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BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 18-0229
)	
...)	Registration No. . . .
)	

RCW 82.04.050, RCW 82.04.051: RETAIL SALES TAX – SERVICES RENDERED IN RESPECT TO REAL PROPERTY – PREDOMINANT ACTIVITY. The inspection, cleaning, and repair of power plant turbines is subject to retail sales tax where the turbines are fixtures to real property and the predominant activity is repair work.

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.

Margolis, T.R.O. – A gas and electric utility company (Taxpayer) seeks adjustment of use tax paid and retail sales tax assessed on vendor invoices on grounds that it paid for gas turbine inspection services or services to real property not subject to tax. Taxpayer’s petition is denied.¹

ISSUE

Are inspection, cleaning, and repair services performed on Taxpayer’s gas turbines services in respect to the repairing of structures under RCW 82.04.051 . . . subject to retail sales tax?

FINDINGS OF FACT

Taxpayer is a local energy utility that serves electric and natural gas customers The Department of Revenue’s Audit Division (Audit) examined Taxpayer’s records for the period of January 1, 2012, through December 31, 2015, and issued multiple partial assessments.

Taxpayer owns nine natural gas-fired power plants, all located in Washington State, which consist of buildings that house generators.² The generators make electricity using natural gas powered turbines that convert natural gas into mechanical energy.³ Taxpayer’s plants include [Facility 1], which has three . . . gas turbines, and [Facility 2], which has four single-cycle generating units. The turbines are large, complex, heavy duty machines that comprise the main functional

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

² . . .

³ . . .

components of the power plants, and require routine inspection, maintenance, and repair.⁴ Taxpayer hired [Contractor] to inspect and service these machines. It did not pay retail sales tax on its purchases from Contractor, and seeks refund of use tax paid on parts of the invoices that it characterizes as inspection services, and correction of retail sales tax assessed on purchases. It also argues that if services on the turbines are taxable as services with respect to the repair of real property structures, no use tax can be due as a matter of law.

On July 24, 2017, Audit refunded Taxpayer \$. . . in Audit No. [1], which was a partial audit to determine whether use tax was reported correctly. The refund is comprised of \$. . . in use/deferred sales tax, and \$. . . in interest. Audit used a statistical sample to test use tax reported. In the actuals, there were 3 purchases from Contractor for gas turbine work at Facility 1, on which Taxpayer had paid use tax. Audit did not credit Taxpayer for tax paid on these 3 purchases on grounds that the use tax was correctly paid.

On February 7, 2018, Audit assessed Taxpayer \$. . . in a post assessment adjustment in Audit No. [5]. The assessment is comprised of \$. . . in retail sales tax, a credit of \$. . . in use/deferred sales tax, \$. . . in interest, and \$. . . in additional interest from August 29, 2017, to March 9, 2018. The assessment includes retail sales tax on four purchases from Contractor for gas turbine work at Facility 2.

In summary, Taxpayer is seeking relief for use tax paid or retail sales tax assessed on what Taxpayer claims are non-taxable inspection services as follows:

Plant	Invoice No.	Contract/Statement of Work	Invoice Total	Claimed Inspection services
Facility 1	[1]	[Contract #A1]	\$. . .	\$. . .
Facility 1	[2]	[Contract #A2]	\$. . .	\$. . .
Facility 1	[3]	[Contract #A3]	\$. . .	\$. . .
Facility 2	[4]	Statement of Work No. [1]	\$. . .	\$. . .
Facility 2	[5]	Statement of Work No. [1]	\$. . .	\$. . .
Facility 2	[6]	Statement of Work No. [1]	\$. . .	\$. . .
Facility 2	[7]	Statement of Work No. [1]	\$. . .	\$. . .

Taxpayer explains that Contractor first inspects the turbines, and after preparing a report detailing recommended repairs, Taxpayer may hire Contractor to perform the repairs, do the repairs itself, or hire a third party to make the repairs.

We examined two of the contracts and invoices for work done at [Facility 1] in detail. First, we examined Contract [#A1] and its associated Invoice No. [1]. The contract reads as follows (in pertinent part):

1. DESCRIPTION OF WORK. Contractor shall provide all labor, tools and materials to perform for [Taxpayer] the following work: [Facility 1] . . . Generator Major Inspection in accordance with Contractor’s proposal dated September 7, 2011

⁴ . . .

4. PLACE OF PERFORMANCE. Contractor shall perform the Work designated by [Taxpayer's] Project Manager at [Facility 1 in Washington].

