Cite as Det. No. 02-0154R, 24 WTD 134 (2005)

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. 02-0154R
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .

[1] RCW 82.32A.020: ESTOPPEL – FAILURE TO DETECT ERROR – RELATED CORPORATIONS. The Department is not estopped from assessing tax on certain amounts although it failed to detect a related corporation's failure to pay tax on these amounts in a prior audit**.** A taxpayer's reliance on instructions given to another taxpayer does not form the basis for estoppel. Further, the Department's failure to detect an error in a prior audit does not estop the Department from assessing the tax in a subsequent audit.

[2] RCW 82.08.020: RETAIL SALES TAX –LIABILITY FOR – TEMPORARY WORKERS – SPECULATIVE BUILDERS. The taxpayers, speculative builders, are liable for retail sales tax with respect to amounts paid for temporary workers because the workers performed labor classified as retailing.

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.

STATEMENT OF THE CASE:

C. Pree, A.L.J. -- The taxpayers petition for reconsideration of Det. No. 02-154, in which we upheld the assessment of deferred sales or use tax on the taxpayers' unreported "retainage" . . . . We conclude that the Department is not estopped from assessing tax on the retainage . . . and the services performed by the workers were properly subject to retail sales tax. Accordingly, we affirm our holding in Det. No. 02-154 and deny the taxpayers' petition for reconsideration.[1]

[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 Nonprecedential portions of this determination have been deleted.

ISSUES:

1. Is the Department estopped from collecting tax on the retainage amounts because it failed to detect a related corporation's failure to pay the tax in a prior audit?
2. . . .

3. If the taxpayers were not the employers of the temporary workers, are the taxpayers liable for deferred sales or use tax on amounts they paid for the temporary workers?

FINDINGS OF FACT:

In their petition for reconsideration, the taxpayers acknowledge that our original determination contains a "generally accurate description of the relevant facts." Accordingly, our statement of facts from the original determination is summarized below.

The Audit Division of the Department of Revenue audited the records of each taxpayer for various periods commencing in 1998 or 1999 and concluding on June 30, 2001, and assessed deferred sales and/or use tax, plus interest, against each taxpayer. [2]

Each of the taxpayers developed and constructed a separate apartment project as a speculative builder. The taxpayers filed a joint petition for reconsideration, which raises two issues.

The first issue relates to "retainage." The taxpayers admit that they erred in failing to report or pay sales or use tax on the retained portion of construction costs.[3] However, the taxpayers argue that a related corporation was audited in the 1990s, and that corporation used the same accounting system in reporting its taxes on apartment construction. In the audit of that corporation, the Audit Division did not detect the corporation's erroneous failure to report the retainage. The taxpayers argue that they relied on the audit of the related taxpayer in setting up their own accounting systems and in excluding sales or use tax from the retainage amounts.

The second issue involves the assessment of deferred sales or use tax with respect to the taxpayers' payments for temporary workers the taxpayers hired for general cleanup and other work at their construction sites. At the reconsideration hearing, the taxpayers explained that although most of the work performed by these temporary workers occurred during construction, the workers were also involved in the final construction clean-up. These temporary workers were typically hired either through a labor pool, such as . . . or . . . , or through one of the taxpayers' drywall subcontractors, . . . (collectively, "the labor pools"). . . .

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[2] Our original determination set forth the audit periods for each of the taxpayers and the amounts assessed. That table will not be repeated here.

[3] When the vendors billed the taxpayers for services, the taxpayers paid a portion of the invoice, but retained an amount ("retainage"), generally 5-10% of the invoice amount. When the taxpayers later paid the retainage to the vendors, the taxpayers did not include retainage in the amounts subject to deferred sales or use tax on their returns.

ANALYSIS:

[1] 1. The Department is not estopped from collecting deferred sales or tax on the retainage amounts although it failed to detect a related corporation's failure to pay the tax in a prior audit. As we discussed in our original determination, there are at least two reasons estoppel does not apply here. On reconsideration, the taxpayers take exception to both reasons.

