Cite as Det. No. 00-028, 20 WTD 32 (2001)

BEFORE THE 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. 00-028
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

RULE 170; RULE 171; RCW 82.04.050; RCW 82.32.070(1): USE TAX – PUBLIC ROAD COSNTRUCTION vs. CUSTOM CONSTRUCTION – DUTY TO KEEP AND PRESERVE RECORDS. Whether a contractor/taxpayer who performed work on road projects was engaged in custom construction or in "public road construction" depended on whether the road projects were done on state-owned land or on land owned by a city, county, or other political subdivision of the state or the federal government. The taxpayer failed to keep and preserve records to support his claim that the road projects were custom construction.

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:

An owner of a construction company (the taxpayer) protests the assessment of use tax on materials used in public highway construction.[1]

FACTS:

De Luca, A.L.J. – The taxpayer owns and operates a construction company. The taxpayer claims he only does work as a subcontractor and only works on government contract projects. The Audit Division of the Department of Revenue (the Department) reviewed the taxpayer's books and records for the period January 1, 1995 through December 31, 1997 and assessed $. . . in tax and interest. Except for $. . . in tax, related interest, and a small credit, the assessment was comprised of use tax ($. . .) and related interest.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

In Schedule 3, the Audit Division assessed use tax after it determined the taxpayer was engaged in public road construction as a subcontractor for two different construction projects involving [Interstate Freeway] (. . .) and had not paid sales tax on the materials he purchased and used on the projects. The taxpayer worked on bridges on each project, including "concrete for bridge, bridge overlay, superstructure deck preparation, bridge railing, and pedestrian barrier." In Schedule 4, the Audit Division assessed use tax on capital assets and/or other acquisitions not made on a routine or recurring basis. The Audit Division did not find evidence in the taxpayer's records that retail sales tax had been paid on these assets and/or other acquisitions.

The audit report declares that some future adjustments to the assessment may be required if the taxpayer can provide additional records. In particular, the Audit Division advised the taxpayer by letter that no adjustments to the two [Interstate Freeway] construction projects in Schedule 3 could be made unless the taxpayer provided documents showing those jobs "were wholesale/retail jobs and not public road construction jobs."

TAXPAYER'S EXCEPTIONS:

The taxpayer asserts the construction work he performed on the two road projects was done on state-owned land. Consequently, the taxpayer argues he was not performing public road construction as that term is defined, i*nfra,* and he should not have been assessed use tax on the materials he purchased and installed for those projects. Instead, the taxpayer contends he was acting as a subcontractor selling his services to the general (prime) contractors for resale on the two road construction projects at issue.

Additionally, the taxpayer raised questions regarding some miscellaneous items in Schedule 3. For example, the taxpayer states he used "slab anchors" on a third project near . . . that is not at issue, rather than on one of the two projects in dispute. The taxpayer believes use tax should not have been assessed on the slab anchors. Furthermore, the taxpayer questions why some invoices and amounts were listed twice in Schedule 3. Finally, the taxpayer questioned how the Audit Division determined the value of the capital assets that were assessed use tax in Schedule 4.

ISSUE:

Was the taxpayer performing public road construction on the two disputed projects on [Interstate Freeway]?

DISCUSSION:

The definition of "retail sale" includes

> 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, whether or not such personal property becomes a part of the realty by virtue of installation, and shall also include

> the sale of services or charges made for the clearing of land and the moving of earth excepting the mere leveling of land used in commercial farming or agriculture . . . .

RCW 82.04.050(2)(b). However, the same statute provides that the term "retail sale" does not include . . .

> the sale of or charge made for labor and services rendered in respect to the building, repairing, or improving of any street, place, road, highway, easement, right of way, mass public transportation terminal or parking facility, bridge, tunnel, or trestle which is owned by a municipal corporation or political subdivision of the state or by the United States and which is used or to be used primarily for foot or vehicular traffic including mass transportation vehicles of any kind.