The September 7, 2011, proposal describes a "Generator Inspection Workscope" that includes about 50 various test, measurement, and inspection items, 2 of which have elements of cleaning, with no indication of the value of each item, for a single fixed price of \$. . . , plus the optional inspection/cleaning/calibration of the excitation system for \$

The invoice is for \$. . . , including \$. . . in sales tax and \$. . . in freight. It is comprised of services in the workscope for \$. . . , the optional excitation system work for \$. . . , plus several "adders." The adders are comprised of the . . . Option, which includes about 20 various testing, inspection, removal, cleaning, and materials items, for \$. . . ; a Generator Specialist, labor, tooling, equipment, and materials to perform stator end repairs for \$. . . ; supervision, labor, tooling, equipment, and materials to perform stator end winding stiffening treatment to help arrest movement of end winding components for \$. . . ; and one flux probe kit for an air cooled generator, with supervision, labor, and tooling necessary for installation, for \$ Taxpayer asserts that the \$. . . Generator Inspection Workscope part of the invoice was primarily for inspection, and it should not be liable for use tax on this invoice.

Second, we examined Contract [#A2] and its associated Invoice No. [2]. The contract reads as follows (in pertinent part):

1. DESCRIPTION OF WORK. Contractor shall provide all labor, tools and materials to perform for [Taxpayer] the following Work: . . . Parts Refurbishment in accordance with Contractor's Quote #[1]

4. PLACE OF PERFORMANCE. Contractor shall perform the Work at [Contractor's] Facility [out of state]

Quotation #1 is comprised of 3 sections, namely Pricing Summary, Scope Definitions, and Delivery and Terms. Pricing Summary lists 12 component parts and prices for inspections, estimated repairs (light, medium, or major), and coatings, with a note stating that if Taxpayer would award certain repairs to Contractor, Contractor will give a 5% discount on all repairs. For example, the first component listed is "[Transition] Pieces." Inspection costs \$. . . , light repairs cost \$. . . , medium repairs cost \$. . . , major repairs cost \$. . . , and coatings cost \$ Scope Definitions provide a list of items that comprise various services. Scope Definitions for inspections are comprised largely of items associated with inspections, such as "receive and photograph parts," "remove loose hardware," and "perform material analysis," but a few reference cleaning, such as "perform incoming grit/strip clean."

The associated invoice is for \$. . . , including \$. . . in sales tax and \$. . . in freight. It shows fixed price elements of inspection with detail showing items that comprise the elements (reflecting associated Scope Definitions) and a price, followed by associated fixed price elements of repair (again reflecting associated Scope Definitions) and a price. For example, it lists "Transition Piece Inspection," followed by the elements of that inspection, such as "[r]eceive and photograph parts," and a price of \$. . . , followed by "Transition Medium Repair," the elements of that repair, such

as “[a]pply HICoat H63 to Inlets,” and a price of \$ Taxpayer asserts that elements designated as inspections, amounting to \$. . . , are not subject to use tax. (The invoice shows a 5% discount for awarding Contractor all the components in the project.)

We also examined the one statement of work and invoices provided for work done at Facility 2. The Contract Scope reads as follows:

The Statement of Work attached outlines the mechanical and electrical work to conduct all actions necessary including disassembly, inspection, correction & reassembly of Unit #2 to restore operational vibrations to within . . . original equipment vibration specifications for the unit. Repairs of opportunity will also be conducted as warranted.

The Statement of Work lists the following tasks (detail omitted): combustion turbine disassembly, inspection & cleaning (2.1); generator interference removal (2.2); generator disassembly (2.3); compressor/turbine rotor type 1&2 inspection (2.4); turbine blade inspection & cleaning (2.5); transition inspection & cleaning (2.6); transition support inspection & cleaning (2.7); clamshell inspection & cleaning (2.8); combustion basket inspection & cleaning (2.9); fuel nozzle inspection & cleaning (2.10); compressor blades inspection & cleaning (2.11); compressor diaphragms inspection & cleaning (2.11); blade ring assemblies inspection & cleaning (2.12); vane segments inspection & cleaning (2.14); combustion turbine reassembly (2.15); generator reassembly (2.16); miscellaneous scope and clarification items (2.17); combustion turbine & generator bearing cleaning & inspection (2.18); generator stator inspection & cleaning (2.19); generator rotor on-site inspection & brushless exciter inspection (2.20); and, conduct complete oil flush of lube oil system Units 1&2 (2.21). It identifies Contractor’s optional work as: conduct turbine & compressor repairs (3.1); conduct 100% generator stator re-wedge (3.2), generator rotor shop complete clean & inspect (3.3); generator pole crossover modification (3.4); and, relocation & installation of additional vibration monitor (3.5). Specific items are priced as follows: 2.1-2.3 and 2.15-2.17, \$. . . ; 2.4-2.14, \$. . . and \$. . . ; 2.18, \$. . . ; 2.19, \$. . . ; 2.20, \$. . . ; 2.21, \$. . . ; 3.2, \$. . . ; 3.3, \$. . . ; and 3.4, \$ The contract also specifies costs for specific repairs of compressor blades, turbine blades, turbine vanes, transitions, combustion baskets, clamshells, fuel nozzles, and compressor diaphragms.

