Cite as Det. No. 04-0138E, 24 WTD 187 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	F I N A L E X E C U T I V E
	)	D E T E R M I N A T I O N
	)	
	)	No. 04-0138E
	)	
. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .
	)	
. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .
	)	
. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .
	)	
. . .	)	Registration No. . . .
	)	Document Nos. . . .
	)	Audit No. . . .
	)	Docket No. . . .
	)	
. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .
	)	
. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .

. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .
	)	

RULE 24003; RCW 82.63.010, RCW 82.04.4452: B&O TAX -- R&D CREDIT -- ENVIRONMENTAL CLEANUP. All environmental cleanup activities are not necessarily qualified research and development (R&D). While non-routine activities, which translate technological activities into new or improved processes, constitute qualified R&D, the process becomes routine when repeated to meet specific contractual "deliverables" (*e.g.* cleaning up a specific area). These routine cleanup activities are not eligible for the credit.

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.

M. Pree, A.L.J. – Seven corporations paid by U.S. Department of Energy to clean up nuclear waste in Washington request a refund of business and occupation taxes. They seek to have the high technology (research and development) B&O tax credit computed by using ***all*** of their direct environmental cleanup expenditures in Washington. We find that the Audit Division properly limited application of the credit to expenditures directly incurred in qualified research and development, and properly excluded other environmental cleanup costs.[1]

ISSUE

Do all environmental cleanup activities constitute qualified research and development for purposes of the high technology B&O tax credit under RCW 82.04.4452?

FINDINGS OF FACT

The taxpayers are corporations that contracted to clean up the Hanford Federal Reservation in Washington. The taxpayers:

- stabilize nuclear materials;
- remediate waste sites and facilities;
- remove nuclear materials from uncontained storage and place them into secure storage; and
- treat and dispose of various hazardous and mixed waste.

The activities involved new, innovative processes, which the taxpayers constantly strived to improve. The taxpayers performed their activities for the U.S. Department of Energy (DOE)

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

under the authority of the . . . Contract. They reported their receipts from DOE and paid Washington Business and Occupation (B&O) tax for the period from September 1, 1996 through September 30, 2001 on those receipts.

In December 2001, the taxpayers requested a refund of B&O taxes paid based on the high technology credit. Following several meetings with the taxpayers and a review of their books and records, the Department of Revenue's Audit Division authorized a tax refund of $ . . . plus $ . . . interest with which the taxpayers "totally" agree. The refund was based upon computing the tax at a lower rate of .471% for environmental remedial action and allowing a high technology credit against the B&O tax on expenditures the Audit Division determined were for research and development activities.

Following receipt of the refund, the taxpayers petitioned for an additional refund of $ . . . for the period from October 1, 1997 through September 30, 2001. The taxpayers requested the high technology credit on all payments they received from DOE for environmental cleanup. They contended that all of their environmental cleanup activities constitute research and development (R&D). The Audit Division denied the refund, and the taxpayers appealed.

The Audit Division's detail of differences and instructions to the taxpayers explained, "Qualified R&D stops when the processing of radioactive material begins using the new technology developed." The instructions identified the Audit Division's issue as, "where does R&D of environmental technology end and the ongoing activity of processing radioactive waste material begin?"

The taxpayers characterize the dispute as an issue of whether their environmental cleanup activities constituted R&D. The taxpayers refer to the actual cleanup as "steady state operation" where they apply their new innovations. The taxpayers explain that most of their techniques were new, and some would not work unless they continued to alter and innovate these processes during steady state operation. Finally, they explain their claim only involves direct cleanup costs, not overhead.[2]

The Audit Division limited the credit to the direct costs associated with the specific R&D done with respect to qualified technology. The Audit Division did not allow the credit for all the costs associated with the cleanup. However, the Audit Division did allow the credit for expenditures made by the taxpayers to develop the processes used to clean up the site.

