

Cite as Det. No. 99-263, 19 WTD 307 (2000)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of	)	<u>D E T E R M I N A T I O N</u>
Assessment of	)	
	)	No. 99-263
	)	
...	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
	)	
	)	

[1] RULE 171; RCW 82.04.050 RETAILING B&O TAX VS. PUBLIC ROAD CONSTRUCTION B&O TAX – SERVICES IN RESPECT TO CONSTRUCTING -- WATER DRAINAGE SYSTEMS -- Contractor who installs lines that collect water from downspouts on houses to drain the downspouts into sewer catch basins properly taxed under the retailing classification. Such lines handle runoff from roofs, not the streets and roads in which the lines are constructed.

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:

Contractor who installs lines that collect water from downspouts on houses to drain the downspouts into sewer catch basins protests the reclassification of its income from the public road construction classification of the business and occupation (“B&O”) tax to the retailing classification.<sup>1</sup>

FACTS:

C. Pree, A.L.J. -- The Department of Revenue audited the taxpayer’s records for the period of January 1, 1993, through June 30, 1995. The audit resulted in the assessment of retail sales tax of \$. . . , retailing B&O tax of \$. . . , use tax of \$. . . , and interest of \$. . . . The taxpayer received a credit of public road construction B&O tax of \$. . . . The assessment totaled \$. . . .

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

The taxpayer protests the reclassification of a portion of its income from installing storm water drainage systems from the public road construction to the retailing B&O tax classification. The taxpayer argues that all portions of the storm water system are public road construction. Specifically, the taxpayer disagrees with the reclassification of “lot” or “yard” drains. The Audit Division described these drains as follows:

These are lines that run from storm sewer catch basins to a corner of each lot. These lines have connection[s] for each house to attach it's [sic] respective downspout or other drain.

The taxpayer does not disagree with this description. Instead, the taxpayer argues that roof runoff would become road surface water without these drains. Further, the taxpayer argues, in some instances, the drainpipe between lot corners and storm catch basins is in the road right-of-way. The taxpayer also believes that the local government to whom the road was dedicated is responsible for maintaining this portion of the roof drainage lines. However, the Audit Division noted that the taxpayer did not provide any evidence to support the latter assertion.

The Audit Division concluded that the lines are not installed primarily to handle road run-off. Instead, they are primarily designed to handle roof or lot runoff. Thus, the Audit Division concluded that the installation of these lines does not qualify as public road construction.

#### ISSUE:

Whether a contractor who installs lines that collect water from downspouts on houses to drain the downspouts into sewer catch basins is subject to tax under the public road construction classification or the retailing classification.

#### DISCUSSION:

Persons engaged in making sales at retail are subject to B&O tax under the retailing classification. RCW 82.04.050(2) defines retail sales to include:

the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following:

...

(b) The constructing . . . of . . . structures under, upon, or above real property of or for consumers, including the installing or attaching of any article of tangible personal property therein or thereto . . . .

RCW 82.04.050(7) further provides:

[T]he term [retail sale] shall not include the sale of or charge made for services rendered in respect to the building, repairing, or improving of any street . . . , easement, right of way, . . .

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 . . .

Thus, rather than being taxed under the retailing classification, persons engaged in the following activities are subject to B&O tax under the "public road construction" classification:

building, repairing or improving any street, . . . easement, right of way . . . 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 . . .

RCW 82.04.280(2). WAC 458-20-171 (Rule 171) is the administrative rule that explains the statute. It provides in pertinent part as follows:

The term "building, repairing or improving of a publicly owned street, place, road, etc.," includes . . . the constructing of . . . drainage facilities . . .; also the constructing of a drainage system in streets and roads, even though such system is also used for the carrying of sewage: PROVIDED, That the drainage facilities are sufficient for disposal of the normal runoff of surface waters from the particular streets and roads in which the system is constructed or an ordinance authorizing the construction of a combined sewer system is incorporated by reference in the contract and the contract or specifications clearly indicate that the system is designed and intended for the disposal of the normal runoff of surface waters from the streets and roads in which the system is constructed.

