

Cite as Det. No. 14-0373, 34 WTD 479 (2015)

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. 14-0373
	)	
...	)	Registration No. . . .
	)	

[1] RULE 170 – RETAIL SALES TAX – CUSTOM v. SPECULATIVE CONSTRUCTION – HOME BUILT ON LAND OWNED BY CORPORATE PRESIDENT. When a construction company performs construction upon land owned by its corporate president, it is constructing upon land owned by another person and is thus taxable as a seller, and not as a "speculative builder."

[2] RCW 82.08.130(2) – RETAIL SALES TAX – DEDUCTION – TAX PAID AT SOURCE – UNSUBSTANTIATED AMOUNTS. A taxpayer must be able to produce records to support a tax paid at source deduction.

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.

Bauer, A.L.J. – A corporate contractor [(Taxpayer)] objects to [the Department of Revenue’s (Department’s)] assessment of retail sales tax on the full contract price of a home it built for its corporate president and his wife, and further asserts that the assessment did not take into consideration all amounts of retail sales taxes that it paid to its vendors and subcontractors. The assessment is upheld.<sup>1</sup>

ISSUES

1. Under WAC 458-20-170, is a construction company entitled to treatment as a speculative builder for its construction of a house on property owned by its corporate president?
2. Under RCW 82.08.130(2), is a construction company engaged in a custom construction project entitled to a tax paid at source sales tax deduction for unsubstantiated amounts?

FINDINGS OF FACT

The Audit Division (Audit) of the [Department] conducted a partial audit in the Department’s field office of [Taxpayer’s] records for the period . . . (audit period). The audit was limited in

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

scope to a review of income and purchases, and was not a detailed examination of Taxpayer's accounting records.<sup>2</sup> As a result, Audit issued an assessment, on October 24, 2013, for the following amounts:

\$ . . .	Small Business Credit (amount disallowed)
. . .	Retail Sales Tax
. . .	Retailing B&O Tax
. . .	Wholesaling B&O Tax
. . .	Total Taxes
. . .	Delinquent Penalty
. . .	Interest through November 25, 2013
. . .	5% Assessment Penalty for Substantial Underpayment
\$ . . .	Total Due

Taxpayer's business activities during the audit period included residential and commercial construction. . . . is Taxpayer's president [(President)].

Taxpayer purchased land in May 2006. According to [President], in order for Taxpayer to qualify for the necessary \$ . . . construction loan to build a house on that land, [the credit union] required that [President and his wife] own the underlying land and the loan be issued to them, and not to Taxpayer.

For that reason, on April 21, 2008, Taxpayer quitclaimed the property to [President], and [President] in turn quitclaimed the property to [himself and his wife]. [President and wife] were not licensed or registered with the Department as contractors able to provide a resale certificate or reseller's permit to Taxpayer as speculative builders. When the house was completed, [President and wife] -- not Taxpayer -- sold it for \$ . . . . The proceeds from this sale were not deposited into Taxpayer's bank account, but retained by [President and wife].

Taxpayer, for tax purposes, treated the building of this house as speculative construction, thus paying only retail sales tax on the materials and subcontracted labor used.

Audit disagreed that Taxpayer was the speculative builder of the house. Treating [President and wife] as the consumers and the construction of the house as custom construction by Taxpayer, Audit asserted retailing B&O and retail sales taxes on the \$ . . . construction cost financed by President and wife's credit union. Because Taxpayer's records were incomplete, Audit estimated a tax paid at source credit to be 50% of Taxpayer's taxable income.<sup>3</sup> Audit made numerous attempts to obtain additional records supporting the tax paid at source deduction before the assessment had to be issued before the statute of limitations and waiver expired, but Taxpayer failed to keep those appointments.

<sup>2</sup> The audit report was, therefore, qualified to allow a future audit covering all areas of possible taxation.

<sup>3</sup> Audit noted that the sales tax paid at source credit supported by Taxpayer's records was \$ . . . . The sales tax paid at source deduction allowed in the audit was \$ . . . , a difference of \$ . . . . For that reason, Audit stated that any additional tax paid at source documentation provided by Taxpayer would have to exceed \$ . . . in order for Audit to examine more records.

## ANALYSIS

1. Speculative v. Custom Construction. In accordance with WAC 458-20-170(2), a speculative builder is:

One who constructs buildings for sale or rental upon real estate owned by him. The attributes of ownership of real estate 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.