The contract under which the fees at issue are taxed provides a summary description of the work:

1. Cleanup
2. Science and technology

[2] There is no issue regarding whether the costs were direct. Nor do the taxpayers dispute the annual $2 million credit limit per taxpayer.

The contract describes cleanup outcomes. Key cleanup activities include the deactivation, decontamination, decommission, demolition,[3] and site restoration at the Hanford site. The taxpayers monitor, treat, store, and dispose of spent nuclear fuel. The contract requires the taxpayers to comply with many environmental, security, and safety regulations during the cleanup and afterwards.

The contract provides the specific requirements, "deliverables," and incentives for cleanup activities. While the contract states science and technology is a major mission, it lacks similar requirements and monetary incentives for R&D activities. DOE has a separate contract with [third party] to . . . conduct research and technology development having direct relevance to the taxpayers' cleanup mission.

The taxpayers performed the cleanup activities to meet specific contractual requirements with "deliverables" for which they were paid. The taxpayers could be paid based upon incremental performance incentives measured by units or items moved, stabilized, or demolished in accordance with timelines in the contract.

The taxpayers do not dispute the Audit Division's computation of the credit, but disagree with the underlying legal theory only. The Audit Division distinguished between environmental cleanup and qualified R&D. The taxpayers contend that all environmental clean-up constituted qualified R&D, and have asked us to address this legal issue only.

ANALYSIS

Taxpayers may be entitled to the high technology B&O tax credit under RCW 82.04.4452 for research and development spending. The credit is allowed for each taxpayer whose research and development spending during the year in which the credit is claimed exceeds 0.92 percent of the taxpayer's taxable amount during the same calendar year.

The credit is equal to the greater of the amount of qualified research and development expenditures of the taxpayer or eighty percent of amounts received[4] in compensation for the conduct of qualified research and development multiplied by the rate provided in RCW 82.04.290(2).[5] RCW 82.04.4452(2).

The credit for each calendar year may not exceed the lesser of two million dollars or the amount of tax otherwise due under this chapter for the calendar year. RCW 82.04.4452(4). "Qualified research and development expenditures" means operating expenses directly incurred in qualified research and development. RCW 82.04.4452(10)(b).

[3] Demolition may include entombment or dismantlement.
[4] By a person other than a public educational or research institution
[5] The credit is computed with the rate under RCW 82.04.260(3) in the case of a nonprofit corporation or nonprofit association.

Under RCW 82.04.4452 (10)(c), we use the RCW 82.63.010 definition of "Qualified research and development," which provides the definition in §(14):

> (14) "Qualified research and development" means research and development performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology.

See also WAC 458-20-24003(2)(m).

RCW 82.63.010(8) includes environmental cleanup in the definition of "environmental technology:

> "Environmental technology" means assessment and prevention of threats or damage to human health or the environment, environmental cleanup, and the development of alternative energy sources.

Thus, if we insert the RCW 82.63.010(8) definition into RCW 82.04.4452(9)(b), qualified R&D includes R&D in the field of environmental cleanup. Through this statutory labyrinth, we come to our issue: Are all environmental cleanup activities performed in Washington qualified R&D? To answer this, we must determine whether environmental cleanup is the same as R&D performed in the field of environmental cleanup. While the set of R&D activities may overlap with the set of environmental cleanup activities, each set has distinct activities separate from the other. Activities constituting environmental cleanup are not necessarily R&D activities.

RCW 82.63.010(16) defines R&D:

> "Research and development" means activities performed to discover technological information, and technical and nonroutine activities concerned with translating technological information into new or improved products, processes, techniques, formulas, inventions, or software. The term includes exploration of a new use for an existing drug, device, or biological product if the new use requires separate licensing by the federal food and drug administration under chapter 21, C.F.R., as amended.
>
> The term does not include adaptation or duplication of existing products where the products are not substantially improved by application of the technology, nor does the term include surveys and studies, social science and humanities research, market research or testing, quality control, sale promotion and service, computer software developed for internal use, and research in areas such as improved style, taste, and seasonal design.