Invoices [5] and [6] are progress bills that show no detail. Invoice [7] is described in the attached email from Contractor as “the final invoice for the Unit 2 Major Overhaul,” and includes detailed tasks from the statement of work. It shows a total charge of \$. . . , minus payments made on invoices [5] and [6], for a total of \$. . . (including \$. . . in sales tax and freight).

ANALYSIS

Washington imposes both a retail sales tax and a use tax. Retail sales tax is an excise tax levied on each retail sale in this state, to be paid by the buyer to the seller. RCW 82.08.020; RCW 82.08.050. The use tax complements the retail sales tax and is generally equal in amount to the retail sales tax on the use of items and services defined as a retail sale, where the retail sales tax has not been paid. RCW 82.12.020.

RCW 82.04.050 defines “retail sale” to include:

. . . the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following:

[(a) The installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers . . .] (b) The constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, . . .

RCW 82.04.050(2).⁵

In addition, the phrase “services rendered in respect to” is statutorily defined to mean, “. . . those services that are directly related to the constructing, building, repairing, improving, and decorating of buildings or other structures and that are performed by a person who is responsible for the performance of the constructing, building, repairing, improving, or decorating activity. . . .” RCW 82.04.051(1). Under RCW 82.04.051(2), the “predominant activity under the contract or agreement” determines whether income from a contract that includes both retail activities and service-taxable services is retail taxable or service taxable.

[In general, if a seller sells products or services subject to retail sales tax along with products or services not subject to retail sales tax, and the products or services are separately stated in the sales documents, retail sales tax is due only on amounts charged for the taxable products. *See* RCW 82.04.440(1). However, that general rule does not apply with respect to “services rendered to real property” under RCW 82.04.050(2)(b). As stated above, RCW 82.04.051(1) modifies the phrase “services rendered in respect to” under RCW 82.04.050(2). RCW 82.04.051(2) provides that an agreement where a person is responsible for service that are not subject to retail sales tax along with rendering services in respect to real property that are subject to retail sales tax is subject to the tax that applies to the “predominant activity” under the agreement.

Thus, if Taxpayer’s activities regarding the turbines are “services rendered in respect to” real property under RCW 82.04.050(2)(b), then we apply the predominant activity test – if the predominant activity of Taxpayer’s Contractor’s activities is a product or service taxable as a retail sale, all of the activities at issue are subject to retail sales tax regardless of whether the activities are separately stated in the invoices. If, however, Taxpayer’s activities regarding the turbines are “services rendered in respect to” personal property under RCW 8.04.050(2)(a), then the general rule applies and retail sales tax is only due on the separately stated Contractor services that are taxable as retail sales under RCW 82.04.050(2)(a).

⁵ [“Under the rules of statutory construction, a specific provision controls over one that is general in nature.” *Miller v. Sybouts*, 97 Wn.2d 445, 645 P.2d 1082 (1982). Thus, we apply RCW 82.04.050(2)(b), rather than RCW 82.04.050(2)(a), which provides, more generally, that “retail sale” includes the repairing of tangible personal property for consumers.]

Because Contractor was rendering services with respect to turbines, we must first determine whether the turbines are real property or personal property. The term “fixture” is defined as: “[p]ersonal property that is attached to land or a building and that is regarded as an irremovable part of the real property, such as a fireplace built into a home.” Black’s Law Dictionary (10th ed. 2014). If the contracts at issue are for the repairing of structures upon real property, we look to the predominant activity to determine the correct classification. RCW 82.04.050; RCW 82.04.051. This would include the repairing of fixtures to those structures, since the fixtures are regarded as part of the structures.]

