Cite as Det No. 99-109, 19 WTD 398 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessments of	)	D E T E R M I N A T I O N
	)	No. 99-109
. . .	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
. . .	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
. . .	)	Registration No. . . .
	)	FY. . . / Audit No. . . .

[1] RULE 227: SUBSCRIBER TELEVISION SERVICES. Taxpayers who have a contract with a video entertainment provider under which the provider is permitted to make videos available to hotel guests for which the hotel receives a commission are not in the subscriber television business based on the following: they do not provide television programming; do not pay a cable tax or fee to the city they operate in; and do not own any transmission facilities, distribution lines, or equipment that is being used to provide this service to guests.

[2] RULE 119; RULE 124: MEALS PROVIDED TO EMPLOYEES VS. MEALS PROVIDED TO MANAGERS. Taxpayers failed to distinguish meals consumed by managers from those consumed by employees. Taxpayers failed to prove that there was no "exchange of services" involved with the managers' meals.

[3] RULE 170; RULE 174; RCW 82.04.050. SERVICES IN RESPECT TO CONSTRUCTING – ADMINISTRATIVE SERVICES – ARCHITECTURAL SERVICES. The review of the progress of capital upgrades is not a service in respect to constructing where the service is included within the overall management service provided because the review was not the predominant activity performed under the management services contract. Where services received were in the nature of professional services normally offered by architectural firms and the degree to which the architects were involved in actual

construction was de minimis, the payments to the architects were not subject to retail sales tax.

[4] RULE 166; RCW 67.40.090: CONVENTION AND TRADE CENTER TAX – INCIDENTAL CHARGES – ROLLAWAY BEDS – REFRIGERATORS. The intent of the convention and trade center tax is to tax those articles that are primary to the room rental, such as rollaway beds and refrigerators. Such items do not fit within the definition of incidental charges.

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:

Hotel operating companies seek correction of assessments of taxes assessed on airline room rentals, subscriber television business, promotional meals and manager meals, capital asset purchases, and unreported convention and trade center taxes.[1]

FACTS:

D. Thomas, A.L.J. – The Department of Revenue (Department) examined the records of the taxpayers listed below for the following periods:

[Taxpayer 1]: January 1, 1993 through July 31, 1995. The audit disclosed taxes and interest owing in the amount of $. . . . . Document No. FY. . . in that amount was issued on August 15, 1997.

[Taxpayer 2]: January 1, 1993 through December 31, 1996. The audit disclosed taxes and interest owing in the amount of $. . . . Document No. FY. . . in that amount was issued on August 15, 1997. Additionally, for the same period, the audit disclosed taxes and interest owing in the amount of $. . . . Document No. FY. . . . in that amount was issued on July 17, 1998.

[Taxpayer 3]: August 1, 1995 through September 30, 1996. The audit disclosed taxes and interest owing in the amount of $. . . . Document No. FY. . . in that amount was issued on August 27, 1997.

Because of the close relationship of the companies and similar nature of the issues involved, we will refer to the business entities collectively as "Taxpayers" or individually, as designated above. The Department's Audit Division issued the assessments.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

The taxpayers contested the following portions of the assessments:

. . .

Subscriber Television Business.

Taxpayers state the Audit Division gave prospective reporting instructions, clarified in PAA #1, advising [Taxpayers] that [they] must report 100 percent of the charges paid by guests for movies under the service and other activities tax classification. Taxpayers contend the Audit Division erroneously concluded that [Taxpayers] [are] in the "Subscriber Television business." Taxpayers argue that only the commissions they receive on rental movies should be taxable.

Manager Meals.