The Department's high technology Rule 24003 (WAC 458-20-24003), was effective after the audit period, but addressed the high technology statutes in effect at that time, provides an example in §(6)(b) of environmental cleanup activities, which are not R&D:

> A company that engages in environmental cleanup contracted to clean up a site. It had never faced exactly the same situation before, but guaranteed at the outset that it could do the job. It used a variety of existing technologies to accomplish the task in a combination it had never used before. The company was not engaged in research and development in performing this contract. It applied existing technologies in a routine manner, considering the nature of its business, and the outcome was certain.

We understand the taxpayers developed many of the technologies they used at Hanford. The Audit Division allowed the credit for amounts DOE paid to the taxpayers to discover technological information and for nonroutine activities concerned with translating that technological information into new or improved processes. Those payments to develop the technologies are not at issue. From the taxpayers' records, the Audit Division determined when the taxpayers incorporated existing technologies into their cleanup processes, which activities the taxpayers repeated to meet specific contractual requirements with "deliverables" for which they were paid. In these instances the Audit Division found that the processes were no longer new or nonroutine and, therefore, did not fall within the definition of qualifying R&D. The taxpayers assert every one of their cleanup activities was a "steady state operation," which required the continual/constant development and discovery of new and improved techniques as the cleanup activities progressed.

While the taxpayers may have continually strived for improvement of a process, we recognize that at some point the adaptation or duplication of an existing process, like a product being duplicated, does not substantially improve the process. We recognize that everyone should continue to strive to improve processes and products, whether cleaning up nuclear waste, manufacturing widgets, or providing technical services. At some point, however, these activities are concerned less with translating the information into a new process, and more with performing the process for the purpose of obtaining an outcome, in this case, a cleaner environment.

While R&D may have been necessary for the taxpayers to develop processes to cleanup the environment, ultimately, the taxpayers were compensated to transform the Hanford area into a cleaner, safer place. In addition to amounts paid for R&D, DOE paid the taxpayers for accomplishing the task of cleanup, which was an activity distinct from discovering technological information, and distinct from technical and nonroutine activities concerned with translating technological information into new or improved processes or techniques.

The Washington Supreme Court provided guidance regarding how we should interpret and apply statutes affording tax benefits such as RCW 82.04.4452 (9)(b) and RCW 82.63.010(14):

> In connection with each, the burden of showing qualification for the tax benefit afforded likewise rests with the taxpayer. And, statutes, which provide for either are, in case of doubt or ambiguity, to be construed strictly, though fairly and in keeping with the ordinary meaning of their language, against the taxpayer.

Group Health v. Department of Rev. 106 Wn.2d 391, 401-402, 722 P.2d 787 (1986).

The taxpayers' interpretation that the RCW 82.63.010(14) definition of "Qualified research and development" to include all environmental cleanup activities renders the qualifying words "research and development" meaningless in RCW 82.63.010(14). Effect must be given, if possible, to every word in a statute. *International Paper v. Department of Rev.,* 92 Wn. 2d 277,281, 595 P. 2d 1310 (1979). *United Parcel Service, Inc. v. Department of Rev.,* 102 Wn.2d 355, 361-2, 687 P.2d 186, (1984). Had the legislature intended to include all environmental cleanup activities, the words "research and development" could have been omitted in defining "Qualified research and development" and the legislature could have merely defined qualified research and development as, "advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology" performed within this state. But instead the legislature specifically defined qualified research and development as meaning "research and development performed within this state in the fields of . . . environmental technology."

The Audit Division allowed the taxpayers the benefit of the R&D credit only to the extent they qualified. The Audit Division properly gave meaning to the words "research and development" by interpreting RCW 82.63.010(14) to not include all environmental cleanup. We conclude that this interpretation is reasonable and keeps within the ordinary meaning of the statute.

DECISION AND DISPOSITION

The taxpayers' petitions are denied.

Dated this 16th day of June 2004.