

Cite as Det. No. 99-147, 19 WTD 447 (2000)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment	)	<u>D E T E R M I N A T I O N</u>
	)	
	)	No. 99-147
...	)	
	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
	)	

- [1] RULE 178; RULE 211; RCW 82.04.050; RCW 82.12.020: RENTAL OR LEASE OF EQUIPMENT – PAYMENT BY SUBLESSEE OF LESSEE’S OBLIGATION TO LESSOR. A lessee of personal property becomes liable for the use tax when it does not pay the sales tax to its lessor. Where the sublessee makes lease payments directly to the lessor, and those payments include retail sales tax, the sublessee does not owe use tax with respect to those payments.
  
- [2] RCW 82.32A.030: IGNORANCE OF TAX OBLIGATIONS – LIABILITY FOR TAX. The fact that the taxpayer is not aware that tax is due on a transaction is not a valid defense to a valid tax assessment issued by the Department.
  
- [3] RULE 17001; RCW 82.04.190: GOVERNMENT CONTRACTING – USE TAX ON MATERIALS SUPPLIED -- CONSUMER. Contractor or subcontractor who installs materials for the federal government is considered the consumer of the materials and is liable for the use tax based upon the material costs.
  
- [4] RULE 171; RCW 82.04.190: PUBLIC ROAD CONSTRUCTION – CONSUMER. Where a contractor performs road construction for a municipality, the contractor will be required to pay retail sales/use tax on the materials used. However, where the contractor’s activities on a project were limited to supplying labor, and the contractor neither purchased nor installed any materials, the contractor neither used nor consumed any materials on which to assess retail sales or use tax.

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 trucking and excavating company (Taxpayer) seeks a correction of use tax assessments on rental equipment and materials used on government contracting jobs.<sup>1</sup>

FACTS:

D. Thomas, A.L.J. – The Taxpayer operates a trucking and excavation company.<sup>2</sup> The Taxpayer's company provides services related to the construction of roads (federal, state, and local), buildings, school playgrounds, and parking lots. The Taxpayer's business activities for this audit period included excavating, grading, and earthmoving, principally as a subcontractor for public road construction, and construction for the federal government.

The Department of Revenue's Audit Division (Audit) examined the Taxpayer's records for the period January 1, 1993 through December 31, 1996. An audit disclosed \$. . . in taxes and interest owing. Tax Assessment No. FY . . . in that amount was issued September 3, 1997. The assessment was due October 3, 1997.<sup>3</sup>

**The Taxpayer contests the following portions of the assessment:**

Rental of equipment subject to use tax.<sup>4</sup>

In Schedule 3 Audit asserted use tax on equipment the Taxpayer leased from another construction company, which in turn was leasing from an equipment leasing company. The Taxpayer stated she and the other construction company's owner have co-habited for over thirteen years in Washington and considered themselves married. The Taxpayer stated she made the lease payments, for which her domestic partner's company was responsible, directly to the equipment leasing company (lessor), which had included the retail sales tax in the original lease agreement. The Taxpayer stated during the teleconference that though she and her domestic partner "were not married", business transactions between their respective companies are in essence transactions between a married couple, and therefore not subject to either retail sales or use tax. The Taxpayer contends the assessment amounts to being taxed twice on the leased equipment.

Audit's position is that for excise tax purposes, the definition of "person or company" does not include a "marital community" nor does it include persons living together. Audit considered

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

<sup>2</sup> The Taxpayer ceased operating as a sole proprietor June 30, 1998. The Taxpayer began operating as . . . , Inc. July 1, 1998.

<sup>3</sup> On October 1, 1997 the Taxpayer paid that portion of the audit assessment which she does not contest (\$. . . on Schedule 4). The current remaining balance indicates principle in the amount of \$. . . and interest in the amount of \$. . .

<sup>4</sup> The equipment included two backhoes, a bulldozer, and a dump truck. The agreement was a bare equipment lease; the Taxpayer's employees operated the equipment on all jobs.

each individual in this situation a “person” and accordingly assessed use tax on the transactions between the Taxpayer and her partner.

