

WSR 22-03-092

PROPOSED RULES

DEPARTMENT OF REVENUE

[Filed January 18, 2022, 1:47 p.m.]

Original Notice.

Preproposal statement of inquiry was filed as WSR 21-22-027.

Title of Rule and Other Identifying Information: WAC 458-20-17001 Government contracting—Construction, installations, or improvements to government real property, is the rule that explains the taxation of businesses engaged in government contracting and the reporting requirements for persons engaged in these activities.

Hearing Location(s): On February 23, 2022, at 10:00 a.m., virtual meeting. Contact Keith Dacus at KeithD@dor.wa.gov for login/dial-in information.

Date of Intended Adoption: March 16, 2022.

Submit Written Comments to: Patrick Watkins, P.O. Box 47453, Olympia, WA 98504-7453, email patrickw@dor.wa.gov, fax 360-534-1539, by February 25, 2022.

Assistance for Persons with Disabilities: Contact Julie King or Renee Cosare, phone 360-704-5733 or 360-704-5734, TTY 800-833-6384.

Purpose of the Proposal and Its Anticipated Effects, Including Any Changes in Existing Rules: The department is updating this rule to ensure consistency with statutory language, improve readability, format to current standards, and provide guidance on reporting requirements.

Reasons Supporting Proposal: Businesses engaged in government contracting will find that the updates to the rule will clarify statutory language while providing examples that will assist with reporting requirements.

Statutory Authority for Adoption: RCW 82.01.060(2), 84.32.300.

Statute Being Implemented: RCW 82.04.050, 82.04.190, 82.04.240, 82.04.280.

Rule is not necessitated by federal law, federal or state court decision.

Name of Proponent: Department of revenue, governmental.

Name of Agency Personnel Responsible for Drafting: Patrick Watkins, 6400 Linderson Way S.W., Tumwater, WA, 360-534-1539; Implementation and Enforcement: John Ryser, 6400 Linderson Way S.W., Tumwater, WA, 360-534-1605.

A school district fiscal impact statement is not required under RCW 28A.305.135.

A cost-benefit analysis is not required under RCW 34.05.328. This rule is not a significant legislative rule as defined by RCW 34.05.328.

The proposed rule does not impose more-than-minor costs on businesses. Following is a summary of the agency's analysis showing how costs were calculated. The proposed rule does not impose more-than-minor costs on businesses, as it does not propose any new requirements not already provided for in statute. The proposed rule does not impose fees, filing requirements, or recordkeeping guidelines that are not already established in statute.

January 18, 2022
Atif Aziz
Rules Coordinator

OTS-3384.3

AMENDATORY SECTION (Amending WSR 86-10-016, filed 5/1/86)

WAC 458-20-17001 Government contracting—Construction, installations, or improvements to government real property. (1) (~~Special business and occupation tax applications and special sales/use tax applications pertain for prime and subcontractors who perform certain construction, installation, and improvements to real property of or for the United States, its instrumentalities, or a county or city housing authority created pursuant to chapter 35.82 RCW. These specific construction activities are excluded from the definition of "sale at retail" under RCW 82.04.050. All other sales to the United States, its agencies or instrumentalities are taxable as retail sales or wholesale sales, as appropriate. See WAC 458-20-190.~~

~~(2) The definitions of terms and general provisions contained in WAC 458-20-170 apply equally for this rule, as appropriate. In addition, the terms, "clearing land" and "moving earth" include well drilling, core drilling, and hole digging, whether or not casing materials are installed and any grading or clearing of land, including the razing of buildings or other structures.~~

Business and Occupation Tax

~~(3) Amounts derived from)~~ **Introduction.** This rule explains the taxation of businesses engaged in "government contracting"; i.e., constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property of or for the United States, its instrumentalities, or a county or city housing authority created pursuant to chapter 35.82 RCW. It also explains the reporting requirements for persons engaged in these activities.

(a) **Examples.** Examples included in this rule identify a number of facts and then state a general conclusion; they should be used only as a general guide. The tax consequences of all situations must be determined after a review of all the facts and circumstances.

