

Cite as Det. No. 04-0013, 24 WTD 289 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction)	<u>D E T E R M I N A T I O N</u>
of Assessment of)	
)	No. 04-0013
)	
...)	Registration No. . . .
)	Document No. . . . Audit No. . . .
)	Docket No. . . .
)	

- [1] RULE 262; RCW 82.08.02745: RETAIL SALES TAX -- FARM WORKER HOUSING EXEMPTION -- FAMILY MEMBERS. The construction of two houses did not qualify for the farm worker housing exemption from retail sales tax where the houses were built for the occupancy of the employer and his family members. The employer's daughter is a family member for purposes of the exemption.

- [2] RULE 102; RCW 82.32.291: RETAIL SALES TAX -- RESALE CERTIFICATE -- PENALTY FOR MISUSE OF A RESALE CERTIFICATE. The penalty for misuse of a resale certificate was upheld where the taxpayer used a resale certificate to purchase housing under the farm worker housing exemption, and the housing did not qualify for the claimed exemption.

- [3] RULE 102; RCW 82.08.020: RETAIL SALES TAX -- TAX PAID AT SOURCE. A buyer who purchases items at retail, but later resells the items, may take a deduction for retail sales tax paid at source. However, a consumer of construction services may not claim a tax paid at source deduction for retail sales tax paid by its prime contractor to the prime contractor's suppliers and subcontractors.

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:

Chartoff, A.L.J. – A taxpayer who gave a resale certificate to a contractor protests the fifty percent penalty the Audit Division (Audit) imposed on its assessment of unpaid retail sales tax. In addition, the taxpayer requests a credit for retail sales tax the contractor paid to the contractor's suppliers. We sustain the fifty percent penalty and also find that there is no basis for granting a credit to the taxpayer for taxes paid by its contractor. The taxpayer's petition for correction of assessment is denied.¹

ISSUES:

1. Whether the construction of housing for the taxpayer and his family members qualifies for the sales tax exemption for agricultural employee housing;
2. Whether Audit properly assessed a fifty percent penalty for the misuse of a resale certificate; and
3. Whether the taxpayer is entitled to a credit for sales tax allegedly paid by his contractor to the contractor's suppliers.

FINDINGS OF FACT:

. . . , (Taxpayer) engages in the business of farming in . . . , Washington. In early 2001, Taxpayer verbally contracted with . . . (Contractor) for the construction of a single family home on Taxpayer's lot located in a residential subdivision adjacent to Taxpayer's farm. Taxpayer agreed to pay Contractor \$. . . plus costs. Contractor allegedly purchased some materials and services for the project at retail and paid retail sales tax. Contractor issued progress billings to Taxpayer of costs incurred. Sales tax was not charged to Taxpayer as a separately stated item in the progress billings or the final statement.

Taxpayer initially intended to build the house for sale on the open market. Midway through the construction of the house, Taxpayer decided to provide the house to his farm manager as an employee fringe benefit. The farm manager is Taxpayer's son-in-law and is married to Taxpayer's daughter. Accordingly, the house would be occupied by Taxpayer's daughter and her family.

Taxpayer told Contractor that the house qualified for the agricultural employee housing exemption from sales tax. Taxpayer provided Contractor with a completed and signed resale certificate. The certificate is dated [early] 2001, which coincides with the beginning of construction, and contradicts Taxpayer's claim that he initially intended the house to be for sale. Taxpayer claims he was unaware when he signed the certificate that the date was wrong, and instead claims he provided the certificate at the request of Contractor in mid 2002. The resale

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

certificate declares that Taxpayer is in the business of farming and that he is entitled to purchase for resale “agricultural employee housing.”²

Contractor continued to not include retail sales tax as a separately stated item on billings to Taxpayer. Taxpayer paid Contractor a total of \$. . . for this house. At no point was retail sales tax charged to Taxpayer as a separately stated item. Taxpayer also purchased approximately \$. . . of supplies directly from a supplier without paying retail sales tax.

