Cite as Det. No. 06-0120R, 27 WTD 70 (2008)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| In the Matter of the Petition For Correction of Assessment of | ) | F I N A L<br>D E T E R M I N A T I O N |
| | ) | No. 06-0120R |
| . . . | ) | |
| | ) | Registration No. . . . |
| | ) | FY . . ./Audit No. . . . |
| | ) | Docket No. . . . |

Rule 211; RCW 82.04.050: RETAIL SALES TAX -- USE TAX -- RENTAL OF EQUIPMENT WITH OPERATOR -- WATER TREATMENT SYSTEMS. A taxpayer who engages in subcontract work or otherwise is responsible for performing the work to contract specification and determines how the work is to be performed, is the consumer of the components it purchased to build water treatment systems, and therefore does not qualify for the exemption from retail sales tax in RCW 82.04.050(1)(c).

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.

Prusia, A.L.J. – A taxpayer that provides water treatment and related services for construction, industrial and marine sites, using a filtration system it manufactures with a technician who operates the system, requests reconsideration of Det. No. 06-0120, which sustained an assessment of use tax on components it purchased that became part of its water treatment systems, which components it purchased without paying retail sales tax. The taxpayer contends Det. No. 06-0120 erred in its analysis and application of the statutes and rules addressing rental of equipment with operator and the components/ingredients exemption from retail sales tax, erred in ignoring the legislative intent of 2004 changes to RCW 82.04.050(4), and erred in failing to consider actual customer contracts that the taxpayer had provided. We review the actual contracts and modify our analysis, but continue to deny the request for correction of the assessment.[1]

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

## ISSUES

[1] Was the taxpayer engaging in an activity that was defined as a "retail sale" under RCW 82.04.050(4)?

[2] If taxpayer was engaged in such an activity, did it demonstrate that the equipment was only rented as tangible personal property, under the requirements in WAC 458-20-211(4) (Rule 211(4))?

[3] What is the effect of the statutory change in RCW 82.04.050(4) that became effective July 1, 2004, on the classification of the taxpayer's activity and whether its purchases were exempt from retail sales tax?

## FINDINGS OF FACT

[Taxpayer] petitions for reconsideration of Det. No. 06-0120, which denied a petition for correction of an assessment of use tax on components Taxpayer purchased without paying retail sales tax, which components Taxpayer used to build water treatment facilities that it installed and operated at construction and industrial sites. Taxpayer contends Det. No. 06-0120 erred in its analysis and application of the statutes and rules addressing rental of equipment with operator (RCW 82.04.050(4) and Rule 211) and the components/ingredients exemption from retail sales tax (RCW 82.04.050(1)(c) and Rule 113), erred in ignoring the legislative intent of amendments to RCW 82.04.050(4) that became effective in 2004, and erred in failing to consider actual customer contracts that the taxpayer had provided. We find Taxpayer did provide actual agreements that should have been considered. We also find that the determination was unclear in its analysis, and Taxpayer has raised additional arguments that should be addressed. We grant reconsideration in part, reviewing the actual contracts and modifying our analysis of the applicable law. Because the analysis herein differs somewhat from the analysis in Det. No. 06-0120, we repeat and supplement the statement of facts from that determination.

Taxpayer is a Washington corporation engaged in business activities in Washington, including comprehensive water treatment services for construction, industrial, and marine sites.

Taxpayer designs, manufactures, installs, and operates stormwater filtration systems known as "Chitosan-Enhanced Sand Filtration Treatment Systems" ("CESF"). CESF is a stand-alone construction site water treatment technology, comprised of four basic components: (1) stormwater transfer pump; (2) chitosan addition (a natural coagulant); (3) pressurized multipod sand filtration unit; and (4) interconnecting treatment system piping. CESF is a flow-through stormwater treatment technology that utilizes chitosan, a natural polymer coagulant, in conjunction with pressurized sand filtration to remove turbidity (suspended sediment). Each treatment system is designed and installed to operate on an as-needed basis, pumping water from a retention basin whenever the water level of the retention basin is high enough to warrant processing. When stormwater is transferred from the retention basin to the sand filtration unit, chitosan is introduced to the stormwater to coagulate suspended solids, producing larger particles which are retained within a sand filter. The filtration systems are equipped with automatic

backwash systems, which backwash the collected sediment from the individual filter pods as necessary to maintain the hydraulic capacity of the filtration media.

