

Cite as Det No. 08-0138, 28 WTD 19, (2009)

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. 08-0138
)	
...)	Registration No. . . .
)	Document No. . . . /Audit No. . . .
)	Docket No. . . .
)	

RULE 211; RCW 82.04.050: RETAIL SALES TAX – RENTAL OF EQUIPMENT WITH AN OPERATOR – TRUE OBJECT TEST. The taxpayer is not renting equipment with an operator under the true object test in Rule 211, but providing a service subject to service and other activities business and occupation tax, when it uses equipment in connection with diagnosing the structural integrity of a bridge, dam, or other structure. Even though the taxpayer charges its customers for its use of the equipment, the taxpayer is ultimately employed for its knowledge, skill, and expertise in providing diagnostic services, which are the true object of the transaction.

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.

Jensen, A.L.J. – An out-of-state engineering company that provides testing services on bridges, dams, and other structures located in the State of Washington appeals a reclassification of income from service and other activities business and occupation (B&O) tax to retailing B&O tax and retail sales tax, claiming that its services do not entail rental of equipment with operator. We hold that the taxpayer does not rent equipment with an operator.¹

ISSUE

Whether the taxpayer is subject to retailing B&O tax and retail sales tax as a renter of equipment with an operator pursuant to WAC 458-20-211 (Rule 211) when it charges its customers fees

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

relating to its use of electronic testing equipment in testing the structural integrity of a bridge, dam, or other structure.

FINDINGS OF FACT

[Taxpayer] is an [out-of-state] company in the business of providing engineering and structural testing of bridges, dams, and other structures. Specifically, Taxpayer contracts with construction companies, engineering firms, and government entities to test the structural integrity of various bridges, dams, and other structures located in the State of Washington. . . . Although some of these contracts are directly with the federal government, Taxpayer mostly acts as a subcontractor to a construction company or an engineering firm [that] is the general contractor to the government entity.

Taxpayer's services can vary slightly depending on each project. However, generally speaking, Taxpayer services in this state include the following activities: (1) Taxpayer sends its engineers [from its out-of-state location] to the Washington site that requires testing; (2) Taxpayer's engineers bring "electronic testing gear" equipment with them, and attach the equipment's strain transducers, or sensors, to the structure; (3) Taxpayer's engineers then record data on the movements and vibrations of the structure to an onsite laptop computer; (4) the equipment is generally attached to the structure for a day or two, after which it is removed and taken back to [the out-of-state location]; (5) Taxpayer then compiles the data [at the out-of-state location] and produces a report, including a detailed instrumentation and proposed monitoring plan, interpreting the data retrieved concerning the structure.

Taxpayer . . . testified at the hearing that its customers employ Taxpayer for its expertise in interpreting the data received from its electronic testing equipment, and ultimately for its report regarding the structural integrity of the bridge or dam. Although not always the case, Taxpayer generally performs its services before any actual repair work is done to the structure. This is because Taxpayer's customers use its diagnosis of the structure to determine the source of the vibrations and what repairs are needed. Sometimes Taxpayer's testing services are provided post repairs to determine if the repairs successfully improved the structure.

Taxpayer develops the electronic testing gear equipment that it uses. Taxpayer generally does not rent the electronic testing gear to the parties with which it contracts It generally uses the equipment for 1-2 days at a time to assist it in generating the report that it creates. . . .

The parties with which the Taxpayer contracts do not operate the equipment in question. The parties' involvement may vary depending upon the contract, but is generally limited to providing Taxpayer's engineers access to the structure, running cables, assisting with welding, and possibly collecting data.

Depending on the contract, Taxpayer may charge its customers certain fees related to the equipment, including: (1) an equipment fee, similar to a usage fee, used to cover equipment wear and tear, insurance, and to recoup Taxpayer's investment in developing and designing the

equipment; (2) shipping charges; (3) set up services; and (4) fees for the number of channels used on the equipment. Taxpayer separately itemizes these charges on its invoices.

When Taxpayer started doing business in the State of Washington it contacted the Department of Revenue (Department) by phone to determine how to properly report its taxes to the state. The Department's records show that Taxpayer called it [early in] 2003, asking how it should report retail sales tax and B&O tax. Taxpayer claims that it subsequently sent sample invoices to the Department employee, at [the employee's] request. This Department employee called Taxpayer back [a few days later], and, according to Taxpayer, explained that Taxpayer should generally report its income under the service and other activities B&O tax classification and pay retail sales tax on equipment that it installs on Washington sites on a long-term basis (more than a few days). Taxpayer then began reporting and paying B&O tax and retail sales tax to the Department based on this advice.

The Department's Audit Division (Audit) audited Taxpayer's records for the period of January 1, 2003, through December 31, 2006. When reviewing Taxpayer's records Audit noticed the various fees relating to the equipment that Taxpayer charges its customers. Audit determined that these fees represent rental of equipment with an operator, and are therefore retail sales under RCW 82.04.040. For purposes of determining the "value of products" sold under WAC 458-20-112, Audit included all of Taxpayer's direct and indirect costs attributable to coming into Washington, installing the electronic testing gear equipment, operating the equipment in Washington, and shipping the equipment in and outside of Washington.²

Audit issued an assessment against Taxpayer This amount included: a . . . small business tax credit; \$. . . in retail sales tax; \$. . . in retailing B&O tax reclassified from service B&O tax; a credit of \$. . . in service and other activities B&O tax already paid by Taxpayer³; \$. . . in interest; and a 5% assessment penalty of \$. . . . Audit did not include in this assessment certain retail sales made directly to the federal government.

Taxpayer appeals this assessment, claiming that: (1) its fees related to the electronic testing equipment in the State of Washington are not subject to retail sales tax and retailing B&O tax; and (2) even if these services are retail sales, the Department should waive the assessment because it received erroneous advice from a Department employee before conducting business in this state.