When the first house was completed, Taxpayer had Contractor build a second house to be occupied by Taxpayer, for his personal use. Taxpayer instructed Contractor that this house also qualified for the agricultural employee housing exemption. Contractor continued to not charge sales tax. The total amount Taxpayer paid Contractor for this house was approximately \$ Taxpayer also purchased approximately \$. . . of supplies directly from suppliers without paying retail sales tax.

When the second house was nearing completion, Taxpayer asked his accountant for advice as to whether he qualified for the exemption. On September . . . , 2002, the accountant advised that he might qualify for the exemption on the house for his son-in-law, but that he probably did not qualify for the second house. At that point Taxpayer began purchasing supplies and services for the house directly from suppliers at retail. Taxpayer’s retail purchases from suppliers totaled approximately \$ Taxpayer testifies that he did not pay the overdue sales tax to the Department on the two houses because he assumed either Contractor or Audit would bill him for the sales tax.

Audit discovered the resale certificate and in December of 2002, began an investigation of taxpayer’s records. Audit’s investigation was limited to determining Taxpayer’s liability for sales and use tax. Audit determined that Taxpayer was not entitled to the agricultural employee housing exemption because the houses were built for the occupancy of Taxpayer and his family. Based on Taxpayer’s declaration on the resale certificate that Taxpayer was entitled to the exemption when he was not so entitled, Audit assessed what it termed a fifty percent “fraud” penalty, in addition to taxes and interest. The assessment consisted of \$. . . retail sales tax, \$. . . penalties, and \$. . . interest. No payments have been made on the assessment.

Taxpayer filed this petition protesting Audit’s assessment of the fifty percent penalty. Taxpayer contends that his failure to pay tax was not due to fraud, but to an unintentional mistake. Therefore, Taxpayer contends Audit should not have assessed the 50% penalty. Also, Taxpayer requests a credit against sales tax in the amount of sales tax Contractor paid to its suppliers in purchasing supplies and services for the two houses.

² The resale certificate contains a series of declarations as to why the item is eligible to be purchased for resale. A taxpayer is supposed to check the box next to the declaration that applies to their case (for example, purchased for resale in the ordinary course of business). In this case, Taxpayer did not check any of the boxes.

ANALYSIS:

[1] The first issue is whether Audit properly concluded that Taxpayer does not qualify for the agricultural employee housing exemption, on either of the two houses Taxpayer built.

The sales tax exemption for agricultural employee housing is found in RCW 82.08.02745. It provides, generally, that the retail sales tax shall not apply to charges made for labor and services rendered by any person with respect to constructing buildings used as agricultural employee housing. *Id.* Also exempt are sales of tangible personal property that becomes an ingredient or component of the building or structure. *Id.* The statute further provides that the exemption “shall not apply to housing built for the occupancy of an employer, family members of an employer, or persons owning stock or shares in a farm partnership or corporation business.” *Id.*

As a condition for claiming the exemption, the authorizing statute requires that the buyer provide the seller with “an exemption certificate in a form and manner prescribed by the department by rule.” *Id.* The Department has issued WAC 458-20-262 (Rule 262), which explains the farm worker housing exemption. As directed by the authorizing statute, Rule 262 provides the form of exemption certificate that must be provided in order to claim the tax exemption. The exemption certificate requires the person claiming the exemption to certify, *inter alia*, that “The building or other structures will not be used as housing for an employer, family members of an employer, or persons owning stock or shares in a farm partnership or corporation business.”

With regard to the two houses at issue, Taxpayer does not qualify for the agricultural employee housing exemption. The first house was built for the occupancy of Taxpayer’s daughter and her family, and the second house was built for Taxpayer’s own occupancy. Taxpayer argues that the first house may qualify for the exemption because a son-in-law is not a “family member of the employee” for purposes of this rule. We decline to examine this issue because Taxpayer’s daughter is clearly a family member, and she also occupies the house. . . .

Because Taxpayer does not qualify for the agricultural employee housing exemption for the two houses at issue, we find that Audit properly assessed retail sales tax on the amount Taxpayer paid Contractor and suppliers to build the houses.