(b) **Other rules that may apply.** The following rules may contain additional relevant information for persons engaged in government contracting or persons working with or for government contractors:

(i) WAC 458-20-134 Commercial or industrial use;

(ii) WAC 458-20-170 Constructing and repairing of new or existing buildings or other structures upon real property;

(iii) WAC 458-20-171 Building, repairing or improving streets, roads, etc., which are owned by a municipal corporation or political subdivision of the state or by the United States and which are used primarily for foot or vehicular traffic;

(iv) WAC 458-20-178 Use tax and the use of tangible personal property;

(v) WAC 458-20-190 Sales to and by the United States and certain entities created by the United States—Doing business on federal reservations—Sales to foreign governments;

(vi) WAC 458-20-211 Leases or rentals of tangible personal property, bailments.

(c) **Definitions.** The definitions in WAC 458-20-170 apply equally for this rule, as appropriate. In addition, the terms "clearing land" and "moving earth" include any grading or clearing of land, including razing buildings or other structures, as well as well drilling, core

drilling, and digging holes, regardless of whether or not casing materials are installed.

(2) **Business and occupation tax.**

(a) **Manufacturing.** Government contractors that manufacture or produce any tangible personal property for their own commercial or industrial use in performing government contracting activities must report the value of the property manufactured under the manufacturing B&O tax classification. See RCW 82.04.240. In these circumstances, the government contractor is considered the consumer of the manufactured product and should not report the value of the manufactured product on either the retailing or wholesaling B&O tax classifications. The multiple activities tax credit is not allowed on this transaction.

(b) **Government contracting.** Persons, including subcontractors, engaged in constructing, repairing, decorating, or improving new or existing buildings or other structures under, upon, or above real property, including installing or attaching tangible personal property ~~((therein or thereto))~~ on the real property, and clearing land or moving earth, of or for the United States, its instrumentalities, or county or city housing authorities of chapter 35.82 RCW are taxable under the government contracting B&O tax classification ~~((of business and occupation tax))~~, on the gross income from those activities. See RCW 82.04.280 (1) (g). The measure of the tax is the gross contract price.

~~((4) Government contractors who manufacture or produce any tangible personal property for their own commercial or industrial use as consumers in performing government contracting activities are subject to the manufacturing classification of business and occupation tax measured by the value of the property manufactured or produced. See also, WAC 458-20-134. The manufacturing tax applies even though the property manufactured or produced for commercial use may be subsequently incorporated into buildings or other structures under the government contract and may thereby enhance the gross contract price.~~

Retail Sales Tax

~~(5))~~ (3) **Retail sales tax.**

(a) **Government contracting activities excluded.** The retail sales tax does not apply to ~~((the gross contract price, or any part thereof,))~~ any portion of the contract price for any business activities taxable under the government contracting B&O tax classification described in subsection (2) (b) of this section.

(b) **Materials.** Prime and subcontractors ~~((who perform such activities))~~ engaged in government contracting are ~~((themselves included within the statutory definition of))~~ "consumers" under RCW 82.04.190 and ~~((are required to))~~ must pay retail sales tax ~~((upon))~~ or use tax on all purchases of materials ~~((, including))~~. Examples of common materials on which sales or use tax would apply include prefabricated and precast items, equipment, and other tangible personal property ~~((which is))~~ installed, applied, attached, or otherwise incorporated in their government contracting work. ~~((This))~~ Sales tax applies ~~((for all such))~~ to the contractor's purchases ~~((of tangible personal property for installation, etc., even though))~~ notwithstanding that the full purchase price of ~~((such))~~ the property will be reimbursed by the government or housing authority in the gross contract price ~~((. It also applies))~~, and notwithstanding that the contract ~~((may contain an immediate title vesting clause which))~~ provides that the title to the property vests in the government or housing authority immediately upon its acquisition by the contractor.