First, as we noted in our original determination, the auditing error did not occur in a prior audit of one of the taxpayers. Instead, it occurred in a prior audit of a related taxpayer. A taxpayer's reliance on instructions given to another taxpayer does not form the basis for estoppel. *See* RCW 82.32A.020(2) ("The taxpayers of the state of Washington have . . . [t]he right to rely on specific, official written advice and written tax reporting instructions from the department of revenue to **that** taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment." (Emphasis added.)) On reconsideration, the taxpayers argue, "this is a general statement of taxpayer rights and in no way limits the scope of relief an individual taxpayer may be entitled to based on the facts in a particular case." Although we agree that this statute contains a statement of taxpayer rights, it also prescribes the criteria that must be met to exercise those rights. One of those criteria is that the advice must have been given to the taxpayer who is claiming reliance on the advice. This is not a novel interpretation of the statute. In Det. No. 99-027, 19 WTD 44 (2000), we found the taxpayer "has not established all the required elements of RCW 82.32A.020(2)." Specifically, we concluded that the taxpayer in that determination could not rely on a TI&E ruling involving an undisclosed taxpayer because "TI&E's written advice was not directed to the taxpayer." *See also* Det. No. 89-372, 8 WTD 115 (1989) ("Because an estoppel argument is available only to the person who was misled or those in privity with him, a person cannot claim reliance on admissions, statements or acts directed at others."); Det. No. 93-287R, 17 WTD 36 (1998) (Reliance may not be claimed on unpublished determinations issued to third parties.).

The taxpayers further argue that the fact that the audit was of a related taxpayer and not of the taxpayers themselves is irrelevant because RCW 82.32A.020(2) was meant to apply to related taxpayers, "especially where the evidence clearly shows that the taxpayer in the prior audit was an entity owned or controlled by the same entities that own and control the taxpayers." The taxpayers argue that the accounting, bookkeeping, record-keeping and tax reporting for the related taxpayer and all of the taxpayers involved here were identical and that the taxpayers were aware of, and followed the procedures developed by, the related taxpayer. The taxpayers conclude, for the Department to limit its application to the same taxpayer "ignores reality" and results in "unlikely, absurd, or strained consequences." (Citations omitted.)

However, the separate treatment of separately incorporated entities is fundamental to Washington's tax system. *See* WAC 458-20-203 (Rule 203). This is true regardless of the corporations' affiliation. Specifically, Rule 203 provides:

> Each separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation [or] by the same group of individuals.

See, e.g., Det. No. 98-004, 17 WTD 231 (1998) ("Absent abuse of . . . separate forms, . . . the Department will recognize each entity individually for purposes of the taxes it administers."); Det. No. 90-175, 9 WTD 286-69 (1990)("[T]he relationships and affiliations between the taxpayer/partnership and its two partners . . . do not sanction any other treatment of them except as separate 'persons' under the law."); Det. No. 88-155, 5 WTD 179 (1988) ("The taxpayers' shareholders, among themselves and in combination with others, have elected to transact business through a variety of separately organized business entities, and, in so doing, have secured whatever financial and competitive advantages inherent in that arrangement. We have no authority to now disregard these distinctions for purposes of determining excise tax liability.") In short, we are not persuaded by the taxpayers' arguments on reconsideration that they were entitled to rely on the related corporation's audit.

In our original determination, our second reason for concluding that the Department was not estopped from assessing tax against the taxpayers because of the audit of the related taxpayer was that the Department's failure to detect an error in a prior audit does not estop the Department from assessing the tax in a subsequent audit. *See Kitsap-Mason Dairymen's Assoc. v. State Tax Comm'n*, 77 Wn.2d 812, 467 P.2d 312 (1970). In *Kitsap*, the court reasoned:

> This is not a case in which auditors changed their interpretation of a statute or rule. It is one in which they overlooked through ignorance, neglect or inadvertence Kitsap's error in computing the tax. The fact that the oversight only recently has been discovered does not relieve Kitsap of its liability for the correct tax during the audit period now under consideration.

