Cite as 9 WTD 045 (1990)

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

In the Matter of the Petition For Refund of . . .	D E T E R M I N A T I O N No. 90-4 Registration No. . . . . . . /Audit No. . . .

[1] RULE 170: RETAILING B&O TAX -- WHOLESALING B&O TAX -- PRIME CONTRACTOR -- SUBCONTRACTOR -- PRINCIPAL/AGENCY RELATIONSHIP -- JOINT VENTURE. Where one entity bids and wins a construction contract and retains another entity to perform the work, a contractor/subcontractor relationship is established with Retailing/Wholesaling B&O tax consequences respectfully. Principal/agency relationship between the parties or joint venture status not found to be present.

[2] RULE 107, RULE 224: RETAILING B&0 TAX -- SERVICE B&O TAX -- AUTOMATIC SPRINKLER SYSTEM -- INSPECTION. The inspection, testing and lubricating of automatic sprinkler systems, as an improvement of personal or real property, is held to be a Retailing B&O activity, not a Service B&O activity. ETB 425.08.107.

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 REPRESENTED BY: . . .
. . .
. . .

DATE OF CONFERENCE: February 25, 1988

NATURE OF ACTION:

Petition protesting the taxing of unreported income where the taxpayer was held to be a subcontractor. The taxpayer claims it reported the income as the prime contractor or as a member of a joint venture. The taxpayer also protests the reclassification of income reported as subject to Retailing B&O tax to be subject to Service B&O tax. The income was earned from inspecting, testing and related services involving automatic sprinkler systems.

FACTS AND ISSUES:

Krebs, A.L.J. -- [The taxpayer] is engaged in the business of installing, maintaining and inspecting fire control systems. The taxpayer's parent corporation is . . . which also owns . . . Corp.(Oregon) which will be referred to as "[Corp.] Oregon."

The Department of Revenue (Department) examined the taxpayer's business records for the period from July 1, 1981 through June 30, 1985. As a result of this audit, the Department issued the above captioned assessment on December 5, 1985 asserting excise tax liability and interest due which have been paid in full.

The taxpayer's protest involves Schedules V and IX. At the conference, the taxpayer withdrew its protest involving Schedules XI and XIII, and abandoned a protest involving a transaction with . . . Industries or [Rick] . . . which was not addressed in the audit and could not be found in any of the audit schedules.

Schedule V. In this Schedule, Wholesaling business and occupation (B&O) tax was assessed on taxpayer's unreported income which the auditor concluded was from subcontract work done for the taxpayer's sister corporation, [Corp.] Oregon, which signed construction contracts as principal, not as agent for the taxpayer, with Washington customers and did some work related to those contracts. [Corp.] Oregon did the bidding for the contracts and job site inspections. The taxpayer invoiced those customers as agent for [Corp.] Oregon. The taxpayer reported amounts received on behalf of [Corp.] Oregon, who was not registered with the Department, as subject to Retailing B&O tax. The taxpayer did not report amounts it received for its subcontracting work as subject to Wholesaling B&O tax.

The taxpayer contends that the relationship between the taxpayer and [Corp.] Oregon was that of principal and

nominee/agent in that [Corp.] Oregon secured the contracts on behalf of the taxpayer and the taxpayer did all of the work in Washington. Alternately, the taxpayer contends that there was a joint venture arrangement between the parties in that they shared the funds received according to the work done by each party. Furthermore, as evidence of the joint venture agreement, the taxpayer points out that there was a sharing of employees because if the employees did work in Oregon they were paid by [Corp.] Oregon; if the employees did work in Washington they were paid by the taxpayer. The taxpayer stresses that it was not a subcontractor to [Corp] Oregon and that such characterization by the auditor has absolutely no basis in fact and caused its reported "retailing" income to be taxed also as "wholesaling" income.

The issue is whether there was a contractor/subcontractor arrangement between the parties or another arrangement that avoids the same income from being subject to both Wholesaling and Retailing B&O tax.

Schedule IX. In this schedule, income received by the taxpayer for sprinkler system testing and reported as subject to Retailing B&O tax was reclassified by the auditor as subject to Service B&O tax. The auditor did so on the basis that the charge for testing was not for the sale, repair or installation of personal property. The auditor concluded that although the taxpayer may open or close valves, remove sprinkler heads, or run booster pumps in order to test sprinkler system pressure and flow rates, the system is restored to its original state at the end of the test; and if the test discloses that repairs are needed, the repairs are separately contracted for and invoiced as retail activities.

The taxpayer asserts that its inspection, testing and improving of the automatic fire protection systems are within the "retailing" activities of a "prime contractor" as defined in Rule 170, that is, "a person engaged in the business of performing for consumers, the...improving of new or existing buildings...."

The taxpayer points to ETB 425.08.107 (ETB425) which declares:

> The Department of Revenue held that, where the maintenance agreement specifically required that inspections, cleaning and adjustments be made on furnaces, they constituted repairs and improvements of tangible personal property for consumers and

> amounted to "sales at retail" under all circumstances. (Emphasis supplied.)

The taxpayer explains that when it inspects the customer's automatic sprinkler system, it removes the valves, cleans and lubricates them, and repacks them -- all of which improves their effectiveness. The taxpayer submitted representative inspection forms on which were reported those actions to have occurred.

The issue is whether the amounts received for the above-described sprinkler inspections are subject to Retailing B&O tax or to Service B&O tax.

DISCUSSION:

We will discuss the issues in the order presented.