. . . Whether an item constitutes a fixture or personal property depends on the particular facts of each case. *Union Elevator & Warehouse Co., Inc. v. State ex rel. Dep’t of Transp.*, 144 Wn. App. 593, 603, 183 P.3d 1097 (2008).

The common law test for determining whether an item is a fixture to personal property is as follows:

A chattel becomes a fixture if: (1) it is actually annexed to the realty, (2) its use or purpose is applied to or integrated with the use of the realty it is attached to, and (3) the annexing party intended a permanent addition to the freehold.

Glen Park Associates, LLC, v. Dep’t of Revenue, 119 Wn. App. 481, 487, 82 P.3d 664 (2003), *review denied*, 152 Wn.2d 1016, 101 P.3d 107 (2004) (citations omitted). Each element of the test must be met before an item may be properly considered a fixture. *Id.*

With regard to the first element, annexation, we find that the gas turbines are annexed to the realty, similar to a building. The units can weigh nearly 1,000,000 pounds, far more than the average house.⁶ They are bolted into place within large housings, connected to generators, and cannot be easily removed. While we recognize that, per Contract [#A2], parts can be removed and shipped to . . . for refurbishment, it does not follow that the turbines are not annexed to the realty. This element is clearly satisfied.

The second element of the fixture test looks to whether the chattel has application to the use or purpose of the realty. In the present case, the realty is used as a facility for the generation of electricity, and the gas turbines are integral to that function as they provide the mechanical energy to turn the generators that make the electricity. We find this element is met.

The third element of the fixture test is whether the annexor intended a permanent accession to the freehold.

Intent is the most important element of the fixtures test. [] Evidence of intent is gathered from the circumstances at the time of installation. [] The court determines the party's intent to affix items through objective evidence rather than through the party's subjective belief. [] Factors pertinent to intent include “the nature of the article affixed, the relation and

⁶ See http://old.seattletimes.com/html/asktheexpert/2002122968_homehay19.html (last accessed August 27, 2018) (“[H]ouse movers tell me that most houses weigh in at between 80,000 and 160,000 pounds.”)

situation to the freehold of the annexor, the manner of annexation, and the purpose for which annexation is made.” []

Union Elevator & Warehouse Co., Inc. v. State ex rel. Dept. of Transp., 144 Wn. App. 593, 603-604, 183 P.3d 1097, 1102 (2008) (internal citations omitted).

In *Dep't of Revenue v. Boeing*, 85 Wn.2d. 663, 538 P.2d 505 (1975), the Court concluded that large tools known as “fixed assembly jigs” were not intended to be a permanent benefit to the freehold. Taxpayer argues that the turbines are similar to the cranes and jigs because the turbines are designed to be disassembled and moved, and because parts are shipped to Texas, they are not intended to remain at the power plants. . . .

After weighing the evidence presented, however, we conclude the evidence more strongly supports the conclusion that Taxpayer intended to permanently affix the turbines to the real property. The fact that the taxpayer owns the buildings, the turbines are very large and heavy machines attached to the floor where they generally remain, and the turbines are the most significant equipment necessary for use of the buildings as gas-fired power plants, is persuasive evidence that the taxpayer intended a permanent accession to the realty. The three elements of the fixture test have been satisfied, and we find that the turbines at issue are fixtures.

Generally, charges for professional services only, such as inspection services, are [subject to service and other activities B&O tax rather than] retail sales tax. [RCW 82.04.290(2); WAC 458-20-224.] For fixtures to real property, however, RCW 82.04.051(2) applies such that the “predominant activity under the contract or agreement” determines whether a contract that includes both retail activities and service-taxable services is retail taxable or service taxable.

With regard to the turbines at [Facility 1], the [purchases under the contracts are primarily for repair work, which also have the greatest importance, so] the predominant activity under the contracts is repair work [and] these contracts are retail taxable. Because the work at [Facility 2] is for a major overhaul to restore operational vibrations to within [manufacturer’s] original equipment vibration specifications, we conclude that this contract is also predominantly for repair work and subject to retail sales tax.⁷

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 29th day of August 2018.

⁷ Taxpayer further argues that use tax cannot apply to the repair of real property on grounds that RCW 82.12.020 does not impose use tax for using within this state services defined as a retail sale in RCW 82.04.050(2)(b). However, RCW 82.08.050(10) provides that where a buyer has failed to pay retail sales tax the department may proceed directly against the buyer. Taxpayer was assessed retail sales tax, not use tax, and we find no grounds to refund amounts paid as use tax where Taxpayer was liable for the same amount of retail sales tax.