

Cite as Det. No. 15-0001, 34 WTD 484 (2015)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Refund ) D E T E R M I N A T I O N  
 )  
 ) No. 15-0001  
 )  
... ) Registration No. . . .  
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[1] RULE 171; RCW 82.04.050: RETAIL SALES TAX EXCLUSION FOR PUBLIC ROAD IMPROVEMENTS. The labor and materials charges for the water line reconstruction or relocation were excluded from retail sales tax. The construction constituted public road construction because it was the reconstruction or relocation of a facility in the course of a public road improvement; and Taxpayer was responsible for the cost of relocating the water line. The paved section through a parking lot that connected to a public road construction did not constitute public road construction, and thus the labor and materials charges were not excluded from retail sales tax.

[2] 3 WTD 231; 6 WTD 317: ESTOPPEL – CERTIFICATE OF PAYMENT OF STATE EXCISE TAXES BY PUBLIC WORKS CONTRACTOR. The Department issued the certificate solely based on the information the taxpayer and the contractor provided. The certificate neither precludes the Department from assessing the tax that is due nor does it provide that there is no additional tax due. The Department is not estopped from issuing a tax assessment for additional tax due.

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.

Callahan, A.L.J. – [Taxpayer] protests an assessment of deferred sales tax on charges for a water line reconstruction and for a paved section in a parking lot, claiming that the purchases qualify for the public road construction retail sales tax exception under RCW 82.04.050(10). In addition, Taxpayer claims that the Department of Revenue (the “Department”) is estopped from assessing the tax because the Department issued it a certificate stating that all taxes are paid in full. We grant the petition in part and deny in part.<sup>1</sup>

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

## ISSUES

1. Whether the charges of labor and materials for a water line reconstruction qualify for the public road construction retail sales tax exception under RCW 82.04.050(10).
2. Whether the charges of labor and materials for construction on a paved section in the parking lot connecting a public road to an alley qualify for the public road construction retail sales tax exception under RCW 82.04.050(10).
3. Whether the Department is estopped from assessing Taxpayer because of the Certificate of Payment of State Excise Taxes by Public Works Contractor that it issued stating that all taxes are paid in full or are readily collectible.

## FINDINGS OF FACT

Taxpayer is a political subdivision of the State of Washington that provides municipal services to [the Town]. The Department's Audit Division ("Audit") examined Taxpayer's books and records for the period of . . . ("audit period"). On November 1, 2013, Audit issued an assessment against Taxpayer of \$ . . . , which consisted of retail sales tax of \$ . . . , retailing business and occupation ("B&O") tax of \$ . . . , service and other activities B&O tax of \$ . . . , use tax/deferred sales tax of \$ . . . , power distribution tax of \$ . . . , water distribution tax of \$ . . . , refuse collection tax of \$ . . . , a credit for sewer collection tax of \$ . . . , and, interest of \$ . . . . Taxpayer paid the assessment in full but petitioned the Department's Appeals Division for a refund. Originally, Taxpayer protested nine issues in its petition dated January 2, 2014. Subsequently, it withdrew six issues in its supplemental petition dated July 24, 2014.

During the audit period, Taxpayer entered into contracts with several prime contractors for a reconstruction project on . . . Avenue that was funded by the Washington State Transportation Improvement Board. Audit identified four contracts Taxpayer classified as public road construction in its books and records that do not qualify as public road construction, in whole or in part. Taxpayer did not pay retail sales tax on the charges of labor and materials on those contracts. Audit assessed deferred sales tax on labor and materials on the portions of the projects that do not qualify as public road construction. At issue in this appeal are the water line replacement and the construction on a paved section in the parking lot Taxpayer owns. Taxpayer also argues that the Department is estopped from assessing taxes because the Department issued a Public Works contract clearance. We will first address the public road construction issue.

- 1. Whether the charges of labor and materials for a water line reconstruction qualify for the public road construction retail sales tax exception under RCW 82.04.050(10).*

Taxpayer entered a contract with [Construction Company A] for the construction and improvement of . . . Avenue from approximately 350 feet south of the intersection of . . . to north of . . . Street. The description of the bid Taxpayer awarded to [Construction Company A] contained the following:

Improvements include removing the existing cement concrete panels, removing and replacing the existing cement concrete curb and gutter, and removing and replacing the

cement concrete sidewalks, overlaying the roadway with HMA, striping, illumination, landscaping, drainage improvements, *replacing the existing water line* and other work, all in accordance with the attached Contract Plans, these contract provisions, and the Standard Specifications.