Schedule V. The auditor held the taxpayer to be a subcontractor to [Corp.] Oregon who bid on and was awarded construction contracts by Washington customers.

[1] Excise Tax Bulletin 433.04.170.171 (ETB 433) in pertinent part declares:

> The Department ruled that where a prime contractor assigns a contract to a subcontractor, under an agreement strictly between themselves, the prime contractor retains contractual responsibility to the customer and is subject to the business and occupation taxes measured by the gross contract price. In such a case the subcontractor is also subject to the business and occupation tax measured by the gross price for the work performed under the subcontract.
>
> These pyramiding features of the tax are applicable in all cases of contract assignments except the following: If the customer is a party to the assignment, and relieves the prime contractor of all contractual liability, then the second contractor is taxable as the prime contractor and the first is excused.
>
> As indicated in published Rule 170, prime contractors are taxable under the Retailing classification, and subcontractors under the

> Wholesaling classification upon their gross contract prices. (Emphasis supplied.)

The taxpayer asserts that the facts in ETB 433 are not akin to the facts in this case because the contractor and subcontractor in ETB 433 were unrelated whereas in this case the parties are "sister corporations" owned by one parent corporation. The fact that the taxpayer and [Corp.] Oregon are owned by . . . , Inc. is irrelevant. For Washington excise tax purposes, transactions between separately organized corporations are taxable notwithstanding their affiliation with or relation to each other through stock ownership by a parent corporation. WAC 458-20-203 (Rule 203).

The taxpayer asks that we find the relationship between the taxpayer and [Corp.] Oregon to be that of principal and nominee/agent respectively because [Corp] Oregon allegedly secured the contracts on behalf of the taxpayer and the taxpayer did all of the work in Washington. WAC 458-20-159 (Rule 159) is a duly adopted rule of the Department of Revenue. As such, it has the same force and effect as the law. RCW 82.32.300. In pertinent part, Rule 159 states:

> AGENTS AND BROKERS. Any person [[Corp.] Oregon] who claims to be acting merely as agent or broker in promoting sales for a principal [taxpayer]...will have such claim recognized only when the contract or agreement between such persons clearly establishes the relationship of principal and agent...(Bracketed words supplied.)

In this case, there is no contract or agreement clearly establishing the relationship of principal and agent. A self-serving after-the-fact assertion that [Corp.] Oregon obtained the construction contracts as agent for the taxpayer is neither reliable nor persuasive indicia of agency status; nor does it answer the obvious question of why the taxpayer did not obtain the contracts in its own name in the first place. Furthermore, [Corp.] Oregon retained contractual responsibility as principal to the customer while the taxpayer had none with respect to the same customer. We reject the taxpayer's contention that it became a prime contractor through a principal/agency relationship not established.

The taxpayer asks that we alternately find that the arrangement between the taxpayer and [Corp.] Oregon was that of a joint venture because they shared the funds received

according to the work done by each party and because there was a sharing of employees.

For Washington excise tax purposes, a joint venture is a separate "person". RCW 82.04.030. Although each joint venture should be separately registered with the Department, often one member of a joint venture is already registered and reports the tax liability of the joint venture on its tax returns. As a joint venture is in the nature of a partnership, the Department recognizes that the rights, duties and liabilities of the parties are generally tested by the same rules. See Barrington v. Murry, 35 Wn.2d 744 (1950). There is no requirement that the joint venture agreement be in writing if the facts indicate the parties acted as a joint venture in performing the contract. 46 Am. Jur.2d Joint Venture, Sec.1 (1969). The Department has set forth guidelines/requirements as follows to determine when a joint venture will be recognized as such for excise tax purposes, See 2 WTD 411 (1987). The guidelines are:

> (1) The joint venture was specifically formed to perform the contract work.
> (2) The formation of the joint venture occurred before any of the work required by the contract had been undertaken.
> (3) The contract was in fact performed by the joint venture.
> (4) The funds were handled as a joint venture rather than as separate funds of any party to the joint venture agreement, and
> (5) There is a contribution of money, property and/or labor so that any profit or loss incurred by the joint venture is proportionately shared by all joint venturers.

We find no evidence with respect to requirements (1), (2) and (3). With respect to requirement (4), the funds were handled as separate funds of [Corp.] Oregon when the taxpayer billed customers as agent of [Corp.] Oregon. With respect to requirement (5), there was no contribution of money, property nor labor; there was payment by each party to employees depending on whether they worked in Washington (payment by the taxpayer) or in Oregon (payment by [Corp.] Oregon). There was no sharing of any profit or loss. Consequently, notwithstanding the taxpayer's assertions to the contrary, we conclude that the relationship between the taxpayer and [Corp.] Oregon was that of subcontractor and prime contractor respectively subject to the tax consequences as assessed.

Schedule IX.

[2] We agree with the taxpayer that its income from inspection of sprinkler systems is subject to Retailing B&O tax. The inspection included not merely testing but cleaning, lubricating and repacking of valves which are labor and services which fall within the definition of "retail sale" where tangible personal property or buildings are improved. RCW 82.04.050 and ETB 425.

DECISION AND DISPOSITION:

The taxpayer's petition is denied with respect to Schedule V and granted with respect to Schedule IX. This matter is being referred to the Department's Audit Section for computation of the refund by adjustment of the tax assessment with respect to Schedule IX and authorization of a refund which will include statutory interest.

DATED this 8th day of January 1990.