In this issue, Audit assessed retailing B&O and retail sales tax on meals supplied to managers while on duty. Audit characterized manager meals as a "meal furnished to employees" and therefore taxable as a retail sale under WAC 458-20-119 (Rule 119). Taxpayers contend complimentary meals consumed by managers in the hotel's restaurant are distinguishable from meals furnished to employees, and are not subject to retail sales tax. Taxpayers argue that manager meals are consumed or used by the hotel for its own benefit in contrast to being additional compensation to employees for performing their duties as employees. Taxpayers state managers are encouraged to eat in the hotel's restaurant to evaluate the quality of the food, service, appearance of the facility, and to entertain suppliers and vendors. Taxpayers contend that since the meals are neither additional compensation nor a barter arrangement for exchange of services, there is no sale involved. Therefore, Taxpayers reason, no tax should apply to an "imputed" value of the meal.

Use Tax and/or Deferred Retail Sales Tax on Capital Asset Purchases.

Audit assessed use tax and/or deferred sales tax on capitalized costs attributable to reviewing the progress of [Taxpayer 2's] leasehold improvements. These review services were performed by [Taxpayer 3] (through its Supply Division) under its management contract with [Taxpayer 2] and billed on a time and expense basis. [Taxpayer 2] capitalized the costs because the services involved reviewing the progress of capital upgrades. [Taxpayer 2] argues that these time and expense charges were merely additional management services performed under its management contract and not separate retail sales. Additionally, Audit assessed sales tax on the purchase of architectural services and architectural consultation services from two separate firms, by [Taxpayer 3] for [Taxpayer 2]. Taxpayers contend [Taxpayer 3] purchased architectural services on behalf of [Taxpayer 2] and acted solely as its purchasing agent.

Convention and Trade Center Tax.

The Audit Division assessed convention and trade center tax (Convention tax) on unreported lodging income. Taxpayers concede that charges to customers for specific incidental items were

not reported for the Convention tax. However, Taxpayers contend the differences relate to incidental charges made to guests, specifically extra rollaway beds, small refrigerators, and other special furniture. Taxpayers note these items are generally not furnished with a room and a special charge is made to the customer when these items are requested. Taxpayers note that additional charges for telephone services, laundry, and similar incidental service charges generally are not subject to the Convention tax, and therefore argue, by analogy, that the "incidental" charges made for the rollaway beds and refrigerators are not subject to the tax.

ISSUES:

(1) For the purposes of Service B&O tax, are the Taxpayers engaged in a subscriber television service?

(2) For the purposes of retail sales tax are complimentary meals consumed by managers distinguishable from other employee meals?

(3) (a) Are services performed under a management contract and billed on a time and expense basis, which the purchaser capitalized, subject to retail sales tax and; (b) are an architect's services and consultation services not directly related to the activity of constructing itself, subject to retail sales tax?

(4) Are specific incidental charges not generally provided as part of a room charge subject to the Convention tax?

DISCUSSION:

[1] Subscriber television business.

WAC 458-20-227 (Rule 227) defines "subscriber television" as:

> [A]ll businesses providing television programming to consumers for a fee. It includes, but is not limited to, cable television and satellite television. Subscriber television often transmits to its customers special channels offering a variety of programming such as movies, sporting events, children's entertainment, news and other informational services.
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> (b) "Fee" includes the amount paid by the subscriber to receive the subscription television service. Generally, the fee consists of an amount for installation and a monthly charge for maintenance or service.

Persons engaging in the business of subscriber television are subject to the service business and occupation tax and retail or use tax on all purchases of tangible personal property utilized in providing such services. Rule 227(2). The Audit Division concluded Taxpayers are in the subscriber television business and therefore must report charges to guests for movies at full value under the Service classification.

We conclude Taxpayers are not in the subscriber television business as defined by Rule 227 based on the following facts. Taxpayers do not provide television programming, nor does the FCC license them for this purpose. Taxpayers do not pay a cable tax or fee to the city they operate in, nor do they own any transmission facilities, distribution lines, or equipment that is being used to provide this service to guests. Taxpayers do have a contract with a video entertainment provider (provider) under which the provider is permitted to make videos available to hotel guests for which the hotel receives a commission. The provider sets the price that is charged to guests, exercises control on movie availability, owns all related equipment used to provide the service, and is solely responsible for repair and maintenance of the equipment. Under the contract Taxpayers' authority is limited to collecting the fees from guests, which are held in trust for provider and remain the property of the provider.