The CESF systems are highly technical with design and operational criteria requiring extensive monitoring. The Washington State Department of Ecology ("Ecology") establishes minimum operator qualification requirements. CESF systems are only to be operated by a trained technician certified through an approved training program including classroom and field instruction. Taxpayer has established even more stringent additional standards for qualifying operators for its systems, which include 24 hours of classroom training and 60 hours of field training for persons who already meet the prerequisites established by Ecology.

Virtually no contractors or other customers of Taxpayer have personnel on staff qualified to operate the equipment. Taxpayer provides the operators of its CESF systems, to ensure the system performs as designed.

The operational and implementation requirements of the CESF systems are specific to each construction project. The project owner must submit a plan to Ecology, which includes specifications for the CESF system. By administrative order directed to the project owner, Ecology authorizes the owner to implement and maintain the plan, including specific reference to the CESF system. The order requires the owner to implement and comply with specific discharge requirements, CESF requirements, monitoring requirements, notice requirements, and other requirements. It requires the project owner and its CESF contractor to comply with specified state laws and Ecology regulations. It requires the CESF system operator to document that it meets minimum training and experience requirements.

Once a CESF system is installed on a construction site, the owner of the project determines when it shall be operated. Once the system is put into operation, Taxpayer is not able to remove, or render inoperable, its system, without authorization from the project owner. Taxpayer's technician operates the system according to rules and mandates issued by Ecology, and a plan approved by Ecology. While the system is on a construction project site, the owner of the project maintains control over access to the construction site, including Taxpayer's system, and the owner implements security. The owner provides Taxpayer with either an access code or keys to gain access to the construction site and the CESF system. Taxpayer cannot, without violating its contract, remove the equipment from the site until the site is fully stabilized and a formal Notice of Termination is filed with Ecology by the property owner, certifying that all stormwater discharges associated with the construction activity that are authorized by specified federal and state permits have been eliminated. Taxpayer insures the equipment.

Taxpayer provided three sample contracts:

Contract #1 – contract with [Party A]

Contract #1 was entered into with [Party A] on . . ., 2005. It is titled "Professional Services Agreement." It labels Taxpayer as "Consultant." It states the scope of services to be to "provide all necessary professional and related services for the Project to accomplish the

service specified in Attachment A hereto, or which may hereafter be requested by. [Party A]. The attachment specifies:

- consulting services, including system design and drawing layout for infrastructure layout;
- mobilization and setup of a pond treatment system, including providing interconnecting plumbing between infrastructure and treatment system equipment, having equipment and an operator available to assist in setting submersible pumps or suction floats in the retention pond during mobilization and demobilization, equipment layout, field planning, and oversight of third-party site grading and piping installation;
- operation and maintenance of the pond treatment equipment complex.

The contract states Taxpayer's responsibilities as completing all specified work within the time periods set forth in the attachment. It states that [Party A] will designate a Project manager "to coordinate the work of CONSULTANT with all agencies and individuals involved with the Project. . . . CONSULTANT is expected to work closely with the Project Manager throughout the duration of this Agreement." The contract provides the [Party A] will pay Taxpayer on a time and expense basis "for the professional services specified in [the agreement]. [The agreement] states estimated charges for design, consulting, mobilization, and setup services, and a monthly rental rate for equipment.

Taxpayer also agrees to perform remote water quality monitoring. It agrees to "conduct treatment system operations." An amendment to the contract requires Taxpayer to assist [Party A] in providing continued stormwater treatment services for additional ponds for the project.

The contract requires Taxpayer to maintain in force general liability insurance and professional liability insurance covering the performance of its services.

Contract #2 – subcontract with unnamed party

Contract #2 is a subcontract entered into in . . . 2005 between Taxpayer and an unnamed contractor. It is titled "Subcontract." It labels Taxpayer "Subcontractor." It states that Subcontractor agrees to "furnish and perform all work as described in Paragraph 3 hereof, for the construction of [project title redacted], in accordance with the Contract dated . . . 2003, between the Owner and Contractor, and the general and special conditions of that contract, and in accordance with the drawings . . . and specifications and addenda for the construction . . . ." Paragraph 3 is redacted. The subcontract includes several pages of general conditions, including that "Subcontractor will assume toward Contractor all obligations and responsibilities which Contractor has assumed toward Owner under the Main Contract to the extent of the work herein subcontracted . . . ." The subcontract requires Taxpayer to obtain and pay for all permits, fees, and licenses necessary for the performance of the subcontract. [The subcontract] describes Taxpayer's activity as mobilization,

management, operations and maintenance, and system rental. [The subcontract] states estimated charges for mobilization, management, labor for operations & maintenance, a monthly rent for office trailer, and a monthly rent for system rental (includes generator, tanks, pick-up truck).

