Cite as Det. No. 99-311, 19 WTD 385 (2000)

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. 99-311
. . .	)	Registration No. . . .
	)	FY. . . /Audit No. . . .

[1] RULE 170; RCW 82.04.051: DEFERRED RETAIL SALES/USE TAX -- SERVICES NOT RENDERED IN RESPECT TO CONSTRUCTION. An independent contractor hired to manage an office for a construction company was not rendering services in respect to construction because her services did not directly relate to constructing. For example, she did not work at construction sites and did not perform construction activities. Further, she was not responsible for the performance of the constructing; i.e. she did not supervise or direct the constructing. Therefore, payments for her services were not subject to deferred retail sales tax/use tax.

[2] RULE 170; RCW 82.04.07 AND .090: RETAIL SALES TAX – RETAILING B&O TAX –FULL CONTRACT PRICE – REAL ESTATE COMMISSIONS. A real estate commission paid by a homebuyer to a real estate broker employed by the contractor/seller is included in the full contract price of the house, and seller is liable for retail sales tax and retailing B&O tax on the commission amount unless the seller can show it was not obligated to pay the commission.

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:

A corporate construction company (the taxpayer) protests the assessment of retail sales tax and retailing business and occupation (B&O) tax on commissions paid to real estate brokers and on payments the taxpayer made to an independent contractor.[1]

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

FACTS:

De Luca, A.L.J. – The taxpayer is a prime contractor that builds both custom and speculative homes. The Audit Division of the Department of Revenue (the Department) reviewed the taxpayer's books and records for the period January 1, 1994 through March 31, 1997 and assessed $. . . in tax and interest. *See* Document No. FY. . . . Only Schedule 5 and part of Schedule 8 are at issue.

Schedule 8 pertains to speculative building, although the schedule gives credit both for custom construction projects, where sales taxes were paid on the full contract prices, and where the taxpayer paid sales taxes at source for its speculative projects. During part of the audit period, the taxpayer hired [H] for her experience of running an office for a construction company. There was no written contract between the taxpayer and [H]. Along with her husband, [H] is one of the owners of [H] Homes. [H] Homes is a construction company. The taxpayer paid [H] on an hourly basis and made the payments to [H] Homes for her services. The taxpayer and the Audit Division described these payments as consulting fees for services rendered in respect to constructing. The Audit Division assessed deferred sales tax/use tax on the payments to [H] Homes because the Audit Division found the taxpayer's construction to be speculative and sales tax was not paid at source.

In Schedule 5, The Audit Division reviewed custom construction contracts the taxpayer had with homeowners (buyers). The taxpayer at one time owned the real properties on which the custom construction occurred. The taxpayer sold these real properties to the buyers. Subsequently, the taxpayer built custom homes on these properties for the buyers. Under the construction contracts, the buyers agreed to pay fixed amounts for the construction and fixed amount commissions to a real estate broker. These commission amounts were separately stated from the construction prices listed elsewhere in the same contracts.

The Audit Division found the taxpayer got its buyers to pay the commissions directly to the realtors. The Audit Division further found the commission amounts, although separately stated in the contracts from the construction prices, to be part of the gross contract prices and, therefore, subject to retail sales tax and retailing B&O tax. The Audit Division questioned why the taxpayer would include the commission amounts in its construction contracts with the buyers if the taxpayer were not obligated to the realtor to pay the commissions. The Audit Division also questioned why the taxpayer, as the seller, would not be liable for the commissions. Normally, sellers, not buyers, pay sales commissions on sales of property. The Audit Division noted the taxpayer has not provided documents or answers supporting the position that the commissions were not the taxpayer's obligations.

TAXPAYER'S EXCEPTIONS:

The taxpayer contends [H] merely worked in the taxpayer's office as a consultant. The taxpayer hired her for her organizational expertise in running a construction company's office. According to the taxpayer, she worked on budgeting and kept progress reports on the various construction projects, both speculative building and custom construction. She dealt with suppliers on all projects and with custom construction buyers. The taxpayer explains she helped custom buyers on matters such as choosing and pricing materials and labor, color selection, trouble shooting, etc. The taxpayer argues the payments it made to her are not subject to retail sales tax or use tax because she did not engage in constructing activities per se and she did not schedule or supervise any of the constructing. The taxpayer believes the payments it made to her construction company for her services misled the Audit Division in treating her services as ones rendered in respect to constructing.

