Cite as Det. No. 05-0060, 24 WTD 433 (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. 05-0060 Registration No. . . . Document No. . . . Docket No. . . .

[1] RULE 170; RCW 82.04.050: RETAIL SALES TAX -- SPECULATIVE BUILDER -- CONSTRUCTION -- TITLE. The holder of record title is one of the factors considered in conjunction with other the attributes of ownership in identifying the "owner" of real property in construction cases.

[2] RULE 102, RULE 170: RETAIL SALES TAX -- SPECULATIVE BUILDER -- PRIME CONTRACTOR -- CONSTRUCTION -- TAX PAID AT SOURCE. Contractors may deduct the construction purchases on which retail sales tax had been paid when they report the "resale" of those purchases.

[3] RULE 170: RETAIL SALES TAX -- PRIME CONTRACTOR -- CONSTRUCTION -- GROSS SALES PRICE. Lacking better evidence of a prime contractor's construction charges, the measure of sales tax is the gross sales price of the property less non construction costs (land and real estate selling costs).

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 CASE

M. Pree, A.L.J. – A building contractor protests an Audit finding that it was a prime contractor rather than a speculative builder, involving condominiums constructed on land owned by its shareholders. In the alternative the contractor seeks to deduct 1998 purchases upon which it paid retail sales tax and land costs from the 1999 condominiums' sales prices used as the measure of retail sales tax assessed on its activities as a prime contractor. We conclude the taxpayer was acting as a prime contractor because it constructed the condominiums on land owned by its shareholders. However, the Audit Division must deduct condominium construction purchases upon which sales tax was paid from construction costs used to measure the retail sales tax

assessed. Land costs and sales costs incurred by the shareholders as owners of the real estate should not be used to measure the sales tax. [1]

ISSUES

1. Was a corporate builder acting as a prime contractor, when it constructed homes on land owned by its shareholders?

2. If found to be a prime contractor on buildings it sold in 1999 for which it was assessed retail sales tax, could it deduct 1998 purchases from its measure of tax or credit retail sales tax paid at source in 1998 against the assessment, if 1998 is beyond the statute of limitations?

3. If the builder was a prime contractor, what costs are included in its measure of tax?

FINDINGS OF FACT

The taxpayer is a corporation, which builds residential housing in Washington. The corporation's shareholders purchased land in 1997 for a condominium project. The taxpayer, acting as a speculative builder, paid retail sales tax on materials purchased for the construction of the condominiums as well as on construction services provided by subcontractors. The corporation did not charge or collect retail sales tax from its shareholders who held title to the land.

The Department of Revenue (Department) reviewed the taxpayer's books and records for the period from January 1, 1999 through June 30, 2002. The Department's Audit Division concluded the taxpayer was not a speculative builder, but acted as a prime contractor regarding construction of the condominium units.[2] On October 22, 2003, the Audit Division assessed retail sales tax on the 1999 sales of the condominiums units.[3] The Audit Division did not allow a deduction from the measure of tax or credit against the tax assessed for any sales tax on materials or services, which the taxpayer paid prior to January 1, 1999.

The taxpayer petitioned for correction of the assessment. The taxpayer contends it acted properly as a speculative builder because the legal title was the only attribute of ownership not held by the taxpayer. The taxpayer explains the individual shareholders took title to the property because the taxpayer's bank would finance 80% of the cost of undeveloped land if the land was titled in individual names versus only 50% of the land's cost if a corporation held title.[4] While the land purchase and sales agreement named both the individuals and the taxpayer as the

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[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] The Audit Division does not specify for whom the taxpayer acted as prime contractor, but we presume it was the shareholders who held title to the land.
[3] The shareholders sold the units to third parties.
[4] The bank's policy pertained to land for which the buyer had not obtained building permits.

purchaser, it was signed by the shareholders in their individual capacity only, and the property was titled accordingly without naming the taxpayer.

The Audit Division notes after the individuals acquired the land, they rented out the "shack" building on the land. The rental income and expenses appeared on the individuals' federal income tax return rather then the taxpayer's corporate income tax return. When the condominiums were sold, the closing statements named the individuals as the sellers, not the taxpayer.

The taxpayer explains the condominiums were built with funds from a construction loan using the land as collateral. About one year after the shareholders purchased the land for $ . . ., the taxpayer obtained an $ . . . bank loan. The taxpayer signed the promissory note payable to the bank, while the shareholders signed the deed of trust providing the land as collateral.[5]

In 1998, the taxpayer began to construct condominium units on the land. The taxpayer paid retail sales tax to many of its subcontractors and material vendors. In 1999, the shareholders sold each unit to third parties. The proceeds from the initial sales[6] went to the bank to payoff the taxpayer's construction loan. Later, it appears some of the sales proceeds were deposited into the taxpayer's checking account. The taxpayer then "reimbursed" the individual shareholders $ . . . for their land costs.[7] Neither a formal agreement nor corporate minutes exist regarding the land transactions or financing between the corporation and the individuals.

