Cite as Det. No. 00-029, 19 WTD 714 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 00-029
	)	
. . .	)	Use Tax Assessment
	)	

RULE 17001; RCW 82.04.050; RCW 82.04.190(6): GOVERNMENT CONTRACTING – NONPERMANENT INSTALLATIONS – MATERIAL COSTS IN RELATION TO LABOR COSTS. A person engaged in the business of constructing, repairing, decorating, or improving new or existing buildings or other structures for the United States government is a consumer of the installed materials even though the materials do not become a part of the realty by virtue of the installation and labor costs are minor in relation to material costs.

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.

Mahan, A.L.J. – The federal government seeks a refund of use tax assessed against and paid by an electrical subcontractor on materials installed by the subcontractor at a federal government facility.[1]

ISSUE:

Did the Department properly impose use tax on materials installed by a government contractor at a federal facility, or did it improperly tax the sale of tangible personal property to the United States government?

FACTS:

. . . (now known as . . .) entered into an agreement with the federal government to design, manufacture, and install uninterruptible power systems (UPS) at various airport facilities in the United States, including one located in the State of Washington. The systems were designed so that they could be unbolted and removed from one facility and reinstalled in another facility

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

should the need arise. In early 1990, [Corp] entered into an "[Corp] Electronics' Subcontract Agreement for Power System Modification at Seattle ARTCC Under Air Force Contract No. . . ." with [Electrical Subcontractor]

As an electrical subcontractor, [Electrical Subcontractor] completed wiring of the building where the UPS was placed and installed the generator, batteries, and other components of the UPS. [Corp] supplied most of the materials. In total, [Electrical Subcontractor] installed $. . . in materials supplied by [Corp] and $. . . in materials supplied by [Electrical Subcontractor]. [Electrical Subcontractor]'s total labor costs were approximately $. . . .

The Department of Revenue (Department) audited [Electrical Subcontractor]'s records. The Department concluded that [Electrical Subcontractor] was engaged in government contracting activity and all materials installed as part of the activity were subject to use tax. On April 6, 1994, the Department issued an assessment imposing use tax on all materials installed by [Electrical Subcontractor] at the federal facility. The use tax assessment totaled $. . ., not including any penalties or interest. In 1994, [Electrical Subcontractor] paid this amount, plus penalties and interest, in the total amount of $. . ., for which it was reimbursed by the federal government, through [Corp].

In 1996, [Corp] requested a ruling from the Department's Taxpayer Information and Education section (TI&E) as to whether the use tax exemption for tangible personal property sold to the United States government applied to an uninterruptible power system "sold and installed at existing Federal facilities by our client [[Corp]]".[2] By letter dated November 19, 1996, TI&E ruled:

> Considering that the installation of the UPS is not done in a permanent fashion, and that the installation costs are minor when compared to the total contract, this is not a government contracting job. The total contract price is subject to the retailing business and occupation tax. A deduction is allowed from the retail sales tax for *Sales to the U.S. Government*.[3]

As a result of this ruling, [Corp] sought a refund of the use tax from [Electrical Subcontractor], which contacted the Department's auditor. In response, the Department's auditor informed [Corp], by letter dated June 24, 1997, that it should file a refund request directly with the Department (not with [Electrical Subcontractor]), and included a copy of WAC 458-20-100, regarding appeals of departmental actions. On February 8, 1999, the United States government filed a petition for refund of the use tax.

ANALYSIS:

[2] The ruling request made no mention of the audit assessment or [Electrical Subcontractor].

[3] The record before us does not identify the basis for the factual conclusion that [Corp]'s installation costs were minor.

Under Washington law, most prime contractors must collect retail sales tax from consumers for all materials, labor, and overhead costs incurred during construction. RCW 82.04.050(2); WAC 458-20-170. However, retail sales tax cannot be imposed directly on the federal government for the construction, installation, or improvements to government property. RCW 82.04.050(7); WAC 458-20-17001.[4]

In order to receive some retail sales or use tax revenues from federal government contracting activity, Washington developed a statutory framework whereby federal government contractors pay sales or use tax on materials used in completing the contract. The sales or use tax becomes part of the cost of the project and is passed on to the United States in the contract price, thus allowing the state to collect some state tax on federal government contracts without directly taxing the United States. That procedure was sustained by the United States Supreme Court in *Washington v. United States*, 460 U.S. 536 (1983).[5]

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[4] The United States Supreme Court has interpreted the Supremacy Clause of United States Constitution, Art. VI, cl. 2, such that a state may not "lay a tax directly upon the United States or upon any agency or instrumentality so closely connected to the United States that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." *United States v. New Mexico*, 455 U.S. 720, 735 (1982).