The taxpayer further asserts it was not primarily or secondarily liable for the real estate commissions and should not be assessed tax on those amounts. The taxpayer contends the provision describing the buyers' obligations to pay the realtor the commissions was in the construction contracts between the taxpayer and the buyers at the buyers' requests. The taxpayer claims the buyers wanted to get loans to finance the construction costs and the real estate commissions, rather than the buyers pay the commissions out-of-pocket. Furthermore, the taxpayer claims the realtor requested the parties include the commission provision in the construction contracts to assure the realtor would get paid the commissions.

ISSUES:

Were the payments to [H] for services rendered in respect to constructing and, therefore, subject to deferred sales tax/use tax?

Were the real estate commissions the buyers paid to the realtor part of the full construction contract prices and, therefore, subject to retail sales tax and retailing B&O tax?

DISCUSSION:

RCW 82.04.050(2) defines a "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 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, 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;

Accordingly, "services rendered in respect to . . .constructing" are subject to retail sales tax.

The legislature has recently issued clarifying legislation on the issue of the taxation of services rendered in respect to constructing. Chapter 212, Laws of 1999 (HB 2261) became effective on July 25, 1999:

> NEW SECTION. **Sec. 1.** (1) The legislature finds that the taxation of "services rendered in respect to constructing buildings or other structures" has generally included the entire transaction for construction, including certain services provided directly to the consumer or owner rather than the person engaged in the performance of the constructing activity. Changes in business practices and recent administrative and court decisions have confused the issue. It is the intent of the legislature to clarify which services, if standing alone and not part of the construction agreement, are taxed as retail or wholesale sales, and which services will continue to be taxed as a service.
>
> (2) It is further the intent of the legislature to confirm that the entire price for the construction of a building or other structure for a consumer or owner continues to be a retail sale, even though some of the individual services reflected in the price, if provided alone, would be taxed as services and not as separate retail or wholesale sales.
>
> (3) Therefore, the intent of this act is to maintain the application of the law and not to extend retail treatment to activities not previously treated as retail activities. Services that are otherwise subject to tax as a service under RCW 82.04.290(2), including but not limited to engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services, remain subject to tax as a service under RCW 82.04.290(2), if the person responsible for the performance of those services is not also responsible for the performance of the constructing, building, repairing, improving, or decorating activities. Additionally, unless otherwise provided by law, a person entering into an agreement to be responsible for the performance of services otherwise subject to tax as a service under RCW 82.04.290(2), and subsequently entering into a separate agreement to be responsible for the performance of constructing, building, repairing, improving, or decorating activities, is subject to tax as a service under RCW 82.04.290(2) with respect to the first agreement, and is subject to tax under the appropriate section of chapter 82.04 RCW with respect to the second agreement, if at the time of the first agreement there was no contemplation by the parties, as evidenced by the facts, that the agreements would be awarded to the same person.

(Underlining ours.)

Because HB 2261 is a clarifying statute and not an amendatory statute, it has retroactive application. *Marine Power and Equip. Co. v. Human Rts. Comm. Hearing Tribunal*, 39 Wn.App. 609, 614, 694 P.2d 697 (1985). The retroactive application of HB 2261 applies even though an appeal may be pending. *Id*. 620-21. Therefore, this legislation applies to this appeal even though the activities in dispute took place before its effective date. In short, the legislature, in passing this bill, expressed its intent not to change the existing law by extending retail treatment to activities not previously treated as retail activities.

The additional language interpreting professional services related to managing construction activities in HB 2261 provides:

> NEW SECTION. Sec. 2**.** A new section is added to chapter 82.04 RCW to read as follows:
>
> (1) As used in RCW 82.04.050, the term "services rendered in respect to" means those services that are directly related to the constructing, building, repairing, improving, and decorating of buildings or other structures and that are performed by a person who is responsible for the performance of the constructing, building, repairing, improving, or decorating activity. The term does not include services such as engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services provided to the consumer of, or person responsible for performing, the constructing, building, repairing, improving, or decorating services.

(Underlining ours.) The term "responsible for the performance" is defined in section 2(4) of HB2261 as:

> the person is obligated to perform the activities, either personally or through a third party. A person who reviews work for a consumer, retailer, or wholesaler but does not supervise or direct the work is not responsible for the performance of the work. A person who is financially obligated for the work, such as a bank, but who does not have control over the work itself is not responsible fore the performance of the work"

(Underlining ours.) The new statutory language considers both the nature of the services being provided and the entity providing them in characterizing the services for tax purposes. To be rendered in respect to construction the services themselves must "directly relate to the constructing" and the provider of the services must be responsible for "the performance of the constructing."

