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

In The Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 89-63
. . .	)	Registration No. . . .
) . . . /Audit No. . . .	)	

[1] **RULE 170:** CONTRACTING -- GENERAL CONTRACTOR -- AGENCY -- BOISE CASCADE -- REQUIREMENTS. The requirements of agency in tort and/or contract law are not the same as those necessary in tax. In order to be considered an agent for state tax purposes, a contractor must be "so assimilated" into the owner as to be considered one of its constituent parts. Boise Cascade Corp. v. State, 3 Wn.App. 78 (1970), review denied, 78 W.2d 995 (1970).

[2] **RULE 17001:** GOVERNMENT CONTRACTING -- FSLIC -- INSTRUMENTALITY OF UNITED STATES. When a project owner is taken over by the FSLIC, the tax liability of the contractor shifts from the retailing category to the government contracting category. The FSLIC is an instrumentality of the federal government.

[3] **RULE 170:** CONTRACTING -- SERVICES IN RESPECT TO CONSTRUCTION -- PROFESSIONAL SERVICES. When services are rendered in respect to construction, and arranged by the general contractor, they will be considered part of the contract and subject to retailing B&O and retail sales tax, even though performed before the contract was signed.

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 REPRESENTATIVES: . . .

. . .

DATE OF HEARING: November 29, 1988, Seattle, Washington

FACTS AND ISSUES:

Hesselholt, A.L.J. -- Taxpayer is a licensed general contractor, experienced as a commercial developer and builder. Its records were examined for the period August 2, 1983 through June 30, 1987 by the Department of Revenue. An assessment was issued for $. . . in taxes and interest. Taxpayer timely filed a petition for correction of assessment. Taxpayer takes issue with a number of the audit findings, the primary one being the auditor's conclusion that the taxpayer was acting as a general contractor.

In 1984, taxpayer's principal, . . . , met with the chairman of . . . (S&L), a California chartered savings and loan association based in Los Angeles. S&L was pursuing real estate development markets, and was interested in a presence in the greater Seattle market. S&L's interest in taxpayer was for its development and construction expertise and Northwest connections. Taxpayer ultimately undertook four apartment developments on behalf of S&L or its fully-owned subsidiary.

The development procedures generally followed the same pattern. Taxpayer would locate suitable land for the development and execute the necessary documents for the acquisition. The acquisition documents listed taxpayer's wholly-owned Nevada corporation as the buyer, but S&L provided all of the funds. Taxpayer arranged for the necessary engineering, architectural and construction work on behalf of the developments. Taxpayer incurred substantial earnest-money, architectural, engineering, construction and feasibility expenses long before the formal documents were executed between S&L and taxpayer. Funds for all of these expenditures were provided by S&L, as were all subsequent funds for the projects. In early 1984 S&L sent a representative to Seattle to examine the four sites that taxpayer had chosen. The representative approved all of the sites and the purchases were closed and title was taken in the name of S&L.

The payments by S&L to taxpayer evolved over time, but generally went through the following stages:

1. Single Dual-Signature Checking Account.

Initially, S&L maintained a central checking account within itself, and established taxpayer as joint signatory with itself. Taxpayer's officers signed checks which the vendors would then send to S&L for countersignature. S&L advanced funds from its general ledger to fund the checking account for the payments thus made to vendors.

2. Separate Dual-Signature Accounts.

Subsequently, S&L established separate accounts within itself as to each of the four development ventures. When a vendor presented an invoice, taxpayer sent a check and the invoice to S&L for countersignature, which S&L then returned to taxpayer. Taxpayer would then deliver the check to the vendor on behalf of S&L.

3. Voucher System.

In the final stage, taxpayer would prepare, sign and provide project vendors with a voucher, which the vendor would then present to S&L. S&L would prepare a check to the vendor drawn on S&L's corporate account maintained at a New York bank, which taxpayer would present to the vendor.

