

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. 98-165
)	
...)	Registration No. . . .
)	Notices of Balance Due
)	. . .
)	

RULE 170; RULE 211; RULE 17001; RULE 171; RCW 82.04.050, RCW 82.04.190; RCW 82.04.270; RCW82.04.280: RETAIL SALES TAX -- WHOLESALE -- SERVICES RENDERED IN RESEPT TO CONSTRUCTION -- PUBLIC ROAD CONSTRUCTION -- GOVERNMENT CONTRACTING. A person hired for his skill, knowledge, and expertise in operating a water truck to compact soils at construction sites is rendering services in respect to construction. The person is not merely renting equipment with an operator to perform work under the specific direction of a lessee. The proper tax classification for such activities depends on whether the person is a prime contractor or a subcontractor, and/or whether the construction project is normal retail sale, or public road construction, or government contracting.

Headnotes are provided as a convenience for the reader and are not in anyway a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

A taxpayer protests his reclassification to retailing business and occupation (B&O) tax and retail sales tax.¹

FACTS:

De Luca, A.L.J. -- The taxpayer and his employees operate water trucks for a variety of government and private construction projects. Some of the trucks have capacities of 2000 gallons of water and others hold 4000 gallons of water. The taxpayer's company provides services related to the construction of roads (federal, state, and local), buildings, and parking

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

lots. For road construction, the taxpayer explains that contractors hire him to water crushed rock to compact it for paving. The taxpayer also waters asphalt during road construction to cool it. On building sites, the taxpayer's water trucks spray water on fill materials to properly compact soil for footings, foundations, sidewalks, parking lots, etc. For example, putting in new soil or fill materials at construction sites requires that the soil be compacted by watering before building or paving can begin. The taxpayer adds that certified inspectors inspect for proper compaction at the sites. The water trucks also provide water to compact soils for underground utility lines to prevent their suspension or shifting, and breaking. Additionally, the trucks provide water to flush debris from new water lines and to test them for leaks. The taxpayer explains that the water trucks are also used on "auger cast" building sites, where water has to be added to mortar. At all types of construction sites, the taxpayer provides dust control, when needed, in addition to the compaction or other services rendered by him and his employees.

The Department of Revenue (the Department) reviewed the taxpayer's excise tax returns for Q3/96 and Q2/97 and issued balance due notices . . . on September 26, 1997 in the amount of \$. . . and . . . on October 17, 1997 in the amount of \$ The taxpayer had reported his gross income under the Service B&O tax classification. The Department reclassified the taxpayer's reporting to the retailing B&O tax and retail sales tax classifications.

Concurrently, on October 31, 1997 the Department's Taxpayer Information and Education Section (TI&E) issued a letter to the taxpayer's representative explaining why the Department decided that the retailing classification applied to the taxpayer. In a prior letter to TI&E, the taxpayer had contended that his proper classification was wholesaling B&O tax. TI&E reasoned that the taxpayer "provides a rental of equipment with an operator." TI&E explained "such an activity is included within the definition of a retail sale" under RCW 82.04.050(4). TI&E also cited WAC 458-20-211(2)(d) and -(5)(b) for the provisions that the rental of equipment with operator means the operator is performing work under the specific direction of the lessee rather than the operator determining for himself how the work will be performed. TI&E further concluded that the taxpayer was not performing an element of actual construction, but was merely controlling dust. Therefore, according to TI&E, the taxpayer was not providing subcontractor services and was not engaged in a wholesale activity regardless of who hired him.

TAXPAYER'S EXCEPTIONS:

The taxpayer contends his company is providing an element of actual construction and not just dust control. The taxpayer states that 85% of his business involves compacting soil for the various types of construction projects. Any dust control is provided in combination with soil compaction.

Furthermore, the taxpayer states that he and his drivers are hired because of their knowledge, skills, and expertise to perform their tasks. The taxpayer explains that he and his drivers do not relinquish control of their trucks to the contractors. The contractors do not tell the taxpayer and his drivers how to do their jobs. Instead, the truck operators determine how to perform their jobs by determining the types of soil or materials at the job sites as well as determining how to apply

the water and the necessary amounts of water. The taxpayer adds that his company does not rent the trucks without operators, and he contracts only with contractors, not with consumers. He states he has on file resale certificates from all contractors with whom he has contracted.

ISSUES:

1. Is the taxpayer providing an element of actual construction or merely controlling dust?
2. If the taxpayer provides an element of actual construction, is he merely renting equipment with operators, or does the taxpayer have responsibility for performing construction to contract specification, while assuming control over how the work will be performed?
3. If the taxpayer is performing construction services to contract specification while assuming control over how the work will be performed, what are the proper tax classifications to report his income?

DISCUSSION:

We find that the taxpayer is doing more than controlling dust. The taxpayer is providing necessary elements of actual construction. Soils need to be compacted before buildings, roads, parking lots, and utility lines can be built upon them. Without a proper foundation, sinking, sliding, shifting, or similar effects will occur to structures, roads, parking lots, sidewalks, utility lines, etc.

