

Cite as 2 WTD 19 (1986)

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

In the Matter of the Petition ) D E T E R M I N A T I O N  
for Correction of Assessment )  
                                  ) No. 86-296  
                                  )  
                                  ) Registration No. . . .  
                                  ) Tax Assessment No. . . .  
                                  )

**RULE 170:** RETAILING B & O -- RETAIL SALES TAX -- PRIME CONTRACTOR -- SUBCHAPTER S CORPORATION -- CONSTRUCTION ON LAND OWNED BY CORPORATION'S SOLE SHAREHOLDER -- ETB 436. Construction by a corporation on land owned separately by its sole shareholder is a sale at retail, not speculative building.

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 the Determination.

TAXPAYER REPRESENTED BY: . . .  
                                  . . .

DATE OF HEARING: October 15, 1986

NATURE OF ACTION

The taxpayer, a construction company, protests the assessment of Retailing B&O tax and Retail Sales tax on unreported construction income. The taxpayer contends the construction projects were speculative building rather than retail construction by a prime contractor.

FACTS AND ISSUES

Frankel, ALJ -- The taxpayer's records were audited for the period January 1, 1981 through December 31, 1985. The examination disclosed taxes and interest owing in the amount of \$68,721. Tax Assessment No. . . . in that amount was issued on May 15, 1986.

The taxpayer registered with the Department in 1974 as a general contractor. The primary issue in this appeal is the assessment of Retailing B&O tax and Retail Sales tax on unreported construction income. The auditor found the taxpayer had acted as a prime contractor in the construction of three buildings for . . . , the taxpayer's president and single shareholder.

The taxpayer argues the construction projects at issue were speculative buildings. In support of its position, the taxpayer emphasized the following facts:

- 1) The land was acquired by the shareholder personally with the intent of constructing the buildings. He personally paid for the land and borrowed the money for the construction. No written contracts for construction were executed.
- 2) The corporation was formed and used for liability purposes only. The taxpayer is a subchapter S corporation; its income or losses are reported by the shareholder on his personal returns.

The taxpayer also contends that material suppliers believed they were dealing with the shareholder personally rather than the corporation, because the invoices have only the first or full name of the shareholder rather than the taxpayer corporation. The taxpayer believes the Department should consider the substance of the transactions rather than the form. The taxpayer states the corporation is the "alter ego" of the shareholder and that the Department should disregard the corporate entity.

The auditor relied on WAC 458-20-170 and ETB 436.04.170 and concluded that the taxpayer's relationship with its shareholder was as a prime contractor. The auditor relied on the following facts:

- 1) The taxpayer is registered and licensed as a general contractor. The building permit was in the name of the corporation and the corporate contractor's license was used.
- 2) All construction bills were paid by the taxpayer corporation from a corporate account. The taxpayer purchased the

supplies without paying retail sales tax, using its resale certificate and registration number.

- 3) The corporation paid the subcontractors and construction employees and withheld employee taxes.
- 4) The buildings were not constructed upon land which was owned by the taxpayer corporation, but on land that was personally owned by the corporation's shareholder.

The taxpayer stated it mistakenly issued resale certificates and agrees that the retail sales tax is due. It does, however, contend that the amount assessed should be reduced by the amount paid on its annual excise tax return for 1985 (. . . ).

The taxpayer also objects to the method used by the auditor in computing the amount of retailing and retail sales tax. (. . . ) The auditor based the assessment on the gross receipts as reported by the taxpayer on its federal income tax returns. The auditor added the gross receipts for each fiscal year and divided them by twelve to compute the monthly average. The auditor then computed the income for a calendar year and applied the applicable tax rates for each period. The taxpayer contends that an actual audit of its books and records for each calendar year would result in a lower assessment.

#### DISCUSSION

Subchapter S corporations are treated no differently for state excise tax purposes from any other business entity. They are "persons" under RCW 82.04.030, and their business activities are fully subject to the excise tax impositions of the Washington State Revenue Act. Transactions between separate "persons" are subject to excise taxes notwithstanding their affiliation with or relationship to each other. A "person" is defined in RCW 82.04.030 to mean

". . . any individual . . . firm . . . company . . . corporation . . . or any group of individuals acting as a unit, . . ."