The subcontract includes a main contract change order from the Washington Department of Transportation. It states: "The Contractor shall install, operate, maintain and monitor two separate mobile stormwater treatment systems using chitosan enhanced sand filtration (CESF). It sets out, at considerable length, contract requirements for the construction and operation of the CESF systems. The contract states Taxpayer is responsible for insuring its equipment, and is required to take all reasonably necessary safety precautions pertaining to its work.

Contract #3 – subcontract with unnamed contractor

Contract #3 is a subcontract entered into in . . . 2005 between Taxpayer and an unnamed contractor. It is titled "Subcontract." It labels Taxpayer "Subcontractor." It includes general conditions "the plans and specifications as enumerated in Exhibit 'A,' below . . . ." It describes the work as follows: "The Subcontractor shall provide all supervision, management, labor, tools, materials, supplies, equipment, engineering, and layout for; furnish, installation, operation of two storm water treatment systems per the plans and specifications . . . ." It requires Taxpayer to integrate and coordinate its work with the work to be performed by other contractors. [The contract] sets out the list of plans and specifications for the project [and] states that "Subcontractor shall complete their scope of work in strict accordance with the plans and specifications. It states that the work "shall be completed in the timeframes as indicated per the Construction Schedule." One of the specific requirements in the scope of work . . . is: "Subcontractor shall be responsible for treating and discharging storm water from the construction site via the equipment, materials, and operators as outlined in the ". . . Treatment Plan" for the [project] as prepared by [Taxpayer] dated . . ., 2005." The contract includes an updated estimate of probable costs, which lists the following tasks performed or to be performed by Taxpayer: prepare stormwater treatment plan; install equipment including interconnecting plumbing assemblies; operate water treatment system; on-call consulting services. The contract provides that Taxpayer will submit progress billings consistent with those tasks. It states Taxpayer is responsible to furnish safety devices and safeguards to its employees as well as any workers under its direct supervision. It requires Taxpayer to provide a site-specific safety plan.

The contract includes an estimate of probable cost for preparing stormwater treatment plan, providing stormwater treatment system (stated as a monthly rental), equipment mobilization and installation, and water treatment system operation.

Taxpayer does not consider its relationship with the project owners to be either a service contract or a subcontract on any of the projects, but rather a lease of equipment with an operator who is essentially a part of the equipment being leased.

During the period January 1, 2001, through September 30, 2004 ("audit period"), Taxpayer did not pay retail sales tax on its purchases of components for the stormwater treatment systems it designed, manufactured, and installed. Taxpayer viewed the purchases as purchases for resale.

The Audit Division of the Department of Revenue examined Taxpayer's books and records for the audit period. As a result of the audit examination, the Audit Division concluded that Taxpayer should have paid retail sales tax on its purchases of stormwater treatment system components. The Audit Division assessed use tax on the purchases of components on which Taxpayer had not paid retail sales tax . . . Taxpayer appeals the assessment in its entirety.

ANALYSIS

All sales of tangible personal property to consumers in the state of Washington are subject to retail sales tax unless the sales are exempt from taxation. RCW 82.08.020; RCW 82.04.050. The term "sale at retail" or "retail sale" is incorporated into chapter 82.08 RCW through RCW 82.08.010. If retail sales tax is not paid, but a person uses within Washington "as a consumer" any article of tangible personal property purchased at retail, the person is liable for use tax. RCW 82.12.020.

RCW 82.04.050 provides that a retail sale does **not** include a sale to a person who presents a resale certificate and who:

> (a) Purchases for the purpose of resale **as tangible personal property** in the regular course of business without intervening use by such person . . .
>
> . . .
>
> (c) Purchases for the purpose of consuming the property purchased in **producing for sale a new article of tangible personal property** or substance, of which such property becomes an ingredient or component . . .