[5] In *Washington*, the United States Supreme Court summarized the development of this statutory framework as follows:

> Before 1941, building contractors were treated as consumers for sales tax purposes. All sales of tangible personal property, such as construction materials, to contractors were subject to the sales tax. The legal incidence of this tax was on the contractor; the tax was collected by suppliers who sold to contractors, and remitted by them to the State.
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> In 1941, Washington changed the sales tax system it applied to contractors by defining the landowner who purchases construction work from the contractor, rather than the contractor, as the "consumer." The legal incidence of the tax was now on the landowner, who paid tax on the full price of the construction project. The net result was that contractors' labor costs and markups were added to the tax base, which had previously included only the cost of tangible personal property sold to contractors.
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> The post-1941 tax system could not, however, be applied to construction for the Federal Government because the Supremacy Clause prohibits States from taxing the United States directly. *United States* v. *New Mexico*, 455 U.S. 720 (1982). Thus, when the United States was the landowner, Washington did not collect any tax on the sale either of tangible personal property to the contractor or of the finished building to the Government.
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> In 1975, the Washington Legislature acted to eliminate the complete tax exemption for construction purchased by the United States. It did so by reimposing the pre-1941 tax on contractors that work for the Federal Government ("federal contractors"). Thus, Washington now taxes the sale of nonfederal projects to the landowner, and taxes the sale of materials to federal contractors. The net result is that for federal projects the legal incidence of the tax falls on the contractor rather than the landowner, and the tax is measured by a lesser amount than the tax on nonfederal projects because the contractor's labor costs and markup are not included in the tax base.

Washington v. United States, 460 U.S. at 539-40 (1983) (footnotes omitted).

In regard to government contracting, RCW 82.04.190(6) provides that contractors performing work for the United States government are consumers and, as a consequence, are subject to tax on materials used in completing the contract.[6] In relevant part it defines the term "consumer" to include:

> Any person engaged in the business of constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property of or for the United States, any instrumentality thereof, or a county or city housing authority created pursuant to chapter 35.82 RCW, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation; also, any person engaged in the business of clearing land and moving earth of or for the United States, any instrumentality thereof, or a county or city housing authority created pursuant to chapter 35.82 RCW. Any such person shall be a consumer within the meaning of this subsection in respect to tangible personal property incorporated into, installed in, or attached to such building or other structure by such person; . . .

(Emphasis added.) As a result, the ultimate consumer pays retail sales tax on the full contract price on nonfederal contracts, while on federal government contracts the contractor, as a consumer of the materials, pays retail sales or use tax only on the materials used in completing the contract.

In the present case [Electrical Subcontractor], as an electrical subcontractor, was "engaged in the business of constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property of or for the United States". RCW 82.04.190(6). The question then is whether [Electrical Subcontractor] was the consumer of the materials subjected to tax. Under the plain meaning of the statute, [Electrical Subcontractor] is considered the consumer of the materials it installed as a government contractor, and it is liable for retail sales or use tax on the materials it installed.

The TI&E ruling provides no authority for a different result. That ruling was premised on mixed findings of law and fact that [Corp] was not engaged in government contracting activity because the installation was not permanent and labor costs were minor in comparison to material costs. The facts in the present case are different. For example, [Electrical Subcontractor]'s labor costs were not minor. Even if we accept the ruling's factual finding and apply it to [Electrical Subcontractor], there is no basis in the law to limit imposition of use tax in this manner. In fact, the statute expressly provides that installed materials do not have to become part of the realty, that is, they do not have to be permanently installed. Similarly, the statute does not require a comparison of labor to material costs in order for use tax to be imposed.

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[6] RCW 84.04.280(7) specifically makes contractors on federal contracts subject to B&O tax and, by extension, consumers. RCW 82.12.020 provides that use tax will be paid when those identified as consumers by RCW 82.04.280(7) purchase articles of tangible personal property at retail. *See, e.g., Metalfab, Inc. v. Department of Rev.*, No. 93-33 (Bd. of Tax Appeals 1993).

Our holding in this regard is consistent with the *Washington v. United States* decision. In a nonfederal contract, the consumer would be required to pay retail sales tax on all materials installed on the job, even if not permanently installed and labor costs were minor in relation to material costs, and on all labor and overhead costs. In the context of a federal government contract, even if labor costs were minor in relation to material costs and installation was not permanent, the tax is still measured by "a lesser amount than the tax on nonfederal projects because the contractor's labor costs and markup are not included in the tax base." *Washington v. United States*, 460 U.S. at 540 (1983).[7]

Accordingly, we sustain the Department's assessment of tax.

DECISION AND DISPOSITION:

The petition for refund is denied.

Dated this 29th day of February, 2000.

[7] In reaching this conclusion, we note that the petition for refund may also be time barred under the facts before us. RCW 82.32.060, as amended in 1992, provides a nonclaim period for refunds and credits. It specifically provides that "[n]o refund or credit shall be made for taxes paid more than four years prior to the beginning of the calendar year in which the refund application is made or examination of records is completed." Because it appears that a refund claim was not made with the Department until 1999 for taxes paid in 1994, the claim appears time barred on the limited record before us. *See also* WAC 458-20-229.