RCW 82.04.050(7). The activities referenced in RCW 82.04.050(7) are commonly known as "public road construction." The Department adopted WAC 458-20-171 (Rule 171) many years ago to administer public road construction in light of the governing statute. Rule 171 provides in pertinent part:

> The word "contractor" means a person engaged in the business of building, repairing or improving any street, place, road, highway, easement, right of way, mass public transportation terminal or parking facility, bridge, tunnel, or trestle which is owned by a municipal corporation or political subdivision of the state or by the United States and which is used or to be used primarily for foot or vehicular traffic, either as a prime contractor or as a subcontractor. It does not include persons who merely sell or deliver road materials to such contractors or to the public authority whose property is being improved. It also does not include persons who construct streets, roads, etc. owned by the state of Washington. (See WAC 458-20-170 for the tax liability of such persons.)

Thus, the word "contractor" for public road construction includes both prime contractors and subcontractors who build, repair, or improve roads, highways, bridges, etc. that are owned by a municipal corporation, or political subdivision of the state or by the United States. However, contractors and subcontractors who construct roads, bridges, streets, etc. owned by the state of Washington are not engaged in "public road construction" under Rule 171. Such construction is custom construction and governed by WAC 458-20-170 (Rule 170) and the definition of retail sale in RCW 82.04.050(2)(b), above.

Rule 171 continues by providing that public road contractors are taxable under the public road business and occupation (B&O) tax classification upon their total contract prices. Rule 171 then provides:

> RETAIL SALES TAX

> The retail sales tax applies upon the sale to such contractors of all materials including prefabricated and precast items, equipment and supplies used or consumed in the performance of such contracts.
>
> The retail sales tax does not apply upon any portion of the charge made by such contractors.
>
> The sales tax does not apply to charges made for labor and services which are exempt from business tax as indicated above.
>
> USE TAX
>
> The use tax applies to the use by all contractors of all materials including prefabricated and precast items, equipment and supplies upon which the retail sales tax has not been paid. This tax also applies in respect to articles produced or manufactured by them for commercial use. (See WAC 458-20-134.)

In other words, public road contractors (both prime and subcontractors) do not collect retail sales tax from their customers (municipalities, counties, or the federal government, for example) because the contractors are the consumers of the materials they incorporate as an ingredient or component of a road or bridge. RCW 82.04.190(3). Instead, public road contractors must pay retail sales tax or use tax on all materials they place in, or on, roads or bridges, as well as on equipment or supplies they purchase. This situation applies to materials that are purchased, provided by others, or manufactured by the contractor. See Det. No. 86-264, 1 WTD 229 at 232 (1986) and Det. Nos. 87-192A, 85-125A, 6 WTD 317 at 320 (1988).

By comparison, road construction performed on state-owned roads or bridges is, as noted, custom construction and Rule 170 applies. Rule 170(1)(a) defines a "prime contractor" as a person engaged in the business of performing for consumers constructing, repairing, or improving new or existing buildings or other structures on or above real property. Whereas, Rule 170(1)(b) defines a subcontractor as a person engaged in similar business for persons other than consumers (such as prime contractors.)

Rule 170(3) explains the B&O tax obligations of prime contractors and subcontractors:

> (a) 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 the construction and paid by the builder.

Rule 170(4) explains retail sales tax in relation to prime contractors and subcontractors:

> (a) Prime contractors are required to collect from consumers the retail sales tax measured by the full contract price. Where no gross contract price is stated, the measure of

> sales tax is the total amount of construction costs including any charges for licenses, fees, permits, etc., required for construction and paid by the builder.
>
> . . .
>
> (c) Sales to prime contractors and subcontractors of materials such as concrete, tie rods, lumber, finish hardware, etc., which become part of the structure being built or improved are sales for resale and are not subject to the retail sales tax….

In sum, 1 WTD 229 at 232, *supra*, describes the tax differences between public road construction under Rule 171 and road construction performed on state owned roads and highways in accordance with Rule 170:

> Thus, when a contractor performs road construction for the State of Washington, neither retail sales tax nor use tax applies to its purchase and use of "materials . . ., equipment and supplies used or consumed in the performance of the contract." This cost will then not be figured into the contractor's original bid, as the state will pay sales tax over and above the bid price. On the other hand, if the contractor performs road construction for a municipality or the federal government, it, and not the governmental entity, will be required to pay retail sales tax/use tax on its materials, and thus these costs will have to be factored into the original bid. Retail sales tax will not be collected from the municipality or federal government.