(Emphasis added.) We will refer to these two exceptions to the definition of "retail sale" as the resale exemption and the ingredients or components exemption. It is the ingredients or components exclusion or exemption in RCW 82.04.050(1)(c) that is the concern of this appeal. It is explained in WAC 458-20-113 (Rule 113).

The term "retail sale" includes renting or leasing tangible personal property to consumers. RCW 82.04.050(4). Thus, the retail sales tax does not apply to sales to persons who purchase items of tangible personal property for the purpose of only renting or leasing such property. Nor does it apply to persons who purchase components for the purpose of consuming them in producing a new article of tangible personal property solely for renting or leasing. Rule 211(6)(a).

Generally, persons who purchase items of tangible personal property for their own use or consumption in performing a service or subcontract are not purchasing the items for resale. The

retail sales tax applies upon sales to them of such items, and the use tax applies to their use of the items. *See* WAC 458-20-178(7) (Rule 178(7). This is true even when the service they perform is itself defined as a retail sale. For example, construction or improvement of buildings for consumers is defined as a retail sale,[2] but "[t]he retail sales tax applies upon sales and rentals to prime contractors and subcontractors of tools, machinery and equipment, and consumable supplies . . . which are primarily for use by the contractor rather than for resale as a component part of the finished structure." WAC 458-20-170(4)(d).

How persons are taxable who rent equipment with an operator has been specifically addressed by statute, rule, and case law. Prior to a Washington Court of Appeals decision, *Duncan Crane Service, Inc. v. Department of Rev.*, 44 Wn. App. 684, 723 P.2d 480 (1986), the Department took the position that the terms "leasing" and "renting" (of tangible personal property) in RCW 82.04.050(4) did not include any rental agreements pursuant to which the owner or lessor operated the equipment or supplied an employee operator, whether or not such employee operator worked under the supervision or control of the lessee, and the position that a lessor who leased equipment with an operator was a user and was liable for the tax on the full value of the equipment. As a result of that interpretation, no one who rented equipment with an operator could qualify for the purchase for resale exemption in RCW 82.04.050(1).

Duncan Crane was a lessor of construction cranes that leased them bare or on an hourly basis that included the services of an operator who worked under the supervision and control of the lessee. It did not operate cranes as a subcontractor. Duncan Crane challenged the Department's 1982 denial of Duncan Cranes' claim that its purchase and use of cranes were exempt from sales and use tax because it purchased solely for rental as tangible personal property. The Court of Appeals ruled that the term "lease" in RCW 82.04.050(1) applied to a contract whereby one party gives to another the right to the use and possession of property for a specified time, and ruled that the Department's rules were *ultra vires* in excluding from the term the rental of equipment with operator where the operator worked under the supervision or control of the lessee for a specified time. The court remanded for entry of summary judgment for Duncan Crane.

The *Duncan Crane* decision expressly distinguished the situation of construction subcontractors, suggesting the Department draft narrow regulations to prevent construction subcontractors from escaping sales and use taxes by recharacterizing their usual services as leases of equipment with operator.

In 1987, the Department amended its rule that addresses leases of tangible personal property, including rental of equipment with operator (Rule 211), to incorporate the ruling in *Duncan Crane*. The 1987 amendments distinguished between "true leases" of operated equipment, and rentals where the equipment owner provides the equipment with operators for a charge, without relinquishing substantial dominion and control. The rule further explained that the retail sales tax did not apply upon sales of tangible personal property to persons who purchase solely for the purpose of making "true" leases of operated equipment, but did apply upon sales to persons who

[2] RCW 82.04.050(2)(b).

provided such property with operators for a charge, without relinquishing substantial dominion and control, or who intended to make some use of the property other than or in addition to renting or leasing. The 1987 rule also explained that equipment provided with an operator was considered to be resold, rented, or leased, for purposes of the RCW 82.04.050(1) exemption from retail sales tax, only when the rental agreement was designated as an outright lease or rental, and the customer acquired the right of possession, dominion, and control of the equipment. The rule also set out factors to be considered in determining whether the owner/operator had relinquished the degree of control necessary to establish a lessor-lessee relationship.

