

BEFORE THE APPEALS 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. 98-087
	)	
...	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
	)	
...		Registration No. . . .
		FY. . . /Audit No. . . .

RULE 170: B&O TAX -- SALES/USE TAX -- SPECULATIVE BUILDER -- LICENSING OF. For excise tax purposes, one's status as a speculative builder is not determined by whether that person has been conferred a contractor's license by the Department of Licensing.

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.

NATURE OF ACTION:

Protest by related corporations of Department's conclusion that one performed custom construction for the other.<sup>1</sup>

FACTS:

Dressel, A.L.J. -- . . .(taxpayer) and . . .(taxpayer S), collectively referred to as "taxpayers", are builders and developers of residential properties. The books and records of the taxpayer were examined by the Department of Revenue (Department) for the period January 1, 1993 through December 31, 1994. As a result a tax assessment, identified by the numbers opposite the taxpayer's name in the caption above, was issued for \$. . . The books and records of taxpayer S were also examined by the Department for the period January 1, 1993 through March 31, 1994. As a result a tax assessment, identified by the numbers opposite the taxpayer's name in the caption above, was issued for \$. . . The taxpayers appeal portions of each assessment.

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

The taxpayer is [a] home builder. It is a . . . , wholly-owned subsidiary of . . . [Corporation]. The taxpayer is incorporated in . . . and is registered to do business in Washington. Taxpayer S, formed in 1990, was a wholly-owned subsidiary of [Corporation]. Taxpayer S was also incorporated in . . . and qualified to conduct business in Washington. Taxpayer S discontinued business operations and was liquidated on . . . , 1994.

From 1988 through 1990 there was a shuffling of the [corporation] corporate hierarchy. Through that process a . . . bank came into possession of some undeveloped land in [Washington]. In 1990 taxpayer S was created in order to acquire this parcel of land from the bank. The [Corporation] organization formed a corporation separate from the taxpayer because the bank had gone bankrupt, and [Corporation] wanted to shield the taxpayer of any potential liability related to that. In September, 1990, taxpayer S purchased the land for \$. . . Taxpayer S acquired the land with the intent of developing it, erecting structures, and, eventually, selling the constructed homes.

Taxpayer S did just that during the period of its audit by the Department. Although it shared the same office and officers with the taxpayer, business was conducted separately. While taxpayer S was developing the property in [Washington], the taxpayer was building houses elsewhere. Each entity kept separate checking accounts from which they paid for materials and subcontractors. Neither the taxpayer nor taxpayer S did much actual construction work. In fact, taxpayer S had no employees. Its work was accomplished by the officers it had in common with the taxpayer or by borrowing employees from the taxpayer. Each entity, according to their testimony, functioned as general contractors and got their respective projects built by hiring subcontractors. Not surprisingly, many of the same subcontractors were hired by the two companies.

In examining the operations of these two related corporations, the Audit Division (Audit) of the Department observed the fact that the same individual headed up the taxpayer and taxpayer S. It further observed that the taxpayer had a contractor's license while taxpayer S did not. In addition, taxpayer S had no employees. Title to the referenced property in [Washington] was found to be in the name of taxpayer S. Audit also says that applications for insurance by the federal government, relative to the tract in question, were in the name of the taxpayer, as opposed to taxpayer S. Additionally, building permits from the city of [Washington] showed the contractor's license number of the taxpayer. As a result of this combination of circumstances, Audit reasoned that the taxpayer was the only one of the two companies in a position to construct houses and that since houses were being constructed on the land of taxpayer S, taxpayer S must have hired the taxpayer to do the building. This, Audit concluded, was custom construction. As such, taxpayer S should have paid sales tax on the purchase prices of the homes built for it by its corporate relative, the taxpayer. To insure that one party or the other paid the tax, Audit assessed it of both. It was assessed against taxpayer S, the primary obligor as the purchaser. It was also assessed, in a "protective assessment", against the taxpayer, as the seller and the party responsible for collecting the tax.

The taxpayers contend that taxpayer S was a legitimate, separate entity in its own right and engaged in speculative (spec) construction on its own property. In protesting the Audit

conclusion that it hired the taxpayer to do the building, taxpayer S makes a number of points. It says, among other things, that it hired its own contractors, that there was never any construction contract between it and the taxpayer, and that it never paid the taxpayer any consideration for construction. The parties contend that, as a spec builder, taxpayer S owes sales/use tax on only the building materials it purchased and the charges of its subcontractors.

#### ISSUE:

Did a housing construction company do custom construction for a related housing construction company?

#### DISCUSSION:

While we understand Audit's reasoning in concluding that the taxpayer was the builder, for the following reasons, we find that taxpayer S was the builder:

1. There is no evidence of a contract, written or oral, between the taxpayer and taxpayer S.
2. There is no evidence that taxpayer S paid the taxpayer anything for its alleged construction services.
3. Checks written to pay for subcontractors and building materials were written on the account of taxpayer S.
4. In an earlier audit, the Audit Division recognized taxpayer S as a spec builder.<sup>2</sup> Further, Audit has presented no evidence contradicting the taxpayers' claim that its business operations were the same in both audit periods.
5. Two major subcontractors, who worked for both the taxpayer and taxpayer S, recognized the separate identities of their employers based on the locations of the projects on which they worked and the checks they received for their services.<sup>3</sup>

[1] Audit has made the point that taxpayer S had no contractor's license. The regulation pertaining to building and speculative construction, WAC 458-20-170, however, imposes no requirement that one possess a contractor's license to be a prime contractor, subcontractor, or a spec builder. Indeed, the Washington Supreme Court addressed a similar issue in *Boeing v. Dept. of Revenue*, 103 Wash.2d 581 (1985) relative to the excise tax on aircraft fuel. In determining whether a fuel distributor had to be licensed in order to qualify for certain exemptions, the court said, at p. 585:

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<sup>2</sup> From Auditor's Detail of Differences and Instructions to Taxpayer, dated October 29, 1993, from audit of taxpayer S, covering period January 1, 1990 through December 31, 1992.

<sup>3</sup> From letters submitted with the taxpayers' November 4, 1996 appeal petition.

[1] As a preliminary matter, we find that Boeing was a distributor during the audit period. Moreover, we agree with the decision of the trial court that distributors need not be licensed in order to be entitled to the exemptions of RCW 82.42.030. The statute does not state that licensing is a prerequisite to exemption entitlement. (Footnotes omitted.)

Similarly, in the instant case, there is no statutory requirement that a spec builder be licensed. Nor for that matter is there a requirement that it do actual work or have actual employees. It is not uncommon for prime or general contractors to subcontract all of the construction work on a project.

Audit states that the building permits for the project of taxpayer S in [Washington] list the state contractor's license number of the taxpayer. While we suspect that to be in compliance with Department of Licensing rules, taxpayer S should have had its own license, we are loath to find that the taxpayer performed custom construction for taxpayer S because the latter had no license. In our judgment, the five factors listed above outweigh those relied upon by Audit and dictate a conclusion that taxpayer S was engaged in spec building.

Inasmuch as we have found that taxpayer S is a spec builder, we need not determine whether the Department is actually estopped, based on its 1993 audit, from saying otherwise.

#### DECISION AND DISPOSITION:

The taxpayers' petitions are granted.

DATED this 29th day of May, 1998.