(Emphasis added).

The bid contained a bid schedule for unit prices for all items, and the total amount of the bid. The bid schedule was broken down into the subsections of Preparation, Grading, Storm Sewer, Water line, Surfacing, Hot mix asphalt, Erosion Control and Planting, Traffic, and, Other Items. The only bid item in dispute in this project is the water line reconstruction.

The bid schedule of the water line reconstruction included charges for “tapping sleeve and valve assembly, hydrant assembly, service connection, ductile iron pipe for water, and gate valves.” Taxpayer did not pay retail sales tax on the labor and materials charges on the water line reconstruction claiming those sales qualify for the public road construction retail sales tax exception under RCW 82.04.050(10). Audit determined that the water line reconstruction was a separate piece of work from the public road construction improvement of . . . Avenue. Audit assessed deferred sales tax on both the labor and materials used in this project. Audit also allocated a percentage of general contract charges including mobilization and temporary project traffic control to the retail portion of the job.

On appeal, Taxpayer argues that the water line reconstruction was part of the public road improvement construction on . . . Avenue because the removal of the old water line was an essential part of the improvement project. Taxpayer asserts that the construction on . . . Avenue impacted the old water line and it had to be replaced along with the street project. Taxpayer provided a letter from the Washington State Transportation Improvement Board, which discussed the water line issue:

During design of the . . . Avenue project there was adequate concern communicated by [Taxpayer] and their Engineer that the water line would be impacted by the construction work. [Washington State Transportation Improvement Board] staff shared these concerns and agreed to participate in replacement of the water line.

During the appeal, Taxpayer submitted another document explaining the impacts to the water line by the road construction work. This document is signed by the engineer of record for the project who signed off on the final project plans, and states, in relevant part:

I understand there is a question about whether the moving of the water line running under . . . Avenue was necessary in order to complete the work being done to the road. In reviewing the location of the water line during the design process, I determined it was necessary to move the water line in order to complete the road project. We were concerned we would penetrate the water line with the storm water crossings and while removing the concrete which formed the old road surface. *The water line depth would also have been inadequate given the planned level of the new road surface.*

(Emphasis added).

Taxpayer contends that the water line construction was therefore a necessary byproduct of the public road improvement construction and thus the charges for labor and materials should be exempt from retail sales tax pursuant to RCW 82.04.050(10).

2. *Whether the charges of labor and materials for construction on a paved section in the parking lot connecting a public road to an alley qualify for the public road construction retail sales tax exception under RCW 82.04.050(10).*

Taxpayer contracted with [Construction Company B] in 2009 to construct a visitor center for the city, which included a building, off-street parking, picnic areas, a lighting system, and a bathroom facility. Also included were improvements to the sidewalks on both . . . Avenue and an alley to the east and west of the visitor center respectively. The parking lot is on the south edge of the project and has entries onto both the alley and . . . Avenue. There are breaks between parcels on both the east and west side of the project for . . . Avenue and the alley respectively.

The portion of the project in dispute is the paved section in the parking lot that connects to . . . Avenue and the alley. This paved section does not have a street name. Both the alley and . . . Avenue are distinguished as public roads based on separations between parcels. Parcels both to the south and north of the project are not separated by a public right-of-way. The area in dispute is on the south edge of the parcel on which the Visitor Center was built. Audit allowed the public road construction retail sales tax exception on the project with [Construction Company B] but disallowed the exception for this disputed area, because Audit considers this area as merely access to the off-street parking lot.

Taxpayer asserts that this paved area qualifies as a public road construction pursuant to RCW 82.04.050(10), because it connects . . . Avenue to the alley. Taxpayer argues that the disputed area is a right-of-way that it owns and it is used primarily for foot or vehicular traffic.