If we determine the taxpayer was taxable as a prime contractor, the taxpayer contends it should be allowed to deduct the cost of construction materials and services on which it paid retail sales tax in 1998 from the measure of the 1999 sales for the purpose of measuring retail sales tax. The Audit Division denied any credit for retail sales taxes paid in 1998, explaining no credit for taxes paid prior to January 1, 1999 could be made after 2002.

In addition, the taxpayer notes that the assessment was measured by the gross selling price of the condominiums.[8] These selling prices appear on the closing statements, which named the individual shareholders as the only sellers (not the taxpayer). The taxpayer contends that if we determine that it was not a speculative builder because it did not own the land or sell the condominiums, its measure of tax should include neither the land nor costs of sale incurred by the shareholders as owners of the land. The Audit Division explained the taxpayer had not provided information regarding land cost.

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[5] The shareholders were not named as the borrower on the note. Only the taxpayer was liable for the construction loan. While a shareholder did sign the note, he did so as an officer of the corporation, not in his individual capacity.

[6] After paying direct selling costs (*i.e.*, realtors commissions, pro-rated property taxes, and real estate excise taxes).

[7] Because this amount is substantially less than the actual cost of the land, it appears the shareholders may have received additional consideration for the land, either from the condominium sales, from the taxpayer directly, or indirectly, possibly, by refinancing any note or other shareholder acquisition obligation into the taxpayer's construction loan.

[8] Schedule A-2 of the assessment subtotaled the gross sales prices of all the condominium units with a line "less land acquisition cost" below which nothing was entered. In other words, the Audit Division assessed retail sales tax on the gross sales price of all the units without any deduction for land or closing costs.

ANALYSIS

Retail sales tax applies on each retail sale. RCW 82.08.020. "Retail sale" is defined in RCW 82.04.050 to include construction activities. RCW 82.04.050(2)(b) states:

> (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:
> . . . .
> (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 . . . .

WAC 458-20-170 ("Rule 170") discusses RCW 82.04.050 and provides contractors guidance and instructions on the subject of construction and their state tax responsibilities. Rule 170 distinguishes between "speculative" construction performed by speculative builders and "custom" construction performed by prime contractors. A speculative builder is a person who builds for resale on land it owns. A custom builder is one who builds on land owned by another. The land owner is considered the consumer.[9] The distinction is based upon the identity of the consumer of the construction services. The central issue is whether the construction was done on "real property of or for consumers." Specifically, whether the contractor owned the land at the time the construction occurred, and was, therefore, the "consumer." *See* RCW 82.04.190(1).[10]

[1] Construction by a corporation on land owned separately by its sole shareholder is a sale at retail, not speculative building. Det. No. 86-296, 2 WTD 19 (1986); Rule 170(2)(f). Rule 170(2)(a) defines "speculative builder" to mean:

> As used herein the term "speculative builder" means one who constructs buildings for sale or rental upon real estate owned by him. The attributes of ownership of real estate

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[9] Rule 170 does not define "custom" construction *per se*; however, it provides a definition of "prime contractor":

> The term "prime contractor" means a person engaged in the business of performing for consumers, the constructing, repairing, decorating or improving of new or existing buildings or other structures under, upon or above real property, either for the entire work or for a specific portion thereof.

[10] RCW 82.04.190(1) defines "consumer" as:

> Any person who purchases, acquires, owns, holds, or uses any article of tangible personal property irrespective of the nature of the person's business and including, among others, without limiting the scope hereof, persons who install, repair, clean, alter, improve, construct, or decorate real or personal property of or for consumers . . . .

> for purposes of this rule include but are not limited to the following: (i) The intentions of the parties in the transaction under which the land was acquired; (ii) the person who paid for the land; (iii) the person who paid for improvements to the land; (iv) the manner in which all parties, including financiers, dealt with the land. The terms "sells" or "contracts to sell" include any agreement whereby an immediate right to possession or title to the property vests in the purchaser.

Under RCW 82.04.050, RCW 82.04.190(1), and Rule 170, the holder of record title is but one of the factors to be considered in identifying the "owner" of real property in construction cases and must be considered in conjunction with the attributes of ownership set forth in Rule 170(2)(a). Det. No. 94-154, 15 WTD 46 (1995). The issue of ownership is to be determined by an analysis more rigorous than a simple search for the holder of record title. Ownership is to be determined by the intent of the parties as evidenced by objective factors. *Id.*; Det. No. 97-189, 17 WTD 148 (1998).

We lack documents or other objective evidence to support a finding that the taxpayer intended to own the land under Rule 170(2)(a)(i). The taxpayer failed to keep any corporate records such as minutes evidencing an intention to own the real estate or be liable for the purchase of the real estate (*i.e.*, resolution approving debt). The individuals initially financed the land purchase with their funds. When each condominium was sold, the documents named the shareholders, not the taxpayer, as the seller. Finally, for federal income tax purposes, the individual shareholders reported income from the property as the owners.

While the taxpayer financed the improvements, an attribute of ownership per Rule 170(2)(a)(ii), the shareholders paid for the land one year prior to the taxpayer's construction loan, an ownership attribute per Rule 170(2)(a)(iii). Under Rule 170(2)(a)(iv), the shareholders in their individual capacity sold the condominiums. There were no corporate records approving the sale of the individual units.