Subsequent to *Duncan Crane* and the 1987 rule changes, the Department examined claims that agreements to provide equipment with operator were true leases, and therefore the property should be considered held for resale and exempt from sales and use tax, by determining whether the owner/operator relinquished the necessary degree of control under the criteria in Rule 211. Det. No. 89-328, 8 WTD 45 (1989); Det. No. 91-313, 12 WTD 29 (1993); Det. No. 93-259, 14 WTD 029 (1994).

In 1993, the Legislature amended RCW 82.04.050(4), as follows (1993 amendment in italics): "The term [retail sale] shall also include the renting or leasing of tangible personal property to consumers *and the rental of equipment with an operator*."

In early 1996, the Department adopted the most recent amendments to Rule 211. The amended rule added provisions for distinguishing between "rental of equipment with operator" and subcontracting situations. Rule 211(2)(c) - (e) state:

> (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.
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> (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 specifications 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 is used.
>
> (e) The term "true object test" as it relates to this section means the analysis of a transaction involving equipment and an operator to determine if the lessee is simply purchasing the use of the equipment or purchasing the knowledge, skills, and expertise of the operator beyond those needed to operate the equipment. Even if it is determined that the customer is purchasing the knowledge, skills, and expertise of the operator, the transaction may still be a retail sale if the activity is specifically included by statute within the definition of a retail sale. This test can also be applied to rentals of tangible personal property when the seller performs some service in connection with the rental.

The 1996 rule included most of the 1987 rule's requirements and factors for determining whether equipment provided with an operator is considered to be resold, rented, or leased "as tangible personal property," for purposes of the RCW 82.04.050(1) exemption from retail sales tax, and also expressly distinguished the situation of persons who use operated equipment in performing services as prime contractors or subcontractors. Rule 211(4) states:

> RCW 82.04.050 excludes from the definition "retail sale" any purchases for the purpose of resale, "as tangible personal property. Persons who use equipment in performing services either as prime contractors or as subcontractors are not purchasing the equipment for purposes of reselling the equipment as tangible personal property. These contractors must pay retail sales tax or use tax at the time the equipment is acquired. Generally persons who rent equipment with an operator are not purchasing the equipment for resale as tangible personal property and must pay retail sales tax or use tax at the time the equipment is acquired. Persons renting operated equipment to others may purchase the equipment without payment of retail sales tax only when the equipment is rented as tangible personal property. This can be demonstrated only when:
>
> (a) The agreement between the parties is designated as an outright lease or rental, without reservations; and
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> (b) The lessee acquires the right of possession, dominion, and control of the equipment, even to the exclusion of the lessor.
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> This last requirement is a factual question and the burden of proof is upon the owner/operator of the equipment to establish that the degree of control has been relinquished necessary to constitute a lessor-lessee relationship. Weight will be given to such factors as who has physical, operating control of the equipment; who is responsible for its maintenance, fueling, repair, storage, insurance (risk of loss or damage), safety and security of operation, and whether the operator is a loaned employee. If control of these factors is left with the owner/operator, then as a matter of fact, there has not been a relinquishing of control of the equipment to the degree necessary to create a lessor-lessee relationship for the rental of tangible personal property. This is true, even though the customer exercises some constructive control over such matters as when and where the equipment is used in connection with the construction work being performed, i.e., the contractor controls the job site.

Section (6)(a) of Rule 211 addresses the same subject, as follows:

> RCW 82.04.050 excludes from the definition of the term "retail sale," purchases for resale "as tangible personal property." Thus the retail sales tax does not apply upon sales of tangible personal property to persons who purchase the same solely for the purpose of renting or leasing such property without operators. However, the retail sales tax applies upon sales to persons who provide such property with operators for a charge, without relinquishing substantial dominion and control, or who intend to make some use of the property other than or in addition to renting or leasing.

In applying the current Rule 211, the Department has held that where the facts show the operator of equipment is working to contract specifications and determining how the work will be

performed, the contract is not "the rental of equipment with an operator" for purposes of RCW 82.04.050(4), and the activity is taxed under some other section of Chapter 82.04 RCW. Det. No. 98-165, 19 WTD 122 (2000); Det. No. 01-178, 21 WTD 240 (2002).