[2] The next issue is whether Taxpayer is liable for the fifty percent penalty. RCW 82.32.291 imposes a fifty percent penalty on the unlawful use of a resale certificate and provides, in part:

Any person who uses a resale certificate to purchase items or services without payment of sales tax and who is not entitled to use the certificate for the purchase shall be assessed a penalty of fifty percent of the tax due, in addition to all other taxes, penalties, and interest due, on the improperly purchased item or service.

A resale certificate is defined in RCW 82.04.470(5) as “documentation provided by a buyer to a seller stating that the purchase is for resale in the ordinary course of business, or that the buyer is exempt from retail sales tax. . . .”³

WAC 458-20-102 (Rule 102) explains the conditions upon which a buyer may furnish a resale certificate and provides in part: “The resale certificate cannot be used for purchases which are not purchases at wholesale, or where more specific certificates, affidavits, or other documentary evidence is required by statute or other section of chapter 458-20 WAC.” Rule 102(2); *see also* Rule 102(4).

In the case under review, Taxpayer provided a resale certificate in order to purchase supplies and services free of retail sales tax. Taxpayer was not entitled to use the resale certificate because it was not purchasing supplies and services at wholesale. [Taxpayer was not entitled to use the specific certificate for the agricultural employee housing exemption] Because Taxpayer used a resale certificate to purchase items or services without payment of sales tax when he was not entitled to do so, Audit properly assessed a penalty of fifty percent of the tax due.

We note that Audit’s labeling of the fifty percent penalty as a fraud penalty in this case is incorrect. The labeling of the fifty percent penalty as a fraud penalty stems from the fact that prior to 1994, the fifty percent penalty was limited to situations where the department could prove fraud or evasion by clear and convincing evidence.⁴ In an effort to curb widespread

³ The full text of RCW 82.04.470(5) reads as follows:

(5) As used in this section, “resale certificate” means documentation provided by a buyer to a seller stating that the purchase is for resale in the regular course of business, or that the buyer is exempt from retail sales tax, and containing the following information:

- (a) The name and address of the buyer;
- (b) The uniform business identifier or revenue registration number of the buyer, if the buyer is required to [be] registered;
- (c) The type of business engaged in;
- (d) The categories of items or services to be purchased for resale or that are exempt, unless the buyer is in a business classification that may present a blanket resale certificate as provided by the department by rule;
- (e) The date on which the certificate was provided;
- (f) A statement that the items or services purchased either: (i) Are purchased for resale in the regular course of business; or (ii) are exempt from tax pursuant to statute;
- (g) A statement that the buyer acknowledges that the buyer is solely responsible for purchasing within the categories specified on the certificate and that misuse of the resale or exemption privilege claimed on the certificate subjects the buyer to a penalty of fifty percent of the tax due, in addition to the tax, interest, and any other penalties imposed by law;
- (h) The name of the individual authorized to sign the certificate, printed in a legible fashion;
- (i) The signature of the authorized individual; and
- (j) The name of the seller.

⁴ The evasion penalty is authorized in RCW 82.32.090, which provides: “If the department finds that all or any part of the deficiency resulted from an intent to evade the tax payable hereunder, a further penalty of fifty percent of the additional tax found to be due shall be added.”

misuse of resale certificates, the legislature in 1993 passed legislation, codified at RCW 82.32.291, which makes misuse of resale certificates subject to the fifty percent penalty.⁵ In other words, it is not necessary to prove fraud when a Taxpayer declares in a resale certificate that he may purchase items free of tax when he is not so entitled.

Because proof of fraud is not necessary where a taxpayer misuses a resale certificate, the fifty percent penalty in this case will be sustained unless there are grounds provided by statute or rule to waive the penalty. RCW 82.32.291 provides that the Department may waive the fifty percent penalty if it finds that the misuse of the resale certificate was “due to circumstances beyond the taxpayer’s control,” or if the certificate was used to make purchases for dual purposes and the taxpayer made a good faith effort to comply. In the case under review, Taxpayer did not purchase the houses for dual purposes. Therefore, we must consider whether the misuse of the resale certificate was due to circumstances beyond the control of the taxpayer.

