

Cite as Det. No. 99-159, 19 WTD 270 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 99-159
)	
...)	Registration No. . . .
)	FY. . . /Audit No. . . .
)	

- [1] RULE 223; RULE 170; RCW 84.04 220; RCW 82.04.250: COST PLUS CONSTRUCTION CONTRACTS – INCLUDABLE EXPENSES – Where the entity providing the cost plus services is liable for an expense, that amount is included in the total project cost even if the expense is paid by another individual.
- [2] RCW 82.08.050: RETAIL SALES TAX – COLLECTION OF EXCESSIVE TAX. Where excessive tax is collected, a credit for that Amount may not be issued absent verification that the excess amount was refunded to the purchaser.

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:

Petition for cancellation of assessment for retail sales tax and retailing business and occupation tax arising from audit of several construction projects.¹

FACTS:

Kreger, A.L.J. - . . . , a corporation (the taxpayer) commenced business activities in Washington state on May 15, 1991. The taxpayer was a successor entity to . . . and engaged in construction activities as a speculative builder and a custom builder. The taxpayer built new buildings and did remodeling work in . . . , . . . , and . . . counties. In July of 1995, the Department of Revenue (the Department) audited the taxpayer's business records for the period of January 1, 1991, through June 30, 1994.

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

As a result of this audit, the Department determined that the taxpayer had been reporting certain income items incorrectly and had failed to remit the proper amount of retail sales tax. An assessment was therefore issued to the taxpayer in the amount of \$. . . , comprised of: \$. . . in retail sales tax, \$. . . in retailing business and occupation (B&O) tax, \$. . . in use tax, \$. . . in interest, and a \$. . . credit for service B&O tax paid in error. The assessment was subsequently reduced by the application of two credit invoices totaling \$ These credits were for funds the Department was holding from payments made by . . . precursor entity. Thus, the total amount of the assessment issued to the taxpayer on August 30, 1995, was \$

The taxpayer was active in the custom construction industry and performed work pursuant to construction contracts, which established the total contract price on a “cost plus” basis. Thus, the final cost of the construction project would be determined by the cost of materials and payments to subcontractors in addition to a fixed fee for the builder. This contract price was not to exceed a set amount stated in the contract. The taxpayer’s contracts, also, stated that the price included the payment of retail sales and use tax due on all items and fees supplied by the taxpayer.

The audit report states that the taxpayer’s documentation of construction costs “was not rigorous nor uniform” and that the project records frequently included multiple “final corporation cost sheets,” which indicated different total amounts for the same line item. The taxpayer ascribed some of the bookkeeping difficulties to errors by a previous bookkeeper. The auditor also conveyed concern about the fact that changes or addition to the original construction plan were not documented, invoiced, or added to the cost sheets, as was expressly required by the construction contracts.

Because of the absence of pertinent information in conjunction with the duplications and discrepancies of costs ascribed to certain items in the taxpayer’s records, the auditor determined that the costs sheets, available bank construction draw sheets, and escrow documents relied upon by the taxpayer to support the amount of tax remitted did not accurately reflect the corporation’s actual costs on the construction projects at issue. The auditor did, however, to the greatest extent possible use the project cost sheets, the project records, bank loan documentation, and checks received by the corporation as a basis to establish the cost plus price of the custom construction activities at issue.

The taxpayer asserted during the audit, and again in the petition for correction of the assessment, that a number of the itemized expenses contained in the records provided were direct costs of the property owner/consumer and not of the corporation. Based on this assertion the taxpayer believes that these items should not be included in the contract price and thus should not be subject to B&O retailing tax or retail sales tax. Amongst these costs were building permits, utility expenses during construction, and other items where the vendors supplying items were paid directly by the property owner/consumer and not of the corporation. The auditor’s review of the available records indicated that any funds released from the construction loan and used by the real property owner were not considered part of the corporation’s custom construction project cost.

