

Cite as Det. No. 12-0344, 32 WTD 302 (2013)

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  
Assessment of )  
 ) No. 12-0344  
... )  
 ) Registration No. ....  
 ) Document Nos. ....  
 ) Audit No. ....  
 )  
 ) Docket Nos. ....

- [1] RCW 82.16.020: PUBLIC UTILITY TAX – CONTRACT MAIL  
TRANSPORTATION SERVICE – AGENCY OR INSTRUMENTALITY OF UNITED STATES – DIRECT TAXATION – TAX IMMUNITY. Under the Supremacy Clause of the United States Constitution, U.S. Const., Art. VI, cl. 2, a state may not directly tax the United States or any agency or instrumentality so closely connected to the United States that the two cannot realistically be viewed as separate entities. A state can never directly tax the United States but is free to tax those private parties with whom the Government does business, even when the financial burden is passed on to the United States, so long as it is done without discrimination. A contract mail transportation service that contracts with the United States Postal Service to deliver mail is not an officer or employee of the federal government, but is an independent contractor and is not so closely connected to the United States that it cannot be viewed as a separate entity. Its gross income is not immune from public utility tax even though the financial burden of the tax may ultimately be passed on to the United States.
  - [2] RCW 82.16.050(8): PUBLIC UTILITY TAX – CONTRACT MAIL  
TRANSPORTATION SERVICE – DEDUCTIONS – EXPORTS – COMMODITIES – FOREIGN ORIGINS OR DESTINATIONS. RCW 82.16.050(8) allows a deduction from gross income revenue from the transportation of commodities from points of origin in this state to a final destination outside this state, or from points of origin outside this state to a final destination in this state. Revenue from contract mail transportation services that begin and end in Washington is not deductible under RCW 82.16.050(8).

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.

Eckholm, A.L.J. – Contract mail transportation business disputes an assessment for public utility tax on its income from services provided in Washington, asserting that Washington is prohibited from taxing its interstate activities and that it is immune from state tax as a federal agency. Petition denied and remanded for production of records.<sup>1</sup>

## ISSUES

1. Whether Washington is prohibited under the Supremacy Clause or federal law from taxing gross income from U.S. mail transportation services contracted by the United States Postal Service.
2. Whether gross income from contract mail transportation services, that originate and end in Washington, is deductible under RCW 82.16.050(8).

## FINDINGS OF FACT

. . . [T]he taxpayer contracts with the United States Postal Service (USPS) to transport U.S. mail between postal facilities located in Washington, and between Washington and [State A] postal facilities. The Department of Revenue (Department) Audit Division requested that the taxpayer complete a Washington Business Activities Questionnaire to verify the taxpayer's Washington activities. Prior to being contacted by the Department the taxpayer was on non-reporting status since April, 2007. In response to the auditor's request that the taxpayer clarify the completed questionnaire, the taxpayer informed the auditor that it provides mail transportation services between [a port in Washington and a facility also located in Washington]. The auditor asked the taxpayer to provide business records for the period January 1, 2007, through March 31, 2011. The taxpayer refused to provide the requested records and told the auditor that its mail transportation services between Washington locations were interstate activities contracted by the USPS; therefore, not subject to state tax. The auditor asked that the taxpayer provide authority for its exemption from tax. The taxpayer provided several reports from the Joint Legislative Audit & Review Committee (JLARC) regarding tax exemptions and deductions for income from certain interstate activities, in addition to webpages containing tax definitions, but did not provide authority for a tax exemption for income from its Washington activities.

Because the taxpayer refused to provide requested records related to its Washington activities, the auditor estimated the taxpayer's Washington income based on the taxpayer's Washington payroll amounts reported to the Washington Employment Security Department. The auditor then applied an industry average to these amounts to estimate the taxpayer's Washington income and public utility taxes due. As a result, an assessment was issued to the taxpayer for public utility tax (PUT), use tax and/or deferred sales tax, penalties, and interest.<sup>2</sup> The assessment was based on the taxpayer's description of its Washington mail delivery services.

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

<sup>2</sup> Document No. . . . includes assessments of public utility tax of \$ . . . , use tax and/or deferred sales tax of \$ . . . , a delinquency penalty of \$ . . . , an assessment penalty of \$ . . . , and interest of \$ . . . , for a total amount of \$ . . . .

The taxpayer appealed the PUT assessment, and subsequent invoices for PUT,<sup>3</sup> asserting that Washington is prohibited from taxing its interstate activities, and that it is immune from state tax as a federal agency.

At the hearing, the taxpayer described its transportation routes as follows: [between two postal facilities located in the same Washington city; between two postal facilities located in different Washington cities; and between a postal facility and a port located in the same Washington city.] The taxpayer indicated its contract mail services also include transportation routes between [State A] and Washington cities. The taxpayer provided copies of reports issued by JLARC supporting its assertion it is not subject to Washington tax, and also provided its own estimates of PUT liability if it is subject to Washington tax. The taxpayer requested that if its appeal is denied it be permitted to provide records to the auditor for consideration of adjustment to the estimated assessments.