For each of the four projects, taxpayer and S&L executed essentially the same set of documents. They included a contractors agreement, management agreement, joint venture agreement, guarantee, and, in three of the projects, a repudiation agreement. The contractor's agreement covered taxpayer's responsibilities during the development phase; the management agreement covered taxpayer's responsibilities during the leasing phase; the joint venture agreement, which was never executed, gave taxpayer a one half interest in the project in the event that S&L decided not to sell; the guarantee by taxpayer's principal to personally guarantee taxpayer's performance; and the repudiation agreement.

In March, 1986, S&L was taken over by the Federal Savings and Loan Insurance Corporation (FSLIC). At that time, one of the four projects was substantially incomplete.

Taxpayer argues that its relationship with S&L was that of an agent to its principal, not a prime contractor to an owner.

It further argues that the takeover of S&L by the FSLIC was a succession of a United States instrumentality to the project and that the tax consequences of the transaction were altered by that takeover. It finally argues that the auditor made numerous and substantial factual and accounting errors in the preparation of the audit, and that even if the auditor's theory is correct, there are numerous errors that artificially inflate the assessment.

DISCUSSION:

RCW 82.04.050 defines a "sale at retail," in part, as:

> (2) The term "sale at retail" . . . shall include the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following: (b) 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 of tangible personal property therein or thereto. . . .

WAC 458-20-170, the administrative rule implementing the statute as regarding construction activities, provides as follows:

> The term "prime contractor" means a person engaged in the business of performing for consumers, the constructing, repairing, decorating or improving 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 . . . The term "constructing, repairing, decorating or improving of new or existing buildings or other structures," in addition to its ordinary meaning, includes: . . . the sale of or charge made for all service activities rendered in respect to such constructing, repairing, etc., 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 . . . . Persons, including corporations, partnerships, sole proprietorships, and joint ventures, among others, who perform construction upon land owned by their corporate officers, partners, owners, co-venturers, etc., are constructing upon land owned by others and are

> taxable as sellers under this rule. . . . prime contractors are taxable under the retailing classification, and subcontractors under the wholesaling classification upon the gross contract price. (b) Where no gross contract price is stated in any contract or agreement between the builder and the property owner, then the measure of business and occupation tax is the total amount of construction costs, including any charges for licenses, fees, permits, etc., required for construction and paid by the builder.

[1] Taxpayer argues extensively that it was not acting as a general contractor to S&L, but was instead acting in the capacity of agent to S&L's principal. Taxpayer cites a number of cases to support its theory, but none of those cases deal with agency in respect to Washington's tax laws. There is, however, a case decided by the Washington Appellate Court that is directly on point on this issue: Boise Cascade Corp. v. State, 3 Wn.App. 78, (1970), review denied, 78 W.2d 995 (1970). In that case, Boise Cascade objected to a finding that a contractor hired by it acted as an independent agent, rather than Boise Cascade's agent. In that case, Boise Cascade argued that "the amount of control it exercised was substantially more than normally reserved by an owner in a construction contract, and that [the contractor] acted as Boise Cascade's agent, rather than as a general or independent contractor." Id, at 84. The court found that even where the contract stated that the contractor was to be the agent, that was not sufficient to establish the existence of such a relationship. The court went on to say that "It is apparent from the Du Pont case [Du Pont de Nemours & Co. v. State, 44 Wn.2d 339 (1954)] that a different test is applied to the agency concept in tax cases than in tort or contract cases." Id, at 87. The court determined that the contractor had not been "'so assimilated [into Boise Cascade] as to become one of its constituent parts'" [citations omitted] so as to be considered as an agent of Boise Cascade for tax purposes.
In this case, S&L exercised a great deal of control over the financial side of the construction business, but the taxpayer was responsible for all of the construction, as evidenced by the guarantee that taxpayer's principal was required to sign. We find no evidence that taxpayer was "so assimilated into S&L as to become one of its constituent parts", and in fact, when S&L was taken over by FSLIC, taxpayer continued to do business independently and presumably, thrive.