Based on the evidence – as set forth above – we find that taxpayers are not engaged in a subscriber television service.

Taxpayers' petition is granted on this issue. We find the commissions received are the proper measure of the Service B&O tax as set forth in WAC 458-20-166 (3)(b)(i)(C)(D). Accordingly, we rescind Audit's prospective reporting instructions, clarified in PAA #1.

[2] Manager Meals.

WAC 458-20-119 (Rule 119) explains this state's B&O and retail sales taxes applications to the sales of meals. In addressing how meals furnished to employees are taxed, Rule 119(7) states in part:

> [M]eals furnished to employees are sales at retail and subject to the retailing B&O and retail sales taxes. This is true whether individual meals are sold or whether meals are furnished as a part of compensation for services rendered.

WAC 458-20-124 (Rule 124) addresses the taxation of meals given away, and it states in part:

> (6) **Discounted meals, promotional meals, and meals given away.** Persons who sell meals on a "two for one" or similar basis are not giving away a free meal, but rather are selling two meals at a discounted price. Both the retailing B&O and retail sales taxes should be calculated on the reduced price actually received by the seller.
>
> (a) Persons who provide meals free of charge to persons other than employees are consumers of those meals. However, certain food products are statutorily exempt of retail sales or use tax unless sold by a retail vendor. . . Persons operating restaurants or similar businesses, where a food handler's permit is required, will not be required to report use tax on food products given away, even if the food products are part of prepared meals. . . . A sale has not occurred, and the food products exemption applies.

> (b) Meals provided to employees are presumed to be in exchange for services received from the employee and are not considered to be given away. These meals are retail sales. (See WAC 458-20-119 on employee meals.)

(Emphasis added.) Thus, under the related rules, the issue with respect to the retail sales tax turns on whether the meals are given away, or conversely, provided as additional compensation in exchange of services from the managers.

Taxpayers attempt to distinguish meals consumed by managers from those consumed by employees by noting that there is no "exchange of services" involved with the managers' meals. Taxpayers state that managers are encouraged to eat in the hotel's restaurant for the purpose of evaluating the quality of the service and food, entertaining suppliers/vendors relating to business or, in some instances, meeting with managers from different departments to discuss overall hotel operations. Therefore, Taxpayers reason, that since the meals are given to managers without the expectation that some service will be performed in exchange for the meal, the meals are not subject to use tax for the same reasons that use tax does not apply to promotional meals.

As stated above, under Rule 124(6)(b), a burden of proof is imposed on taxpayer to come forward with evidence to rebut the presumption that the meals are provided to managers in exchange for services. Although Taxpayers assert there was an understanding with managers that meals consumed were in connection with evaluating the restaurant service, product, and other related duties, the Taxpayers presented no documentation evidencing any such policy or employment agreement.

We find the taxpayers have not overcome the presumption the meals were not in exchange for services. Accordingly, we hold that complimentary meals consumed by managers are not distinguishable from employee meals under Rule 124 and are, therefore, subject to the retailing B&O and retail sales taxes.

Taxpayers' petitions are denied on this issue.

[3] Capital Asset Purchases

[a] Capitalized Management Services billed on a time and expense basis.

RCW 82.04.050(2) addresses administrative[2] labor charges which are to be included in the taxable charges. It states in pertinent part:

> (2) The term "sale at retail" or "retail sale" 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:

[2] The affiliation relationship does not alter the taxability of these services. *See* ETA 50 & ETA 90.

> (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.

