

Cite as Det. No. 17-0285, 37 WTD 147 (2018)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| 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. 17-0285 |
| |) | |
| ... |) | Registration No. . . . |
| |) | |

[1] RULE 170; RCW 82.04.050(2)(b): RETAILING B&O TAX – RETAIL SALES TAX – GROSS INCOME – CONSTRUCTION ACTIVITIES. All compensation a taxpayer receives for construction activities is subject to retailing B&O tax and retail sales tax.

[2] RULE 170; RCW 82.04.050, RCW 82.04.051: RETAILING B&O TAX – RETAIL SALES TAX – CONSTRUCTION CONTRACT – DESIGN FEES. A contract for services, such as design work, will be combined with a construction contract and taxed as a single activity if at the time of the first contract it was contemplated by the parties that the same person would be awarded both contracts.

[3] RCW 82.32.130, RCW 82.32.135(1): NOTICE VIA REGULAR MAIL. The Department is not required to notify taxpayers of tax assessment via certified mail.

[4] RULE 230; RCW 82.32.050(4): STATUTORY LIMITATIONS ON ASSESSMENTS. The Department is not barred from issuing a tax assessment that is within four years of the close of the tax year in which the tax was incurred.

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.

Sattelberg, T.R.O. – A construction contractor (“Taxpayer”) protests the Department of Revenue’s (“Department”) assessment of retail sales tax and retailing business and occupation (“B&O”) tax. Taxpayer argues that a certain payment it received from its customer was a “commission,” and not a retail sale. Taxpayer also argues that its design fees were not retail sales. We deny the petition.¹

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

ISSUES

1. Whether certain amounts received by a general contractor from its customer constitute retail sales under RCW 82.04.050(2) when the amounts were paid as compensation for general contractor's construction services.
2. Whether design fees charged under a design contract by a general contractor are taxable as retail sales under RCW 82.04.050(2) and RCW 82.04.051(3) when the general contractor was also contracted for the subsequent construction activities at the time of the design contract.
3. Whether the Department failed to properly notify Taxpayer of the tax assessment under RCW 82.32.130.
4. Is the Department barred by the limitations for assessing tax for the tax year 2012 under RCW 82.32.050(4)?

FINDINGS OF FACT

Taxpayer is a residential construction contractor based out of . . . Washington. Taxpayer constructs and remodels houses on land it owns and on land its customers own. In addition to its construction services, Taxpayer also offers design services.

In 2016, the Department's Audit Division ("Audit") began auditing Taxpayer for the period January 1, 2012, through December 31, 2015. During the course of the audit, Audit discovered income from three projects from 2012 that it thought Taxpayer had reported incorrectly. We discuss each project in turn.

Project #1

In Project #1, Taxpayer constructed a new house on land Taxpayer's customer owned. The contract for Project #1 [provided Taxpayer shall perform the construction in accordance with plans and specifications as appended to the contract. Customer owns the real property upon which the house shall be constructed. Customer shall pay for all costs of construction. For its performance under the contract, Owner shall pay Taxpayer (1) a flat fee and (2) 40% of the selling price of the house after subtracting the cost of the land and the cost of construction.]

Taxpayer received three payments from its customer under Project #1, as follows: (1) a payment of \$. . . on . . . 2012, (2) another payment of \$. . . on . . . 2012, and (3) a payment of \$. . . on . . . 2012. Taxpayer collected and remitted retail sales tax on the first two payments, and reported these payments under the retailing B&O tax classification. Taxpayer reported the income from the third payment under the service and other activities B&O tax classification, as it considered the third payment a commission.

Project #2

In Project #2, Taxpayer remodeled an existing house in . . . Washington. Project #2 consisted of two contracts, a design contract and a construction contract. Both contracts were dated . . . 2012, and both were signed by the parties on . . . 2012. Under the design contract, Taxpayer agreed to serve “as Project Design Manager” for Project #2; however, the design contract does not describe the scope of work any further. Taxpayer represented that it completed the designs of Project #2 pursuant to the design contract. Under the design contract, Taxpayer received a flat fee of \$. . . for “these services.” Taxpayer reported and paid service and other activities B&O tax on the income it received under the design contract.