On reconsideration, the taxpayers argue there is no finding that the Audit Division overlooked the previous audit errors through ignorance, neglect, or inadvertence. To the contrary, the taxpayers argue, the accounting records of the affiliate clearly show that sales or use tax was not paid on retainage, and this fact was accepted by the Department's auditor. First, we note that we cannot discuss the audit or bookkeeping of other taxpayers because of confidentiality requirements. RCW 82.32.330; Det. No. 00-206E, 21 WTD 66 (2002). However, even if the affiliate's accounting records clearly showed that sales or use tax was not paid on retainage, this would not require us to find that the Department "accepted" the affiliate's failure to report and would not foreclose the possibility that the error was "overlooked through ignorance, neglect or inadvertence." The requirement that taxpayers pay the proper amount of sales or use tax on construction purchases simply is not a change in interpretation of a statute or rule. *See* RCW 82.08.020; 82.04.050; WAC 458-20-170 (Rule 170).

Accordingly, we deny the taxpayers' petition with respect to the estoppel issue.

. . .

[2] 3. The taxpayers are liable for retail sales tax with respect to amounts paid for the temporary workers because the workers performed labor classified as retailing. On reconsideration, the taxpayers argue that the business of an entity such as [the labor pool] is personnel services because they supply temporary workers across a variety of industries.[4] Accordingly, the taxpayers argue, because this is a professional service, [the labor pools] should be taxed under the service classification. In other words, the taxpayers argue, "This means that no sales tax or use tax is ever due on the charges the personnel business makes to its clients for the workers. This not only makes sense but recognizes the economics of the transaction as well." (Emphasis original.)

In Det. No. 00-206E, which we cited in our original determination, we held that "if the taxpayer holds itself out as providing specialized workers, it must report gross revenues from activities that are specifically tax classified according to the tax classification of the workers' activities." (Footnote omitted.) We reasoned:

> The logic of this position is evident if we consider the classification issue from the perspective of what the taxpayer's customer is receiving, and tax the customer is liable for. In Washington, retail sales tax is to be paid by the buyer to the seller, and the seller is to collect the tax from the buyer. RCW 82.08.050. When the taxpayer's customer receives services that are classified as retail sales, the customer is liable for retail sales tax, and the taxpayer is responsible for collecting the tax. It would create an incongruity if the Department were to classify the taxpayer's receipts from retailing-classified activities as Service and Other, when the same activities are classified as retail sales from the customer's perspective. It also likely would result in retail sales tax going unpaid.

We further note the tax inequities that would result if a consumer could purchase the same services from two different service providers and owe retail sales tax on its purchases from one provider but not the other. For example, if the taxpayers in this case purchased the cleanup services from a cleaning services company, there is no question that sales tax would be due. WAC 458-20-170(Rule 170) ("The retail sales tax applies upon . . .sales of labor . . . to speculative builders by independent contractors."); WAC 458-20-172 (Rule 172); Det. No. 01-196, 22 WTD 56 (2003).[5] There is no reason the taxpayers' purchases of the same services from a labor pool should result in different tax consequences. Such a result would lead to a competitive disadvantage to the cleaning services company because its total charges to the consumer would effectively be higher because of imposition of the retail sales tax on its charges.

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[4] We note that this argument is inapplicable regarding workers the taxpayers obtained from its drywall contractor because it does not appear that the drywall contractor was in the temporary labor business.

[5] At the reconsideration hearing, the taxpayers argued that the services the workers performed were not always retail services, regardless of who provided them. The taxpayers argued that some of the cleanup occurred after construction, and would more appropriately be classified as janitorial services, which are not retail services. *See* RCW 82.04.050. However, post-construction cleanup is not a janitorial service and is properly classified as a retail service. *See, e.g.,* Det. No. 01-196, in which we held that a cleaning company's charges for final construction cleanup services, *i.e.*, services that transform newly constructed buildings into a "not previously existing condition," are subject to retail sales tax.

