employees.

The Department of Revenue's Audit Division assessed use tax in Schedule V on all of the above-mentioned items and other ones as well. Audit deemed the use of these items to be a taxable bailment because the federal government acquired them without paying sales tax. The assessed tax was based upon acquisition costs. RCW 82.12.020 and WAC 458-20-211 (Rule 211), subsection (15).

#### TAXPAYER'S EXCEPTIONS:

The taxpayer objects to the assessment in Schedule V for three reasons. First, no bailment exists since the taxpayer and the government have shared use of the property. The taxpayer cites

Rule 211, subsection (3), which provides that a bailment does not arise unless the bailee or its employees take possession of the property and exercise dominion and control over it. The taxpayer claims such possession must be exclusive in order for the bailee to be subject to use tax. The taxpayer relies on Boeing Co. v. State, 74 Wn.2d 82, 442 P.2d 970 (1968).

Second, even if a bailment exists, the retrievers and carousels are permanent fixtures and not subject to use tax. The taxpayer relies on WAC 458-12-010 (Rule 010) which defines real property for property tax purposes to include machinery, equipment or fixtures affixed to land. Such items are considered affixed when they are securely attached to real property or are permanently situated in one location on real property and adapted to use in the place it is located. In further support of its argument, the taxpayer cites Lipsett Steel Products v. King County, 67 Wn.2d 650 (1965) and Det. No. 89-451, 8 WTD 439 (1989).

Third, if a bailment exists, some of the property at issue is used property, and hence, acquisition cost (replacement value) is not the proper measure of tax. Many of these items have been salvaged from government storage facilities and put back into service. Some of the items are up to 30 years old. Due to their age, the rental prices of similar products of like quality and character would be far less than the replacement costs used by the auditor. RCW 82.12.010 and Rule 211(15). Furthermore, the taxpayer argues the tax should be reduced or prorated by two-thirds because it uses the items only for one shift each day while the military has exclusive control and possession of them the other two shifts each day.

#### ISSUES:

1. Does a taxable bailment exist where government employees share use of property with the taxpayer and such employees have first priority in using such property?
2. Are the retrievers and carousels fixtures when they are bolted to mounts embedded in concrete floors?
3. Is the measure of tax reasonable rental value of similar products of like quality and character, or replacement cost where property is up to 30 years old and its use is shared with others?

#### DISCUSSION:

[1] Rule 211 provides in part:

(1) DEFINITIONS. The terms "leasing" and "renting" are used interchangeably and refer generally to the act of granting

to another the right of possession to and use of tangible personal property for a consideration.

(2) The term "bailment" refers to the act of granting to another the temporary right of possession to and use of tangible personal property for a stated purpose without consideration to the grantor.

(3) A true lease, rental, or bailment of personal property does not arise unless the lessee or bailee, or employees or independent operators hired by the lessee or bailee actually takes possession of the property and exercises dominion and control over it. Where the owner of the equipment or the owner's employees or agents maintain dominion and control over the personal property and actually operate it, the owner has not generally relinquished sufficient control over the property to give rise to a true lease, rental, or bailment of the property.

To accomplish change and acceptance of possession there must be delivery. See 8 Am. Jur. 2d Bailments § 68 (1963) which states:

In order to constitute a sufficient delivery of the subject of a bailment in any given case, it is the general rule that there must be such a full transfer, actual or constructive, to the bailee as to exclude the possession of the owner and all other persons and give to the bailee, for the time being, sole custody and control thereof. While there need not be delivery in the technical sense, there must be an actual change of possession from one person to another by a delivery to the bailee. The bailee must have so far assumed control of the property as to be liable to the owner for any losses occasioned by his neglect in the discharge of his trust with respect to it, but the delivery need not exclude the bailor's right to govern the bailee's conduct with regard to the chattel.

(Emphasis supplied.)

See also Collins v. Boeing Co., 4 Wn. App. 705, 711-712, 483 P.2d 1282 (1971) which concerned a bailment issue involving a theft of tools. The appeals court as well described the need to change physical possession and have a bailee accept possession. The court then stated:

In addition to physical control over the thing possessed, there must be a manifested intention to exercise that control. Accordingly, the intention of the parties accompanying the acts in relation to the subject matter

involved is explanatory of the nature and significance of the acts on the issue of change or assumption of possession.

