

Cite as Det. No. 17-0146, 37 WTD 036 (2018)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 17-0146
)	
...)	Registration No. . . .
)	

[1] WAC 458-20-24003; RCW 82.63.020: HIGH TECHNOLOGY SALES AND USE TAX DEFERRAL – APPORTIONMENT OF COMMON AREA COSTS. An unfinished portion of a renovation project does not qualify as a common area. When apportioning common area costs, the total square footage of the project includes the unfinished area if the unfinished area was included in the eligible renovation project approved by the Department.

[2] WAC 458-20-24003; RCW 82.63.020: HIGH TECHNOLOGY SALES AND USE TAX DEFERRAL – ALTERNATIVE ENERGY SOURCE. Qualifying research and development in the high technology area of environmental technology includes development of an “alternative energy source,” as defined in WAC 458-20-24003. Development of a new type of nuclear reactor does not qualify as development of an “alternative energy source” because traditional energy sources, such as nuclear energy, are specifically excluded.

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, T.R.O. – A taxpayer that renovated a facility to relocate a laboratory objected to the disallowance of the high technology retail sales and use tax deferral for portions of the project. The taxpayer asserted that an unfinished area should have been excluded in apportioning common area costs. The taxpayer also asserted that the area used for developing a new type of nuclear reactor qualifies for the deferral as development of an alternative energy source. The Department denies the petition.¹

ISSUES

1. Is an unfinished lab area included in the total square footage of the investment project in apportioning common area costs under WAC 458-20-24003?

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

2. Does the development of a new type of nuclear reactor qualify as development of an alternative energy source for purposes of deferral under chapter 82.63 RCW and WAC 458-20-24003?

FINDINGS OF FACT

. . . (the taxpayer) is engaged in the development of intellectual property in a variety of industry sectors. On October 29, 2014, the taxpayer submitted to the Department of Revenue (the Department) an application for deferral of sales and use tax available to high technology businesses for qualified activities under chapter 82.63 RCW. The taxpayer requested the deferral for renovation of a building where it intended to relocate its lab. Based on the information in the taxpayer's application and correspondence with the taxpayer, the Department estimated that renovation of 82 percent of the building was eligible for deferral. The Department apportioned the total construction costs according to this percentage to determine the eligible construction costs.

The Department issued Certificate # . . . to the taxpayer for eligible construction costs during the period October 29, 2014, through September 30, 2015. The Department granted the taxpayer's request for an extension of the completion date to November 30, 2015. On November 9, 2015, the Department sent a letter reminding the taxpayer of the project completion date and requested that the taxpayer indicate on the incorporated form whether the taxpayer needed another extension. The taxpayer returned the form indicating the project would be operationally complete by November 30, 2015, and provided the requested contact information for the future audit of the project.

In January of 2016, the Department's Audit Division audited the deferral project. The taxpayer provided the Audit Division a tour of the lab on March 29, 2016. During the tour, the taxpayer identified certain areas of the lab used by the taxpayer's affiliates for research in unrelated fields. The Audit Division observed an unfinished, taped-off area where they were not allowed access. This area was labeled "Area . . ." on the site map. The taxpayer indicated that Area . . . would be the physics lab and construction had not started. The taxpayer indicated the physics lab would be a future building project.

In April 2016, the taxpayer corresponded with the Audit Division through email to clarify how the taxpayer used all of the separate areas within the lab. The Audit Division requested this information to determine the designation of each area as common area, qualified space, or nonqualified space. The taxpayer indicated that the construction of the physics lab did not start until after the project completion date and the city had not issued the building permit for this area until January 2016. The Audit Division confirmed with the lab architect that the physics lab area was 11,001 square feet.

The taxpayer emailed the Audit Division at the end of April 2016 and indicated that the physics lab was now completed, and asked if the Audit Division could return for another site inspection. The Audit Division responded that further inspection was not necessary because the taxpayer did not complete construction of the physics lab by the certificate completion date of November 30, 2015, and the area was not qualified for the deferral.

The Audit Division designated as common areas the break room and conference room, and areas devoted to circulation throughout the lab. The Audit Division included the mezzanine area in the circulation area because it is used to access other areas of the lab.