## ANALYSIS

The public utility tax (PUT) is imposed upon the gross income of a “motor transportation business” and other named utility businesses for the “act or privilege” of engaging in such business within this state. RCW 82.16.020(1)(f). The term “motor transportation business” is defined in RCW 82.16.010(8) as:

[T]he business (except urban transportation business) of operating any motor propelled vehicle by which persons or property of others are conveyed for hire, and includes, but is not limited to the operation of any motor propelled vehicle as an auto transportation company (except urban transportation business), common carrier or contract carrier as defined by RCW 81.68.010 and 81.80.010.

WAC 458-20-180 (Rule 180) further defines “motor transportation business” to specifically include “the business of operating taxicabs, armored cars, and contract mail delivery vehicles . . .”

The taxpayer operates contract mail delivery vehicles in Washington, a motor transportation business as defined above; therefore, it is subject to PUT under RCW 82.16.020(1)(f). The taxpayer references RCW 81.80.040 in support of its assertion that its income derived from the delivery of U.S. mail is exempt from PUT. RCW 81.80.040 provides an exemption from certain licensing requirements for motor vehicles that transport the U.S. mail; it does not exempt the income from operation of those motor vehicles from PUT.

### 1. State taxation of federally contracted U.S. mail transportation services.

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<sup>3</sup> Document No. . . . , issued November 23, 2011, includes assessments of public utility tax of \$ . . . , delinquency penalty of \$ . . . , and interest of \$ . . . , for a total amount of \$ . . . . Document No. . . . issued June 11, 2012, includes assessments of public utility tax of \$ . . . , delinquency penalty of \$ . . . , and interest of \$ . . . , for a total amount of \$ . . . .

[1] The taxpayer asserts that its income from contract mail transportation services is exempt from PUT because it is acting for the United States Postal Service (USPS), a federal agency. The Supremacy Clause of the United States Constitution, U.S. Const., Art. VI, cl. 2, has been interpreted to preclude a state from imposing a tax “when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned.” *United States v. New Mexico*, 455 U.S. 720, 735, 102 S.Ct. 1373 (1982); *United States v. City of Spokane*, 918 F.2d 84, 86-87 (1990).

The United States Supreme Court has repeatedly held that mail carriers contracted with the USPS for the delivery of U.S. mail are not immune from state taxation on the basis that they are federal instrumentalities. *Alward v. Johnson*, 282 U.S. 509, 513-514, 51 S.Ct. 273 (1931) (rejected a contract mail carrier’s assertion that through its contract with the USPS to deliver U.S. mail it became a federal agency immune from state tax on its gross income); *Tirrell v. Johnston*, 293 U.S. 533, 55 S.Ct. 238 (1934) (per curiam) (affirmed a New Hampshire Supreme Court decision, 86 N.H. 530, 171 A. 641 (1934), that a contract mail carrier was not immune from a gasoline road toll as an agency of the government by virtue of its contract to carry U.S. mail). The Virginia Supreme Court provided an apt summary of the Supreme Court’s holding in *Alward v. Johnson* in a decision upholding a gross receipts road tax applied to a contract mail carrier, explaining that contract mail carriers are independent contractors with the federal government, not employees of a federal agency:

The appellants carry the mail under written contracts between them and the Postmaster General of the United States, acting under the authority and conditions imposed by Congress (U.S.C.A., Title 39, Chapter 12). They are not officers or employees of the Federal Government or of any of its departments. They are independent contractors doing certain prescribed work for the Government at fixed compensation.

*Crowder v. Commonwealth ex rel. State Corp. Comm.*, 197 Va. 96, 102, 87 S.E.2d 745 (1955).

As indicated by the above authorities, while the state is prohibited from directly imposing tax on the United States, persons who conduct business with the United States government are nonetheless subject to applicable taxes unless otherwise exempt. See WAC 458-20-190(1). The taxpayer is not immune from PUT on its gross income from mail delivery services because it contracts with the USPS.

The taxpayer also has not established that its mail delivery activities are federally exempt from state tax. Although the taxpayer did not provide legal support for its position, the taxpayer provided copies of reports issued by JLARC in support of its assertion that a state may not tax the delivery of U.S. Mail. See “2010 Full Tax Preference Performance Reviews,” Report 11-4, available at: <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2010/Pages/11-4.aspx>. The reports summarize JLARC’s review of the interstate transportation public utility tax deduction set forth in RCW 82.16.050(8), and its recommendations to the Legislature to repeal the deduction because it is not constitutionally required. The taxpayer references JLARC’s statement that, “[f]ederal law specifically preempts states from taxing air transportation of goods, U.S. mail delivery, interstate bus transportation of passengers, and Amtrak rail services,” citing

49 U.S.C. § 40116(b), 49 U.S.C. § 14505, and 49 U.S.C. § 24301(1). *Id.* at 53. The United States Code sections cited by JLARC contain specific prohibitions against state taxation of: air commerce and transportation (49 U.S.C. § 40116(b)); passengers traveling interstate by motor carrier (49 U.S.C. § 14505); and railway transportation provided by Amtrak and its subsidiaries (49 U.S.C. § 24301(1)). Motor vehicle mail delivery is not included in these statutory exemptions, but it is referenced in the Amtrak exemption, providing:

Amtrak, a rail carrier subsidiary of Amtrak, and any passenger or other customer of Amtrak or such subsidiary, are exempt from a tax, fee, head charge, or other charge, imposed or levied by a State, political subdivision, or local taxing authority on Amtrak, a rail carrier subsidiary of Amtrak, or on persons traveling in intercity rail passenger transportation or on mail or express transportation provided by Amtrak or such a subsidiary, or on the carriage of such persons, mail, or express, or on the sale of any such transportation, or on the gross receipts derived therefrom after September 30, 1981. In the case of a tax or fee that Amtrak was required to pay as of September 10, 1982, Amtrak is not exempt from such tax or fee if it was assessed before April 1, 1997.