3. *Whether the Department is estopped from assessing Taxpayer because of the Certificate of Payment of State Excise Taxes by Public Works Contractor that it issued to Taxpayer's Prime Contractor.*

When [Construction Company A] completed its work, Taxpayer notified the Department following the requirements of Chapter 60.28 RCW.<sup>2</sup> The Department reviewed the information Taxpayer and [Construction Company A] submitted and issued a Certificate of Payment of State Excise Taxes By Public Works Contractor to Taxpayer. The certificate, in relevant part, provided:

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<sup>2</sup> RCW 60.28.010 and .011 provide that public improvement contracts shall provide, and public bodies shall reserve, a contract retainage not to exceed five percent of the moneys earned by the contractor. The retainage is held as a trust fund for the protection and payment of: (a) the claims of any person arising under the contract; and (b) the state with respect to taxes imposed pursuant to Title 82 RCW that may be due from such contractor.

[A]ll other taxes, increases and penalties due from such contractor, have been paid in full or that they are, in the Department's opinion, readily collectible without recourse to the state's lien on the retained percentage.

...

This certificate does not release said contractor from liability for additional tax that may be later determined to be due with respect to the above-mentioned contract or other activities.

(Emphasis added).

Taxpayer argues that the Department is estopped from assessing tax against it because the Department issued a certificate stating that the taxes were paid in full.

## ANALYSIS

### 1. *Water line reconstruction issue:*

Washington imposes a tax on “retail sales,” which include the following:

[T]he sales of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to . . . (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 . . .

RCW 82.04.050(2).

For such “retail sales,” the consumer is generally the owner of the property upon which the construction, repair work, or decorating work occurs. RCW 82.04.190(4). The retail sales tax is measured by the full contract price for the construction, including the cost of materials consumed in the construction, labor costs, and markups. WAC 458-20-170(4)(a).

For road construction, the sale of materials and labor to build, repair, or improve structures on real property are generally subject to retail sales tax. RCW 82.08.020; 82.04.050. A limited exclusion is provided for certain public road improvements. RCW 82.04.050(10). Under this provision, labor and service charges for improvements to roads owned by municipal corporations or political subdivisions of the state are not retail sales. See WAC 458-20-171 (Rule 171). Contractors are considered to be the consumers of the materials used in such projects, and must pay retail sales tax on the purchase of such materials. RCW 82.04.190(3). Thus, the state receives retail sales tax on the value of the materials used, but receives no retail sales tax on the labor and services portion of public road construction projects.

RCW 82.04.050(10) provides:

The term [retail sale] does not include the sale of or charge made for labor and services rendered in respect to the building, repairing, or improving of any street, place, road, highway, easement, right-of-way, mass public transportation terminal or parking facility, bridge, tunnel, or trestle which is owned by a municipal corporation or political subdivision of the state or by the United States and which is used or to be used primarily for foot or vehicular traffic including mass transportation vehicles of any kind.

Thus, there are three requirements for the retail sales tax exclusion under RCW 82.04.050(10): 1) the street, place, road, easement, right of way, etc., must be owned by a municipal corporation or political subdivision of the state or the United States; 2) the work must involve building, repairing, or improving the street, place, road, easement, right of way owned by such entities; and 3) the primary purpose or use of the street, place, road, easement, right of way, etc. must be for foot or vehicular traffic. *Id.*

At issue is whether the water line reconstruction qualifies for the public road improvement retail sales tax exclusion under RCW 82.04.050(10) and thus Taxpayer is not subject to the retail sales tax as a consumer of the labor and materials charged. The first element is not in dispute. With respect to the second requirement, the construction must also involve building, repairing, or improving the street, place, road, easement, or right of way.

[WAC 458-20-171 (Rule 171)] defines “building, repairing or improving of a publicly owned street, place, road, etc.” to specifically exclude the following:

the constructing of water mains, telephone, telegraph, electrical power, *or other conduits or lines in or above streets or roads*, unless such power lines *become a part of a street or road lighting system* as aforesaid; ...

(Emphasis added). Under the rule, the construction of conduits or lines, such as water line is not by itself public road construction unless it has become a part of a public road. However, Rule 171 further defines the term “building, repairing or improving of a publicly owned street, place, road, etc” also includes:

*[A]ny contract for the readjustment, reconstruction or relocation of the facilities of any public, private or cooperatively owned utility or railroad in the course of building, repairing or improving a street, place, road, etc., which is owned by a municipal corporation or political subdivision of the state or by the United States, the cost of which readjustment, reconstruction, or relocation is the responsibility of the public authority whose street, place, road, etc., is being built, repaired or improved.*

(Emphasis added).

