

Cite as 6 WTD 33 (1988)

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u>
<u>N</u>	
For Correction of Assessment of)	
)	No. 88-221
)	
. . .)	Registration No. . . .
)	Tax Assessment No. . .
.	
)	

[1] **RULE 138, RULE 173 AND RULE 224:** B&O/SALES TAX --
CLASSIFICATION -- MACHINERY -- REPAIR -- ENGINEERING
-- SEPARATION. Where engineering services are
readily separable from the repair of portable
machinery, the two activities will be judged
independently for purposes of the B&O and retail
sales tax. Here, the basis for such separation is
found in two different contracts.

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.

TAXPAYER REPRESENTED BY: . . .
. . .

DATE OF HEARING: May 11, 1988

NATURE OF ACTION:

Petition protesting the B&O reclassification of income derived
from an engineering study.

FACTS AND ISSUES:

Dressel, A.L.J. -- . . . (taxpayer) is engaged in the business
of truck design and modification. Its books and records were
examined by the Department of Revenue (Department) for the

period October, 1983 through September, 1986. As a result the above-captioned assessment was issued for tax and interest totaling \$

The issues in this case grow out of a relationship between the taxpayer and a company called [XYZ]. [XYZ] maintains a fleet of trucks specially modified to help the company accomplish its business activity of roofing. [XYZ] was having some difficulty with the operation of the trucks in that they broke down frequently. After consultations, it was decided that the taxpayer could help [XYZ] with that problem. As a result the two parties came to three basic agreements. One called for a design and engineering study by the taxpayer to determine the sources of difficulty with the trucks and how they might be modified to better accomplish the purpose for which they were intended. Another agreement called for the taxpayer to implement the results of that study by actually modifying the taxpayer's trucks. The third agreement was for the taxpayer to provide ongoing advice to [XYZ] as to the maintenance of the trucks and for the taxpayer to offer specific repair instructions when any of the taxpayer's vehicles ran into mechanical difficulties.

The details of these agreements were set forth in letters dated September 2, 1983; September 22, 1983; and January 11, 1984. The September 22 letter specified that the taxpayer would perform a study of the [XYZ] pump truck design for the sum of \$24,000, one half of which would be paid by December 1, 1983 with the second half of that total sum to be paid in \$2,000 increments as six of the taxpayer's trucks were converted to conform with the recommendations established by the engineering study. In the letter this process is labeled as the "study phase of the program." Reference is also made in the same letter to the "conversion phase of the project" under which the taxpayer would convert six new taxpayer trucks on a cost-plus fee basis to be determined at the end of the study phase of the program.

The Department's auditor concluded that the \$24,000 in income that resulted from this agreement was properly categorized for business and occupation tax purposes under Retailing and was subject to retail sales tax. The taxpayer disagrees and maintains that the income was the result of engineering services only and should be categorized under Service and Other Business Activities. That is the issue.

DISCUSSION:

[1] The installation, repair, or alteration of tangible personal property for consumers is a retail sale. RCW 82.04.050. Income from such operations is subject to Retailing B&O tax and retail sales tax. WAC 458-20-173 (Rule 173). Income from the rendition of "personal services," however, is subject to B&O tax under Service and Other Business Activities. WAC 458-20-138 (Rule 138). This administrative rule reads in part:

Personal services rendered to others. The term "personal services," as used herein, refers generally to the activity of rendering services as distinct from making sales of tangible personal property or of services which have been defined in the law as "sales" or "sales at retail." (See RCW 82.04.040 and 82.04.050.)

The following are illustrative of persons performing personal services who are within the scope of this rule: Attorneys, doctors, dentists, architects, engineers, public accountants, public stenographers, barbers, beauty shop operators. (See also WAC 458-20-224.)

BUSINESS AND OCCUPATION TAX

Persons engaged in the business of rendering personal services to others are taxable under the service and other activities classification upon the gross income of such business.

. . .

RETAIL SALES TAX

The retail sales tax does not apply to the amount charged or received for the rendition of personal services to others, even though some tangible personal property in the form of materials and supplies is furnished or used in connection with such services. (*Italics ours.*)

Generally speaking, engineering or other services rendered as part of the repair or alteration of tangible personal property are considered a part of the retail sale and may not be separated out for B&O or sales tax purposes. That is undoubtedly how the auditor has judged the subject business activity. The audit supervisor points out that the September

2 and September 22 letters both reference repair and construction work, and he opines that the engineering and design work cannot be separated from the total contract price.