The issue in this present matter is whether the taxpayer performed his construction services on state-owned roads and/or bridges as he claims, or on roads and/or bridges owned by a city, county, other political subdivision of the state, or the federal government. If his services were public road construction as described by Rule 171, then the taxpayer was the consumer of the materials he used in those projects. Consequently, the taxpayer would owe use tax on those items, unless he can show that sales tax had been previously paid on them.

On the other hand, if the taxpayer performed his work on state-owned roads and/or bridges, he would not owe sales tax or use tax on the purchases or use of the construction materials, providing appropriate resale certificates were issued. In such cases, the taxpayer as the subcontractor would report his gross income under the wholesaling B&O tax classification.

Whether the taxpayer was engaged in public road construction under Rule 171 or as a subcontractor in custom construction under Rule 170 is purely a question of fact. The Audit Division requested in writing that the taxpayer prove his claim with documents showing he performed his work on state-owned roads and/or bridges. The Audit Division suggested the taxpayer provide documents such as contracts or bids.

The Audit Division also suggested the taxpayer obtain statements about the nature of the work from the two prime contractors who employed him on those projects. The taxpayer did obtain a letter from one of the contractors, who replied that part of the . . . project was public road

construction and part of it was custom construction. Documents included with the prime contractor's reply indicated the bridge work on that project was done outside the state's right-of-way and was public road construction. Subsequently, the taxpayer asserted that the prime contractor was referring to the wrong bridge, but the taxpayer failed to provide the Department with documents supporting his claim. Consequently, the Audit Division determined use tax was due on the materials the taxpayer installed on that project. *See* Audit Division letter to taxpayer dated December 3, 1998.

The taxpayer did not provide to the Audit Division a letter from the prime contractor or other supporting documents for the second disputed project, which was in . . . . The Audit Division stated in the same December 3, 1998 letter that the job description for the . . . project did not indicate the work was performed on a state-owned bridge or road, but implied the work was done on roads owned by the city. The Audit Division added it did not have copies of any documents showing that the state owned the bridge. Therefore, the Audit Division determined the taxpayer was liable for use tax on materials installed there.

Thus far, the taxpayer has not presented the Department with documents proving the work his company performed was done on state-owned roads and/or bridges. We alert the taxpayer that he has a legal obligation to keep and preserve records to determine his tax liability:

> (1) Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue. *** Any person who fails to comply with the requirements of this section shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

RCW 82.32.070(1). If the taxpayer does not provide the Department suitable records to support his claim, adjustments to the tax assessment cannot be made. It would appear the taxpayer could obtain such documentary evidence from the prime contractors or the government agencies that sought the bids and let the contracts. If he can show the Audit Division that the roads and/or bridges his company worked on were owned by the state, the assessment will be adjusted accordingly.

We will next address the miscellaneous questions raised by the taxpayer in his petition. In reply to the taxpayer's petition, the Audit Division mailed a letter dated March 22, 1999. That letter informed the taxpayer the Audit Division obtained the list of capital assets that were assessed in Schedule 4 from the taxpayer's "fixed asset listing (depreciation schedule)." The letter further explained if the taxpayer would present invoices that show he has paid sales tax on those assets, the assessment will be adjusted.

The Audit Division letter also asked the taxpayer to provide it with a letter from the prime contractor declaring that the anchor slabs listed in Schedule 3 were not used or did not become part of the construction project for which the taxpayer was responsible. The Audit Division stated other mutually credible evidence would be acceptable as well.

Finally, the same Audit Division letter informed the taxpayer if he has additional records to adjust the audit, then he should contact the auditor. We agree. All of these questions are factual in nature. If the taxpayer has suitable records to support his claims and timely presents them to the Audit Division, the assessment will be adjusted.

DECISION AND DISPOSITION:

The taxpayer has sixty (60) days from today's date (or additional time if deemed necessary by the Audit Division) to provide the Audit Division with suitable documents and records that support his claims pertaining to both Schedules 3 and 4.

Dated this 29th day of February, 2000.