Effective July 1, 2004, the Legislature again amended RCW 82.04.050(4), as part of a package of changes in Washington's sales and use tax laws to move the state toward compliance with the multi-state streamlined sales and use tax agreement. Ch. 168, Laws of 2003, Sec. 1. The legislation changed the description of the activity covered by RCW 82.04.050(4) from "the rental of equipment with operator" to the following, now codified as RCW 82.04.050(4)(a)(ii):

> Providing tangible personal property along with an operator for a fixed or indeterminate period of time. A consideration of this is that the operator is necessary for the equipment to perform as designed. For the purpose of this subsection (4)(a)(ii), an operator must do more than maintain, inspect, or set up the tangible personal property. [3]

[3] The following table sets out the provisions for the periods before and after July 1, 2004:

| Before 7-1-2004 | After 7-1-2004 |
|---|---|
| **RCW 82.04.050**<br>(4) The term ["retail sale"] shall also include the renting or leasing of tangible personal property to consumers and the rental of equipment with operator. | **RCW 82.04.050**<br>(4)(a) The term ["retail sale"] shall also include:<br>(i) The renting or leasing of tangible personal property to consumers; and<br>(ii) Providing tangible personal property along with an operator for a fixed or indeterminate period of time. A consideration of this is that the operator is necessary for the equipment to perform as designed. For the purpose of this subsection (4)(a)(ii), an operator must do more than maintain, inspect, or set up the tangible personal property.<br>(b) The term ["retail sale"] shall not include the renting or leasing of tangible personal property where the lease or rental is for the purpose of sublease or subrent. |
| **RCW 82.04.040**<br>(1) "Sale" means any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a "sale at retail" or "retail sale" under RCW 82.04.050. It includes renting or leasing . . . .<br><br>["renting or leasing" not defined] | **RCW 82.04.040**<br>(1) "Sale" means any transfer of the ownership of, title to, or possession of property for a valuable consideration and includes any activity classified as a "sale at retail" or "retail sale" under RCW 82.04.050. It includes lease or rental . . . .<br><br>(3)(a) "Lease or rental" means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. . . .<br>(b) "Lease or rental" does not include:<br><br>* * *<br>(iii) Providing tangible personal property along with an operator for a fixed on indeterminate period of time. A condition of this is exclusion is that the operator is necessary for the equipment to perform as designed. For the purpose of this subsection (3)(b)(iii), an operator must do more than maintain, inspect, or set up the tangible personal property. |

The legislation also added a definition of "lease or rental," at RCW 82.04.040(3)(a), that expressly excludes the activity set out in RCW 82.04.050(4)(a)(ii).[4]

Analysis for periods before July 1, 2004

For periods before July 1, 2004, the issues are whether Taxpayer's activity was "the rental of equipment with operator" for purposes of RCW 82.04.050(4), and, if so, whether Taxpayer only rented its water treatment systems "as tangible personal property," as demonstrated under the requirements and factors set out in Rule 211(4).

Based on the contracts Taxpayer provided, we conclude that Taxpayer's activity was not "the rental of equipment with operator" for purposes of RCW 82.04.050(4). The contracts Taxpayer provided show that its customers contracted with Taxpayer to perform portions of the work, and did not merely purchase someone to physically operate equipment under the control and direction of the customer. Under Contract #2 and Contract #3, Taxpayer contracted to perform services as a subcontractor. It was contractually required to perform its services to the specifications in the contract between the general contractor and the property owner. Under Contract #1, Taxpayer provided consulting services, plumbing installation, field planning, oversight of third-party grading and pipe installation, and remote water quality monitoring. Taxpayer agreed to "conduct" the treatment system operations, not merely provide an operator to operate the equipment under the direction of the general contractor. The customers purchased the knowledge, skills, and expertise of the operator beyond those needed to operate the equipment. Under all three contracts, Taxpayer was responsible for determining how to perform its work within the parameters set by the governing contract specifications. As is explained in Rule 211(2)(d), (2)(e), and (4), such activity is not "the rental of equipment with operator."

We find Taxpayer purchased the components to produce equipment for its own use in performing services as a subcontractor or in providing its knowledge, skills, and expertise beyond those needed to operate the equipment. It follows that its purchases were not exempt from retail sales tax under RCW 82.04.050(1). Rule 211(4); Rule 211(5)(a)(iii); Rule 211(6)(a). Because Taxpayer failed to pay retail sales tax on its purchases of components for its water treatment systems, it is liable for use tax on its use of the systems. RCW 82.12.020.[5]

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[4] This change affects the measure of the tax. Retail sales tax generally is due on the selling price at the time of sale. RCW 82.08.020. The tax due on rentals is measured by gross income from rentals as of the time the rental payments fall due. Rule 211(6). The change may also impact sourcing of the tax due.