The Audit Division determined that certain areas of the lab used by the taxpayer's affiliates were not qualified for deferral because they are not used for qualifying R&D technology. One of the nonqualified areas is used by a taxpayer affiliate [Affiliate] . . . for the development of . . . a new type of nuclear reactor. [Affiliate] describes the [new type of nuclear reactor as being fueled in a novel way, and offers advantages that current nuclear reactors do not possess].

...

[Affiliate states that the new type of nuclear reactor will produce more energy while using less fuel and producing less waste.]

The Audit Division determined that [Affiliate] was engaged in the development of a nuclear power source, specifically excluded from qualifying alternative energy sources under WAC 458-20-24003(3)(e)(v)(C) (Rule 24003(3)(e)(v)(C)).

Because the building included both qualified and nonqualified areas, under Rule 24003(4)(e), it was necessary to apportion the costs of the common areas. The Audit Division used the apportionment methodology under Rule 24003(4)(f)(iii) by taking qualifying square footage of the project (excluding common areas) divided by total square footage of the project (excluding common areas) to generate a percentage, which was then applied to total construction costs.²

The Department issued an assessment against the taxpayer of use tax and/or deferred retail sales tax on the nonqualifying expenditures and interest in the total amount of \$³

The taxpayer sought review of the assessment. The taxpayer asserted that the Audit Division should have excluded the physics lab area from the total square footage of the project in apportioning common area costs because the unfinished area was not part of the construction area encompassed by the deferral certificate. The taxpayer also asserted that the physics lab area should have been excluded as a common area because it was used for impromptu meetings and additional lunch space similar to the use of the conference and break rooms. The taxpayer indicated that the Audit Division designated the mezzanine area as a common area and it was also unfinished, so the fact that the physics lab was unfinished should not prevent it from qualifying.

In addition, the taxpayer asserted that [Affiliate] is developing an energy source that is unique from what is currently available today and cannot be considered the same as the nonqualifying traditional energy source referred to as "nuclear power" in Rule 24003(3)(e)(v)(C). The taxpayer

² [RCW 82.63.065 expressly states that the Department may adopt rules to administer the tax deferrals for high technology businesses.]

³ Document No. . . . , issued on May 26, 2016, included assessments of use tax and/or deferred sales tax of \$. . . and interest of \$. . . , for a total amount of \$

indicates that in some ways the [new type of nuclear reactor] relies on principles of traditional nuclear energy but that it is a fundamentally different [technology.]

ANALYSIS

Chapter 82.63 RCW establishes a retail sales and use tax deferral program to promote high technology R&D and pilot scale manufacturing in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology. The tax deferral applies to sales and use taxes imposed on the construction, expansion or renovation of qualified buildings, and acquisition of qualified machinery and equipment, used in pilot scale manufacturing or qualified R&D. *See* RCW 82.63.045.

A party must submit an application for tax deferral to the Department before initiation of construction of the investment project. RCW 82.63.020(1). The Department's application process is described in Rule 24003, the administrative regulation that administers the high technology sales and use tax deferral program. The applicant must provide the required information regarding its investment project on the Department's form and submit the completed form to the Department. Rule 24003(5). Based on the information provided by the applicant, the Department will determine if all or a portion of the project qualifies for the tax deferral. *Id.*

If the Department approves the application, in whole or in part, the Department will issue to the applicant a sales and use tax deferral certificate on the eligible investment project. Rule 24003(7). The certificate will state the amount of tax deferral for which the recipient is eligible and the date by which the project will be operationally complete. *Id.* Applicants may request amendment of the application or certificate based on certain grounds, including when the project will take more time than originally stated or because of changes in the project. Rule 24003(10). A recipient must notify the Department when the project is operationally complete. Rule 24003(11)(a). After appropriate investigation, the Department will certify the project as operationally complete; not certify the project; or certify only a portion of the project. *Id.* If the Department determines that an investment project is used for purposes other than qualified R&D or pilot scale manufacturing, the recipient must repay all or a proportional part of the deferred taxes. RCW 82.63.045(2); Rule 24003(11)(b).

Apportionment of common area costs.