(Emphasis added.) See also WAC 458-20-170 (Rule 170). Pursuant to the above statute Audit considered [Taxpayer 3's] activities as services rendered in respect to construction, and accordingly assessed retail sales tax on costs attributable to reviewing the progress of capital upgrades at . . . , one of the hotels. In contrast, [Taxpayer 3] contends that included within the overall management service provided by [Taxpayer 3], through their affiliate supply division, was the responsibility for making equipment purchases and arranging for upgrades by independent third party contractors.

The pivotal issue in determining the correct measure of the tax is dependent upon what activity [Taxpayer 3], through its supply division, was principally engaged in. If [Taxpayer 3] was constructing, repairing, etc., a new or existing building for [Taxpayer 2], the activity is retail under RCW 82.04.050. If their activities were primarily management services performed under a management contract with [Taxpayer 2], a separate legal entity, the activity is taxable as a service.

In order to determine the primary activity, we need to look to the predominant nature of the overall management services contract [Taxpayer 3] had with [Taxpayer 2]. We have held that "we must determine the predominant nature of the contract to determine the business and occupation tax classification of the receipts received under its terms." Det. No. 91-163, 11 WTD 203 (1991). The items in this audit schedule are charges for occasionally monitoring building construction activities of capital upgrade contractors that had been previously hired by the supply company on behalf of . . . . The supply company acted in the capacity of purchasing agent in these transactions, not a building contractor.

We have also held that in those instances when "a single contract calls for different activities with some classified as retailing and some as service . . . . the predominant activity performed under the contract controls."[3] Id. The ongoing nature of business activity which took place between [Taxpayer 2] and [Taxpayer 3] permit us to reasonably conclude the time and expense charges involved in reviewing the process of capital upgrades were additional management services performed under their management contract. The predominant nature of this contract is management services, not construction. We find that the services performed under this management services contract and billed on a time and expense basis are not subject to retail sales tax.
Taxpayers' petition is granted on this issue and the matter is remanded to the Audit Division to be adjusted accordingly.

[b] Architectural services.

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[3] See also Det. No. 89-433A, 11 WTD 313 (1992), where the Department was not receptive to segregating a single contract unless there is a reasonable basis for doing so:

> We do believe that bifurcation of a contract for taxation will be the unusual case. In most cases income from a performance contract will be taxed according to the primary nature of the activity.

Services rendered in respect to construction are retail sales. RCW 82.04.050. By contrast, a company providing a professional service, e.g. architectural service, is not required to collect retail sales tax, but rather is taxed at the higher "service and other activities" B&O tax rate on its gross income. RCW 82.04.290. WAC 458-20-224(2) (Rule 224) provides in part:

> Persons engaged in any business activity, other than those for which a specific rate is provided in the statute, are taxable under service and other business activities. . . . including persons rendering professional services such as architects. . . .[4]

In determining the proper measure of the tax in this case the issue turns on to what degree the respective architects were involved in the actual construction. The Department has held that when the relationship between service and actual construction is so directly related as to control or determine the nature of the actual construction, the activity is subject to retail sales tax. See Det. No. 89-63, 7 WTD 163 (1989); Det. No. 93-159, 13 WTD 316 (1994); Det. No. 98-27, 17 WTD 99 (1998).

In contrast to the cited cases, the services rendered in this case were in the nature of professional services as are normally offered by architectural firms. RCW 08.08.320 (10) defines the practice of architecture as "the rendering of services in connection with the art and science of building design. . .including but not specifically limited to schematic design, design development, interpretation of construction contract documents, and administration of the construction contract." In this case one contract was for "architectural services" regarding a proposed restroom upgrade and another for a "consultant" fee regarding access to restrooms. It appears the degree to which the respective architects were involved in actual construction was de minimis.

We do not agree with Audit's conclusion. Although the services provided by the respective architectural firms were related to the general process of construction and consultation regarding such construction, neither activity appears to be sufficiently related to the actual act of constructing a new or existing facility to warrant the imposition of the retail sales tax. The services rendered were in the nature of professional services, well within the services provided by architects in general.

