

Cite as Det. No. 89-433A, 11 WTD 313 (1992).

BEFORE THE DIRECTOR  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>F</u> <u>I</u> <u>N</u> <u>A</u> <u>L</u>
For Correction of Assessment of	)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
	)	
. . .	)	No. 89-433A
	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] FIXED PRICE CONTRACT TO PERFORM VARIETY OF ACTIVITIES -  
- TAXATION OF. A fixed price contract to perform  
retailing, service, and government contracting  
activities treated as a contract to perform a variety  
of activities, each of which is taxable according to  
its corresponding B&O tax category, where the values  
assigned to the various activities were negotiated by  
the contracting parties prior to performance of the  
contract.

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: . . .  
. . .

DATE OF CONFERENCE: January 9, 1991

NATURE OF ACTION:

At issue is whether 100% of the income earned by the taxpayer  
under its contract with the military (Contract B) is taxable at  
the Service rate rather than at the rates applicable to the  
various activities performed pursuant to the contract.

FACTS AND ISSUES:

Roys, Sr. A.L.J. -- The taxpayer is a prime contractor for the  
United States [military]. At issue is the income from its  
contract for providing services at the . . . (Contract B). The

taxpayer contends the Determination erred in concluding it received a fixed price for the contract which was paid regardless of performance and in concluding that the contract was overwhelming a service contract.

The taxpayer submitted an affidavit from its vice president of finance which explained the nature and structure of its contracts with . . . (contract A) and . . . . According to the taxpayer, "contract A" was one for operation of base morale services such as the Officer's Club and other recreational facilities. The taxpayer received a commission on its sales for those services.

The taxpayer explained "Contract B" as follows:

The contract at the . . . facility is one for operation and maintenance of the physical plant and assets at that facility. The contractor reviews the requirements for performance of the contract which are specified in the Annexes to the contract, and makes a fixed price bid for the performance of the activities specified. Assuming the contractor is otherwise qualified to perform the contract, the contract is awarded to the contractor making the lowest bid.

The contractor awarded the contract prepares a Schedule of Deductions, which assigns values to the activities described in the Annexes. The total of the values assigned to the activities equals the fixed price bid. The values assigned to the various activities are negotiated with [military] personnel, as these values form the basis for non-payment by the [military] in the event the contractor does not perform an activity.

Payment of an amount listed in the Schedule of Deductions is contingent upon performance of the activity. If [taxpayer] does not perform a particular activity, the value assigned to the activity in the Schedule of Deductions is not paid. The [military] has an extensive quality assurance program, and [taxpayer] is required to submit detailed reports, such that performance of the activities required under the contract is closely monitored. In a few instances, [taxpayer] has not been paid amounts listed in the Schedule of Deductions, and thus, did not receive the entire fixed price for the fiscal year, as a result of claims by the [military] that certain activities were not performed by [taxpayer].

The taxpayer also provided portions of Contract B. Section B6 of the contract explained the Schedule of Deductions. The Schedule

was to be prepared and submitted for approval within 15 calendar days after the date of the confirmation of the tentative award of the contract. No work was to begin until the Schedule of Deductions was approved.

The issue on appeal is whether Contract B should be treated as a contract to perform a variety of activities, each of which should be taxed under the corresponding B&O tax category, or as one for general services subject to Service B&O tax.

In the alternative, if the income from Contract B is to be taxed under the same B&O tax category, the taxpayer argued it should not be the service category. According to the taxpayer's calculations, less than 50% of the income from the activities is classified as a service activity. For example, for 1987, the percent of the total contract price was allocated as follows:

Service taxable -----	41.9383%
Government contracting --	26.5728
Retail - -----	16.4251
Warehousing-----	15.0638

---

total	100%
-------	------

#### DISCUSSION:

The taxpayer relies on RCW 82.04.220 through 290, 82.04.440; Fidelity Title Co. v. Department of Rev., 49 Wn.App.662 (1987); ETB 49.04.171; Pan Am World Airways, Inc. v. State, (Thurston Cty. Superior Ct. No. 82-2-00358-9 1983); and WAC 458-20-224 (Rule 224) for its position that income should be taxed according to the type of activity performed. We agree that those authorities and others support the general proposition that a given business may involve more than one classifiable activity.

Clearly the Department recognizes that proposition. Assessments of businesses routinely include more than one B&O tax classification. For example, a business might perform accounting functions for affiliates, make retail sales, print forms for internal use, etc. and it would be subject to the applicable B&O tax on those activities. See, e.g., Group Health Cooperative of Puget Sound v. Department of Rev., 106 Wn.2d 391 (1986)(B&O tax upheld on Group Health's carpentry and print activities). Also, a personal service business would be subject to retailing B&O and retail sales tax on any income received from sales of tangible personal property apart from the rendition of personal services. WAC 458-20-148.

We also agree with the taxpayer that the fact it was required to submit a fixed price bid for performing all of the activities should not require all of the income for the contract to be subject to the same tax classification. The Department has allowed taxpayers to report income from lump sum contracts under more than one tax classification. ETB 49.04.171 summarizes a 1966 decision by the former Washington Tax Commission. At issue was whether the construction of publicly owned roads as part of a construction contract for a large housing project was taxable as a retail sale where the contract or contractor's records only showed a lump sum amount. The Commission held that the taxpayer's records only needed to prove that such work was performed and that the value as reported was reasonable to be taxable under "Public Road Construction" rather than "Retailing."

If a person sold a going business, the total price might be allocated between the real property, personal property, and goodwill. Assuming the allocated amounts were reasonable, the Department would assess real estate excise tax on the value of the real property transferred and retail sales or use tax on the value of the personal property sold. Similarly, we believe that some contracts to perform various business activities could be bifurcated between the various activities to be performed.

We do believe that bifurcation of a contract for taxation will be the unusual case. In most cases income from a performance contract will be taxed according to the primary nature of the activity. For example, income from processing for hire is taxed at the processing for hire rate even though some storage or other services are also involved. Rule 136, subsection 11, states that persons processing for hire are taxable under the processing for hire classification "upon the total charges made therefor." The total charges could include unloading and loading which would be subject to tax at the stevedoring rate if they had been separate charges and not in conjunction with any processing activities.

In the present case, however, we agree Contract "B" should be treated as a contract to perform a variety of activities, each of which should be taxed under the corresponding B&O tax category. In reaching this conclusion we have relied on the fact that the contract required the taxpayer to perform a variety of different business activities with different B&O tax classifications and the Schedule of Deductions provides a reasonable basis for determining the value of the various activities performed. The Schedule of Deductions was required by the contract and was negotiated with the [military] before the work was performed and the values form the basis for non-payment in the event the taxpayer does not perform an activity.

Clearly, if the [military] had contracted with different businesses to perform the different activities, the Department would tax the amounts according to the nature of the activity performed. For example, if the [military] had hired one business to do its data entry services and another to do maintenance and repairs, the income from each contract would be taxed differently. We believe the result should be the same with a fixed price contract to perform a variety of activities where values are assigned to the various activities to be performed by the parties to the contract and the assigned values are reasonable.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. The matter will be remanded back to the Audit Division for a revised assessment. Unless Audit has evidence that the Schedule of Deductions was not a reasonable allocation of the lump-sum amount, those amounts shall provide a basis for classifying the income for B&O tax purposes.

DATED this 4th day of December 1991.