

Cite as Det. No. 99-135E, 19 WTD 160 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Issuance of)	<u>F I N A L</u>
Certificate of Payment of State Excise Taxes)	<u>E X E C U T I V E L E V E L</u>
by Public Works Contractor)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 99-135E
)	
...)	Registration No. ...
)	
)	
)	

RULE 171; RCW 82.04.050: RETAIL SALES TAX – EXEMPTION – PUBLIC ROAD CONSTRUCTION. Legally required mitigation work performed on wetlands does not qualify as public road construction when those wetlands are physically separate from the actual county road construction project and/or when the wetlands are owned by the state.

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 county contends that construction work done on state-owned wetlands, in mitigation for the loss or deterioration of wetlands elsewhere in the county due to county road construction, qualifies as “public road construction” pursuant to RCW 82.04.050(6).¹

FACTS:

De Luca, A.L.J. – Depending on location, the county’s public works can impact wetlands or wetland buffers. The county’s own ordinance (. . .), as well as state law and the Federal Clean Water Act, require the county to mitigate such loss or damage by creating, restoring, or enhancing wetlands in the county. Such mitigation is known as “wetland banking.” Examples of wetland banking are where wetlands are created or enhanced by mitigation in one part of the

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

county to supplement wetlands that are diminished in size or quality by county road projects in another part of the county.

In the present case, the county performed road and bridge construction in a watershed separate and apart from the mitigation area, which is known as the The land upon which the wetland preserve is located is owned by the state of Washington. The county has a list of specific road projects that qualify for mitigation work in that particular wetland preserve under the terms of an “Interlocal Governmental Agreement” between the Washington State Department of Fish and Wildlife and the county. The county hired a landscaping contractor to perform the mitigation work in the preserve.

The county informed bidders interested in the job at issue that the income earned from this contract (. . .) would be taxable to the contractor under the public road construction business and occupation (B&O) tax classification. The county also informed bidders it would not pay retail sales tax on the contract amount. Instead, the successful bidder would be required to pay sales tax on its purchases of materials, equipment, and supplies used or consumed in the project. WAC 458-20-171 (Rule 171). The actual contract amount was \$. . . .

When the work was completed, the county notified the Department of Revenue (the Department), following the requirements of Chapter 60.28 RCW.² When the Department’s Audit Division reviewed the information submitted by the county, the Department determined that this work was a retail sale and sales tax was due on the full contract amount.³ Consequently, the Department did not issue the certificate that would have authorized the release of \$. . . of retainage. We note the Department has not assessed the amount of sales tax owing. The Department reasoned that the mitigation work was not performed in any road, easement, or right of way owned by the county that was used primarily for foot or vehicular traffic. Furthermore, the work was not performed on county-owned land, but on land owned by the state.

TAXPAYER’S EXCEPTIONS:

The county appeals the Department’s decision not to issue the Certificate of Payment of State Excise Taxes by Public Works Contractor that is required before the county may release the retainage. The county argues that the mitigation work done on the wetland preserve by the contractor qualifies as public road construction according to RCW 82.04.050(6) and Rule 171, rather than being a retail sale. The county contends various laws require the county to do the

² RCW 60.28.010 and .011 provide that public improvement contracts shall provide, and public bodies shall reserve, a contract retainage not to exceed five percent of the moneys earned by the contractor. The retainage is held as a trust fund for the protection and payment of: (a) the claims of any person arising under the contract; and (b) the state with respect to taxes imposed pursuant to Title 82 RCW that may be due from such contractor.

³ RCW 60.28.051 provides that the person in charge of disbursing payment funds for the public works contracts shall notify the Department of Revenue of the completion of contracts over \$20,000. That person shall not make any payment from the retainage until he has received from the Department a certificate that all taxes due and to become due with respect to the contract have been paid in full, or are readily collectible without recourse to the state’s lien on the retainage.

wetland mitigation work in order to perform the actual road and bridge construction elsewhere in the county.

The county also cites Pierce County v. Department of Rev., BTA Docket No. 94-44 (1995). The Department in that case applied a primary use test to find that Pierce County was not entitled to the sales tax exemption for public road construction because the weir was designed to pass fish and was not on a county road right-of-way. The Board of Tax Appeals agreed with Pierce County that the construction of the fish weir was public road construction because it was both legally required by state fisheries law and necessary to the operation of the road.