Materials on government subcontracting and public road construction jobs.

In Schedule 5, the Audit Division listed Taxpayer’s business activities of construction for the federal government and public road construction.

In reliance upon WAC 458-20-17001 (Rule 17001), Audit noted prime and subcontractors are subject to the retail sales tax or use tax on the value of materials incorporated into buildings or structures constructed for the U.S. government, its agencies or instrumentalities, and city and county housing authorities.

In reliance upon WAC 458-20-171 (Rule 171), Audit noted the retail sales tax also applies upon the sales to public road contractors on all materials used or consumed in the performance of such government contracts and public road construction jobs. The use tax was assessed on the value of all items when the retail sales tax had not been paid.

Pursuant to the above Rules, Audit assessed deferred sales tax and/or use tax on materials used by the Taxpayer as a “consumer” in the performance of the government contracts and public road construction jobs. The use tax was assessed upon the value of all items installed including government-furnished items.

The Taxpayer takes exception to Audit’s assessment of deferred sales or use tax on the following government jobs in Schedule 5:<sup>5</sup>

1. Federal Aviation Administration (FAA): The Taxpayer stated the general contractor on this project supplied all materials. The Taxpayer contends that her sub-contract book, spec book, and plans did not indicate use tax was due on the materials she used in the project. The Taxpayer argues her failure to include use tax in her bid is directly attributable to the lack of information in the cited materials.

2. . . . Schools: The Taxpayer stated she acted as a subcontractor for a general contractor on this playground job for the federal government. The Taxpayer contends she only submitted a bid for equipment and labor. The Taxpayer stated the general contractor supplied all other materials, with the exception of some “pea gravel”,<sup>6</sup> which she supplied. The Taxpayer thought the general contractor paid the retail tax on material. The Taxpayer also noted that pertinent information regarding tax liability was not in the bid documents.

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<sup>5</sup> Materials used on a federal contracting job for the FAA were used as a test, the results of which were then projected to the other government contracting jobs and the public road construction jobs based on their percentage relationship to the contract price. Audit stated future adjustments to this portion of the audit were contingent upon the Taxpayer providing additional records.

<sup>6</sup> The Taxpayer purchased and paid sales tax on the pea gravel, and no tax was assessed on this transaction.

3. . . . Highway: The Taxpayer contends no material was used or installed on this job by her company, therefore no use tax is due. The Taxpayer stated her company only cleared and grubbed the side of the highway for a general contractor, i.e., she supplied only labor.

#### ISSUES:

1. Is the use of tangible personal property acquired by sublease subject to use tax when the user directly paid the sublessor's obligation to the lessor which included retail sales tax with respect to the property used?
2. Are the materials used by a subcontractor as a consumer in the performance of government contracts and public road construction projects subject to deferred sales tax and/or use tax?

#### DISCUSSION:

##### **[1] Rental of equipment subject to deferred sales or use tax.**

RCW 82.04.050 defines the term "sale at retail" or "retail sale" to include every sale of tangible personal property . . .

(4) [including] the renting or leasing of tangible personal property to consumers and the rental of equipment with an operator.<sup>7</sup>

When retail sales tax has not been paid, RCW 82.12.020 imposes the use tax for:

the privilege of using within this state as a consumer any article of tangible personal property purchased at retail.<sup>8</sup>

WAC 458-20-178, the administrative rule implementing the use tax statute, states in part:

1) Nature of the tax. The use tax supplements the retail sales tax by imposing a tax of like amount upon the use within this state as a consumer of any article of tangible personal property . . . acquired by lease . . . where the user has not paid retail sales tax under chapter 82.08 RCW with respect to the property used.

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<sup>7</sup> WAC 458-20-211 (Rule 211) addresses the above statute's terms and states 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.

<sup>8</sup> RCW 82.04.190 defines the term "consumer" to include:

Any person who purchases, acquires, owns, holds, or uses any article of tangible personal property irrespective of the nature of the persons business . . . .