Under the construction contract, Taxpayer agreed “to remodel” the home “according to the construction documents” and “in accordance to the provisions of the plans and specifications.” Taxpayer represented that it performed the construction of Project #2 pursuant to the construction contract. Taxpayer collected retail sales tax on its billings and paid retailing B&O tax on the amounts Taxpayer received from its customer.

Project #3

In Project #3, Taxpayer remodeled an existing house in . . . Washington. Project #3 also consisted of two contracts, an undated design contract and a construction contract dated . . . 2012. Both contracts were signed by both parties on . . . 2012. Under the design contract, Taxpayer agreed to serve “as Project Design Manager” for Project #3; however, the design contract does not describe the scope of work any further. Taxpayer represented that it completed the designs of Project #3 pursuant to the design contract. Under the design contract, Taxpayer received a flat fee of \$. . . for “these services.” Taxpayer reported and paid service and other activities B&O tax on the income it received under the design contract. This design contract also mentioned that Taxpayer received the customer’s initial payment on . . . 2012, nearly a month before the contract was signed.

Under the construction contract, Taxpayer agreed “to remodel” the home “according to the construction documents” and “in accordance to the provisions of the plans and specifications.” Taxpayer represented that it performed the construction of Project #3 pursuant to the construction contract. Taxpayer collected retail sales tax on its billings and paid retailing B&O tax on the amounts Taxpayer received from its customer.

Audit’s Assessment

Audit reclassified the third payment of \$. . . from Project #1, and all design income from Projects #2 and #3, from the service and other activities B&O tax classification to the retailing B&O tax classification, and assessed retail sales tax on that income. On November 7, 2016, Audit issued Taxpayer an assessment totaling \$. . .²

² The assessment consisted of \$. . . in retail sales tax, \$. . . in retailing B&O tax, a credit of \$. . . for service and other activities B&O tax paid, and \$. . . in interest. Audit made no other adjustments other than for the three projects at issue here.

Taxpayer timely sought administrative review arguing that it reported each contract correctly. Regarding Project #1, Taxpayer states the \$. . . payment was solely a commission for acting as investor on the project, and also states it was fully compensated for its construction activities prior to receiving this commission from the sale of the new house. Regarding Projects #2 and #3, Taxpayer argues the amounts it received were entirely for design. Taxpayer states that there was no discussion that it would be the builder until months after the design was complete and paid in both cases. For Project #3 specifically, Taxpayer notes that (1) the customer paid for the design work approximately a month before the contract was signed, and (2) the customer was out of the country and could not sign the contract, and put the project out for bid while out of the country. Taxpayer did not provide any evidence to support its claims regarding Projects #2 and #3 on review.

ANALYSIS

Washington imposes retail sales tax and retailing B&O tax on each retail sale in this state. RCW 82.08.020; RCW 82.04.250. If a business activity is not specifically classified, such as being a retail sale, the activity will be taxed under the service and other activities B&O tax classification. RCW 82.04.290(2).

1. Construction Activities

The term “sale at retail” or “retail sale” includes:

(2) . . . [T]he 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*
. . . .

RCW 82.04.050 (emphasis added).

Here, for Project #1, Taxpayer constructed a new house under the terms of its contract with its customer, the owner of the land. Taxpayer’s compensation for the construction of the house came in three forms: (1) customer paid the construction costs according to the contract, (2) a flat \$. . . fee, and (3) 40% of the selling price of the house after subtracting the cost of the land and the cost of construction, which ended up being \$ Thus, Taxpayer constructed a new building, and was compensated for this activity, making it a retail sale under RCW 82.04.050(2)(b). It follows that all of the compensation that Taxpayer received for that retail sales is subject to both retailing B&O tax and retail sales tax.

Taxpayer, however, argues that it was fully compensated for its construction services through the payment of construction costs plus the flat \$. . . fee. Taxpayer argues that the payment of \$. . . was solely a “commission” paid for Taxpayer’s investment in the property. There is no evidence

in the record that Taxpayer was an investor in Project #1. Instead, the contract simply indicates that all three payments under the contract were compensation for Taxpayer's construction services. Because of the lack of evidence supporting Taxpayer's arguments, and the fact that the contract is clear that Taxpayer was responsible for the construction, we hold that Audit properly reclassified this income from the service and other activities B&O tax classification to the retailing B&O tax classification, and properly assessed retail sales tax on it as well. Accordingly, we deny Taxpayer's petition on this issue.³

Regarding Projects #2 and #3, Taxpayer does not dispute that the construction activities that took place under the construction contracts were retail sales. Taxpayer collected and remitted retail sales tax on the construction portions of the projects, as well as paid retailing B&O tax on them.