The county in this matter also disagrees with the Audit Division's position that because the county does not own the wetland property upon which the mitigation work was performed, it does not qualify for the sales tax exemption. The county replies "the most logical approach to this issue is that taken by the Board in the fish weir matter when the same argument was raised. The rule does not specifically address the situation at issue, and therefore, does not apply." Moreover, the taxpayer argues the Department is applying Rule 171 in a way that exceeds the scope of RCW 82.04.050(6) because the BTA in the fish weir case granted the exemption for work on "road systems" without regard to the ownership of the off-site mitigation. Further, the county argues since it owns the roads under construction, the exemption should apply because the contractor's mitigation work is legally necessary for road construction and operation.

Finally, the county notes the Department has not denied the exemption on previous wetland mitigation projects including this same wetland preserve.

ISSUE:

Does legally required mitigation work performed on state-owned wetlands qualify as public road construction when those wetlands are physically separate from the actual county road construction?

DISCUSSION:

For public road construction, a retail sale does not include...

(6) ...the sale of or charge made for labor and services rendered in respect to the building, repairing, or improving of any street, place, road, highway, easement, right of way, mass public transportation terminal or parking facility, bridge, tunnel, or trestle which is owned by a municipal corporation or political subdivision of the state or by the United States and which is used or to be used primarily for foot or vehicular traffic including mass transportation vehicles of any kind.

RCW 82.04.050.⁴ The Department adopted Rule 171 to administer the statute. The rule repeats the statute and adds in part:

The word "contractor" means a person engaged in the business of building, repairing or improving any street, place, road, highway, easement, right of way, mass public transportation terminal or parking facility, bridge, tunnel, or trestle which is owned by a municipal corporation or political subdivision of the state or by the United States and which is used or to be used primarily for foot or vehicular traffic, either as a prime contractor or as a subcontractor. It does not include persons who merely sell or deliver road materials to such contractors or to the public authority whose property is being improved. It also does not include persons who construct streets, roads, etc. owned by the state of Washington.

(Underlining ours). As noted, contractors performing public road construction report B&O tax under that classification upon their total contract price. RCW 82.04.280. Such contractors pay sales tax on all purchases of materials, equipment, and supplies used or consumed in the construction. Labor and services are exempt from sales tax. Rule 171.

However, if the mitigation project does not qualify as public road construction, the full contract price is subject to retail sales tax because all transactions involving construction or repair of real property are retail sales (RCW 82.04.050 (2)(b)), and landscaping maintenance also is a retail sale. RCW 82.04.050(3)(e).

In Pierce County v. Department of Rev., *supra*, a Pierce County road created an obstacle across a creek for the migration of fish. State law requires Pierce County to provide and maintain a durable and efficient fishway. Therefore, Pierce County hired a private contractor to perform maintenance and make improvements to a fish weir on land in which it holds an easement. The land with the easement is adjacent to Pierce County's right-of-way for the county road. The road right-of-way and the easement for the fish weir are on two separate parcels of land. The fish weir is located downstream of a culvert that is under the road.

Pierce County considered the fish weir repair work to be public road construction, which exempted Pierce County from sales tax. Pierce County argued the fish weir work on the adjacent property was performed as much to protect the culvert under the road from washing out as it was to protect fish. It was undisputed that the fish weir slowed the creek's water flow in such a manner to protect the soil under the culvert. Because the culvert was necessary to keep the road open, Pierce County argued the fish weir repairs were necessary to maintain the road and were related to continued use of the right-of-way for foot or vehicular traffic.

The Department's position was the primary purpose or use of the fish weir was not for foot or vehicular traffic. Rather its purpose was to allow for fish passage. The Department argued that

⁴ Effective July 1, 1998, this statutory section became RCW 82.04.050(7).

Pierce County had not shown that the repair charges to the fish weir were related to easements or rights-of-way for foot or vehicular traffic.

The BTA agreed with the Department that the primary purpose of the fish weir was to allow the passage of fish, but the BTA stated the Department too narrowly construed the tax exemption. The BTA declared the test for the tax exemption was not whether the fish weir easement was used primarily for foot or vehicular traffic, but whether the fish weir was necessary for the operation of the road. The BTA ruled that it was necessary because Pierce County “cannot complete its physical or legal requirements to construct and maintain the road without functioning fish weirs.” The BTA concluded:

Where a political subdivision can show charges are required to maintain the road, for both a physical and legal reason, a fair interpretation of the statute and legislative intent would be that the charges are for “foot or vehicular traffic”, pursuant to RCW 82.04.050(6) and are excluded from the term “retail sale”.