Rule 211 provides in pertinent part:

(2) (c) The term "subcontractor" refers to a person who has entered into a contract for the performance of an act with the person who has already contracted for its performance. A subcontractor is generally responsible for performing the work to contract specification and determines how the work will be performed. In purchasing subcontract services, the customer is primarily purchasing the knowledge, skills, and expertise of the contractor to perform the task, as distinguished from the operation of the equipment.

(d) The term "rental of equipment with operator" means the provision of equipment with an operator to a lessee to perform work under the specific direction of the lessee. In such cases the lessor is generally not responsible for performing work to contract specification and does not determine how the work will be performed. Though not controlling, persons who rent equipment with an operator typically bill on the basis of the amount of time the equipment was used.

...

(5) (b) Persons who provide equipment or other tangible personal property and, in addition, operate the equipment or supply an employee to operate the same for a charge, without relinquishing substantial dominion and control to the customer, are providing a

service that is classified as a retail sale unless the nature of the activity is specifically classified under another tax classification. Where a specific tax classification applies to the activity, the income is subject to the business and occupation tax (or public utility tax) according to the classification of the activities performed by the equipment and operator. In the case of building construction, it will be presumed that the rental of equipment with operator to a contractor is a retail sale unless the operator has responsibility for performing construction to contract specifications and assumes control over how the work will be performed

From our review of Rule 211 and the evidence submitted, including testimony during the telephone conference, the taxpayer's petition, and the TI&E letter, we find that the taxpayer is a subcontractor who performs work to contract specification and determines how the work will be performed. In short, the taxpayer is hired for his skill, knowledge, and expertise in determining how to compact the soils and fill materials at construction sites. The taxpayer is not renting equipment with an operator to perform work under the specific direction of a lessee.

The last question is under what tax classifications should the taxpayer report his gross income? He should not report income from his water truck construction services under the service B&O tax classification. When the taxpayer works on city, county, and federal roads and highways, he should report his gross income under the public road construction B&O tax classification provided in RCW 82.04.280. Portions of RCW 82.04.050, RCW 82.04.190, and RCW 82.04.280 together provide for "public road construction" treatment of certain public construction projects, resulting in the labor and services portion of such projects not being retail sales taxable. In the 1969 Public Mass Transportation Systems Act, this special tax treatment, previously granted only to publicly-owned roads and associated structures in their right-of-ways, was expanded to include mass public transportation terminals and parking facilities. As a result of this and later amendments, RCW 82.04.050(6) currently provides:

The term [retail sale] shall not include 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.

Under this provision, when any of the enumerated construction projects are performed, contractors and subcontractors are required to pay retail sales/use taxes on all of the construction materials they use instead of purchasing them tax-free with resale certificates and then charging tax to their customers. This is because "public road construction" contractors and subcontractors, and not their customers, are considered to be the consumers of the materials used. RCW 82.04.190(3). Because the labor and services on such construction projects are not taxable to consumers as retail sales, retail sales tax is not charged or collected by the contractor. Instead of reporting under the "retailing" or "wholesaling" B&O tax classification, the "public

road construction” contractor and the subcontractors report B&O taxes under the special rate provided in RCW 82.04.280.

The ultimate result of this statutory scheme is to remove the labor and services portion of the contract from retail sales taxability, the sales tax on materials already having been paid by the subcontractors and contractor (and that cost passed along to the customer in the bid price). Thus, the state receives retail sales/use tax on the value of the materials used, but receives no sales/use tax on the labor and services portion of “public road construction” projects. See also WAC 458-20-17001 (Rule 17001, government contracting) and WAC 458-20-171 (Rule 171, public road construction).

We add that the public road construction classification can also include work done on sidewalks and streets in private developments that are conveyed by the developers to a public body, such as a city or county.

However, the public road construction classification does not include work on state-owned roads, streets, or highways. Such projects are considered retail sales that are made by the general contractor to the state. Subcontractors working on such state road projects should obtain resale certificates from the general contractors. Subcontractors should report under the wholesaling B&O tax classification provided in RCW 82.04.270. See WAC 458-20-170 (Rule 170) and Rule 171. We note that the B&O tax rate is the same under the wholesaling and public road construction classifications.

Like state road projects, when the taxpayer acts as a subcontractor to general contractors who are performing construction services for consumers on privately-owned property, the taxpayer should obtain resale certificates from the general contractors. The taxpayer should report under the wholesaling B&O tax classification, with the exception for streets and sidewalks conveyed to public bodies, as noted above. If the taxpayer ever contracts directly with consumers, he should collect retail sales tax and report under the retailing B&O tax classification. Rule 170.

If the taxpayer is uncertain in the future about whether he should report under the wholesaling or public road construction B&O tax classification, he should inquire in writing to the Department’s Taxpayer Information and Education Section at P.O. Box 47450 Olympia, WA 98504-7450.

DECISION AND DISPOSITION:

The taxpayer’s petition is granted.

Dated this 30th day of September, 1998.