The penalty statute expressly authorizes the Department to define by rule what circumstances are considered to be “beyond taxpayer’s control.” *Id.* The Department has defined “circumstances beyond the taxpayer’s control” with regard to the fifty percent penalty in Rule 102(12), which provides in pertinent part:

. . . the use of a resale certificate to purchase items or services for personal use outside of the business shall not qualify for the waiver or cancellation of the penalty. The penalty will not be waived merely because the buyer was not aware of either the proper use of the resale certificate or the penalty. In all cases the burden of proving the facts is upon the buyer.

(a) Situations under which a waiver of the penalty will be considered by the department include, but are not necessarily limited to, the following:

(i) The resale certificate was properly used to purchase products or services for dual purposes; or the buyer was eligible to issue the resale certificate; and the buyer made a good faith effort to discover all of its deferred sales tax liability within one hundred twenty days of purchase; and the buyer remitted the discovered tax liability upon the next excise tax return. (Refer to subsection (11)(a)(i) of this section for an explanation of what constitutes “good faith effort.”)

(ii) The certificate was issued and/or purchases were made without the knowledge of the buyer, and had no connection with the buyer's business activities. However, the penalty for the misuse of resale certificate privileges may be applied to the person actually issuing and/or using the resale certificate without knowledge of the buyer.

⁵ State of Washington, Senate Ways & Means Committee, Explanation of Proposed Substitute Bill 5967, March 31, 1993; State of Washington, Department of Revenue, Fiscal Note for Bill Number HB 2112 / SB 5967, April 12, 1993.

Taxpayer does not meet the criteria for waiver or cancellation of the penalty due to circumstances beyond the control of the taxpayer. Taxpayer argues that he was not aware that he did not qualify for the exemption or that he should not have given a resale certificate. The rule clearly states that lack of knowledge of the proper use of the resale certificate, without more, is not sufficient to waive the penalty. Furthermore, the materials and labor were purchased to build custom homes for the personal use of Taxpayer and his daughter's family. The rule plainly states that Taxpayer's use of the resale certificate to purchase items for personal use outside the business will not qualify.

Taxpayers who do not qualify for waiver of the penalty due to circumstances beyond the control of the taxpayer may still qualify for a one time only waiver. Rule 102(12) describes the requirements for the one time waiver and provides:

(b) The penalty prescribed for the misuse of the resale certificate may be waived or cancelled on a one time only basis if such misuse was inadvertent or unintentional, and the item was purchased for use within the business. If the department of revenue does grant a one time waiver of the penalty, the buyer shall be provided written notification at that time.

(Emphasis ours). In order to qualify for the one time waiver, the taxpayer's misuse of the resale certificate must be inadvertent or unintentional and the item must be purchased for use within the business. In this case, the housing purchased was not for use within Taxpayer's farming business. Instead, the houses were built in a subdivision adjacent to Taxpayer's farm for the personal use and enjoyment of Taxpayer and his daughter's family. Therefore, Taxpayer does not qualify for the one time waiver.

In summary, we find that Audit appropriately assessed a penalty of fifty percent of the tax due and we find no grounds for waiving the penalty. Audit's assessment is hereby sustained.

[3] The final issue is whether Taxpayer may receive a credit for sales tax paid by Contractor. To review, Contractor allegedly purchased some supplies and services for the houses at retail. Contractor then billed Taxpayer for his costs which allegedly included the sales tax it allegedly paid to suppliers. Taxpayer argues that we should give Taxpayer a credit for retail sales tax the Contractor paid to its suppliers because those materials eventually became part of the house.

If the Contractor paid retail sales tax in error, Contractor may be entitled to a tax paid at source deduction or tax credit. Rule 102(11)(b). However, we can find no basis for giving Taxpayer a credit or refund for taxes that may have been paid by Contractor. Taxpayer's remedy, if any, in this case lies not with the Department, but with the Contractor.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 22th day of January 2004.