Speculative builders are required to pay sales taxes only on the building materials and subcontract labor they purchase, and do not owe B&O tax or retail sales tax on the value of their own construction services. WAC 458-20-170(2)(e); *Dep't of Revenue v. Nord Northwest Corp*, 164 Wn. App. 215, 225 (2011). Speculative builders are further not subject to B&O tax or required to collect retail sales tax when their properties are sold because the sale of real estate is exempt from B&O tax. RCW 82.04.390.

A contractor that is not a speculative builder is a "prime contractor" engaged in "custom construction" taxable under RCW 82.04.050(2), which provides:<sup>4</sup>

The term "sale at retail" or "retail sale" includes the sale of or charge made . . . for labor and services rendered in respect to the following: . . . (b) The constructing . . . of new . . . buildings . . . upon . . . real property of or for consumers, . . . .

(Emphasis added.) Thus, when such a contractor builds a house for a consumer, the contractor is making a "retail sale" taxable as such for B&O and retail sales tax purposes.

Moreover, WAC 458-20-170(2)(f) specifically provides:

Persons, including corporations, . . . who perform construction upon land owned by their corporate officers, shareholders . . . are constructing upon land owned by others and are taxable as sellers under this rule, not as "speculative builders."

. . .

Accordingly, we find that when Taxpayer built the house on land owned by the [President and wife], it was engaged in the business activity of "custom construction," a retailing activity under RCW 82.04.050(2)(b). Prime contractors engaged in custom construction are making retail sales and must pay B&O tax and charge and collect retail sales taxes from their consumer on the full contract price, which, when not stated, is the "total amount of construction costs including

<sup>4</sup> See *Washington Department of Revenue, Industry Specific Guides, Construction*, <http://dor.wa.gov/Content/DoingBusiness/BusinessTypes/Industry/construction/default.aspx> (last accessed November 19, 2014).

any charges for licenses, fees, permits, etc., required for construction and paid by the builder.” WAC 458-20-170(4)(a).

Taxpayer was required to charge and collect retail sales tax from the [President and wife] in accordance with RCW 82.08.050(1). Taxpayer did not do so, and, in accordance with RCW 82.08.050(3),<sup>5</sup> such failure rendered Taxpayer personally liable for the tax for the uncollected tax.

We find that Taxpayer was engaged in custom construction when it built the [President and wife’s] home, and that it failed to charge and collect the retail sales tax due on the “full contract price” for doing so. We hold that Taxpayer was correctly assessed for the retail sales tax that it failed to collect on the building of this house, minus any credits due for any taxes paid at source.

Taxpayer’s petition as to this issue is denied.

2. Tax Paid at Source Credit. RCW 82.08.130 provides:

(2) A buyer who pays a tax on all purchases and subsequently resells property or services at retail, without intervening use by the buyer, must collect the tax from the purchaser as otherwise provided by law and is entitled to a deduction on the buyer's tax return equal to the cost to the buyer of the property or service resold upon which retail sales tax has been paid. The deduction is allowed only if the taxpayer keeps and preserves records that include the names of the persons from whom the property or services were purchased, the date of the purchase, the type of property or services, the amount of the purchase, and the tax that was paid.

(Emphasis added.) Thus, a tax paid at source deduction is available, but a taxpayer must produce records to support it. Taxpayer originally provided purchase invoices to support a sales tax paid at source deduction in the amount of \$ . . . . Audit, having determined that Taxpayer’s records were incomplete, gave Taxpayer the benefit of the doubt and allowed a sales tax paid at source deduction in the amount of \$ . . . , a difference favoring Taxpayer in the amount of \$ . . . . Audit advised Taxpayer that it would increase the amount of tax paid at source deduction if Taxpayer could document any sales taxes paid at source over and above that \$ . . . amount.

Taxpayer stated in its petition, that Audit “did not include the tax that was paid to vendors or subs.” Taxpayer, however, has provided no new documentation to support an additional deduction.

Taxpayer’s petition as to this issue is denied.

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<sup>5</sup> RCW 82.08.050(3) provides:

Except as otherwise provided in this section, if any seller fails to collect the tax imposed in this chapter or, having collected the tax, fails to pay it to the department in the manner prescribed by this chapter, whether such failure is the result of the seller's own acts or the result of acts or conditions beyond the seller's control, the seller is, nevertheless, personally liable to the state for the amount of the tax.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 24th day of November, 2014.