

Cite as Det. No. 15-0127, 34 WTD 541(2015)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Correction of )                   D E T E R M I N A T I O N  
Letter Ruling of    )  
  )  
   No. 15-0127  
  )  
   Registration No. . . .  
  )  
  )

Rule 171; RCW 82.04.050: B&O TAX – RETAIL SALES TAX – PUBLIC ROAD CONSTRUCTION. Taxpayer is not exempt from retail sales tax where the improvement to its combined sewer and storm water system does not affect the drainage of roads actually under construction.

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, A.L.J. – A [Taxpayer] appeals a letter ruling that improvements to its combined sewer and storm water system do not qualify as public road construction. We sustain the letter ruling.<sup>1</sup>

ISSUE

Whether, under RCW 82.04.050(10), the improvement of Taxpayer's combined sewer and storm water system qualifies for exemption from retail sales tax.

FINDINGS OF FACT

Taxpayer solicited bids from construction companies to improve its combined sewer and storm drain system. The project involves replacing the combined sewer system's larger main trunk lines and interceptor pipes (currently located along the shoreline and in some places in the harbor) from a central location in town to the sewage treatment plant. It includes: installation of larger capacity main lines, renovation and connection of a five million gallon storage tank, improvements to the wastewater treatment plant, and improvements to the outfall pipes from the treatment plant into the bay. It occurs outside the right-of-way of alleys that feed storm water runoff into the combined sewer system. None of the main pipes or lines directly accepts storm water runoff from the particular streets under which a portion of new mains are constructed. A separate dedicated storm drain system services the streets. At times, the combined system carries mostly sewage, and at other times it carries mostly storm water. The improvement is designed to reduce the number of sewage overflow events that occur during storms, which result in the release of mixed storm water and sewage into the bay.

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

On October 31, 2012, Taxpayer requested a letter ruling from the Department of Revenue (Department) to confirm Taxpayer's conclusion that the improvement constitutes public road construction not subject to retail sales tax. Taxpayer provided further information at a meeting with the Department's Audit Division (Audit) and Taxpayer Information and Education Section of its Taxpayer Services Division (TI&E). On March 25, 2014, TI&E issued a letter ruling. TI&E held that the improvement does not qualify as public road construction [for purposes of the retail sales tax exemption] because the system does not accept normal runoff from the streets and roads in which the system is constructed, and "in which" means that the system must be constructed in the streets and roads that are the source of the runoff. Taxpayer appeals on grounds that the improvement is of a system that helps provide drainage for public roads, and there is no requirement for nexus between the streets in which the work is done and surface water runoff from those same streets.

## ANALYSIS

RCW 82.08.020 imposes retail sales tax on each retail sale in Washington. Generally, the seller must collect retail sales tax from the buyer, and then remit the collected tax to the Department. RCW 82.08.050. RCW 82.04.050(2) provides that the term "retail sale" includes the following:

[T]he sale 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 or new or existing buildings or other structures under, upon, or above real property of or for consumers . . .

Thus, in general, a contractor who charges for the improvement of a sewer and storm drain system is making a retail sale, and must collect and remit retail sales tax. RCW 82.04.050(10), however, provides that "retail sale" does not include the following:

[T]he 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.

WAC 458-20-171 (Rule 171) is the administrative rule that explains the statute. Rule 171 provides that retail sales tax does not apply to any portion of the charge made by specified contractors engaged in "building, repairing or improving of a publicly owned street, place, road, etc.," which includes the following, in pertinent part:

[T]he constructing of a drainage system in streets and roads, even though such system is also used for the carrying of sewage: Provided, That the drainage facilities are sufficient for disposal of the normal runoff of surface waters from the particular streets and roads in which the system is constructed or an ordinance authorizing the construction of a combined sewer system is incorporated by reference in the contract and the contract or specifications clearly indicate that the system is designed and intended for the disposal of

the normal runoff of surface waters from the streets and roads in which the system is constructed.

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Except as provided above, the term does not include . . . the constructing of sewage disposal facilities, nor the installing of sewer pipes for sanitation, unless the installation thereof is within, and a part of, a street or road drainage system.

(Emphasis added.) In Det. No. 14-0177, 34 WTD 102 (2015), a different taxpayer argued that “capping” land (covering the land with soil to protect improvements from residual pollution) is exempt from retail sales tax under RCW 82.04.050(10) where it constructed public roads and walkways on the land. In applying Rule 171, we stated as follows (in pertinent part):

We have previously held that, pursuant to Rule 171, only those activities “directly related to” public road construction are exempt from retail sales tax; those activities that are “unrelated to . . . vehicular or pedestrian travel are not exempt.” Det. No. 03-0236, 23 WTD 276 (2004). While Taxpayer maintains that the “capping” of the land, as required by the EPA, was necessary prior to constructing public roads and walkways on the land, such activities are not “directly related to” the construction of such roads and walkways because Taxpayer was required by the EPA to “cap” the land regardless of the nature of improvements Taxpayer eventually constructed atop the land.

34 WTD 102, 106. While statutes imposing tax are generally interpreted in favor of the taxpayer, exemption statutes are construed strictly against the taxpayer,<sup>2</sup> and the taxpayer has the burden of establishing any exemption. *Port of Seattle v. Dep’t of Revenue*, 101 Wn. App. 106, 112, 1 P.3d 607, 610 (2000) (citing *Sacred Heart Medical Ctr. v. Dep’t of Revenue*, 88 Wn. App. 632, 637, 946 P.2d 409 (1997)). The rules of statutory construction apply to agency regulations as well as statutes. *Tesoro Ref. and Marketing v. Dep’t of Revenue*, 164 Wn.2d 310, 322, 190 P.2d 28, 34 (2008) (citing *Mader v. Health Care Auth.*, 149 Wn.2d 458, 472, 70 P.3d 931 (2003)).

The exemption at issue is for public road construction, which Rule 171 interprets to include drainage facilities for those particular streets and roads in which the system is constructed. Taxpayer argues that we should interpret the exemption broadly such that it includes improvement to the combined sewer system to reduce overflow events, even when the improvement does not affect the drainage of roads under construction and instead improves the drainage of alleys elsewhere in the city. Because exemptions are interpreted strictly, and the improvements at issue are not directly related to public road construction as they do not affect

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<sup>2</sup> In *Port of Seattle*, the Court [held] that while the statute at issue is a definition, rather than an exemption, the statute does exempt the public customer from retail sales taxes on labor and services, while the contractor is required to pay retail sales tax only on construction materials. *Port of Seattle*, 101 Wn. App. at 112; see also RCW 82.04.050(10); RCW 82.04.190(3); WAC 458-20-171. Thus, the statute is treated as an “exemption” statute and is to be strictly construed against the taxpayer. *Port of Seattle*, 101 Wn. App. at 112.

the drainage of roads actually under construction, we conclude that Taxpayer does not qualify for the exemption and sustain the letter ruling.<sup>3</sup>

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 13th day of May, 2015.

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<sup>3</sup> Taxpayer cites Det. No. 88-147, 5 WTD 147 (1988) in support of the assertion that construction outside the street right-of-way can qualify as public road construction. In 5 WTD 147, we determined that the entire project was public road construction despite extending outside the boundaries of the street right-of-way. We find that it is distinguishable, as the improvement in this matter is not for the benefit of the right-of-way under construction.