2. Design Activities

RCW 82.04.051(3) clarifies the taxation of when parties enter into separate design and construction contracts that would otherwise be taxed differently:

Unless otherwise provided by law, a contract or agreement under which a person is responsible for activities that are subject to tax as a service under RCW 82.04.290(2), and a subsequent contract or agreement under which the same person is responsible for constructing, building, repairing, improving, or decorating activities subject to tax under another section of this chapter, *shall not be combined and taxed as a single activity if at the time of the first contract or agreement it was not contemplated by the parties, as evidenced by the facts, that the same person would be awarded both contracts.*

(Emphasis added.)

We have held that “conversely, if there is evidence that the parties contemplated . . . that the design and construction work would be done by the same person, the design work will also be characterized as a retail service.” Det. No. 15-0135, 35 WTD 135 (2016).

Here, the design and construction contracts for Project #2 were both signed on . . . 2012, and were both dated as of . . . 2012. We conclude that this evidence is sufficient to demonstrate that the parties contemplated that Taxpayer would be awarded both the design and construction contracts. Thus, Audit properly reclassified the design work performed under the design contract in Project #2 to the retailing B&O tax classification and assessed retail sales tax on it.

For Project #3, the design and construction contracts were both signed on . . . 2012. Taxpayer, though, highlights that the design contract notes that the customer wrote the initial check for design services on . . . 2012. This, Taxpayer argues, shows that the design services were contemplated

³ During the course of the review, Taxpayer used the phrase “construction management” to describe Taxpayer's activities under Project #1, while not explicitly making a construction management argument. We note that construction management is generally a service that is “directly related to” the physical activity of constructing. Det. No. 99-011R, 19 WTD 423 (2000). A person who supervises or directs the construction is “responsible for performance of” the constructing. *Id.*; Det. No. 14-0108, 33 WTD 444 (2014). Taxpayer has not provided evidence to show that Taxpayer engaged in construction management here.

before signing the design and construction contracts. Taxpayer states that the customer was out of the country and could not sign the contracts until back in the country. Taxpayer states that the customer put the project out for bid while out of the country, and awarded it to Taxpayer at some later point, but has not provided evidence of any of these alleged facts. Regardless, we conclude that because the construction contract is dated the same day as the first design payment, . . . 2012, the parties contemplated that Taxpayer would also perform the construction of Project #3. Thus, Audit properly reclassified the design work performed under the design contract to the retailing B&O tax classification and assessed retail sales tax on it.

3. Notice

When Audit examines a taxpayer's books and records and finds that a tax liability exists, Audit is authorized to notify the taxpayer of the tax liability by mail. RCW 82.32.050(1). When Audit mails such notice, it is authorized to do so by regular mail to the address shown in the Department's records. RCW 82.32.130; RCW 82.32.135(1). Additionally, Audit may send this notice electronically. RCW 82.32.050(1); RCW 82.32.135(1). Audit notified Taxpayer of its assessment electronically on November 4, 2016. This notice was proper under RCW 82.32.050(1), RCW 82.32.130, and RCW 82.32.135(1).

Taxpayer argues that Audit did not adequately notify Taxpayer of the assessment because Audit did not send the notice via certified mail. We disagree, as chapter 82.32 RCW contains no requirement that Audit provide notice via "certified" mail. We deny Taxpayer's petition on this issue.

4. Nonclaim

The Department is barred from issuing a tax assessment to enforce tax obligations more than four years after the close of the tax year under RCW 82.32.050(4). *See, also*, WAC 458-20-230. Here, Audit issued Taxpayer an assessment in 2016 covering the period 2012 through 2015. Taxpayer argues 2012 is barred by the nonclaim statute. We disagree. In this case, 2016 was the current year at the time of the assessment, which meant the open years for audit were the four calendar years prior, 2015, 2014, 2013, and 2012. Therefore, calendar tax year 2012 was not more than four years after the close of the then-current 2016 tax year. We deny Taxpayer's petition on this issue.

DECISION AND DISPOSITION

We deny Taxpayer's petition.

Dated this 17th day of November 2017.