The BTA’s decision is not precedential. Det. No. 94-152, 15 WTD 041 (1995). Nonetheless, it is analytically persuasive as well as factually distinguishable from the present matter. Granted, in both Pierce County and the present matter, there are legal requirements for a county to do the environmental mitigation work. In one case, a fish weir had to be built. In the other, a wetland bank had to be enlarged or enhanced. However, by contrast, the easement property in Pierce County was adjacent to the right-of-way for the road and culvert. If the fish weir on the easement property was not properly constructed and maintained, the culvert and the road would wash out. Obviously, the fish weir had a physical connection to the road that is entirely lacking in the present matter. The wetland preserve in the present matter is miles from the county roads under construction that triggered the required mitigation work in the preserve. Thus, the charges for the mitigation work in the preserve are not required to construct or maintain the road for both a physical and legal reason. Only the legal reason applies.

Furthermore, the statute granting the sales tax exemption, RCW 82.04.050(6), makes clear that an eligible street, road, easement, right of way, etc. must be “owned by a municipal corporation or political subdivision of the state or the United States....” Of course, the state is not a municipal corporation or a political subdivision of itself. Tax exemptions are narrowly construed. Taxation is the rule and exemption is the exception. Budget Rent-A-Car, Inc. v. Department of Rev., 81 Wn.2d 171, 174, 500 P.2d 764 (1972). Therefore, the public road construction classification is not applicable to construction on state-owned land. Rule 171 makes this statement clear where it provides that the definition of a public road contractor “does not include persons who construct streets, roads, etc. owned by the state of Washington.” See Det. No. 86-264, 1 WTD 229 (1986). See also Excise Tax Advisory 437.08.171, which provides in part:

The term "construction" as used herein means the building, repairing, or improving of a publicly owned highway, street, place, or road as defined in published Rule 171.

As of July 1, 1971 in implementation of Chapter 299, Laws of 1971, Ex. Sess., state retail sales tax shall be imposed on state highway construction contracts as follows:

1. Where title to the land upon which the facility is being constructed vests in the state of Washington, the construction contract amounts to a sale at retail and retail sales tax shall be imposed upon the full contract price and separately billed.

...

2. The tax liability outlined in #1 above shall also apply to construction of highways under the following circumstances:

...

g. Construction across federally owned lands where the federal government has granted the state an easement for the right of way.

h. Construction across lands acquired for the state by the federal government in federal court proceedings after transfer of title is accomplished from the federal government to the state.

Thus, it is the Department's position that retail sales tax applies on the entire contract price even when the public construction projects occur within state easements on federally owned lands, or when the construction occurs on land previously owned by the federal government, but now owned by the state. We agree with the Department. Construction or landscaping performed on the state-owned wetland preserve does not qualify for the tax exemption allowed public road construction.

Finally, the county noted the Department had issued a Certificate of Payment of Excise Taxes in another county works project involving this same wetland preserve. The Department's Audit Division issues the certificates based solely on the information submitted by the county. The fact that the Department may have overlooked facts or may not have had all the facts does not bar the Department from assessing the taxes that are rightfully due. See, Kitsap-Mason Dairymen's Ass'n. v. Washington State Tax Comm'n, 77 Wn.2d 812, 467 P.2d 312 (1970). In Kitsap-Mason, the taxpayer had made erroneous bookkeeping entries for fifteen years pertaining to sales tax collections and remittances. The state tax commission did not question that bookkeeping practice in audits prior to the one that raised it. Nonetheless, the Supreme Court ruled that the tax commission was not estopped (i.e. barred) from assessing and collecting the tax. The Supreme Court declared:

This is not a case in which auditors changed their interpretation of a statute or rule. It is one in which they overlooked through ignorance, neglect or inadvertence Kitsap's error in computing the tax. The fact that the oversight only recently has been discovered does not relieve Kitsap of its liability for the correct tax during the audit period now under consideration.

77 Wn.2d at 818.

DECISION AND DISPOSITION:

The taxpayer's petition is denied. The county should pay retail sales tax on the full contract price. If it does not, the Department will assess the sales tax due.

Dated this 19th day of May 1999.