A supervisor's conference was held on June 1, 1995, at which time the costs discussed above were particularly addressed. At this time, it was clarified that for each construction project the taxable amount was to include all actual costs to the corporation in addition to the builders' labor and set profit. Any cost for which the corporation was ultimately liable, regardless of whether the corporation or the property owner/consumer paid the expense, was to be considered a cost of the corporation.

The taxpayer subsequently filed a timely petition for review of the assessment. In the spring of 1999, we contacted the taxpayer at which time the taxpayer's representative advised that the taxpayer had gone out of business and was no longer active. The taxpayer indicated that the corporation had been dissolved in July of 1997 and stated that there were no existing corporate assets remaining. Review of Departmental records, however, indicated that the business registration number assigned to the corporation was still active and disclosed no indication of the formal dissolution of the corporate entity.

The taxpayer's representative also advised the Department that he was not certain as to the quantity or quality of corporate records that had been maintained since ceasing business activities. The Department sent detailed correspondence to the taxpayer on April 29, 1999, and on May 14, 1999, advising the taxpayer of the applicable law on the issues identified in his petition and requesting any documentation or argument on the points identified. As of this time, no additional documentation or legal argument has been received.

ISSUES:

1. Where a corporation engages in construction activities on a "cost plus" basis are liabilities of the corporation, which are paid for by the real property owner/home buyer, to be included in the total taxable contract price?
2. Where a corporation has remitted an amount of retail sales tax that exceeds the amount due based upon the cost plus profit for three projects and the contract amount was adjusted to comport with the tax collected, may the taxpayer request reversal of this action absent proof that the excess retail sales tax was remitted to the consumer?

DISCUSSION:

Washington imposes the B&O tax on the privilege of engaging in business in this state. Depending on the nature of the business activity being conducted, the tax is levied upon the value of products, the gross proceeds of sales, or the gross income of the business. RCW 82.04.220.

The service and other activities B&O tax is imposed by RCW 82.04.290 upon persons engaged in business activities other than or in addition to those for which a specific rate is provided

elsewhere in chapter 82.04 RCW. *See also*, WAC 458-20-224. Such persons are taxable upon the "gross income of the business", defined in RCW 82.04.080 as:

"Gross income of business" means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, ... all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

Retailing B&O tax is imposed upon persons engaging in the business in this state of making sales at retail. RCW 82.04.250. Washington also imposes a retail sales tax upon each retail sale in this state. RCW 82.08.020. The term "sale at retail" or "retail sale" is defined in RCW 82.04.050. Generally, sales of tangible personal property and certain specified services to consumers are retail sales. Specifically included in the term, are sales of services rendered in respect to the constructing of buildings or other structures on real property of or for consumers. RCW 82.04.050(2) states:

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: . . .

- (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; . . .

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."

WAC 458-20-170 (Rule 170) is the Department's administrative rule implementing the statutes regarding construction activities. The provisions of Rule 170 provide definitions and delineate the boundaries of various construction activities with regard to how these activities are taxed. Rule 170 provides a definition of what activities are encompassed by the term constructing and goes on to particularly addresses the different manner in which speculative builders (builders who engage in construction activities on real estate they own) in contrast to prime and subcontractors are taxed.

The rule provides that prime contractors are taxable under the retailing B& O classification upon the gross contract price. Where no gross contract price is stated in any contract or agreement between the builder and the property owner, then the measure of B&O tax is the total amount of construction costs required for the construction and paid by the builder.

Were amounts for which the taxpayer was liable, but that were actually paid for by the property owners/consumers, properly included in the taxable contract price?

In this case, the taxpayer was acting as the prime contractor for the projects in question and the contracts entered into for these construction jobs were structured as “cost plus” contracts. The taxation of entities providing services on a cost plus fixed fee basis has been specifically addressed by WAC 458-20-223 (Rule 223). In addressing constructing and repairing of new or existing buildings, under WAC 458-20-170, the rule states:

The measure of the tax under each of the foregoing types of contracts is the amount of profit or fixed fee received, plus the amount of reimbursements or prepayments received on account of sales of materials and supplies, on account of labor costs, on account of taxes paid, on account of payments made to subcontractors, and on account of all other costs and expenses incurred by the contractor, plus all payments made by his principal direct to a creditor of the contractor in payment of a liability incurred by the latter.