RCW 82.04.050 defines "sale at retail" and/or "retail sale" to include

. . . the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the  
 . . . constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers, including the installing or attaching of any article or tangible personal property therein or thereto . . . (Emphasis supplied.)

The statute is implemented by WAC 458-20-170 (Rule 170). Rule 170 defines the term "prime contractor" to mean "a person engaged in the business of performing for consumers contracts for the construction . . . of new . . . buildings . . . upon real property." A prime contractor must collect from all consumers the retail sales tax measured by the full contract price.

The rule also defines the term "speculative builder" to mean "one who constructs buildings for sale or rental upon real estate owned by him." A speculative builder is not liable for sales tax on the full contract price but must pay retail sales tax on "all tangible personal property, including building materials, tools, equipment and consumable supplies" and also upon purchases of "labor, services and materials . . . by independent contractor."

As the taxpayer did not own the land upon which it constructed the building, the taxpayer was not a speculative builder of these buildings. It is the fact of ownership of the land upon which these provisions of the Revenue Act and Rule 170 operate. This conclusion of law was expressed succinctly by the Washington State Board of Tax Appeals in Reliable Builders, Inc. v. Department of Revenue, Docket No. 17074 (1978), as follows:

Under the Revenue Act and Rule 170 the appellant-taxpayer is not the owner of the land and this does not qualify as a "speculative builder".

The taxpayer's intentions or belief that creditor's could "pierce the corporate veil" is not controlling. The doctrine of disregarding the corporate entity is only applied in exceptional cases, as to prevent a fraud upon third persons dealing with the corporation. See, e.g. Dummer v. Wheeler Osgood Sales Corp., 198 Wash. 381, 391 (1939). Mere common

ownership or evidence of close association alone does not justify disregarding corporate identities. Id.

The excise tax laws operate on substantive fact and formal legal intentions. The general rule is that a taxing authority may penetrate the form of a transaction to determine its substance, but a taxpayer may not. Higgins v. Smith, 308 U.S. 473, 60 S.Ct. 355, 84 L.Ed. 409 (1940).

Furthermore, the facts do not clearly show that the material suppliers and laborers believed they were dealing with the shareholder personally rather than the corporation. Even if invoices did not have the corporate name on them, no retail sales tax was collected because the taxpayer had provided a resale certificate with its corporate name and registration number. Also, the employees were paid by the corporation, not by the shareholder personally.

Excise Tax Bulletin 436.04.170, issued in 1971, clearly states that when a company constructs a building on land owned by its prime stockholder, the construction is a retail sale. The bulletin recognizes that:

Under RCW 82.04.030 the corporation is a completely separate entity or "person" from the corporate president personally, and any transactions between these two persons are taxable to the same extent as if the close relationship did not exist.

We find, therefore, that the auditor was correct in concluding the taxpayer was subject to Retailing B & O and Retail Sales Tax. The taxpayer's petition is denied, except that it may present its evidence to the auditor of excise taxes paid for 1985 which it contends should be credited against this assessment.

The taxpayer had also recomputed the retailing B & O and sales tax owing based on its actual expenditures and billings rather than a proration of its federal tax returns. Because the taxpayer believed no sales tax should have been asserted on the labor performed by the corporation employees, though, it omitted tax on invoices for labor. If it still believes an actual audit of its books would result in a lower tax, it may present that additional evidence to the auditor also.

#### DECISION AND DISPOSITION

The assessment of Retailing B & O and Retail Sales tax on the unreported construction income is upheld. The taxpayer may present evidence the auditor of taxes it paid which it contends should be credited against the assessment. The taxpayer may also present its books and records, if it still contends the auditor's method of computing the assessment resulted in a higher assessment than should be due. . . . .

DATED this 21st day of November 1986.