See also Boeing Co. v. State, supra . where the government allowed Boeing to use tools and other property without charge in order to build Air Force planes. Boeing argued the use tax was inapplicable under RCW 82.12.020 and Rule 211 because it did not have exclusive control of the property and, therefore, it did not have exclusive possession of the property. The court acknowledged the government did have the power to terminate the bailment at will and it had the right to direct Boeing in its use. However, the court held that because Boeing did not have exclusive control of its own use of the property, that did not mean Boeing did not have exclusive possession. Rather, in upholding the tax, the court found the property was within the exclusive possession of Boeing during the time that it held it. The court stated Boeing "shared the possession with no one nor did it share its use." The court also noted the statute makes no mention of the right of exclusive possession. 74 Wn.2d at 84-85.

The taxpayer in the present action distinguishes its situation from Boeing Co. v. State by asserting it does not have exclusive possession of government property. The taxpayer has to share government property with military personnel who have priority in using the property. The property remains under the military's control more than in the Boeing case because the taxpayer is not permitted to remove the property from government facilities. Similarly, the military directly instructs the taxpayer in its day-to-day operations and assignments. In contrast, Boeing had more control and discretion over the use of government property in performing its contract to build airplanes.

After reviewing the facts in light of the statute, the rule and case law, we find the parties' contract reflects an intent to change possession with delivery to the taxpayer. The contract provides that before work commences under it, a joint inventory of items to be furnished to the taxpayer will be prepared. After receiving the items, the taxpayer is held to high standards of care and safety in order to maximize their usage and longevity. The contract states the taxpayer shall be responsible for the cost of any repairs caused by its negligence or abuse. Finally, the contract requires the taxpayer to return all items at its end.

We believe these facts meet the rule's definition of a bailment: the taxpayer has the temporary right of possession to and use of tangible personal property for a stated purpose without consideration to the grantor. As shown, a bailment occurs even if the government retains control over the taxpayer's conduct with regard to the property after delivery. 8 Am. Jur. 2d

Bailments § 68. Moreover, the statute does not require the taxpayer to have exclusive possession of the items. Boeing Co. v. State. The taxpayer has sufficient dominion and control over the property during the period it possesses the items to create a bailment.

[2] The next issue concerns whether the retrievers and carousels are fixtures and therefore exempt from use tax. The Department follows the common law rules for determining whether an item is realty or personalty. Lipsett Steel, Inc., supra. The three factors are (1) actual annexation, (2) application to use or purpose, and (3) intention to make a permanent part of the realty. First, the retrievers and carousels are bolted to concrete mounts or plates embedded in concrete floors in their buildings. Second, they are appropriately suited for their use or purposes. Third, they appear to be intended to be part of the real property according to the government's facility layout plan.

The most important factor is the intention of the parties. The courts and the Department have held when a property owner attaches an article to the land, the owner is rebuttably presumed to have annexed it with the intention of enriching the freehold. See Det. No. 89-541, 8 WTD 439 (1989) and Det. No. 88-342, 6 WTD 361 (1988). There has been no evidence presented in this matter to rebut this presumption of intent. Moreover, the present action is distinguishable from the facts in Det. No. 88-342 and Det. No. 89-541 where leases specifically provided that fixtures would be treated by the parties as personalty and not real property. The present action does not concern a lease of personal property and no agreement exists which states the items should be treated as personalty.

[3] Finally, we will address whether the proper measure of tax was used in the assessment. Rule 211(15) provides:

The value of tangible personal property held or used under bailment is subject to tax if the property was purchased or acquired under conditions whereby the retail sales tax was not paid by the bailor. Tax liability is that of the bailor, or of the bailee if the bailor has not paid the tax. The measure of the use tax for articles acquired by bailment is the reasonable rental for such articles to be determined as nearly as possible according to the rental price at the place of use of similar products of like quality and character. In the absence of rental prices for similar products the reasonable rental may be computed by prorating the retail selling price over the period of possession had by a bailee and payable in monthly installments. No further use tax is due upon property acquired by bailment after tax

has been paid by the bailee or any previous bailee upon the full original value of the article.

The taxpayer is correct. The acquisition or replacement value of the items is an incorrect measure of the use tax. The correct measure is the reasonable rental for such articles to be determined as nearly as possible according to the rental price at the place of use of similar products of like quality and character. Thus, the Department of Revenue must assess the tax on old or used items such as desks, lamps, telephones, dollies, file cabinets, etc. based upon the reasonable rental value of similar items in like condition in the area near the military base.

Furthermore, the bailment period covers the length of the contract or however long the taxpayer actually uses the equipment. Because the taxpayer has actual possession and control of the items for only eight hours each day, the rental rate should be apportioned accordingly by reducing or prorating it by two-thirds. In no instance shall the total tax assessed exceed the full original value (most likely the original purchase prices) of the items.

DECISION AND DISPOSITION:

The taxpayer's petition for correction is granted in part. This matter is remanded to Audit to adjust the assessment accordingly. DATED this 18th day of August, 1992.