ANALYSIS

Washington imposes B&O tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220. Washington's B&O tax applies to various tax classifications, including making sales at retail pursuant to RCW 82.04.250, and providing services pursuant to RCW 82.04.290. In addition to the B&O tax, RCW 82.08.020 imposes a retail sales tax on each retail sale in this

² Audit did not reclassify the remaining charges on the invoices to retailing B&O tax and retail sales tax.

³ This amount included an Audit adjustment for B&O taxes paid by the Taxpayer that Audit determined were not subject to Washington's B&O tax because Taxpayer performed the services [at their out-of-state location].

state. Generally, the seller must collect the retail sales tax from its customers, and then remit the collected tax to the Department. RCW 82.08.050. If the seller fails to collect the tax, the seller must still pay the tax to the Department. RCW 82.08.050(3).

The issue in this case is whether Taxpayer provides a “retail sale” when it provides its structural testing services in this state. For purposes of both the retailing B&O tax classification and the retail sales tax, RCW 82.04.050 defines “sale at retail” or “retail sale.” “Retail sale” specifically includes certain services, including:

- (i) The renting or leasing of tangible personal property to consumers; and
- (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 tangible personal property 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.

RCW 82.04.050(4)(a).⁴

To provide its services, Taxpayer brings specialized equipment into this state, sets it up, operates it by obtaining a reading of the safety of the structure through sensors on the equipment, and takes the equipment out of state once this reading is completed. If Taxpayer’s services entail the rental of equipment with an operator, the . . . gross proceeds of sales from those services . . . are subject to retailing B&O and [the selling price subject to] retail sales tax. RCW 82.04.220[, 82.04.250, and 82.08.020]. If Taxpayer’s services [are not a rental of equipment with operator], they are subject to the catchall service and other activities B&O tax rate under RCW 82.04.290.

WAC 458-20-211 (Rule 211) clarifies the distinction between rental of equipment with operator and non-retail services. Rule 211 defines “rental of equipment with operator” as:

[T]he 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.

Rule 211(2)(d).

The record does not show that Taxpayer’s charges related to the equipment it uses meet the definition of “rental of equipment with operator” in Rule 211. Taxpayer’s services include a

⁴ [For periods prior to July 1, 2004, RCW 82.04.050(4) provided “The term [“retail sale”] shall also include the renting or leasing of tangible personal property to consumers and the rental of equipment with operator.” We conclude that the change in language does not affect the result in this case.]

separately itemized “equipment fee,” which Audit claims as evidence that Taxpayer is renting equipment. Taxpayer may bill for this fee on the basis of the amount of time the equipment is used. Taxpayer claims that its “equipment fee” is merely a usage fee to recover direct costs of the equipment, including wear and tear, insurance, and equipment development and design. . . . Taxpayer also charges its customers for equipment shipping, setup, and onsite labor, which includes work done by Taxpayer’s engineers and technicians to operate the equipment in this state.

Audit claims that these fees represent the predominate charges in Taxpayer’s invoices, and as such Taxpayer provides the rental of equipment with an operator. It is difficult to determine from the invoices what each of Taxpayer’s charges entail because the name Taxpayer gives certain charges may vary from invoice to invoice. The invoices contain various fees related to the equipment, and other fees related to the labor or engineering services, which may include services related to setting up and operating the equipment in this state. However, in Rule 211, the test in determining if a taxpayer rents equipment with an operator is not whether its rental related charges represent the predominate activity charged by the taxpayer.

In Det. No. 01-178, 21 WTD 240 (2002), the Department found that a contractor hired to construct a bridge to contract specifications was not renting equipment with an operator pursuant to Rule 211 because it was responsible for performing the work to contract specification and determined how the work was performed. In that case, the contractor was hired for its skill, knowledge, and expertise in building bridges, even though it operated under a contract entitled “equipment rental and labor contract.”

In this case, Audit has not shown that the lessees (i.e., the general contractors and engineering firms that hired Taxpayer) direct how Taxpayer performs its services. Taxpayer’s customers may assist it with some of the equipment setup and take down, but do not appear to do much more than this. Taxpayer’s customers do not have control over how the set up occurs, nor do they direct Taxpayer how to operate its electronic testing equipment. Taxpayer alone determines how to operate the equipment to help it generate its report concerning the structure.

Rule 211 also provides the “trust object test,” which the Department uses to determine the appropriate B&O tax classification on rental payments, and if the lessor has retail sales tax collection responsibilities on those payments. Rule 211 provides:

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.

Rule 211(2)(e).

In this case, Taxpayer is hired for its knowledge, skill, and expertise in diagnosing the structural integrity of a bridge, dam, or other structure. Taxpayer's customers do not employ Taxpayer because of the equipment it uses, even if many items on Taxpayer's invoices entail fees related to the equipment. The fact that various fees relate to expenses Taxpayer incurs in bringing the equipment into this state and using it here does not change the reason why the Taxpayer's customers use its services. The true object of the transaction is the detailed report generated by Taxpayer regarding the structure, not use of the equipment employed by Taxpayer to come up with its detailed report. Taxpayer is not renting equipment with an operator within the meaning RCW 82.04.050(4)(a). Taxpayer's services in this state are subject to service and other activities B&O tax, not retailing B&O tax and retail sales tax.

Taxpayer also argues that the assessment should be canceled because it relied on oral advice from a Department employee when it reported its income under the service and other activities B&O tax classification. We do not reach this issue because, as stated above, we hold that Taxpayer's services are subject to service B&O tax, and that it does not rent equipment with an operator.

DECISION AND DISPOSITION

The taxpayer's petition is granted

Dated this 30th day of May, 2008.