Det. No. 88-389, 6 WTD 465 (1988), addressed the issue of whether two projects were properly taxed under the public road construction classification. The first project involved the construction of a new sewer line within the street right of way. The new line was intended to carry all of the sanitary flow of a particular basin and also carried about twenty percent of the stormwater runoff. This stormwater runoff was from roof drains and other storm system connections which could not be efficiently separated from the sanitary sewer. None of the runoff was from the surface of the streets in which the system was constructed. Street restoration was a major part of this project because the new lines were constructed in street right of ways. We held that this project was properly taxed under the retailing classification. We reasoned:

This is because it is the construction of a sewage system and not a drainage system. Although some storm runoff will flow through the line constructed in Phase I, **the source of the runoff is not the streets and roads in which the system is constructed.**

Even though street restoration is a part of the work performed in Phase I, that portion of the work would not be classified as public road construction. This is because such work consists of:

. . . labor and services rendered in respect to . . . the constructing, repairing, decorating, or improving of . . . structures under . . . real property . . .

RCW 82.04.050(2).

The language quoted above is a portion of the definition of a retail sale. The street restoration is work rendered in respect to the construction of the sewer line, which is a structure under real property. Since the work meets the definition of a retail sale it is taxable under the retailing classification of the business and occupation tax rather than the public utility classification. RCW 82.04.250.

Similarly, the lines at issue here handle runoff from roofs, not the streets and roads in which the lines are constructed. As such, the income from installing such lines is properly taxed under the retailing classification.

In contrast, the second project at issue in the above determination involved converting the existing combined sewer trunk to a storm drain trunk. The storm drain lines were constructed in street right of ways. Existing storm service connections and combined service connections were connected to these storm drain lines, which flowed into the storm drain trunk. The flow in these lines was from the surface of the streets in which the system was constructed. Street restoration was a major part of this project because the new lines were constructed in street right of ways. We held that this project was properly taxed under the public road construction classification. We reasoned, "It is the construction of a drainage system in streets and roads which disposes of the runoff of surface waters from the streets in which it is constructed."

Similarly, Det. No. 88-147, 5 WTD 147 (1988), involved a taxpayer who constructed storm drainage systems that were located in public streets or rights of way. The taxpayer argued that this system was "an integral part of a drainage system designed primarily to carry off and dispose of normal water run-off of public streets and roads." The pipes and drain fields accommodated the runoff of water from public streets and roads, although some house drainage went into the fields on an incidental basis. The Audit Division recognized that storm sewers constructed within a public street right of way were taxable under the public road construction classification. However, the Audit Division reclassified those portions of the storm sewer system which extended outside of the street right of way to the retailing classification. In holding that the entire amount was properly classified as public road construction, we reasoned:

We believe that the construction of the storm sewers is "rendered in respect to" the "improving" of a street in that such construction renders the street better able to serve the purpose for which it was intended, viz. the movement of "foot or vehicular traffic" in an orderly and efficient manner. Were it not for the storm sewers and their extensions including the pipes and drain fields located outside of the street right-of-way, the street would be less usable and desirable as such in that cars and pedestrians would have to plow through small bodies of water. We, therefore, conclude that construction of drainage facilities which extend beyond the borders of a street right-of-way are taxable for B&O purposes under the Public Road Construction classification just as such construction within street right-of-ways is.

Inasmuch as certain unspecified drainage from nearby houses goes into the drain fields on an "incidental" basis, the caveat to Rule 171, to the effect that the drainage facilities must be designed to and capable of disposing of the normal run-off of surface water from the street(s) it serves, may come into play. If this is, in fact, a combined system in that sewage from the nearby houses is accommodated as well as the street run-off, then that condition must be met. Here, based on the descriptions furnished by both the taxpayer and the auditor, we assume that it is met and, therefore, the taxability of the subject project does not change even if the drainage system is used for sewage on an "incidental" basis.

Finally, we wish to note that it would be both impractical and illogical to divide a storm sewer project for taxation purposes. If we followed the auditor's assessment, a contractor would be required to collect sales tax on that part of a storm sewer project built outside of a street right-of-way but not on that part of the project within the street right-of-way. He or she would have to report income from construction without the right-of-way under the Retailing B&O classification but report income within under Public Road Construction. The contractor would not have to pay sales tax on materials used without but would on materials used within. We do not think that either the statute or the rule mandate subjecting the contractor to such a logistical nightmare.

In contrast to the lines at issue in the above determination, which handled drainage from nearby houses on an "incidental" basis, the lines at issue here are designed to handle this drainage as their primary function. Accordingly, we find the installation of such lines does not qualify as public road construction, because the lines are not intended to handle drainage from roads.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

Dated this 31st day of August, 1999.