Here, the construction work in dispute was the reconstruction or relocation of a municipal water line, the cost of which was Taxpayer’s responsibility. Pursuant to Rule 171, the reconstruction or relocation of the water line as part of the . . . Avenue improvement contract was necessary because the old water line’s depth was inadequate for the construction of the new road surface. We conclude that the water line reconstruction or relocation constitutes public road construction,

because it was the reconstruction or relocation of a utility [facility] in the course of the Mashell Avenue improvement and Taxpayer was responsible for the cost of relocating the water line. Thus the labor and materials charges are exempt from retail sales tax under RCW 82.04.050(10).

2. *Paved section issue:*

With respect to the paved section in the parking lot issue, the term retail sale does not include the construction or “improving of any street, place, road, highway, easement, right-of-way.” RCW 82.04.050(10). At issue is whether the paved section through the parking lot that connects to . . . Avenue and the alley constitutes either a street or right-of-way. A “street” includes “boulevard, avenue, street, alley, way, lane, square or place.” RCW 35.69.010. The term “right-of-way” is not defined in the statute. As a result, “it must be given its ‘usual and ordinary’ meaning, which can be found in dictionaries.” Det. No. 06-0280, 26 WTD 169, 173 (2007) (citing *Port of Seattle v. State, Dept. of Revenue*, 101 Wn. App. 106, 1 P.3d 607 (2000)). The applicable ordinary meaning of “right-of-way” is “the strip of land devoted to or over which is built a public road...at the side of improved highways.” Webster’s Third New International Dictionary 1956 (3rd ed. 1993).

Here, we are not dealing with a street or public right of way with respect to a road or sidewalk. The paved section at issue is public property abutting a road or a public right-of-way. We explained in Det. No. 03-0236, 23 WTD 276 (2004):

[R]ight-of-way improvements directly related to the construction of roadways or pedestrian pathways for vehicular or pedestrian travel are exempt, but right-of-way improvements unrelated to such vehicular or pedestrian travel are not exempt. On-street parking is not specifically identified in the Rule 171 definition as being either exempt or not exempt. *But such right-of-way improvements are ordinarily directly related to the construction of roadways or pedestrian pathways for vehicular or pedestrian travel*, unlike water main or electrical distribution system improvements. In fact, on-street parking is a part of the roadway used for vehicular traffic.

The construction in 23 WTD 276 concerned improvements to a portion of a right-of-way that paralleled a part of a public road that was used for vehicular travel. Unlike the facts in 23 WTD 276, the area in dispute is neither part of a public road nor is a portion of a right-of-way that is a part of a public road used for vehicular or pedestrian traffic. Therefore, we conclude that paved section construction does not constitute public road construction, and thus the labor and materials charges are not exempt from retail sales tax under RCW 82.32.050(10).

3. *Estoppel:*

Taxpayer argues that the certificate the Department issued stated that all taxes were paid in full. We previously addressed this issue in Det. No. 87-192, 3 WTD 231(1987) and Det. Nos. 87-192A, 85-125A, 6 WTD 317 (1988). In those cases, we concluded that when the Department issues the certificate at issue it does not do a complete audit of the contractor’s books and records but merely reviews whether retail sales tax was paid on the materials used in performing the contract. We explained in 6 WTD 317 that the language in the certificate, (“in the department’s

opinion, readily collectible without recourse to the state's lien on the retained percentage,") clearly implies:

[I]t is in the discretion of the Department to issue the contract clearance and thus to release the retainage if the Department feels that the state's position is protected and that any taxes remaining unpaid may be recovered without recourse to the lien protection.

Similarly here, Audit issued the certificate solely based on the information Taxpayer and the contractor provided and the Department did not have all the facts when issuing the certificate. The certificate neither precludes the Department from assessing the tax that is due nor does it provide that there is no additional tax due. In addition, the certificate clearly provides that it "does not release said contractor from liability for additional tax that may be later determined to be due." Here, Taxpayer should have paid the retail sales tax on the contract price for contracts that do not qualify for public road construction. We conclude that the Department is not estopped from issuing a tax assessment for additional tax due.

#### DECISION AND DISPOSITION

We deny Taxpayer's petition in part and grant in part.

Dated this 2nd day of January, 2015.