(2) In general, the use tax applies upon the use of any tangible personal property, which has not been subjected to the Washington retail sales tax. Conversely, it does not apply upon the use of any property if the sale to the present user . . . has been subjected to the Washington retail sales tax, and such tax has been paid thereon. Thus, these two methods of taxation stand as complements to each other in the state revenue plan, and taken together, provide a uniform tax upon the sale or use of all tangible personal property, irrespective of where it may have been purchased or how acquired.

...

(6) Lessors and lessees. Any use tax liability with respect to leased tangible personal property will be that of the lessee and is limited to the amount of rental payments paid or due the lessor. However . . . when equipment and similar property are rented under conditions whereby the lessor itself supplies an operator or crew, the lessor itself is the user and the use tax is applicable to the value of the property so used.

Thus, in accordance with the above, a person who leases an article of tangible personal property for use in the regular course of business and uses the item must pay sales or use tax. A lessee of personal property becomes liable for the use tax when it does not pay the sales tax to its lessor. WAC 458-20-211(13); Det. No. 87-75, 2 WTD 385 (1987).

The Taxpayer states she paid the lease payments directly to the lessor. In other words, the Taxpayer substituted performance for her domestic partner's construction company, which had the obligation to make the lease payments on the equipment. Under the principles of general contract law, in a three party situation, the payment of a person's obligation to a third party is deemed a payment to the person. Thus, the Taxpayer's payment of the lease price to the lessor, which included retail sales tax, is deemed to include the payment of retail sales tax to her domestic partner's construction company. To the extent that the Taxpayer can demonstrate that she paid retail sales tax to the lessor, she will be deemed to have paid retail sales tax on the sublease of the equipment. Because the Taxpayer paid retail sales tax, she does not owe use tax.

The file will be remanded to the Audit Division for the purpose of verifying the payment to the lessor of retail sales tax and adjusting the tax assessment.

**[2] Materials on government subcontracting and public road construction jobs subject to deferred sales and use tax.**

Federal Aviation Administration (FAA).

RCW 82.32A.030 addresses taxpayer rights and responsibilities; it states in part:

To ensure consistent application of the revenue laws, taxpayers have certain responsibilities . . . including, but not limited to, the responsibility to . . .

(2) Know their tax reporting obligations, and when they are uncertain about their obligations, seek instructions from the department of revenue . . . .<sup>9</sup>

The Taxpayer's only argument with respect to the assessment on the FAA job was that she wasn't aware any use tax would be due on the costs of materials. However, a taxpayer's lack of knowledge regarding State of Washington tax liability is not a valid defense to a valid tax assessment issued by the Department. Accord: Det. No. 86-278, 1WTD 287 (1986); Det. No. 90-340, 11 WTD 81 (1990).

It would be an impossible burden on the state to be required to specifically inform each taxpayer of its tax responsibilities. The Department does make every feasible effort to provide taxpayers with information by maintaining regional offices throughout the state, the Taxpayer Information and Education Section, and a statewide toll-free telephone system for taxpayers to use. The Department also provides free seminars on the tax system and will respond to written requests.

We are sympathetic to the Taxpayer's situation with respect to the complexities regarding tax liability when submitting public works bids. However, Washington tax law places the burden squarely on all taxpayers to know their own tax liability and to properly report and pay taxes. There is no basis in law by which we are permitted to grant relief. We find the tax was properly assessed.

The Taxpayer's petition on this portion of the assessment is denied.

[3] . . . Schools.

Rule 17001 is the rule that pertains to public works contractors who perform work for the federal government. Rule 17001 addresses with particularity the application of sales and use taxes on "construction, installations, or improvements to [United States] government real property". Rule 17001 states in part:

(5) The retail sales tax does not apply to the gross contract price, or any part thereof, for any business activities taxable under the government contracting classification. Prime and subcontractors who perform such activities are themselves included within the statutory definition of "consumer" under RCW 82.04.190 and are required to pay retail sales tax upon all purchases of materials . . . including tangible personal property which is installed, applied, attached, or otherwise incorporated in their government contracting work. This applies for all such purchases of tangible personal property for installation, etc., even though the full purchase price of such property will be reimbursed by the government . . . in the gross contract price.