[5] Taxpayer argues at length that it demonstrated that it rented its systems "as tangible personal property" under the factors set out in Rule 211(4)(b). We have found that Taxpayer used its systems as a consumer, and therefore do not need to analyze the factors in Rule 211(4)(b). Assuming, solely for purposes of argument, we did reach the issue addressed in that section, we would find that Taxpayer failed to demonstrate that requirement (4)(a) was met. None of the contracts was "designated as an outright lease or rental, without reservations." We also would disagree with Taxpayer's contention that it demonstrated its customers acquired the right of possession, dominion, and control of the equipment. The project owners controlled the work sites, but physical and operating control of the equipment while on site was always with Taxpayer, and Taxpayer's operators decided how the equipment would be operated to meet requirements of the contracts and specifications. The fact that Taxpayer had to follow contract specifications and Department of Ecology requirements does not mean it relinquished dominion and control of the equipment to the project owner. *See* Det. No. 01-178, 21 WTD 240 (2002). The customers did not have responsibility for

Analysis for period July 1, 2004 though September 30, 2004

As noted above, the change in the law respecting provision of equipment with an operator that went into effect July 1, 2004, changed the description of the activity from "rental" to "providing," made the classification applicable to all tangible personal property, and added specific factors defining the classification.

Taxpayer contends the change of wording from "rental" to "providing" indicates a legislative intent to make any providing of tangible personal property with an operator, where the operator is necessary for the equipment to perform as designed, a retail sale, argues its activity clearly fits the new description, and contends that if its activity fits the description, it necessarily follows that it is purchasing the treatment system components for resale.

Taxpayer has provided no evidence that the Legislature intended a change that would make every provision of equipment with operator equivalent to a sale of tangible personal property. As noted above, the changes were part of a package of changes related to implementing the streamlined sales and use tax agreement. We have found no legislative history explaining these specific changes. We find no reason to read the 2004 statute as creating a category of retail sale that substantially differs from the category that existed before the change, as that category was interpreted by the Department in Rule 211. We continue to read the classification as applying to the limited situation where the true object of the transaction is purchasing the use of the equipment. When the owner/operator is responsible for performing the work to contract specification and determines how the work will be performed, the activity does not fall under that section. The factors that are added clarify the scope of the limited classification; the transaction will not fall within RCW 82.04.050(4) unless the operator is necessary for the equipment to perform as designed, and the operator must do more than maintain, inspect, or set up the property for the transaction to fall under that statute. The changes are consistent with the requirement that we analyze a transaction to determine whether its true object is the use of the equipment or the knowledge, skills, and expertise of the operator beyond those needed to operate the equipment.

The issues for the last quarter of the audit period are like those for the earlier period. Was Taxpayer's activity "providing tangible personal property along with an operator" for purposes of RCW 82.04.050(4), and, if so, did Taxpayer only rent its water treatment systems "as tangible personal property," as demonstrated under the requirements and factors set out in Rule 211(4)?

Under the contracts Taxpayer submitted for review, its activity was not just providing tangible personal property and a loaned operator. It was generally responsible for performing the work to contract specification and determined how the work was to be performed. We conclude that Taxpayer did not engage in activity that fell within RCW 82.04.050(4), as amended.

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maintenance or repair of the equipment. Taxpayer's operators were not loaned employees, in that the project owner did not assume control over the details of the work.

Because Taxpayer engaged in subcontract work or otherwise was responsible for performing the work to contract specification and determined how the work was to be performed, it was the consumer of the components it purchased to build its water treatment systems, and therefore did not qualify for the exemption from retail sales tax in RCW 82.04.050(1)(c). Rule 211(5)(a)(iii), Rule 211(6)(a). Because it did not pay retail sales tax on its purchases of components, it was liable for use tax on its use of the water treatment systems. RCW 82.12.020.

## DECISION AND DISPOSITION

Taxpayer's petition for reconsideration is denied.

Dated this 30th day of January 2007.