

Cite as Det. No. 02-0124, 24 WTD 124 (2005)

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 and For Refund of )	
)	No. 02-0124
)	
... )	Registration No. . . .
)	FY . . . /Audit No. . . .
)	Docket No. . . .
)	

RCW 82.08.02565: RETAIL SALES TAX – M&E EXEMPTION – CONSTRUCTION FOR LESSOR. To be potentially eligible for the manufacturing machinery and equipment (M&E) exemption, a sale must be to a manufacturer or processor for hire. Sales of building materials and construction services to a property owner who intends to lease the structure to a manufacturer after construction is complete do not qualify for the M&E exemption.

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.<sup>1</sup>

NATURE OF ACTION:

The lessee of a manufacturing plant, constructed before the lessee entered into the lease, appeals the assessment of deferred retail sales tax or use tax on the sales of materials and construction services consumed in the construction, contending the sales were exempt from retail sales tax or use tax under the manufacturing machinery and equipment (M&E) exemption.<sup>2</sup>

FACTS:

Prusia, A.L.J. – The taxpayer, [Taxpayer], is a Washington corporation. Its principal activity is . . . processing . . . foods. [Taxpayer] is wholly owned by its president, [President]. [Taxpayer] has one processing plant, located in . . . , Washington.

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<sup>1</sup> NONPRECEDENTIAL PORTIONS OF THIS DETERMINATION HAVE BEEN DELETED.

<sup>2</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

The Department of Revenue's (Department) Audit Division examined [Taxpayer]'s books and records for the period January 1, 1996 through December 31, 1999. As a result of the examination, on November 27, 2000, the Audit Division issued the above assessment for additional taxes and interest, totaling \$ . . . . The assessment remains unpaid.

[Taxpayer] timely appealed the assessment. The appeal disputes only one portion of the assessment, \$ . . . in use tax (audit Schedule 6), and related interest.<sup>3</sup>

Audit Schedule 6 is explained in the audit report<sup>4</sup> as follows. The audit investigation found [Taxpayer] had built a new factory and retail store in [Washington] in 1998. Retail sales tax was not paid on some purchases of materials and subcontractor charges that went into the construction of the new building. [Taxpayer] believed construction of the factory was tax exempt because it was built as a manufacturing facility. Department rules covering this issue are WAC 458-20-13601(7) (Rule 13601), which explains what items are eligible for the manufacturing machinery and equipment (M&E) exemption from sales and use tax, and WAC 458-20-170(2) (Rule 170), which describes the tax liability of speculative builders. Applying those rules, Schedule 6 asserts deferred retail sales or use tax on all materials and subcontractor charges incorporated into the structure, on which retail sales or use tax was not paid.

On appeal, [Taxpayer] asserts as follows. 1) Portions of the construction-related charges on which deferred retail sales tax or use tax was assessed under audit Schedule 6 qualified for the M&E exemption from retail sales tax, under Rule 13601. 2) Some materials and charges on which retail sales tax was paid were exempt from tax under Rule 13601, and [Taxpayer] should be given a credit or refund for the taxes incorrectly paid. 3) With respect to \$ . . . charged by the contractor who erected the building, [Contractor], the contractor, rather than [Taxpayer], is liable for any unpaid sales tax. [Taxpayer] relies on the construction contract, in which [Contractor] agreed to be responsible for any indirect costs.

[Taxpayer] contends that the new factory's columns and walls, footings and slab, roof system, most of the cost of electrical components, the plumbing contracts, air conditioning and other mechanical systems contracts, and interior room construction charges, all qualified for the M&E exemption. The petition explains at great length the materials and construction charges that [Taxpayer] asserts were exempt. We omit those facts from this decision, because they are not material to our decision.

Additional relevant facts are as follows. [President] bought the land on which the plant was constructed, in his and his wife's names, in 1993. For tax reasons, [President] had the plant built in his and his wife's name. [President] hired all construction contractors; there was no general contractor. Invoices reviewed during the audit listed [President] and/or [Taxpayer] as the bill-to name. The contract that [Contractor] entered into was between [Contractor] and [President]

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<sup>3</sup> The amount assessed under Schedule 6 is greater than the total amount of the assessment because of credits given under other audit schedules.

<sup>4</sup> Contained in "Auditor's Detail of Differences and Instructions to Taxpayer," dated October 30, 2000.

individually. [President and his wife] leased the plant to the business [Taxpayer] on January 2, 1999, after construction was completed. [President and his wife] continue to own the land and the plant, and continue to lease them to [Taxpayer].