49 U.S.C. Sec. 24301(l)(1) (emphasis added).

The tax exemption for mail transportation applies specifically to Amtrak and its subsidiaries, and passengers or customers thereof. There is no reference to motor vehicle contract mail delivery services in any of the statutory exemptions cited above. The taxpayer has not referenced, and we are not aware of, any federal authority prohibiting state taxation of contract mail delivery services.

2. Deduction from the measure of PUT income from interstate transportation activities pursuant to RCW 82.16.050(8).

[2] The taxpayer also asserts that its transportation of mail from one Washington postal facility to another Washington facility is an interstate commerce activity exempt from state tax. The taxpayer's assertion is incorrect. A state may, under appropriate conditions, tax intrastate activity even though that activity is part of interstate commerce. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 288-289, 97 S.Ct. 1076 (1977) (a Mississippi gross receipts tax applied to a Michigan corporation's income from transporting motor vehicles between a Mississippi railway station and automobile dealers is a constitutionally valid tax on a business's in-state activities); *Dep't of Revenue v. Assoc. of Washington Stevedoring Companies*, 435 U.S. 734, 745, 98 S.Ct. 1388 (1978) (upholding a Washington gross receipts tax on income from loading and unloading ship cargo shipped or to be shipped in interstate or foreign commerce).

Though states are permitted to tax the in-state portion of interstate business activity, Washington has chosen to allow a deduction from the measure of PUT, income derived from:

... the transportation of commodities from points of origin in this state to final destination outside this state, or from points of origin outside this state to final destination in this state, with respect to which the carrier grants to the shipper the privilege of stopping the shipment in transit at some point in this state for the purpose of storing, manufacturing,

milling, or other processing, and thereafter forwards the same commodity, or its equivalent, in the same or converted form, under a through freight rate from point of origin to final destination.

RCW 82.16.050(8) (emphasis added). *See also* WAC 458-20-193D.

This statutory deduction applies only to income derived from transportation services that begin or end outside of Washington. The deduction does not encompass transportation activity that begins and ends at a point within Washington, which is the case here. The taxpayer was issued an assessment for PUT based on an estimate of its gross income from providing mail delivery services *entirely within Washington*. The estimated income forming the basis of the PUT assessment did not include income from the taxpayer's mail delivery routes that began or ended in another state. The taxpayer has not established eligibility for a deduction from gross income from interstate business activities encompassed by RCW 82.16.050(8).

The taxpayer objects to the auditor's estimate of its Washington income. The taxpayer refused to provide the auditor the requested sales and income records to determine the taxpayer's taxable income. Where a taxpayer does not maintain or provide adequate records to determine applicable tax, the Department is authorized to estimate their state excise tax liability. RCW 82.32.100(1), (2).

Here, due to the taxpayer's refusal to provide its sales and income records, the auditor appropriately estimated the taxpayer's income subject to PUT. The auditor indicated that the taxpayer described its Washington activities as picking up mail at [a port in] Washington, and delivering the mail to a U.S. Postal facility in . . . Washington. At the hearing in this matter the taxpayer more fully described its contract mail delivery services as including routes beginning and ending within Washington, and routes beginning or ending in [State A].<sup>4</sup> The taxpayer did not inform the auditor of a full description of its business activities and has not provided records upon which the auditor may calculate taxes due; therefore, in light of the information provided on appeal, the taxpayer will be afforded an opportunity to provide sufficient and reliable records to the auditor for consideration of any adjustments to the estimated assessment.

In summary, the taxpayer is not a federal instrumentality immune from state tax by virtue of its contract with the USPS to deliver U.S. mail. The taxpayer's contract mail services provided between Washington locations are not interstate activities exempt from state tax, and income derived from those services is not deductible from the measure of PUT under RCW 82.16.050(8). This matter is remanded to the Department's Audit Division, consistent with this determination, for consideration of adjustment to the estimated assessments based on records to be provided by the taxpayer.

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<sup>4</sup> It is unclear from the information provided whether any of the taxpayer's contract mail services via routes including Washington ports fall within the deduction for port deliveries under RCW 82.16.050(9). If the taxpayer wishes to assert eligibility for this deduction it may provide substantiating records to the Audit Division on remand.

**DECISION AND DISPOSITION**

We are remanding this matter to the Audit Division (Operating Division) for possible adjustment to the assessments based on records [Taxpayer] must provide.

Dated this 29th day of November 2012.