We therefore find that taxpayer was acting as a prime contractor to S&L for Washington tax purposes, and is subject to the tax consequences thereof.

[2] S&L was taken over by the FSLIC in March of 1986. At that time, one of the projects was substantially uncompleted. The FSLIC is an instrumentality of the United States government, and therefore, exempt from taxation by the state of Washington. Thus, at the time the FSLIC took over S&L, the tax consequences of the relationship between taxpayer and its customer changed. A government contractor is taxable under the government contracting classification of the business and occupation tax. The use tax applies on the value of all materials, equipment, and other tangible personal property purchased at retail, manufactured or produced by the contractor for use in performing the contract. (Rule 17001). Therefore, from the time the FSLIC took over S&L, taxpayer would owe use tax on the items mentioned above, and B&O tax at the government contractors rate on all amounts received by it from that time forward.

[3] Taxpayer also alleged substantial and significant factual errors made by the auditor during the course of the audit. One of the factual errors taxpayer alleges is that the auditor included certain costs as part of the contract price which should have actually been considered land acquisition costs and excluded from the contract price. While the documentation provided does not clearly indicate what all was included, the taxpayer's petition indicates that "the costs in accounts 653-659 are for architecture and engineering professional services incurred in developing the studies and plans necessary to secure building permits on the project which . . . was a condition precedent on the land purchase.
. . . These costs are not part of the construction costs and instead are part of land acquisition costs because the successful completion of these services were contingencies in the land purchase contract. Thus these costs were incurred by the owner purchasing the land rather than as fees charged by the contractor." The taxpayer made the arrangements with some of the professionals, while S&L made arrangements with others to perform services. All were paid by S&L.

The contract between taxpayer and S&L provides, in Section 2.3.1:

> Consultation During Project Development. Formulate with Owner's architect and engineer the preliminary design with respect to site use and improvements,

> and the selection of materials, and building systems and equipment. Provide advice and recommendations as to construction feasibility, availability of materials and labor, time requirements for construction and installation, and cost factors including the costs of alternative designs, materials and labor.

We find that the contract between the taxpayer and S&L required the professional services that were rendered, and the fact that they may have been rendered before the construction contracts were actually signed does not render the transactions nontaxable. Services rendered in respect to construction are retail sales, and subject to the retail sales tax and retailing B&O tax. Taxpayer's petition is denied as to this issue.

Taxpayer also argued that the auditor should have used the "Disbursed to date" column in the Cost Analysis Breakdowns (CAB) rather than the Revised Budget (Contract) column. This appears to be correct, but the taxpayer must verify that all payments have been made, and that no retainages have been left out. The CAB closest to the audit ending date, or the latest CAB which reflects all costs, should be used. Taxpayer also argues that some insurance and interest amounts should be deducted. Verification is required to determine the nontaxable nature of these transactions.

Taxpayer also argued that the road construction costs on one of the properties should not be included in the construction price, as the building of the road was required in the land purchase contract, and should be considered a land acquisition cost. The taxpayer was responsible for the construction of the road and received payment from S&L, who was reimbursed in part by the seller of the land. While this may have been considered part of the land acquisition costs by S&L, the fact remains that the taxpayer was paid to build the road. However, if the road was eventually deeded to the county, the road construction would be taxable under Public Road Construction and would not be subject to retail sales tax. This item is referred back to the Audit Section for investigation.

Taxpayer also points out that in several cases the rental management income is included in the construction contract price. This is incorrect. Fees earned by the taxpayer for the management of rental property is subject to the service B&O classification, and are not part of the retail sale.

Taxpayer has made other allegations of error by the auditor, which will not further be discussed herein. All factual issues will be referred to the Audit Section for review.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. The file is being referred to the Audit Section for a review of the taxpayer's documentation and claims of error in accordance with the instructions outlined in this Determination. An amended assessment shall be issued, to be due on the date stated therein.

DATED this 31st day of January 1989.