Under the attributes of ownership contained in Rule 170(2)(a), as evidenced by objective evidence, the parties intended to have the individuals own the land. They paid for it and dealt with third parties as the owners. The only attribute supporting a finding the taxpayer owned the land was that the taxpayer, through the construction loan, paid for the improvements. We conclude that the taxpayer was not the owner of the land and was, therefore, taxable as a prime contractor.

[2] The taxpayer's alternative argument is based upon the Department's Rule 102 (WAC 458-20-102) and the Department's tax forms. We must determine how the taxpayer, as a prime contractor, should treat the 1998 construction purchases for the condominium units sold in 1999.

Rule 170(2)(d) instructs speculative builders who sell property to report subsequent construction on the property under the retailing classification (as a prime contractor). Rule 170(2)(e) requires them to pay retail sales tax on their construction purchases, then claim deductions for later purchases in accordance with the section, PURCHASES FOR DUAL PURPOSES, in Rule 102. Under Rule 102, they may deduct the construction purchases on which retail sales tax had been

paid when they report the "resale" of those purchases. The deduction is claimed under the retail sales tax classification only.

The Department's returns for reporting the contractor's sales do not provide for a credit in this situation.[11] Rather, on the retailing and other activities return, the gross amount of retailing receipts are entered on line 5 less deductions to determine the measure of tax. Attached to the return is a form for deduction detail, which specifies "taxable amount for tax paid at source." *See* Rule 102(11)(b)(i). If the taxpayer had reported the condominium sales as a prime contractor in 1999, under the Department's procedures, the taxpayer should have deducted the construction purchases from the taxable amount. Therefore, the 1998 purchases would be used to determine the proper amount of retail sales tax due in 1999 on the condominium sales.

RCW 82.32.060[12] limits credits and refunds paid more than four years prior to the beginning of the calendar year in which the examination of records is completed. Because the Audit Division issued the assessment in 2003, neither a credit nor a refund could be made for 1998 taxes. The taxpayer is not requesting a credit or refund.[13] The taxpayer seeks a 1999 deduction in accordance with the Department's Rule 102 and reporting forms. While these 1998 taxes may not be refunded, the taxpayer is entitled to deduct wholesale condominium construction purchases upon which retail sales tax was paid from its 1999 measure of retail sales tax. We conclude that the taxpayer may deduct 1998 purchases of construction purchases on which retail sales tax was paid at source.

[3] We do not have a contract or agreement between the taxpayer and its shareholders. Where no gross contract price is stated in any contract or agreement between the builder and the property owner, then the measure of retail sales tax is the total amount of construction costs, including any charges for licenses, fees, permits, etc., required for the construction and paid for by the builder. Rule 170(4)(a). The Audit Division computed the retail sales tax based on the gross sales price of the condominiums between third party purchasers and the shareholders. From the closing statements, it is evident these amounts included sales costs[14] incurred by the shareholders (realtor

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[11] For the purpose of illustration, we used the April 2004 return available on the internet at http://dor.wa.gov/docs/forms/ExcsTx/ComExcsTxRtrn/CETR_04_M04.pdf and from which the taxpayer illustrated its alternative position. While the return has a section, "VII. Credits," none of the credits specified is for tax paid at source.

[12] RCW 82.32.060(1) states:

> (1) If, upon receipt of an application by a taxpayer for a refund or for an audit of the taxpayer's records, or upon an examination of the returns or records of any taxpayer, it is determined by the department that within the statutory period for assessment of taxes, penalties, or interest prescribed by RCW 82.32.050 any amount of tax, penalty, or interest has been paid in excess of that properly due, the excess amount paid within, or attributable to, such period shall be credited to the taxpayer's account or shall be refunded to the taxpayer, at the taxpayer's option. Except as provided in subsection (2) of this section, no refund or credit shall be made for taxes, penalties, or interest paid more than four years prior to the beginning of the calendar year in which the refund application is made or examination of records is completed.

[13] . . .

[14] Lines 502 and 1400 on the closing statements.

fees, real estate excise taxes, etc.), which were not the taxpayer's condominium construction costs.

If the taxpayer presents sufficient records for all of its construction costs, construction costs may be used to determine the tax.[15] Otherwise, the sales prices of the condominium units may be adjusted by the non construction costs (land costs and selling costs not incurred by the taxpayer) as well as documented wholesale construction purchases upon which retail sales tax was previously paid at source in error.

DECISION AND DISPOSITION

We grant the taxpayer's petition in part and deny it in part. The taxpayer was taxable as a prime contractor on the condominiums. However, the measure of tax should be adjusted, allowing a deduction in 1999 for 1998 condominium construction purchases upon which sales tax was paid. As a prime contractor, the taxpayer should not have the land cost included in its measure of the tax, subject to verification. We recognize the taxpayer previously provided some records regarding these deductions. Additional records must be provided to the Audit Division within 30 days of this determination for consideration.

Dated this 30th day of March, 2005.

[15] These records should include interest on the construction loan plus indirect costs such as wages and overhead. The taxpayer must provide adequate records of all its costs per RCW 82.32.070 and WAC 458-20-254.