ISSUES:

1. If the plant was built for [President], individually, and he leased it to [Taxpayer] after construction was completed, was the construction “for a manufacturer” for purposes of the M&E exemption?
2. Should the assessment of deferred sales tax or use tax under audit Schedule 6 be canceled, because that portion of the assessment is against the wrong person?
3. ...
4. ...
5. ...

DISCUSSION:

Relevant Statutes and Rules

All sales of tangible personal property to consumers in the state of Washington, including successive retail sales of the same property, are subject to retail sales tax, unless there is a specific exemption. RCW 82.08.020 and 82.04.050. In general, the use tax applies upon the use within Washington of any tangible personal property the sale or acquisition of which has not been subjected to the Washington retail sales tax. It complements the retail sales tax by imposing a tax of like amount. WAC 458-20-178 (Rule 178); RCW 82.12.020.

For excise tax purposes, the term “retail sale” includes the sale or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the constructing, repairing, decorating, or improving of new or existing buildings or other structures on real property of or for consumers. RCW 82.04.050(2)(b).

Persons who construct buildings for sale or rental upon real estate they own themselves are called “speculative builders.” They are the consumers of the materials and construction services they purchase. The “retail sale” of the materials and construction services is to them, not to subsequent buyers or lessees of the property. Speculative builders must pay sales tax upon all materials purchased by them and on all charges made by their subcontractors. WAC 458-20-170(2)(e) (Rule 170). A lessee under a long-term lease who constructs a building on the leased property also is treated as a speculative builder. Excise Tax Advisory 489.04.170 (ETA 489).

RCW 82.08.02565, effective July 1, 1995, provides a retail sales tax exemption for “sales to a manufacturer or processor for hire of machinery and equipment used directly in a manufacturing operation . . . or to sales of or charges made for labor and services rendered in respect to installing . . . or improving the machinery and equipment.” RCW 82.12.02565 provides a similar exemption from the use tax.

Issue 1 -- Was the construction for a manufacturer, and, therefore, potentially eligible for the M&E exemption?

To be potentially eligible for the M&E exemption, the sale must be “to a manufacturer or processor for hire.” That is, the manufacturer must be the consumer.

In the present case, [President] and his wife were the consumers of the materials and construction services that went into the plant. [President and his wife] built the plant, on land they owned, for lease to a manufacturer [Taxpayer]. The retail sale of materials and construction services was to them, not to the lessee-manufacturer. *See* Rule 170.

[President and his wife] were not manufacturers. Therefore, the sales of building materials and construction services to them were not eligible for the M&E exemption, even if similar sales to a manufacturer would have been eligible.

The fact that [President] owns [Taxpayer], and built the plant for [Taxpayer], does not make [Taxpayer] the consumer. [Taxpayer] is a separate legal entity. There is no allegation or claim that [President] ignored the corporate form in operating [Taxpayer], or that [Taxpayer] was merely an alter ego of [President]. Generally, the courts will not disregard a corporation unless there is proof of two elements: (1) the corporate form has been intentionally used to violate or evade a duty owed to another, and (2) disregard is necessary and required to prevent unjustified loss to the injured party. *See*, Det. No. 00-036, 19 WTD 723 (2000); Det. No. 89-252, 7 WTD 325 (1989).

We conclude that none of the “retail sales” of materials and construction services that are the subject of this appeal qualified for the M&E exemption, because none of the sales were to a manufacturer.

Issue 2 -- Should the assessment of deferred sales tax or use tax under audit Schedule 6 be canceled, because that portion of the assessment is against the wrong person?

[Taxpayer] was not the consumer of the materials and construction services that are the subject of the assessment under audit Schedule 6. The “retail sale” was to [President and his wife]. [Taxpayer] is not liable for its lessor’s sales tax obligation, and is not subject to use tax on its “use” of the materials and labor that were incorporated into the construction. Therefore, the deferred sales tax or use tax assessed against [Taxpayer] under audit Schedule 6 is canceled.

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DECISION AND DISPOSITION:

The taxpayer's petition for cancellation of the deferred sales tax or use tax assessed under audit Schedule 6 is granted, because the retail sales were not made to the taxpayer, but rather to the taxpayer's lessor. . . . The file is remanded to the Audit Division to issue an amended assessment against [Taxpayer] consistent with this Determination.

Dated this 29<sup>th</sup> day of July, 2002.