. . .

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<sup>9</sup> WAC 458-20-228 similarly states that "taxpayers have a responsibility to become informed about applicable tax laws . . . ."

(7) The use tax applies upon the value of all materials, equipment, and other tangible personal property purchased at retail . . . upon which no retail sales tax has been paid by the contractor . . . .

. . .

(9) The use tax is to be reported and paid by the government contractor who actually installs or applies the property to the contract. Where the actual installing contractor pays the tax, no further use tax is due upon such property by any other contractor.

(Emphasis added.)

Under Rule 17001, amounts derived from improving real property for the United States are not subject to retail sales tax. Rather, the subcontractor who installs the property is considered the consumer. RCW 82.04.190. Therefore, if the subcontractor installs the property, the subcontractor would be liable for the use tax based upon its material costs.

On this federal government job, the contract between the general contractor and the Taxpayer specifically states the “subcontractor shall furnish all labor, materials, supervision, equipment, insurance, all applicable taxes, overhead, and all other item of expense, things or services necessary” to complete the job. Nearly every item in the contract states the “subcontractor shall provide” the materials and labor necessary to install the materials for this job. The actual installation of the materials was performed by the Taxpayer.

Thus, under RCW 82.04.190 and Rule 17001, the Taxpayer, as a public works subcontractor, is a “consumer” of the materials and is required to pay retail sales tax upon all purchases of materials, including tangible personal property, which it installed, applied, attached, or otherwise incorporated in their government contracting. Where the retail sales tax has not been paid, the use tax applies to the value of the materials used. Accordingly, we find the use tax was properly assessed.<sup>10</sup>

The Taxpayer’s petition on this portion of the assessment is denied.

[4] . . . Highway.

Rule 171 applies when work is performed to improve streets or roads owned by a municipal corporation or political subdivision of the state and which are used primarily for foot or vehicular traffic. Rule 171 provides in pertinent part:

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<sup>10</sup> The Taxpayer also argued the bid information contained no information regarding tax liability. However, as also noted above, the subcontract terms under Section 1.0 “Scope of Work” specifically state labor, materials, and all applicable taxes are to be furnished by the subcontractor. The Taxpayer had the responsibility to become informed regarding the applicable tax laws. Id.

## BUSINESS AND OCCUPATION TAX (B&O)

Such contractors are taxable under the public road construction classification upon their total contract price. . . <sup>11</sup>

....

## RETAIL SALES TAX

The retail sales tax applies upon the sale to such contractors of all materials including equipment and supplies used or consumed in the performance of such contracts.

The retail sales tax does not apply upon any portion of the charge made by such contractors.

The sales tax does not apply to charges made for labor and services, which are exempt from business tax. . . .

....

## USE TAX

The use tax applies to the use by all contractors of all materials including . . . . equipment and supplies upon which the retail sales tax has not been paid. This tax also applies in respect to articles produced or manufactured by them for commercial use.

Under Rule 171, if a contractor performs road construction for a municipality, the contractor will be required to pay retail sales/use tax on the materials used.

The Taxpayer's activities on this particular project were limited to "clearing" and "grubbing".<sup>12</sup> Under the terms of the contract the Taxpayer neither purchased nor installed any materials, but rather furnished only labor for a prime contractor. Thus, the Taxpayer neither used nor consumed any materials on which to assess retail sales or use tax. The Taxpayer's particular activity on this project is subject to the B&O, but we find the assessment of use tax on materials was in error.

The Taxpayer's petition on this portion of the assessment is granted.

## DECISION AND DISPOSITION:

The Taxpayer's petition is denied in part and granted in part and this matter is remanded to the Audit Division for adjustment of the assessment as provided in this determination.

Dated this 26<sup>th</sup> May 1999.

<sup>11</sup> Rule 171 defines a "contractor" as a person engaged in the business of building, repairing, or improving any street, road, highway owned by a municipal corporation . . . . either as a prime contractor or a subcontractor.

<sup>12</sup> "Grubbing" is the process by which brush is removed from the land, but does not include, according to the Taxpayer, the removal of any tree stumps.