Thus, under Rule 223, the measure of tax is the full cost of the project, including profit, costs of material and labor, and taxes. The determinative factor for the inclusion of a cost in the total project cost is whether the entity providing services on a cost plus fixed fee basis was liable for the expense, not who paid for the item. We have held that under this rule, direct payments by the owner/consumer to the third parties who contracted with the taxpayer to provide services and/or supplies were properly assessed against the taxpayer as gross income. Det. No. 93-166, 14 WTD 022 (1994).

The taxpayer has particularly challenged the inclusion of permit costs and utility bills. These expenses were cost and expenses incurred by the taxpayer in the course of its business activity in constructing the custom homes and so regardless of which party actually tendered payment for the item these costs were liabilities of the taxpayer and so properly included in the taxable contract price. The available building permits clearly show the taxpayer as the applicant and all permits were paid for by the taxpayer. These costs were cost of the taxpayer for the project and are therefore included in the contract price. The utility costs were included on the taxpayer’s budget, record, and cost sheets and are costs related to and necessary for the completion of the construction projects and should have been included in the contract price.

The taxpayer also objects to the inclusion of items in the contract price where the homeowner/consumer made payment directly to a subcontractor or vendor. The taxpayer did not receive a copy of the receipts for these charges and costs from the homeowners/consumers, but these charges were for items included in the contracts between the corporation and the homeowner and there were budget amounts allocated in the contracts for these costs. Thus as

discussed above, these amounts were part of the total project cost and properly taxable to the corporation.

Additionally it should be noted that the documentation and records maintained by the taxpayer did not clearly define the corporation's costs on any of the projects at issue. The contracts between the taxpayer and the homeowner's expressly stated that additional costs or credit would be approved in writing and accurately identified. There was no documentation available to establish that any of the costs at issue were items separately contracted for by the homeowners and so outside the contract price. The items at issue were carried on the taxpayer's records and books and included in the contract budgets. The taxpayer was unable to provide any documentation to substantiate the claim that these costs were not part of the contract price.

Washington law expressly places the responsibility for maintaining adequate records to determine a tax liability on the person liable for that tax. RCW 82.32.070. The failure to maintain such records bars a person from questioning "the correctness of any assessment of 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)(a).

The auditor correctly identified these contested items as part of the total project cost and liabilities of the taxpayer and properly included them in the total contract price. The assessment is affirmed with regard to these items.

Were the adjustments to the contract price based upon the amount of retail sales tax collected proper?

On four of the projects at issue the taxpayer's records indicated that retail sales tax was collected in an amount greater than should have been assessed based upon the cost plus profit amount for the project. The contract prices were therefore adjusted to comport with the amount of sales tax remitted. The taxpayer requested to be allowed to return the excess amount collected to the homeowner/purchaser and have the contract price reflected in the materials provided be utilized. The auditor advised the taxpayer that prior to allowing such credit, the taxpayer would have to submit acceptable documentation to substantiate that the excess sales tax collected had been refunded. No such documentation was available or provided to the auditor.

The taxpayer's petition states that they wish to refund the excess amounts collected. However, it is not possible for the Department to make adjustments and issue credits prospectively in such matters. Retail sales tax is collected in trust for the state and where excessive tax is collected credit for such amount is dependent upon verification that the amounts were refunded to the purchaser. Det. No. 87-270, 4 WTD 21(1987).

To the extent that the taxpayer can provide documentation that the sales tax was refunded to the homeowners/purchasers deductions shall be granted, but absent such documentation the assessment on this matter is affirmed.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

Dated this 28th day of May, 1999.