In the present matter, the taxpayer hired [H] to help run its office by organizing office procedures, keeping track of the status of various construction projects, and dealing with suppliers and customers. The nature of her services did not "directly relate to the constructing" of buildings. She did not work at construction sites. She did not perform constructing activities. In short, she performed administrative services. Furthermore, she was not responsible for the performance of the constructing because she did not supervise or direct the work. Consequently, payments to her company were not for retail services and were not subject to retail sales tax or use tax.

We next address the real estate broker commissions. The sample construction contract we reviewed contains a paragraph providing…

> the total price of this home excluding lot to Buyer exclusive of Buyer's normal closing costs shall be $. . . . *** Payment to be made as follows: From Buyers [sic] cash and proceeds of Buyers [sic] Custom Construction loan [sic].

Another paragraph in the same contract provides "Buyer agrees to pay a commission of $. . . to . . . , . . . Realty after final payment has been made to [Taxpayer]."

WAC 458-20-170 (Rule 170) and HB 2261 Sec. 1(2), *supra*, require prime contractors to collect retail sales tax from their customers measured by the full contract price. The question is whether the commissions the buyers paid the realtor were part of the taxpayer's full contract prices. RCW 82.04.070 provides:

> "Gross proceeds of sales" means the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.090 defines "value proceeding or accruing" as "the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued." "Consideration" is a basic, necessary element for the existence of a valid contract that is legally binding on the parties. It is defined as "some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other." Black's Law Dictionary 306 (6th ed. 1990). Thus, if the buyers paid the realtor the commissions to satisfy debts the taxpayer owed the realtor, then the taxpayer received consideration from the buyers. That consideration would be part of the full contract prices, along with the other stated amounts in the construction contracts, and subject to retail sales tax and retailing B&O tax.

The taxpayer contends it was not obligated to pay the realtor the commissions although the taxpayer was the seller of the real estate. The taxpayer stated it did not have a written contract with the realtor, but the taxpayer claims it will obtain a written statement from the realtor declaring the realtor did not consider the taxpayer liable for the commission payments.

We review these statements in light of the law and the evidence before us. The Statute of Frauds requires any agreement authorizing or employing a real estate broker or agent to sell or purchase real estate for compensation or commission must be in writing and signed by the party to be charged. Without a signed written agreement to sell real property, the agreement is void. The Statute of Frauds declares:

> In the following cases, specified in this section, any agreement, contract and promise shall be void, unless such agreement, contract or promise, or some note or memorandum thereof, be in writing, and signed by the party to be charged therewith, or by some person thereunto by him lawfully authorized, that is to say:…(5) an agreement authorizing or

> employing an agent or broker to sell or purchase real estate for compensation or a commission.

RCW 19.36.010(5). *See also House v. Erwin,* 83 Wn.2d 898, 524 P.2d 911 (1974).

In light of this statutory requirement, we find it difficult to believe the taxpayer and a licensed real estate broker would not have a written and signed agreement to sell the taxpayer's property. A mere statement by the realtor, made years after the sale and after receiving the commissions, that the taxpayer was not liable for the commissions does not carry the weight of evidence that a legally required real estate broker's agreement would have carried had it been offered into evidence. Moreover, a construction contract between the taxpayer and the buyer does not suffice as a signed written agreement with the real estate broker for brokerage services. The construction contract merely provided, as between the buyer and the taxpayer, that the buyer would pay the commissions. The construction contract did not address whether the taxpayer was or was not legally obligated to the realtor for the commissions.

We find the real estate commissions were part of the full contract price. We do not understand why the taxpayer would include the payment of the commissions in its construction contracts with the buyers unless the buyers agreed to pay the commissions to satisfy the taxpayer's debt to the real estate broker for selling the real properties in the first place. As noted earlier, normally the seller of property pays the broker a commission for selling the seller's property. The general and basic premise is a real estate broker with whom property is appropriately listed for sale becomes the agent of the seller for the purposes of finding a buyer. *Mersky v. Multiple Listing Bureau of Olympia, Inc.*, 73 Wn.2d 225 at 228, 437 P.2d 897 (1968). We have seen nothing that would alter this usual pattern.

Finally, RCW 82.32.070, provides:

> (1)(a) 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.

Without suitable records showing the taxpayer was not liable for the commissions, we sustain the assessment of sales tax and B&O tax on the commissions.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part. We remand this matter to the Audit Division to delete the deferred sales tax/use tax assessed in Schedule 8 from the payments made to [H] Homes. We deny the remainder of the taxpayer's petition. After the adjustment to the tax assessment, the Audit Division will schedule a new payment due date.

Dated this 24th day of November 1999.