Here, the taxpayer requested the deferral for renovation of a building where it intended to relocate its lab and provided its estimated construction costs. The taxpayer's application for deferral included the renovation of the entire building and did not specify any exclusions. Under Rule 24003(5), the Department determined the portion of the building renovation eligible for deferral based on the information provided by the taxpayer during the application process. The Department did not exclude the physics lab from the eligible portion of the project covered by the deferral certificate.

The taxpayer asserts the Audit Division incorrectly apportioned the costs for areas used in common by including the unfinished physics lab area. Where a building is used partly for qualified R&D or pilot scale manufacturing, and partly for nonqualified purposes, apportionment of the common

area costs is necessary. RCW 82.63.010(14); Rule 24003(4)(e). The Audit Division used the apportionment methodology under Rule 24003(4)(f)(iii), by taking qualifying square footage of the project (excluding common areas) divided by total square footage of the project (excluding common areas) to generate a percentage, which was then applied to total construction costs. The Audit Division correctly included the square footage of the physics lab in the total square footage of the project because it was part of the eligible renovation project approved by the Department and covered by the deferral certificate. The taxpayer declined the opportunity to seek an extension of the certificate period for any uncompleted construction and affirmed the project would be operationally complete on November 30, 2015. The taxpayer's failure to complete construction in the physics lab area within the deferral period does not render the area excluded from the total square footage of the investment project covered by the certificate.

The Audit Division also correctly concluded that the physics lab area was not a common area. Rule 24003(4)(f)(iii) describes areas used in common as "hallways, bathrooms, and conference rooms." The taxpayer asserted that it used the unfinished physics lab area for impromptu meetings and additional lunch space similar to the use of the conference and break rooms. The common areas described in Rule 24003(4)(f)(iii) do not encompass unfinished space and such a space would not be suitable to hold meetings and take breaks. In any event, the taxpayer has never indicated that the physics lab would be used as a common area after construction was completed. Based on the facts presented, the Audit Division correctly excluded the physics lab space from common areas.

Area used for development of nuclear power source.

The Audit Division determined that certain building areas used by the taxpayer's affiliates were not qualified for deferral because the entities did not use the areas for qualifying R&D technology. The taxpayer sought review of the area used by [Affiliate] for development of [the new type of nuclear reactor], asserting that it qualifies as environmental technology as development of an alternative energy source. The Audit Division relied on Rule 24003(3)(e)(v)(C), which specifically excludes development of a nuclear power source, a traditional power source, from alternative energy sources.

"Environmental technology" is defined as "assessment and prevention of threats or damage to human health or the environment, environmental cleanup, and the development of alternative energy sources." RCW 82.63.010(8). The terms used in this definition are further explained in Rule 24003(3)(e)(v)(C). The rule describes "alternative energy sources," as follows:

Alternative energy sources are those other than traditional energy sources such as fossil fuels, nuclear power, and hydroelectricity. However, when traditional energy sources are used in conjunction with the development of alternative energy sources, all the development will be considered the development of alternative energy sources.

Rule 24003(3)(e)(v)(C).

The taxpayer concedes that [the new type of nuclear reactor] is a nuclear power source but asserts that [Affiliate] is developing an energy source that is unique from what is currently available today

and cannot be considered the same as the traditional energy source referred to as “nuclear power” in Rule 24003(3)(e)(v)(C). The Department recognizes that [the new type of nuclear reactor] is projected to offer significant benefits but that does not change the fact that [the new type of nuclear reactor] is a nuclear reactor that is a nuclear power source specifically excluded from environmental technology under Rule 24003(3)(e)(v)(C).

The taxpayer also asserts that development of [the new type of nuclear reactor] qualifies as an alternative energy source under the second part of Rule 24003(3)(e)(v)(C), “when traditional energy sources are used in conjunction with the development of alternative energy sources, all the development will be considered the development of alternative energy sources.” [The new type of nuclear reactor] does not qualify under this second provision because there is only one energy source . . . which is a traditional nuclear power source. [The new type of nuclear reactor] is not used in conjunction with the development of an alternative energy source. The Audit Division correctly concluded that the space used by [Affiliate] was not used for qualified R&D purposes.

The Audit Division correctly determined the deferred taxes that the taxpayer must repay, as required by RCW 82.63.045(2) and Rule 24003(11)(b).

DECISION AND DISPOSITION

The taxpayer’s petition is denied.

Dated this 7th day of June 2017.