

Cite as 11 WTD 45 (1990).

BEFORE THE INTERPRETATION AND APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition )	<u>D E T E R M I N A T I O</u>
<u>N</u>	
For Refund of )	
)	No. 90-123
)	
. . . )	Registration No. . . .
)	. . ./Audit No. . . .
)	

**[1] RULE 17001:** B&O TAX CLASSIFICATION -- GOVERNMENT CONTRACTING -- ENGINEERING SERVICES -- CONTRACTING PARTIES -- PROJECTS FUNDED BY UNITED STATES GOVERNMENT. Where taxpayer has contracted with cities and counties to provide engineering services and those local governmental projects were funded by United States governmental grants, the taxpayer's income is not to be reported as subject to the Government Contracting classification of the B&O tax. The taxpayer did not perform construction work to real property of or for the United States, its instrumentalities or a county or a city housing authority -- the name entities to which Rule 17001 applies. The income is taxable under another appropriate tax classification.

**[2] RULE 170:** WHOLESALING/RETAILING B&O TAX -- ENGINEERING SERVICES -- WHEN RENDERED IN RESPECT TO CONSTRUCTION. Engineering services rendered "in respect to construction," that is, as part of a construction contract or contemporaneously applied and rendered at the construction site, are subject to Wholesaling or Retailing B&O tax, not Service B&O tax.

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.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

Petition protesting reclassification of amounts reported as subject to Government Contracting B&O tax (lower rate of tax) to the higher tax rate of the Service B&O classification.

FACTS AND ISSUES:

Krebs, A.L.J. -- [The taxpayer] operates a civil engineering firm which does consulting and design work for cities, counties, and the state of Washington. The federal government often supplies grant monies to fund the design work of the projects undertaken by the city, county or state.

The Department of Revenue (Department) examined the taxpayer's filed tax returns for the period from November 1, 1986 through March 31, 1988. As a result of the examination, the Department issued the above captioned tax assessment (subject to future field audit verification) [in June 1988] asserting excise tax liability in the amount of \$ . . . and interest due in the amount of \$ . . . for a total sum of \$ . . . which has been paid in full.

The tax liability arose because the auditor reclassified amounts reported by the taxpayer as subject to the Government Contracting classification of the business and occupation (B&O) to the higher tax rate of the Service B&O classification.

The taxpayer contends that its engineering services are included within the term "construction". In support thereof, the taxpayer points to the meaning of construction in Washington's law on Mechanics Liens, RCW 61.04.010, that: "Every person performing labor upon or furnishing material to be used in construction, alteration or repair of any mining claim, building ... has a lien upon the same for the labor performed or material furnished." The taxpayer further cites Gould v. McCormick, 75 Wash. 61 (1913) as holding that an architect, who renders the plans and specifications for a building and supervises its construction, is a person performing labor upon or furnishing material and is engaged in construction within Washington's Mechanics and Labor Lien Law.

The taxpayer reports that the majority of its contracts are at the city and county level funded by federal and state grants with local matching funds. The taxpayer asserts that the

contracts require qualified professionals to perform the design, construction and management of the project because of the manner in which they are funded and become part of one government contract when viewed by the government as being essential to the project.

In detail, the taxpayer does the design part of the construction including design calculations, estimates, control data and notes, etc. The taxpayer also does site investigation and field surveys, provides laboratory testing of construction materials, prepares contract plans and specifications, conducts prebid conferences and answers contractors' inquiries.

As part of the construction project, the taxpayer is required as consultant to act as overseer for the construction project with onsite quality controls, and observation and testing by its personnel to provide daily monitoring.

As part of some construction contracts, the taxpayer observes the construction progress in order to prepare change orders, makes daily construction inspections and logs them, furnishes a full-time resident construction manager, and certifies completion of the project in accordance with the contract documents.

The taxpayer points to WAC 458-20-17001(3) as providing that amounts derived from "constructing... new or existing buildings or other structures...are taxable under the government contracting classification of business and occupation tax."

The taxpayer also points to WAC 458-20-170(e) as providing that the term "constructing" includes "the sale or charge made for all service activities rendered in respect to such contracting (sic, constructing), repairing, etc. regardless of whether or not said (sic, such) services are otherwise defined as a sale..." -- and continues -- hence, for example, such service charges as engineering fees or supervisory fees are within the term when the services are included within a contract for construction for the construction of a building or a structure. The taxpayer stresses that in legal terminology the term "constructing" includes civil engineering services.