~~((6) Also, the retail sales tax must be paid by government contractors upon their)) (c) **Tools and consumables.** Government contractors must pay retail sales tax on purchases and leases or rentals of tools, consumables, and other tangible personal property ~~((used by them))~~ they use as consumers in performing government contracting as described in subsection (2) (b) of this section.~~

~~((Use Tax~~

~~(7) The)) (4) **Use tax.**~~

~~(a) Use tax applies ((upon)) to the value of all materials, equipment, and other tangible personal property ((purchased)) a government contractor purchases at retail, ((acquired)) acquires as a bailee or donee, or ((manufactured)) manufactures or ((produced by the contractor)) produces for commercial use or industrial use ((in performing government contracting)) and upon which ((no retail sales tax has been paid by)) the contractor, its bailor, or its donor paid no retail sales tax.~~

~~((8) Thus the use tax applies to all property provided by the federal government to the contractor for installation or inclusion in the contract work as well as to all government provided tooling.~~

~~(9) The use tax is to be reported and paid by the government contractor who actually installs or applies the property to the contract. Where the actual installing contractor pays the tax, no further use tax is due upon such property by any other contractor.~~

~~(10) Note to contractors: The United States Supreme Court has sustained the government contracting tax applications for this state, even though the ultimate economic burden of the tax is borne by the United States Government (Washington v. US, 75 L.Ed 2d 264, 1983).~~

~~(11)) (b) Government contractors are required to remit use tax on the value of government-provided tooling as well as property provided by the federal government to the contractor for installation or inclusion in the contract work.~~

~~(c) Either the prime contractor or a subcontractor may be held responsible for payment of the applicable use tax unless there is proof that one of these persons has paid the tax to the department because both persons are "consumers" of the tooling/property under RCW 82.04.190 (6).~~

Example 1. Prime Contracting LLC contracts directly with the United States government to construct a new mess hall on a military base. As part of the project, Prime Contracting LLC manufactures custom wall cabinet storage units at their workshop, then delivers and installs the units in the newly constructed kitchen. Prime Contracting LLC must report the value of the manufactured cabinets under the manufacturing B&O tax classification. Prime Contracting LLC is also subject to use tax on the value of the cabinets. The gross income from the government contract must be reported under the government contracting B&O tax classification.

Example 2. Assume the same facts as Example 1, except Prime Contracting LLC, after manufacturing the cabinets, hires a subcontractor, Classy Cabinets Ltd., to install them. If Prime Contracting LLC does not report and remit use tax on the value of the cabinets, Classy Cabinets would be responsible for paying the use tax. Both Prime Contracting LLC and Classy Cabinets Ltd. will report their income from the project under the government contracting B&O tax classification.

Example 3. Assume the same facts as Example 1, except Prime Contracting LLC hires subcontractor, Classy Cabinets Ltd., to build and install the custom cabinets. In this scenario, Classy Cabinets Ltd. is

the manufacturer of the cabinet units and must report the value of the manufactured cabinets under the manufacturing B&O tax classification. Both Prime Contracting LLC and Classy Cabinets Ltd. will report their income from the project under the government contracting B&O tax classification. Classy Cabinets Ltd. is also subject to use tax on the value of the cabinets. If Classy Cabinets Ltd. does not report and remit use tax on the value of the manufactured cabinets, Prime Contracting LLC would be responsible for paying the use tax.

Example 4. Assume the same facts as Example 3, except the United States government provides Classy Cabinets Ltd. with a tool necessary to install the manufactured cabinets. Classy Cabinets Ltd. is subject to use tax on the value of the tool used. See RCW 82.12.010(7) and WAC 458-20-178 (4)(f) for information on the use tax value of articles used in bailment situations. If Classy Cabinets Ltd. does not report and remit use tax on the value of the tool used, Prime Contracting LLC would be responsible for paying the use tax.

(5) This rule does not apply to public road construction. See WAC 458-20-171.

[Statutory Authority: RCW 82.32.300. WSR 86-10-016 (Order ET 86-9), § 458-20-17001, filed 5/1/86.]