We find the services for taxing purposes fall within the above referenced rules. Accordingly, we find the services purchased are not subject to retail sales tax, but rather service B&O tax.

Taxpayers' petition is granted on this issue, and the matter is remanded to the Audit Division to be adjusted accordingly.

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[4] See also WAC 458-20-138 which states in part that "persons engaged in the business of rendering personal services to others are taxable under the service and other activities classification . . . . The following are illustrative of persons performing services and are within the scope of this rule . . . architects." And see also RCW 82.04.055(g)(ii), effective until July 1, 1998, which states selected business services means "architectural services including but not limited to building program management."

[4] Convention and Trade Center Tax

RCW 67.40.090 levies a special excise tax on lodging purchased within King County. This statute provides that the tax shall be collected on:

> the sale of or charge made for the furnishing of lodging . . .and the granting of any similar license to use real property. . . .

WAC 458-20-166 (Rule 166), the rule implementing the above statute, states in part:

> (6) **Convention and trade center tax.** Businesses selling lodging to transients, having sixty or more units located in King County, must charge their customers the convention and trade center tax and report the tax under the "convention and trade center" portion of the tax return. See RCW 67.40.090.
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> (a) A business having more than sixty units which are rented to transients and nontransients will be subject to the convention and trade center tax only if the business has at least sixty rooms which are available or being used for transient lodging.
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> (b) The tax only applies to the charge for the rooms to be used for lodging by transients. Additional charges for telephone services, laundry, or other incidental charges are not subject to the convention and trade center tax. Neither is the charge for use of meeting rooms, banquet rooms, or other special use rooms subject to the convention and trade center tax.

(Emphasis added.) The Convention tax only applies to the charge for rooms to be used as lodging. Additional incidental charges are not subject to the tax. The taxpayers contend that extra rollaway beds, small refrigerators, or other special furniture, are not parts of lodging, but rather incidental charges, and are therefore exempt from the convention tax.

Neither the statute nor the rule defines "lodging." To determine the legislative intent of the law and Rule 166 we need to define the term "lodging". In general, statutory terms not defined in the statute [or the rules] are given their ordinary meaning. City of Seattle v. Hill, 40 Wn. App. 159, 697 P.2d 596 (1985). Webster's defines lodging as "sleeping accommodations; a temporary place to stay; a place in which to come to rest, a place to live." Webster's Third New International Dictionary 1329 (1993).

We may deduce the statute's explicit intent is to tax lodging, which by definition includes beds, since they are primary to the room rental, i.e., a place to sleep. The implicit intent within the Rule is to tax those furnishings collateral in nature to lodging, specifically refrigerators, since they are generally considered to be primary to a place to live.

The fact that the legislature did not specifically define extra rollaway beds, etc., as lodging, cannot be construed to mean that [these] items . . . are considered to be incidental charges. The reason incidental charges are not taxed under the rule is because they are separate business activities: e.g., laundry services, telephone fees, etc. Extra beds and refrigerators are

concomitant with lodging; they are additional charges for more luxurious "lodging" accommodations.

We agree with the Audit Division's interpretation that the intent of the statute and Rule 166 is to tax those articles that are primary to the room rental, in this instance rollaway beds and refrigerators. We do not find that these items fit within Rule 166's definition of incidental charges.

The assessment of the Convention tax on Taxpayers' billings to its guests for rollaway beds and refrigerators is affirmed.

DECISION AND DISPOSITION:

Taxpayers' petition for correction of assessment and refund is granted in part, denied in part and remanded in part as follows:

. . .

The prospective reporting instructions regarding movie rental charges shall be adhered to as discussed herein.

The assessment of retail sales tax on management meals is sustained.

The assessment of use and retail sales tax on capital asset purchases shall be adjusted as discussed herein.

The assessment of Convention and Trade Center Tax on rollaway beds and refrigerators is sustained.

Dated this 29th day of April, 1999.