The auditor's conclusion in this regard is readily understandable. The letter of September 22 states in part, "an additional \$12,000 to be amortized over the six truck conversions, or \$2,000 per truck payable at the delivery of each truck."

The taxpayer explains, however, that there were actually two separate contracts. The letter dated January 11, 1984 is the contract for the actual conversion of the trucks. The letter of September 22, 1983 is the contract for the engineering study. Although the engineering contract makes reference to truck conversions, the taxpayer advises that the \$12,000 was entirely for the engineering study and that the allusion to the conversions was simply made to establish dates certain by which the balance of the engineering contract was to be paid. A reading of the January 11 letter convinces us that it, in fact, was the operative contractual basis for the alteration, repair, and conversion (retrofitting) of the [XYZ] vehicles. Specifics are set forth therein as to what changes are to be made and specific rates for the work are mentioned. The total charge for each truck was not to exceed \$3,000. The payment of that amount or slightly less for each truck conversion is reflected on taxpayer invoices 11365, 11163, 11427, 11478, 11490, 11514, 11532, 11577, 11898, 11915, 11958, and 11973. Payment for the \$24,000 engineering study is reflected on taxpayer invoices 11042, 11127, 11308, 11435, and 11634. It is, thus, clear to us that the \$24,000 contract dated September 22, 1983 was entirely for engineering services, and that the contract and payments for the truck conversions were completely separate from the engineering activity.¹

The audit supervisor notes that several trucks were retrofitted prior to the conversion contract of January 11, 1984. The taxpayer explains that, in fact, only one truck was retrofitted prior to that contract and that was for the purpose of giving the parties an idea as to how much work was involved and how much should be charged for the conversion of each truck. The second conversion was not accomplished until

¹ The taxpayer advises that there was some additional engineering involved in the physical conversion of the trucks, but states that that was included in the \$3,000 per truck conversion price and was part of what was reported as a retail sale.

January 18, 1984, one week after execution of the conversion contract. The taxpayer's explanation on this point is corroborated by invoices. We find that only one truck was retrofitted before execution of the January 11, 1984 contract, and that the consideration received for such retrofitting was separate and apart from the \$24,000 paid for the engineering study.

It is our conclusion that there were two separate contracts here, one for engineering services and one for the repair or alteration of tangible personal property. The contracts are separate in terms of the dates of their execution, the activities undertaken, the manner of payment, the method of payment, and the amount of payment. The engineering study could have been performed by one party and the truck conversions by another. The two activities were not so related that the engineering must be considered a part of the repair activity and taxable on the same basis. Where there is such a separation between a service activity and the repair or alteration of tangible personal property, the B&O tax distinction that would be made if there were no connection between the two activities whatsoever, will be maintained. That is to say in this instance the engineering service will be taxed under Service B&O and the repair/alteration will be taxed as a retail sale.

With respect to the \$24,000 engineering study, the taxpayer's petition is granted. That income is deemed to be for engineering services and is subject, in its entirety, to Service B&O tax.

There is another minor issue which we will address. As indicated in the "Facts" portion of this Determination, there was a third area of agreement between the parties, that being for an ongoing engineering consulting service. The taxpayer advises that the audit supervisor had agreed that income from this activity would be reclassified from Retail to Service. The taxpayer claims, however, that only three out of five invoices involved were reclassified as promised. The invoices at issue are 11309 and 11436 in the amounts of \$2,000 each. Those are invoices not previously mentioned as covering either the engineering study or the truck conversions and are consistent with the recitation in the September 22, 1983 letter that such a consulting service would be inaugurated starting in January, 1984 at the rate of \$2,000 per month. Again, this is a separate activity not directly related to the only retailing activity before us, which is the physical conversion of the trucks. Accordingly, we find that income

from this service is appropriately reported under the Service B&O category as well.

The taxpayer's petition relating to the \$4,000 of income for technical support is also granted.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. An amended assessment will be issued consistent with this Determination.

DATED this 20th day of May 1988.