The issue is whether the taxpayer's income is correctly subject to tax under the Government Contracting B&O

classification or under the Service B&O tax classification or some other tax classification.

#### DISCUSSION:

[1] WAC 458-20-17001 (Rule 17001) discusses the tax consequences applicable to "prime and subcontractors who perform certain construction ... to real property of or for the United States, its instrumentalities or a county or city housing authority..." Thus, amounts derived from constructing buildings or other structures "of or for the United States, its instrumentalities. or county or city housing authorities" "are taxable under the government contracting classification" of the B&O tax.

In this case, the taxpayer did not perform its engineering services to "real property of or for the United States, its instrumentalities or a county or city housing authority" but for other local government entities which received grants or funding from the United States government. Accordingly, it was incorrect for the taxpayer to report the income as subject to Government Contracting B&O tax.

[2] WAC 458-20-170 (Rule 170) is the relevant regulation applying to the taxpayer's income from engineering services related to construction. Rule 170 in pertinent part provides:

(1) DEFINITIONS. As used herein:

(a) The term "prime contractor" means a person engaged in the business of performing for consumers, the constructing,...of new or existing buildings or other structures under, upon or above real property, either for the entire work or for a specific portion thereof...

(b) The word "subcontractor" means a person engaged in the business of performing a similar service for persons other than consumers, either for the entire work or for a specific portion thereof...

...

(c) The term "constructing...of new or existing buildings or other structures," in addition to its ordinary meaning, includes... The term includes the sale of or charge made for all service activities rendered in respect to such constructing ...

regardless of whether or not such services are otherwise defined as "sale" by RCW 82.04.040 or "sales at retail" by RCW 82.04.050. Hence, for example, such service charges as engineering fees, architectural fees or supervisory fees are within the term [constructing] when the services are included within a contract for the construction of a building or structure...

...

### (3) BUSINESS AND OCCUPATION TAX.

(a) Prime contractors are taxable under the retailing classification, and subcontractors under the wholesaling classification upon the gross contract price. [Same rate of tax as that of Government Contracting B&O.]

...

### (4) RETAIL SALES TAX.

(a) Prime contractors are required to collect from consumers the retail sales tax measured by the full contract price... (Bracketed words and emphasis supplied.)

Pure engineering services are subject to Service B&O tax. WAC 458-20-224 (Rule 224). Engineering services rendered "in respect to construction", that is, as part of a construction contract or contemporaneously applied and rendered at the construction site, are subject to Wholesaling or Retailing B&O tax, not Service B&O tax. Rule 170.

In this case, the taxpayer reports that his firm does the design work, oversees the construction project as consultant, prepares change orders, makes daily construction inspections, tests construction materials, and furnishes a full-time resident construction manager. We conclude that these service activities when in addition to merely design work are "rendered in respect to constructing". Accordingly, the taxpayer when performing those service activities for a consumer, that is, by contract with a county or city, is within Rule 170's definition of a "prime contractor" and the tax consequences that apply to prime contractors. The taxpayer's gross income from the contract with such consumer is subject to Retailing B&O tax and the taxpayer is required

to collect sales tax from the consumer or be personally liable for the sales tax. Rule 170 and RCW 82.08.050.

In this case, we believe it is necessary for a Department field auditor to examine the taxpayer's contracts to determine whether his firm performed merely design work (taxable under Service B&O) or service activities with respect to construction (taxable under Retailing B&O with sales tax liability). Moreover, it is noted that the tax assessment was issued subject to future field audit verification.

#### DECISION AND DISPOSITION:

The taxpayer's petition is denied with respect to the assertion that the income was subject to Government Contracting B&O tax. The taxpayer's petition is conditionally granted with respect to the assertion that the income was in respect to construction and thus not subject to Service B&O tax. The file is being referred to the Department's Audit Section for examination of the contracts to determine whether the taxpayer's engineering services as required by the contract involved design work only or the additional services which would make the engineering services to have been rendered with respect to construction and taxed accordingly.

If the audit results in a refund, the Audit Section will authorize a refund plus statutory interest. If the audit results in a balance due, interest will be waived for the period from March 1, 1989 through the new date due as indicated on the amended assessment.

DATED this 20th day of March 1990.