This inequity runs contrary to a fundamental principle underlying the Washington retail sales and use taxes. The Legislature intended to levy the retail sales tax and use tax as uniformly as possible so that all persons similarly situated would be treated as much alike as possible. *See, e.g., Gandy v. State*, 57 Wn.2d 690, 359 P.2d 302 (1961); Det. No. 99-238, 18 WTD 466 (1999); *see also* Det. No. 88-232, 6 WTD 55 (1988); Det. No. 85-259A, 1 WTD 173 (1986). Absent a compelling reason to the contrary, such a result should be avoided.

The taxpayers further argue that our original determination, which required the taxpayers to pay deferred sales or use tax on their purchases of labor, would place temporary labor businesses "in the untenable position of trying to guess what activities each individual worker will be performing on a given job, and whether that activity was taxable as a retail sale." Like the taxpayers here, the taxpayer in Det. No. 00-206E argued that it would be impractical for the supplier of the workers (the taxpayer in that determination) to determine the proper tax classification of the services provided by the workers when they were at the job site because the supplier of the temporary workers "has no control or supervision over the workers once they arrive on the client's job site." In Det. No. 00-206E, we concluded that requiring the taxpayer to verify the nature of the services performed by the workers "does not appear to be impractical." Similarly, we conclude that such a result is not impractical here. There are a number of opportunities for the client (here, the taxpayers), to inform the labor pools of the type of work performed by the employees. Prior to selecting workers for a particular job, the labor pools may inquire of the client regarding the type of work the workers are to perform, so that the labor pool may send workers with the appropriate skills. Further, when the workers or client inform the labor pool regarding the number of hours the temporary workers worked on a given job, the client or workers could easily inform the labor pools of the type of work performed and for whom the work was performed. Thus, any administrative burden attendant to proper tax classification does not outweigh the value of treating similarly situated taxpayers similarly.

On reconsideration, the taxpayers' primary argument regarding the tax classification issue relies on the dissenting opinion in [*City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2002)]. We note (and the taxpayers acknowledge) that the issue in *William Rogers* did not involve an issue of the proper tax classification of the temporary staffing service's income. Instead, *William Rogers* involved the issue of the proper tax measure. Accordingly, we find the taxpayers' reliance on the dissenting opinion in this case to support their tax classification argument to be weak, at best.

The dissent in *William Rogers* believed (as do the taxpayers here) that the temporary workers were actually employed by the clients, and not the temporary staffing service. Accordingly, the dissent believed that the temporary staffing service did not actually perform (through its employees) the clerical and other work the temporary workers performed for the clients. Thus, the dissent believed that the compensation the staffing service received was only for the service

of providing the temporary workers, not for providing the actual clerical and other services those workers performed.[6]

On the contrary, we have concluded (as did the majority in *William Rogers*) that the temporary workers were actually the employees of the labor pools. Accordingly, the labor pools, through their employees, did in fact, render the cleanup services. Thus, contrary to the taxpayers' contention (and the dissent in *William Rogers*), we conclude that the compensation the labor pools received was not only for the service of providing the temporary workers, it was for providing the actual construction cleanup services their employees performed.

Because the temporary workers were not the taxpayers' employees and because the temporary workers performed construction cleanup services for speculative builders, the Audit Division properly assessed retail sales tax with respect to the payments the taxpayers made to the labor pools. *See* Rule 170. Accordingly, we must deny the taxpayers' petition regarding the second issue.

DECISION AND DISPOSITION:

The taxpayers' petition is denied.

Dated this 18th day of June, 2003.

[6] The dissent reasoned:

> [The staffing service] collects payments from its clients to compensate (1) the cost of recruiting temporary workers for its clients and (2) the cost of wages to the temporary workers that are hired by [the staffing service's] clients. Only funds to compensate the costs in the first category constitute consideration for services rendered by [the staffing service]. Funds collected to compensate the cost of wages relate to services rendered by the temporary workers.

148 Wn.2d at 186.